FISKALRAT Austria

Recommendations of the Fiscal Advisory Council on Austria's budget policy for 2020

Adopted at the Fiscal Advisory Council meeting on December 9, 2019

New government will need to continue a determined and stability-oriented budget policy and ensure sustained compliance with medium-term budget objective

Background: From today's perspective, Austria's fiscal stance in 2019 is slightly contractionary and countercyclical (i.e. stabilizing in macroeconomic terms); in 2020, it will be mostly neutral. We expect that the medium-term budget objective (MTO) will be fulfilled in 2019 and 2020, even if the decisions taken by parliament since summer 2019 that affect the budget deficit have limited the fiscal leeway for the next government. Following the recent economic boom, the economy will cool down further in 2020, which means that real GDP growth will once more approach the average of recent years.

Recommendations:

- Austria needs a determined, **stability-oriented budget policy**, as seen in recent years, which at the same time ensures **sustained compliance with the MTO**, that is a maximum structural budget deficit of 0.5% of GDP. For this to happen, automatic stabilizers need to be allowed to operate fully, and a countercyclical stance is required. Any new government needs to be guided by this fundamental budget strategy.

- The new government should make prudent use of the still robust economic conditions and the remaining fiscal leeway (within the limits of the fiscal rules) to **make the Austrian economy more resilient and sustainable**, e.g. by strengthening competitiveness, taking labor qualification measures that also address structural change on the labor market, or investing into climate protection.

Correcting negative control account balances without undue delay and improving the framework for an ex ante evaluation of the regional spending rule

Background: The Fiscal Advisory Council has the legal mandate to issue recommendations on activating, extending or discontinuing the "correction mechanism" under Austria's 2012 Fiscal Stability Pact (ÖStP 2012). This relates to the evaluation of the control account balances, which are kept to record deviations between the realized structural budget balances at the different levels of government and the corresponding annual target values. If control account deficits breach certain limits (rule limits, thresholds), they must be corrected in line with specified criteria. Our current evaluation shows a negative control account balance at end-2018 for the local governments in Tirol, which has breached the pro-rata threshold value. Some other regional and local governments may breach the pro-rata threshold values by end-2020. However, the validity of the local governments' medium-term financial estimates on which this assessment is based is limited due to political-economic aspects. These estimates serve as a mere basis for decision-making for investment projects that are subject to approval and that are financed with external funds and for the granting of subsidies by the regional government; they usually reflect maximum figures. What is more, due to a lack of relevant disaggregated data in the context of medium-term budget planning, it is currently not possible to conduct an ex ante evaluation of compliance with the regional spending rule, which also has a very limited steering effect due to its high complexity.

Recommendations:

- The **year 2020** should be used to **improve the starting point for correcting deficits** (which will become necessary because of breaches in 2019) through strict budget discipline and timely counter-measures. Based on the current financial estimates, we see breaches of the pro-rata threshold values at end-2019 in the control accounts of the province of Vorarlberg and the local governments of Lower Austria, Tirol and Vorarlberg.

- To **avoid** a **procyclical effect** when correcting control account deficits, an approach that takes into account the current economic cycle should be considered. Depending on the extent of the breach, it might be sensible to differentiate in terms of time horizon granted for deficit correction.

- The **negative control account balance** of the local governments in Tirol must be **reduced without undue delay**. The local government breach does not trigger any financial sanctions since the rule is complied with on the aggregate level of regional and local governments.

- To enable an **ex ante evaluation of compliance with the spending rule,** we need an **accurate data basis** that reflects reliable expenditure estimates and contains detailed information for calculating the relevant spending aggregate.

- The level of detail required under the spending rule could be avoided if the **complexity of the spending rule were to be reduced**. Such a simplification could also increase its relevance as a steering instrument in budget planning and monitoring.

Sustainable design and funding of long-term care in Austria

Background: The European Commission's Ageing Report analyzes the long-term growth of age-dependent costs. For Austria, the report predicts a marked increase in costs for long-term care to 3.8% of GDP (+1.9 percentage points) over the long run. The automatic inflation-linked rise in long-term care benefits for inflation that was decided in the run-up to the latest parliamentary elections will additionally drive up costs. Previously, these benefits had been raised irregularly and on a discretionary basis. In addition to cost increases, there are other challenges for the sustainable funding of long-term care in Austria, i.e. the discontinuation of the temporary federal subsidies to the regional and local governments (long-term care fund) and the fragmentation of responsibilities between the different levels of government.

Recommendations:

- The **sustainable design and funding** of long-term care in Austria needs to be ensured. This requires fundamental decisions regarding the **financing model** for covering public expenses on long-term care.

- The **power to tax and spend** must be more closely aligned within individual levels of government.

