AUSTRIA'S COMPLIANCE WITH EU FISCAL RULES IN THE YEARS 2016 – 2018

(EXTRACT FROM THE FISCAL RULES COMPLIANCE REPORT 2016–2021 OF THE FISCAL ADVISORY COUNCIL, MAY 2017)

In the following chapter we present an evaluation of Austria's **expected compliance** with EU **fiscal rules** over the coming years. To this end, we compare the budget path outlined in the stability program submitted by the Federal Ministry of Finance with the **Fiscal Advisory Council's own fiscal forecast and output gap calculations** for **2017 and 2018** (**Fiscal Advisory Council's spring forecast**). The calculation of the output gap used to cyclically adjust the fiscal balance as presented in the Fiscal Advisory Council's spring forecast is in line with the methodology of the European Commission; the results correspond to those presented by the Austrian Institute of Economic Research WIFO (March 2017).

A summary of results including the Fiscal Advisory Council's recommendations and conclusions are provided in the **Executive Summary** of the Fiscal Rules Compliance Report.

The Fiscal Advisory Council's current spring forecast takes into account measures with an impact on public finances that have been adopted by the federal government and whose effects on public finances over time were possible to adequately assess to allow their inclusion in the forecasting exercise (status of end-May 2017). These **measures** include those **adopted before the fall of 2016**, such as reducing employers' contributions to the Family Burden Equalization Fund or the expansion of broadband Internet infrastructure, as well as **new measures**, such as an overhaul of the bank tax, which includes a reduction of the tax rate but also one-off payments to be made by banks, the introduction of an "employment bonus" aimed at creating new jobs, investment subsidies for SMEs, large companies and municipalities as well as an employment initiative to reduce long-term unemployment. Given that the current measures tend to have an effect above all on the expenditure side, Austria's **tax structure** can be expected to **change marginally** with a view to improving the economy's growth prospects. As regards **structural reform** measures, the government could seek to make use of the flexibility clauses of the Stability and Growth Pact. The planned increased expenditure on investment and research should help **improve the quality of public finances**, provided that the costs will be **covered** by reallocations within the budget.

The **2012 Austrian Stability Pact** (ÖStP 2012, Federal Law Gazette I 30/2013) – an agreement between Austria's federal government, provinces and municipalities pursuant to Article 15a Federal Constitutional Law – not only lays down binding subsectoral fiscal rules but also regional fiscal rules (for each province and for the municipalities in each province).[1] **Section 3.2** of the report provides an assessment of Austria's compliance with these **national fiscal rules**.

Maastricht deficit clearly below 3% threshold in 2017 and 2018 – envisaged reduction of deficit seems uncertain

According to the **Fiscal Advisory Council's spring forecast**, Austria's **general government deficit ratio** will decrease to 0.9% of GDP in **2017**, down from 1.6% of GDP in 2016, when the ratio had reached a significantly higher level in a year-on-year comparison mostly owing to the 2015/16 tax reform and the

1 On the further development of Austria's subnational fiscal rules see Grossmann et al. (2016).

arrival of large numbers of refugees. This expected **decline of the deficit ratio in 2017** can be mainly attributed to the following factors:

- the economic upswing in combination with low price growth (in particular in 2016);
- anticipatory effects resulting from one-off payments under the bank tax;
- the low interest rate level; and
- measures to cover the decrease of taxes of the 2015/16 tax reform.

Furthermore, the measures of the **federal government**'s 2017/18 **work program** will be extensively reflected in the budget only in 2018. As a result, the Fiscal Advisory Council expects the deficit ratio to climb to 1.0% of GDP in 2018, mirroring a notable year-on-year increase in deficit-enhancing measures since October 2016 (totaling EUR 1.7 billion in 2018 and EUR 0.8 billion in 2017), which will be offset only in part by robust growth and decreasing interest payments.

Both the **Fiscal Advisory Council** and the **federal government** (in its 2016–2021 stability program) forecast the deficit ratio to remain **markedly below the threshold** of 3% of GDP. This means that Austria will be **clearly compliant** with the (nominal) **deficit rule** over the entire forecast horizon, and **no excessive deficit procedure** is likely to be launched (table 1).

