AUSTRIA'S 2017 TO 2019 FISCAL STANCE AND KEY RESULTS OF THE AUSTRIAN FISCAL ADVISORY COUNCIL'S 2018 REPORT ON PUBLIC FINANCES[1]

Fiscal position from 2017 to 2019 and fiscal stance of the general government

According to the **Fiscal Advisory Council's fall forecast for 2018 and 2019**, the **general government** will manage to **balance its budget** (Maastricht definition) already in **2018**, given dynamic employment growth and high tax revenues in the first three quarters of 2018. In **2019**, the general government is forecast to post a budget surplus of 0.2% of GDP. Hence, the Fiscal Advisory Council's current budget forecast is more optimistic than the Draft Budgetary Plan of the Austrian Federal Ministry of Finance of October 2018 (2018 budget balance: –0.3% of GDP; 2019: +0.1% of GDP). Both forecasts are based on the WIFO's economic outlook of September 2018. In its spring 2018 budget forecast, the Fiscal Advisory Council had still assumed a somewhat slower decline in the budget deficit (2018: –0.2% of GDP; 2019: +0.1% of GDP).

Austria's **fiscal stance**,[2] an indicator showing the budget path from a cyclical perspective, is largely **neutral** for the 2017–2019 period, which seems appropriate in light of moderate price increases (chart 1). While the upswing seems to have already passed its peak in the first three months of 2018, the business environment is expected to remain favorable in Austria according to current economic forecasts.

The current **medium-term general government budget program** is aimed at making use of the good economic conditions, avoiding procyclical measures and, by making fiscal consolidation efforts, not incurring new debt as from 2019.

Full compliance with EU fiscal rules in 2017 as dynamic economic developments underpin budget consolidation

Austria's general government budget deficit contracted markedly in **2017** (table 2), which was in line with the Fiscal Advisory Council's expectations. According to **preliminary results** provided by Statistics Austria in September 2018, the government deficit amounted to 0.8% of GDP, following 1.6% of GDP in 2016. The relatively high budget deficit in 2016 had been attributable above all to the 2015/2016 tax relief on wages and mixed income. The **reduction of the deficit in 2017** was due to the dynamic development of all **macroeconomic indicators** relevant to public revenues (e.g. employment, income, consumption). In addition, nominal **government expenditure** expanded by a mere 1.5% year on year.

In 2017, Austria **complied with all key numerical EU fiscal rules** (size of the budget deficit, size of the structural budget deficit, development of nominal government expenditure and development of government debt; table 5).

1 Budget data up to 2017 reflect the data available in September 2018. Budgetary outcomes for 2018 and 2019 are forecasts (generally the 2018 fall forecast of the Fiscal Advisory Council).

2 Change in the structural primary balance ratio (as a percentage of GDP) in relation to the output gap.

Table 1: Assessment and preliminary results of Austria's budget path for 2017

% of GDP	Net lending/borrowing 2017[1] MoF	FISK	EC	Structural budget balance 2017[2] MoF	FISK	EC
October/November 2016	-1.2	-1.3	-1.3	-0.9	-1.0	-0.9
April/May 2017	-1.0	-0.9	-1.3	-0.9	-0.7	-1.1
October/November 2017	-0.9	-0.7	-1.0	-0.7	-0.6	-0.9
April/May 2018	-0.7	-0.7	-0.7	-0.5	-0.5	-0.6
October/November 2018	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8

1) General government budget balance according to the ESA 2010.
2) Including additional cost of assistance to refugees and of counterterrorism
Source: Ministry of Finance (Stability Programme and Draft Budgetary Plan), FISK (fiscal forecast), EC (economic forecast), Statistics Austria.

Table 2: Budget balances of subsectors of the general government, 2015 to 2019

	Central government		State governments (excl. Vienna[1])		Local governments (incl. Vienna[1])		Social security funds		Total	
	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP	bn EUR	% of GDP
2015	-4.2	-1.2	0.4	0.1	0.0	0.0	0.1	0.0	-3.6	-1.0
2016	-4.4	-1.2	-1.2	-0.3	-0.2	-0.1	0.3	0.1	-5.6	-1.6
2017	-3.3	-0.9	0.2	0.1	-0.2	-0.1	0.4	0.1	-2.9	-0.8
2018	.	.	.	.	.	.	.	.	-0.2	0.0
2019	.	.	.	.	.	.	.	.	0.7	0.2