Making the Austrian pension system more sustainable and resilient [1]

Background: According to the European Commission's Ageing Report, Austria's pension expenditure, which is high by international comparison, will increase moderately until 2070, growing by 0.5

1 Because of the Fiscal Advisory Council's orientation, we only look at the immediate fiscal effects of the public pension system here, even if elements of the 2nd and 3rd pillar of the pension system could be relevant for net replacement rates.

percentage points to 14.3% of GDP. Given an aging population, such a stabilization of pension-related expenditure can either be achieved by reducing pension benefits or by raising the effective retirement age.

The fact that the anticipated spending increase in Austria is so low despite clearly progressing population aging (old-age dependency ratio will rise from 27.6% in 2016 to 54.4% in 2070) is primarily attributable to a marked decrease in average pension income as related to average work income (benefit ratio). Pensioners' relative income loss vis-à-vis the employed population will reach more than 12 percentage points by 2070 according to the Ageing Report (benefit ratio will drop from 50.5% in 2016 to 38.3% in 2070).

However, the sustainability of the Austria's pension system rests not only on the amount of spending on the pension system, which is primarily dependent on the amount of individual pension benefit payments, the effective retirement age and demographic factors (birth rate, life expectancy and net migration); any analysis must also consider pension system-related revenues. These primarily depend on macroeconomic and demographic factors and the size of pension contributions. Important factors include productivity, potential output growth, labor force participation and retirement age. For this reason, the Ageing Report shows pension-related expenditure as a share of GDP, which summarizes developments on the revenue side.

The fiscal measures that were decided by parliament in summer 2019 were not included in the cited cost estimates and imply a marked, unfunded increase in pension expenditure. In the short run, the abolition of the traditional waiting period preceding the first increase in pension benefits only causes relatively small spending increases (+EUR 30 million in 2020); in the long run, however, it will put large strain on the budget as compared to 2019 (in 2040, we are already looking at +EUR 600 million). The graduated pension increase that was decided for the year 2020 implies pension benefit increases in excess of the automatic statutory increase (price indexation), as already seen in 2019, and will raise annual pension expenditure by a total of EUR 0.5 billion per year. There will be further annual spending increases of EUR 130 million based on the additional pension-related measures decided in summer 2019 (e.g. receipt of full pension entitlement after 45 years of contributory service and "pension bonus," i.e. higher minimum pension benefits for retirees with long contributory service). To summarize: Over the last two years, policymakers have decided measures, which will increase pension-related spending by an annual EUR 0.7 billion (0.18% of GDP) and which cause much higher spending increases in the long run. Also, these measures imply clearly preferential treatment of some population groups and disadvantages for others.

Recommendations:

- The anticipated strong decline in average pension income relative to average employment income will increase the risk of lower living standards and poverty for older people. The **resilience of the Austrian pension system** needs to be strengthened.

- **Raising the effective retirement age** must be a priority. Measures that make it possible to remain an active member of the workforce until later in life should be strengthened, discretionary measures that counteract a closing of the gap between effective and legal retirement age should be avoided.

- To ensure the long-term **stability of the pension system**, discretionary measures that raise expenditure but are not immediately directed at combating **old-age poverty** should be avoided.

- The design of measures affecting the pension system should be guided by **inter- and intragenerational fairness**.

Ensuring the quality of regulatory impact assessment (costing) and improving its transparency

Background: Estimating the budgetary effects of statutory amendments plays a central role in economic governance. This is reflected in the federal government's fiscal framework, which requires the responsible ministries to conduct a regulatory impact assessment (RIA) for draft bills and reform projects. To be able to determine if the RIA is suited to ensure the optimal allocation of scarce budget resources, the assumptions and models underlying the RIA's cost estimates must be clear. There are publicly accessibly instruments that make it easier to conduct plausibility checks, such as the RIA IT tool provided by the Federal Ministry for the Civil Service and Sport and the "SORESI" social reform microsimulation model provided by the Federal Ministry of Labour, Social Affairs, Health and Consumer Protection. If legislative bills are put forward as parliamentary motions, less detailed information with regard to the impact and financing of reform plans must be provided. In the summer of 2019, parliament used this procedure to decide on measures – without transparent impact assessment – causing additional budget expenses of more than EUR 1 billion (tax relief for lower incomes and reduced health insurance contributions for the self-employed and farmers, graduated increase of pension benefits, receipt of full pension entitlement after 45 years of contributory service).

Recommendations:

- Policymakers should use tried and tested **quality assurance models** when calculating the budgetary impact of economic policy measures, first and foremost:
  - **microsimulation models** for estimating the immediate budgetary effect,
  - suitable **multipliers and macromodels** for estimating macroeconomic effects.
- The new government needs to continue efforts to **make models and assumptions used in RIAs more transparent.** The public should continue to have access to any models used.
- Austria needs suitable measures to ensure high-quality RIAs for legislative initiatives that have not been subject to strict RIAs so far (parliamentary motions, applications filed by parliamentary committees, legislative proposals submitted by the upper chamber of parliament and referendums). Moreover, if legislative proposals are adjusted during the legislative procedure, any such adjustments also need to be examined in an updated RIA before the final version of the legislative proposal is voted on – to ensure that that there is a suitable basis for evaluation.