In contrast to the Fiscal Advisory Council's spring forecast, which expects the Maastricht deficit to come to 0.9% of GDP in 2017 and to 1.0% of GDP in 2018, the federal government's **stability program** update anticipates the ratio to gradually drop, first to 1.0% of GDP in 2017 and then to 0.8% of GDP in 2018. However, the federal government's **stability program** update does not take into account the effects of the 2017/18 government work program.

Table 1 Compliance with EU fiscal rules according to the Fiscal Advisory Council's 2017 spring forecast and the government's 2017 stability program

	EC	FISK-Estimation			MoF-Estimation		
General government	**2016**	**2016**	**2017**	**2018**	**2016**	**2017**	**2018**
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[1)]	⊗	⊗	✓	⊗	⊗	✓	✓
Structural adjustment of deficit ratio[2)]	⊗	⊗	✓	⊗	⊗	✓	⊗
Government expenditure growth[3)4)]	.	✓	⊗	⊗	✓	⊗	⊗
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)							
Budget balance (Maastricht definition)	-1,6	-1,6	-0,9	-1,0	-1,6	-1,0	-0,8
Structural budget balance	-1,0	-1,0	-0,7	-0,9	-1,0	-0,9	-0,8
Structural budget balance incl. eligible clauses	-0,6	-0,6	-0,3	-0,6	-0,6	-0,5	-0,5
Total expenditure (real, adjusted, net of one-offs, change in %)	.	2,0	1,5	2,2	2,0	1,4	2,0
Gross debt (year-end figures)	84,6	84,6	80,3	78,3	84,6	80,8	78,5

Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation[5)]

1) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat. When member states are at their MTO no procedure will be triggered in case of non-compliance with structurel adjustment path or expenditure rule.
2) Reduction of structural deficits depending on macroeconomic conditions, debt-to-GDP ratio and remaining structural adjustment to achieve the MTO.
3) Medium-term rate of potential GDP growth including convergence margin, as long as MTO has not been achieved.
4) Threshold of significance is exceeded only tightly in 2018.
5) A deviation is deemed significant if the structural deficit deviates at least by 0.5% of GDP from the structural adjustment path or the MTO within one year or cumulated over two years; a deviation from the debt rule during the transition period is deemed significant if the structural adjustment deviates from the required minimum linear structural adjustment by more than 0.25% of GDP.

Source: MoF (Stability Program 2017), WIFO (Forecast, March 2017), EC (Spring Forecast, May 2017) and own calculations.

Austria expected to meet MTO in 2017 using flexibility clauses and not to comply in 2018

According to the **Fiscal Advisory Council's forecast**, the structural deficit will contract from 1.0% of GDP in 2016 to **0.7% of GDP in 2017**, but will increase again to reach **0.9% of GDP** in **2018**. If the **additional costs** caused by the arrival of refugees (2015, 2016)[2] and those related to anti-terrorism measures (2016, 2017) are **recognized as additional burden**, as is permissible under the flexibility clauses, the structural deficit will amount to 0.3% and 0.6% of GDP in 2017 and 2018, respectively. This means that in **2017**, Austria will **overachieve its MTO**, which prescribes a structural deficit of no more than 0.5% of GDP, while **exceeding it somewhat in 2018**. In line with the European Commission's established approach, no margin of tolerance will be applied if a Member State invokes one of the flexibility clauses. Austria's noncompliance with its MTO in 2018 may represent a **significant deviation from the requirement under the expenditure rule** and trigger an **early warning by the European Commission**. The EU Council will decide in the **spring of 2019** whether a **significant deviation procedure** will be launched, basing its decision on the **overall assessment using actual data** carried out by the **European Commission**.[3]

No structural adjustments are necessary for **2017** because the 0.3% of GDP requirement is derived from the gap between the 2016 **structural balance based on freezing** and the MTO (European Commission spring 2016 forecast for 2017)[4] and because the additional costs of 0.3% of GDP may be deducted once again. Consequently, the projected decline in the **2017 structural deficit is in line with the relevant requirement**. However, as the structural deficit is projected to increase (by 0.2 percentage points) in **2018** and the flexibility clauses will – in part – cease to be applicable, Austria will fail to meet its structural adjustment requirement in **2018**. The shortfall will remain **only slightly below the significance threshold** as defined by the EU given that the structural deficit is expected to contract by 0.3% of GDP (European Commission spring 2017 forecast for 2018).