1) In the Austrian Stability Pact, Vienna (as state and local government) is included in the state government level.
Source: Statistics Austria, Austrian Institute of Economic Research (GDP) and Fiscal Advisory Council's fall forecast

Table 3: Budget balances and structural balances of the general government, 2015 to 2019

% of GDP	Net lending/borrowing FISK	EC	Structural budget balance FISK	EC	Structural budget balance incl. clauses[1] FISK	EC
2015	-1.0	-1.0	0.2	0.0	0.3	0.0
2016	-1.6	-1.6	-1.0	-1.1	-0.6	-0.8
2017	-0.8	-0.8	-0.8	-0.8	-0.4	-0.4
2018	0.0	-0.3	-0.7	-0.8	-0.4	-0.5
2019	0.2	0.0	-0.5	-0.4	-0.4	-0.4

1) Including additional cost of assistance to refugees and of counterterrorism measures.
Source: Statistics Austria, Austrian Institute of Economic Research (GDP), European Commission's and Fiscal Advisory Council's fall forecast 2018.

Table 4: Government ratios: general government total expenditure, revenue and taxes, 2015 to 2019 (% of GDP)

% of GDP	2015	2016	2017	2018	2019
Expenditure[1]	51.1	50.3	49.2	48.3	47.6
Gross capital formation	3.0	3.0	3.1	3.1	3.0
Interest payments	2.3	2.1	1.8	1.6	1.4
Revenue[1]	50.1	48.7	48.4	48.2	47.8
Tax revenue (national definition)[2]	43.2	41.9	41.8	41.9	41.6
Tax revenue (international definition)[3]	43.9	42.6	42.4	42.4	42.1

1) Interest payments excluding swap transactions.

2) General government tax revenue including actual social contributions (compulsory contributions only; ESA codes: D2+D5+D611+D91-D995); including EU own resources.

3) National tax revenue and imputed social contributions.

Advisory Council's fall forecast (2018 and 2019).

The **structural budget balance (including eligible clauses)**[3] **improved** in 2017, reaching 0.4% of GDP, after having turned from a surplus in 2015 (+0.3% of GDP) to a deficit in 2016 (–0.6% of GDP, including eligible clauses). These **clauses** refer to **extraordinary public expenditure** for which the European Union temporarily grants a deviation from the medium-term budgetary objective (additional costs incurred for refugee assistance and counter-terrorism programs in the period from 2015 to 2019; 2017: 0.4% of GDP).

Government revenues and expenditures in 2017 marked by special effects and favorable economic environment

