FISKALRAT
Austria

# Recommendation of the Fiscal Advisory Council on Austria's budget policy

**Adopted at the Fiscal Advisory Council meeting on June 29, 2016**

In its latest meetings the Fiscal Advisory Council addressed two main issues: the **complexity of EU-wide fiscal rules** and the **2012 Austrian Stability Pact and possible alternatives.** Following the discussion of these topics, which was based on two studies prepared by the Office of the Fiscal Advisory Council, the following **findings and recommendations are published:**

## EU-wide fiscal rules

- To encourage **budget discipline** the EU applies **numerical fiscal rules**. The objective of these rules is to support sound fiscal policies and to contribute to the long-term sustainability of government debt. To ensure sustainable compliance with these fiscal rules, the quality of public finances in terms of their revenue and expenditure structure must also be assured.
- Fiscal rules should allow **fiscal policy** to react to **business cycle fluctuations** within the scope of macroeconomic objectives. Fiscal policy's primary focus on the **structural budget balance** (i.e. a cyclically adjusted indicator) as required by the EU's current fiscal rules, thus has its merits – but it also has its weaknesses. The **methodology for cyclical adjustment** (i.e. the calculation method for determining the output gap) has been subject to some controversy, and **potential output** figures are always mere estimates. Moreover, the leeway for macroeconomic considerations is limited during the **adjustment phase** leading up to the realization of the medium-term objective (MTO). Looking at the aggregate budget path (fiscal stance) within Economic and Monetary Union (EMU), it would also seem advisable to consider the fact that the effect of national fiscal policies is not limited to the national level (as they might trigger spillover effects in other Member States).
- Calculations by the IMF and by the Fiscal Advisory Council show that – despite the procyclicality of the European Commission methodology – in the past the **structural budget balance** proved more suitable as a reference value for **a countercyclical orientation of Austria's fiscal policy** than the (headline) **budget balance**. What is more, in Austria, **revisions of the structural budget balance** for the years 2010 to 2015 were **not driven by revisions of the output gap**. Still, **advance estimates** of the structural budget deficit were **too high** in the past years (average revision of European Commission estimates 2010 to 2015: 0.6% of GDP). According to Maidorn and Reiss (2016), in most EU-12 countries, revisions of potential output estimates make a smaller contribution to revisions of structural balance estimates than other factors (e.g. inaccurate revenue and expenditure estimates).
- It seems **necessary to reconsider** the **European Commission's current methodology for determining the output gap** to reduce the **bias inherent in its calculation method** and increase the **transparency and acceptance** of this reference value across the EU; the **fiscal councils should be involved in any related efforts.** The **negative bias** inherent in real-time estimates of the output gap results in significantly higher public debt figures – if the fiscal space available under the EU's fiscal rules is fully exploited – than an unbiased output gap estimate. The European Commission methodology for estimating the output gap could be **improved** in various ways, e.g. by enhancing the method used for cyclical adjustment or by basing calculations on a medium-term forecast rather than a short-term forecast (with a two-year forecast horizon).
- In the future, the determination of the fiscal policy stance will need to factor in cyclical factors in a **more strongly symmetric manner**. Just as budget deficits, in the case of a pronounced economic downturn, may be appropriate to avoid economic slack, budget surpluses may be useful, under very favorable economic circumstances, to prevent an overheating of the economy.

- Based on the gradual and moderate consolidation path observed in **Austria** in recent years, which was accompanied by employment and growth measures, the **procyclical effect** of fiscal policy was **small** – in comparison with other European countries – up to the achievement of the MTO in 2014.

- As – despite the expansive monetary policy – Europe's economy is still weak, there are increasing calls for **growth-enhancing investments** by the Member States. In Austria, it would also seem advisable – in particular against the background of growing population figures – to **promote purposeful (effective) public investment** within **the framework of EU fiscal rules**, which should trigger further private investment.

- The recent **flexibilization** of EU fiscal rules has made it somewhat easier to implement **growth-stimulating measures** (European Fund for Strategic Investments – EFSI, investment clause, structural reform clause) without jeopardizing compliance with EU fiscal rules. Austria could, for instance, launch a **structural reform plan**, covering reforms in the **education system**, additional **public infrastructure investment** or measures to **reduce the tax burden on labor**; in its **initial stages**, the implementation of such a reform plan could be supported by additional public funds, provided that the reforms can be expected to lead to a **sustainable increase in potential growth** (Member States may deviate from their structural requirements or their MTO for up to three years).

- So far, Austria has only made use of the EFSI model for promoting strategic investment in the case of **a single project** in the field of **energy supply.** The **expansion of broadband Internet infrastructure** in Austria could also be a suitable project; however, individual regional projects would need to be pooled (minimum volume required). The Fiscal Advisory Council recommends that the **federal and regional governments** review whether planned structural reforms are eligible for the flexibilization clauses under the Stability and Growth Pact (SGP).

- There are impediments to rule compliance, in particular where rules can be **interpreted in different ways** or if there is no full **transparency**. These weaknesses, which exist in some areas, need to be eliminated through **additional transparency** on the part of the **European Commission** (in particular with respect to the output gap and flexibilization measures). The effectiveness of **fiscal councils** hinges not only on the resources at their disposal and their access to information at the national level, but also on knowledge of the design and interpretation of EU rules; the European Commission can ensure the transfer of this knowledge only through timely communication.

- The **European Court of Auditors** has argued (among other things) in favor of **more transparency** and for a **bottom-up assessment of the (structural) budget path to be carried out by national fiscal councils**: "Bottom up assessment: national fiscal councils should be involved in the assessment process by inviting them to provide independent scrutiny of the reliability of the figures and information provided by ministries of finance and used by the Commission in its analyses."