Contrary to the government's stability program update, the **Fiscal Advisory Council's spring forecast** expects Austria to **miss its MTO and deviate from the required structural adjustment in 2018**. The differences in the values for the 2018 structural deficit provided by the Fiscal Advisory Council's spring forecast and the government's stability program update result exclusively from the Maastricht deficit; the underlying values for the output gap and one-off measures are identical in both documents.

Austria compliant with expenditure rule only in 2016; government expenditure growth significantly above threshold in 2018

The annual growth of **real government expenditure (adjusted)**[5], **net of one-off measures** (since 2017), which is the applicable value for measuring compliance with the expenditure rule, amounts to an annual average of 1.9% for the period from 2016 to 2018, according to the Fiscal Advisory Council's spring forecast, with growth rates ranging from 1.5% (2017) to 2.2% (2018). The deviations from the MTO as

2 While the European Commission does not expect additional costs caused by the arrival of refugees to increase further (as a percentage of GDP) in 2017 with reference to the government's stability program, it is likely to recognize additional costs for 2017 in line with its current interpretation of the SGP. The Fiscal Advisory Council expects that the costs will increase slightly – by EUR 0.2 billion or 0.1% of GDP year on year – only in 2018.

3 At this time, it will be known whether eligible additional costs in connection with the arrival of refugees will have been incurred in 2017.

4 The required adjustment value that was closer to the MTO must be applied (the actual 2016 deficit deviated from the MTO more strongly than the forecasts).

5 Aggregate expenditure does not include interest payments or cyclical spending on unemployment benefits; discretionary revenues are taken into account.

forecast by the European Commission – even if they are only slight – will give rise to stricter requirements under the expenditure rule (reduction of allowed expenditure growth), which Austria is not expected to be able to meet in 2017 and 2018, according to the Fiscal Advisory Council's spring forecast.[6] This will be due not only to increased expenditure but also to a decline in discretionary government revenues, which affect aggregate real expenditure.

Taking into account applicable add-ons to or deductions from the reference rate for net annual growth of public expenditure, the following **expenditure benchmarks** apply in Austria: [7]

- +2.9% in 2016 (taking into account a 1.8 percentage point add-on derived from the clear overachievement of the MTO in 2015);
- +1.1% in 2017 (without add-ons or deductions because the deviation from the 2016 MTO is within the leeway provided by the flexibility clauses, which implies that there is no need for structural adjustments);
- +0.7% in 2018 (taking into account a 0.5 percentage point deduction derived from the structural adjustment requirement in the amount of 0.3 percentage points projected by the European Commission).

As to **adjusted real expenditure, the Fiscal Advisory Council's spring forecast** sees the following **growth rates**:

- **2.0% in 2016**, which was a considerable increase attributable in particular to the large number of refugee arrivals,[8] but still **clearly below the reference rate**.
- **1.5% in 2017**, i.e. a value above the reference rate of 1.1%, which implies a **breach of the expenditure rule (1-year assessment)**. However, the growth rate will **not** amount to a **significant** deviation from the reference rate according to the EU definition.
- **2.2%** in **2018**, which means that the growth rate will deviate **significantly** from the reference rate of 0.7% according to the EU definition. In 2018, Austria will thus fail to comply with the expenditure rule both in the **1-year and the 2-year assessment**. The surge in expenditure is attributable, on the one hand, to the discretionary expansion of spending following stepped-up efforts to raise employment and investment and, on the other hand, to the discretionary drop in revenues (caused by, e.g., the reduction of the bank tax), which due to netting also adds to the increase in expenditure. [9]

According to the Fiscal Advisory Council's spring forecast, the intended budgetary path is set to **deviate from EU requirements under the preventive arm of the SGP** in **2018**, unless government **measures to contain spending growth** were to be taken in 2018. It is possible that the European Commission addresses an **early warning** (**"significant deviation procedure"**) to Austria in the **spring of 2019** given that the Fiscal Advisory Council's forecast sees "significant" noncompliance with the expenditure rule for 2019 and, additionally, a deviation from the structural adjustment path that is just below the significance threshold.