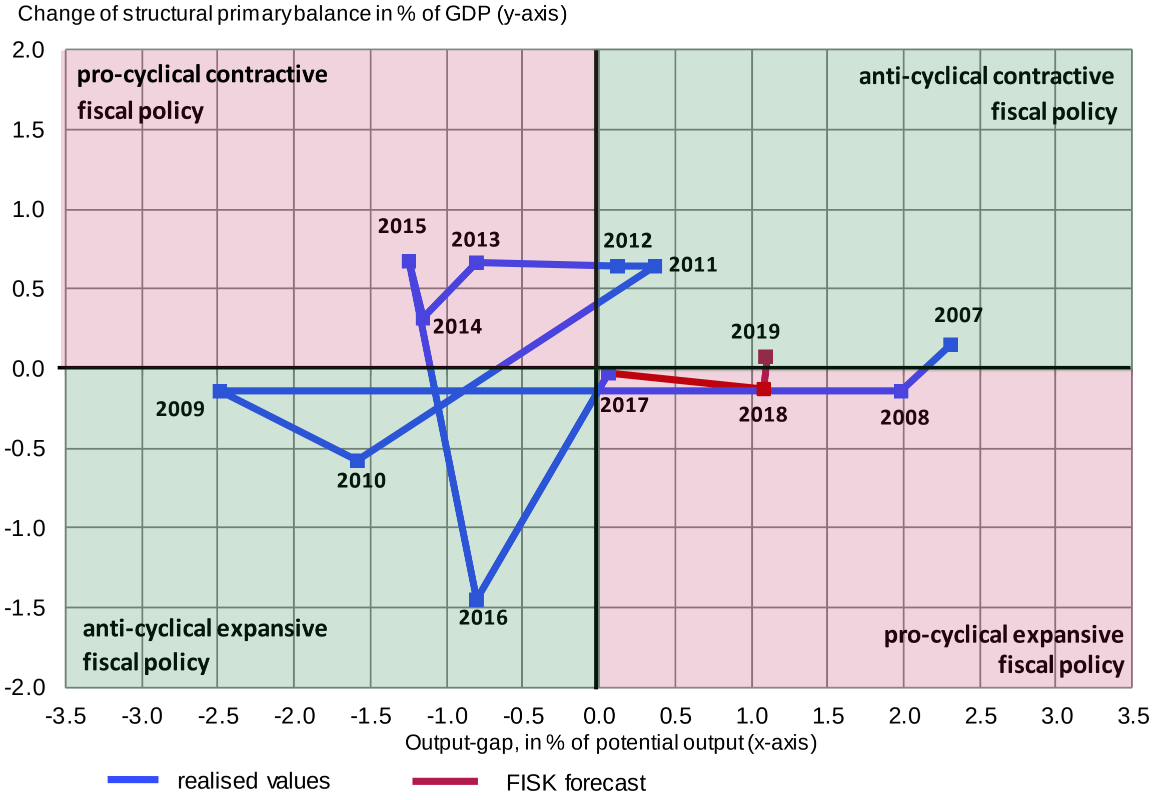
General government revenues came to EUR **178.9 billion** in **2017**, up EUR 5.4 billion or 3.1% on the year, which was slightly below the relative growth of nominal GDP (+3.8%). Several tax-lowering measures, such as **reducing the contribution to the family burdens equalization fund** to 4.1% and **reforming taxation and assessed income taxation including automated tax assessment for employees**, depressed dynamic government revenues fueled by the favorable cyclical conditions. In addition, integrating the wage earners' tax credit into the **deductible amount for travel expenses** caused a **reduction** (**which did not enter the budget result**) of assessed income tax revenues and their respective counterpart on the expenditure side (D.62) by EUR 0.2 billion each. The **tightening of rules for the depreciation of buildings** drove up revenues. **Austria's tax-to GDP ratio** hardly changed in 2017, amounting to 41.8% of GDP according to the national definition.

Austrian government expenditures increased only marginally in **2017**: Totaling 1.5% or EUR 2.7 billion, the nominal increase remained below the inflation rate and GDP growth (HICP: +2.2%; nominal GDP: +3.8%) despite stepped-up **infrastructure investment** (+6.3%). This was, among other things, due to lower inflation rates in the previous years (HICP 2016: +1.0%; 2015: +0.8%), which depressed the development of important revenue positions (above all public wage and pension adjustments). Moreover, expenditure growth went down noticeably as

3 The calculation of the structural budget balance including eligible clauses does not take into account one-off effects (spending on the banking package) as well as expenditure related to extraordinary events (i.e. assistance to refugees, counter-terrorism measures) as well as additional revenues and less expenditure because of the economic upswing in 2017 (cyclical component of the budget).

Figure 1

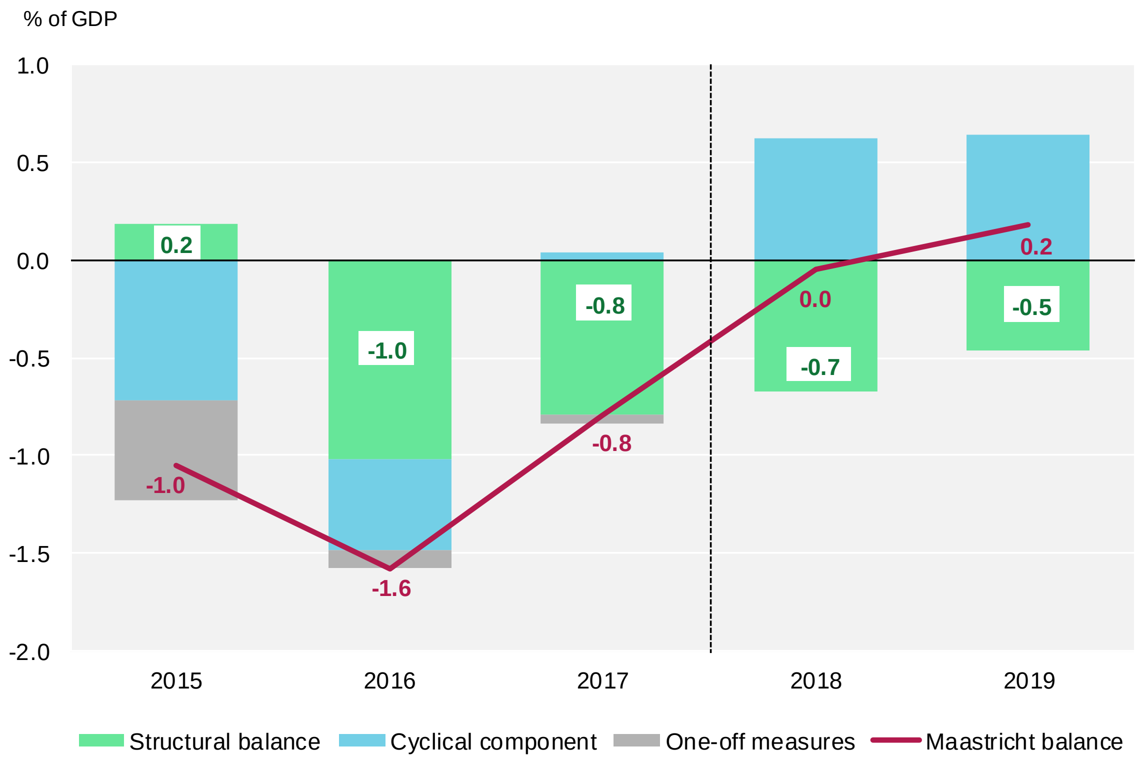
Structural primary balance of gen. govnt. and output gap 2007 to 2019