- **Supranational rules, like the EU's fiscal rules,** appear to require a **more specific wording** in some areas and **flexibilization elements** in others; related amendments, however, should not cause the EU's set of rules to become unnecessarily inflated. Hence, the rules should not be too detailed. In particular, the **individual implementation parameters** of the multidimensional EU fiscal framework could be improved in terms of their feasibility; in some cases, their necessity might even be called into question altogether (e.g. add-ons and deductions applicable to the expenditure rule, two-year assessment, recognition of exceptional circumstances, etc.).

## 2012 Austrian Stability Pact and possible alternatives

- With the adoption of the **2012 Austrian Stability Pact,** the Austrian government fulfilled its obligations under the European fiscal compact, i.e. the obligation to **enshrine** the **medium-term**

**budget objective** (maximum structural budget deficit of 0.45% of GDP from 2017) and a **correction mechanism** in **national law**.

- The **2012 Austrian Stability Pact is to be implemented in full from 2017.** The pact schedules the establishment of a system of national fiscal rules for Austria's federal, regional and local governments by 2017, which essentially corresponds to the EU's fiscal framework and which will further increase complexity. The **operational implementation** and **control** of these regional fiscal rules – especially the structural budget and expenditure rules – is particularly difficult and resource-consuming at the local government level.

- Seeing as EU legislation does not include **any provisions** requiring that the **EU's fiscal framework** be transferred in full to the **sub-levels of government**, it would seem advisable for Austria to implement **regional fiscal rules** that, in effect, ensure compliance with EU fiscal rules and at the same time keep the **administrative burden** at a minimum.

- **Possible solutions** suited to simplify fiscal rules for regional and local governments in Austria primarily include **focusing on a nominal budget rule** that targets a generally balanced budget and a **nominal expenditure rule** on the basis of administrative budget data:

  - A **nominal budget rule in line with ESA 2010** that targets a **generally balanced budget** could provide a reference value for regional and local governments – as has been the case in the past. In boom (or bust) periods in Austria, the targets would be loosened (tightened) and credit authorizations (budget surplus agreements) would be coordinated for the individual regional and local governments per province. Suitable mechanisms for operational implementation still need to be developed. The **key for the regional distribution of target values** could be the same as in the current system outlined in the **2012 Austrian Stability Pact**. This means that the general government **cyclical budget component** would be distributed among the central, regional and local governments based on the distribution key applied to their share in the MTO (federal government and social security funds: 78%; regional and local governments: 22%).

  - An **expenditure rule** could help fine-tune and specify consolidation needs **at province level** (including Vienna); such a rule should cover the **core budgets (government entities)** and should also take into consideration **extra-budgetary entities**. In addition, it would be important to obtain meaningful **reconciliation tables** from Statistics Austria (at least ex post) that convert administrative data into ESA 2010 data.

  - For **local governments,** a suitable **early warning system** should be implemented on the basis of near-real time data to identify problematic budgets; **municipal supervisors** could then concentrate their detailed analyses on such budgets.

- Those fiscal rules that target individual levels of government should be made an **integral part of the budget process**, so as to allow an effective contribution to budget control.

- When applying national fiscal rules, the **budget results** of the **social security funds** should be treated as part of the federal government's responsibility – as has been the case in the past – and be monitored accordingly. Social security funds account for more than one-third of **government expenditure**, which makes them relevant for compliance with the EU's general government expenditure rule.

- It should be ensured that the **national correction mechanism** corresponds to EU requirements and European Commission principles.

- Currently, there are several factors that make it difficult to provide an overall assessment of the **transfers of funds between regional and local governments** and an adequate **statistical record** of **regional government expenditure in Austria** (under the ESA 2010 definition): a lack of differentiation in accounting standards, heterogeneous recording/accounting practices across the different Austrian provinces and the involvement of different players (government entities) in individual tasks (regional funds, municipal cooperatives, extra-budgetary companies). This situation should be remedied as soon as possible. Improvements should include:

- Availability of a **homogeneous database**, in particular for the individual regional governments and the **local governments in each province** within the meaning of ESA 2010. In the medium term, the **2015 Budgeting and Accounts Regulation** (VRV, Federal Law Gazette II No. 313/2015), which will enter into force in 2019 for the regional governments and larger municipalities and in 2020 for the smaller municipalities, should improve data quality provided that **accounting practices** in the individual provinces are harmonized at the same time.

- For **government entities that have been taken off budget,** budget control should be integrated and simplified (e.g. through remunicipalization) and interfaces allowing control mechanisms to take effect (municipal council, supervision at municipality level) should be broadened through integrated budgeting.

- The performance of the legally defined **tasks of the different inspection and monitoring organizations** should be facilitated by implementing, first and foremost, the following improvements:

  - **Ensuring** political or supervisory bodies' **access to information and data** relating to entities that fall into their field of competence.

  - **Ensuring** compliance with fiscal rules at the local level in each province through **supervisory measures** by the provinces **("Gemeindeaufsicht")**.

  - **Increasing transparency** by fully implementing the **"transparency database"** for the private sector, by predefining and publishing distribution keys and by providing **clearer records of transfers of funds between the different levels of government.**

  - **Providing early information to the Fiscal Advisory Council** about Austria's budgetary plans, which need to be submitted to the EU (i.e. federal government's Draft Budgetary Plan in October and its Stability Program in April). The **Fiscal Advisory Council** should in particular be given a role in the **ex ante assessment of Austria's fiscal position**. Finally, a **comply-or-explain principle** should be legally established for circumstances which may trigger or prolong the activation of the **correction mechanism**.