The **federal government's stability program** update, by comparison, projects a real expenditure growth rate for 2018 that will significantly exceed the significance threshold only in the 2-year assessment. With regard to the structural adjustment requirement, the federal government – like the Fiscal Advisory Council – expects a deviation that is not significant according to the EU definition.

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6 As long as a Member State does not comply with its MTO, its spending is constrained by expenditure benchmarks ensuring the required adjustment of the structural budget balance toward the MTO.

7 For details on how the expenditure benchmarks are set, see section 6.3.

8 In addition, the discretionary shortfall in revenues owing to the 2015/16 tax reform increases aggregate expenditure under the expenditure rule.

9 The notable decline in interest payments does not have an expenditure-decreasing effect as this category of spending is not included in the calculation of aggregate expenditure.

Overall, the government's budget data provided in the stability program update confirm the **Fiscal Advisory Council's assessment** that **EU rule compliance will be a particular challenge in 2018**. Furthermore, it must not be forgotten that the stability program update does not take into account the budgetary effects of the government's 2017/18 work program.

Debt rule complied with in 2017 and 2018

In **2016**, the increase in the structural deficit ratio amounted to a substantial 1.0 percentage point but still remained below the requirement under the debt rule. To ensure compliance with the future-oriented debt benchmark, i.e. the **debt rule**, **at the end of the transition period** (2016), Austria needed to achieve a **minimum adjustment of its structural budget balance** of –2.2% of GDP in 2016. Given the better-than-expected performance with regard to the structural budget requirements in 2014 and 2015, even a marked deterioration of the structural budget balance in 2016 would not have caused a breach of the debt rule in the transition period. This means that Austria was **in compliance with the debt rule in the transition period**.

From 2017, the debt rule under the SGP will be applied. According to the **Fiscal Advisory Council's spring forecast**, **from 2017**, Austria will fulfill all three debt rule benchmarks (the backward-looking, the forward-looking and the cyclically adjusted benchmark). Accordingly, the **general government debt path as assessed by the Fiscal Advisory Council** and as assessed by the **federal government in its stability program update complies** with the **debt rule**.

European Commission expects Austria to slightly deviate from structural adjustment requirements in 2017 and 2018

According to its **spring 2017 forecast**, the **European Commission** expects Austria's structural budget deficit to increase to 1.1% of GDP in 2017 (2016: 1.0% of GDP). This stands in contrast to the Fiscal Advisory Council's spring forecast, which sees a 0.3 percentage point decline, and the government's stability program update, which expects a 0.1 percentage point decline. The contraction of the structural deficit, to 0.9% of GDP, forecast by the European Commission for 2018 is right between the values expected by the Federal Ministry of Finance (0.8%) and the Fiscal Advisory Council (1.0%). Although the extraordinary expenditure in connection with the arrival of refugees and anti-terrorism measures – coming to 0.4% of GDP in 2017 and 0.3% of GDP in 2018 according to European Commission calculations – can be accommodated under the flexibility clauses, the **European Commission expects Austria to fail to meet the MTO in 2017 and 2018**. However, the deviations from the MTO and the structural adjustment path are not "significant" according to the EU definition. That said, the European Commission sees a downward **risk for public finances** in the funding of the measures envisaged in the government's current work program, which has not been specified in great detail so far. It also reiterates **calls** upon the government to strengthen the sustainability of the health care and the pension systems and to adopt **measures** to streamline responsibilities and funding structures at the regional level.

In order to ensure Austria's compliance with EU fiscal rules in 2017 and 2018, further fiscal efforts in the amount of 0.1% of GDP each year will be necessary, the European Commission says. **By comparison**, the **Fiscal Advisory Council** does not see the need for additional structural adjustments in 2017 while in 2018, adjustments worth 0.4% of GDP are expected to be needed.