Source: Statistics Austria, WIFO and FISK fall forecast (for 2018 and 2019).

Figure 2

General government deficit and its components 2015 to 2019



Source: Statistics Austria, WIFO and FISK fall forecast (for 2018 and 2019).

interest payments on government debt **declined** amid the **low interest rate environment** (2017: –EUR 0.6 billion) and **EU contributions** were **lower** (own resources based on gross national income: –EUR 0.3 billion). The **government expenditure ratio** came to 49.2% of GDP in 2017 (2016: 51.0% of GDP).

General government deficit was reduced in 2017 following improvements in federal and regional budgets

A breakdown by **central, regional and local governments** shows that in particular the **federal government's budget** and the **budget of the regional governments (excluding Vienna)** improved in **2017**. The federal government reduced its Maastricht deficit to 0.9% of GDP (2016: 1.6% of GDP), and the regional governments recorded a budget surplus of 0.1% of GDP (2016: deficit of –0.3% of GDP). The negative development at the regional level in 2016 was largely due to a one-off special effect of around 0.3% of GDP related to the Carinthian settlement payment fund (Kärntner Ausgleichszahlungs-Fonds, KAF).[4] At the level of regional governments (excluding Vienna), only the regional governments of Styria, Tyrol and Vorarlberg continued to post deficits; almost all regional governments managed to improve their budgets.

The **local governments (including Vienna)** registered a Maastricht deficit of EUR 0.2 billion or 0.1% of GDP in 2017 (no change on 2016). **Excluding Vienna**, however, the **budget balance of the local governments** turned from a surplus to a **small deficit** (EUR 0.1 billion or 0.0% of GDP) for the first time since 2010, reflecting deteriorating budget balances in all provinces but Vorarlberg and Lower Austria (and Vienna).

2018 general government budget (Maastricht definition) likely to be balanced thanks to economic boom

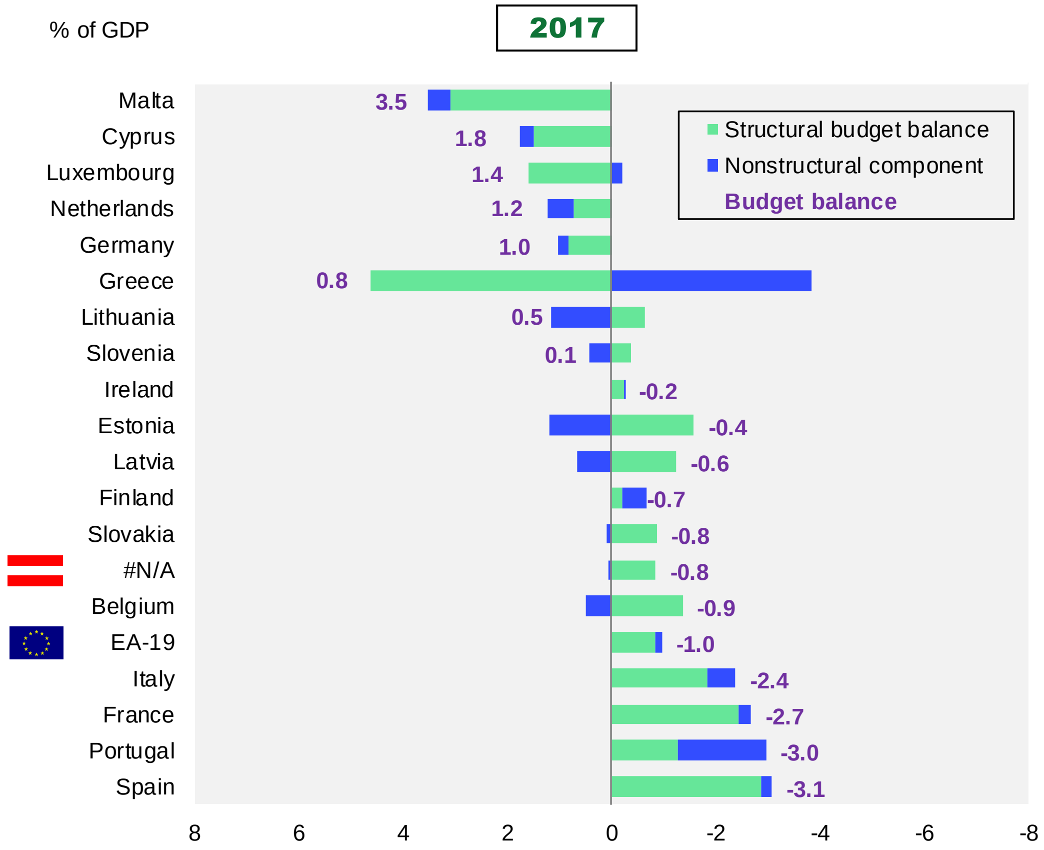
In line with the Fiscal Advisory Council's current forecast (as at November 2018), the **new federal government** will reach its aim of creating **no new debt** one year ahead of schedule. Given the development in 2018 thus far and the boom phase, the **Fiscal Advisory Council** (as at November 2018) expects **government revenues to increase substantially in 2018** (+4.4% year on year). Consequently, the **general government budget** is likely to be **balanced** already in **2018**. For **2019**, the Fiscal Advisory Council **today** anticipates a **slight budget surplus** of 0.2% of GDP despite **muted revenue growth**, with the latter being attributable to a **higher tax relief for families with children** (Familienbonus Plus) and **slowing economic momentum**.

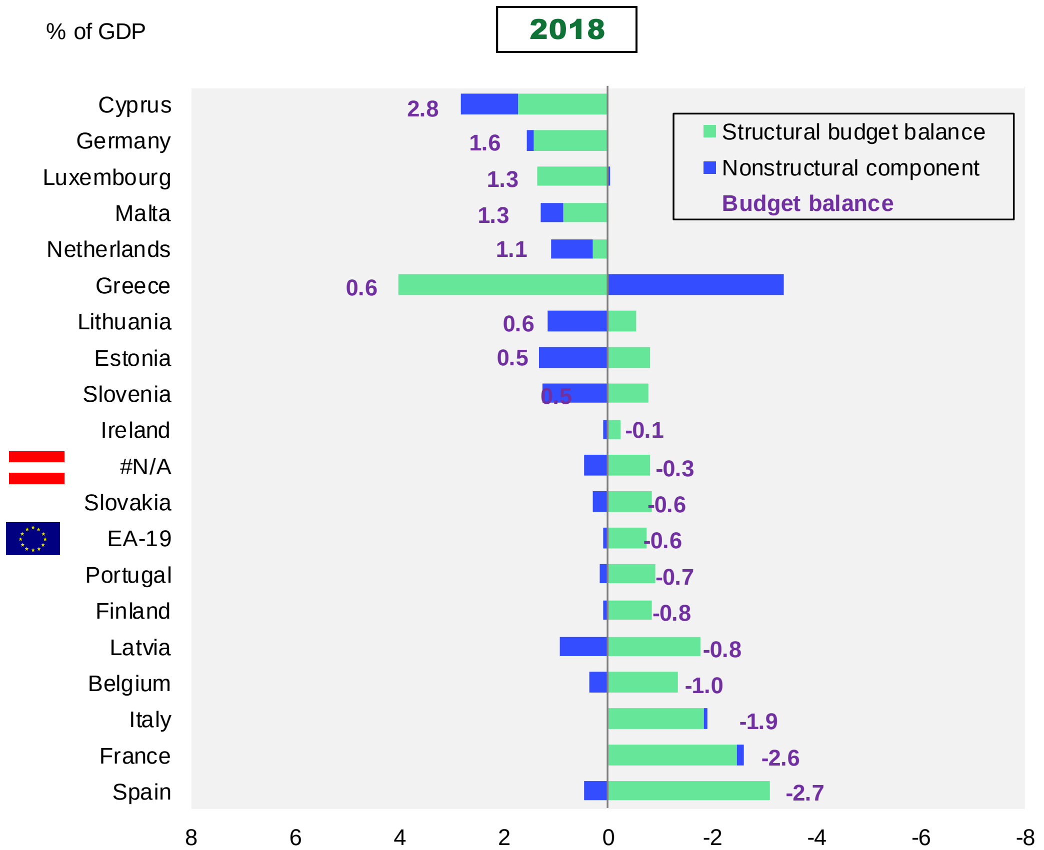
Austria's government expenditures are forecast to **grow at a higher pace in 2018 and 2019 than in 2017** (+1.5%). In its fall 2018 forecast, the Fiscal Advisory Council expects **government expenditures** to **increase** by **2.8% in 2018** and by **2.7% in 2019**. The Austrian government has been implementing **expenditure measures in 2018**, which had been adopted in particular in the 2017 election year (above all an "employment bonus" program, the abolition of public long-term care providers' recourse to patients' assets; totaling +0.3% of GDP). Moreover, **inflation** has been **on the rise** (HICP: 2017 to 2019: +2.2% p.a.; 2016: +1.0%). Rising inflation rates translate – with a time lag – especially into higher compensation of public sector employees and higher annual pension adjustments. The projected **decrease in unemployment** and continued **low interest rate environment** contain government expenditures also in 2018 and 2019 (interest payments: –EUR 0.6 billion in 2018 and –EUR 0.3 billion in 2019).

4 This payment is considered to be an intra-government transfer and therefore has no impact on the general government budget deficit.

Figure 3

Budget balances in the euro area 2017 and 2018





Source: Autumn 2018 forecast, European Commission (as of November 2018).

Brisk economy estimated to improve the budget balance by 0.6% of GDP in both 2018 and 2019 according to the Fiscal Advisory Council's current forecast (based on EC method)

When we look at the **structural budget balance compared with the fiscal balance on a Maastricht basis**, we see that the 2018 economic boom has had a favorable impact on the general government budget balance: higher government revenues and muted social care spending. The year-on-year improvement of the general government budget balance in 2018 (+0.8% of GDP) is largely offset by the cyclical budget component, which rises from 0.0% to 0.6% of GDP. For this reason, **the structural budget balance improves only slightly over the forecast horizon by comparison**, as based on the Fiscal Advisory Council's current output gap estimation, which draws on the European Commission methods. Starting from a **structural budget deficit (no eligible clauses)** of 0.8% of GDP in 2018, the Fiscal Advisory Council anticipates that the structural budget deficit will improve to 0.7% of GDP in 2018 and to 0.5% of GDP in 2019.

Austria to largely comply with EU fiscal rules in 2018 and 2019

The **medium-term budgetary objective** (MTO) set for Austria envisages a **structural budget deficit of –0.5% of GDP,** and compliance with the MTO signals that fiscal policy is sound. According to the **Fiscal Advisory Council's fall forecast**, Austria's **structural deficit (excluding the application of flexibility clauses)** is contracting slightly, namely from 0.8% of GDP in 2017, to 0.7% of GDP in 2018, and to 0.5% of GDP in 2019. Hence, the Fiscal Advisory Council expects Austria to **reach its MTO** (given the margin of tolerance of 0.25% of GDP) **in 2018 and 2019 already without invoking the eligible clauses** (refugee assistance and counter-terrorism programs). **When the eligible clauses** related to additional costs temporarily incurred for providing assistance to refugees and for counter-terrorism measures **are applied**, the structural deficit ratio is reduced to 0.4% of GDP each for the years 2017 to 2019.

In a similar vein, the **European Commission,** in its **autumn 2018 economic forecast for Austria**, projects the **structural budget deficit** to amount to 0.8% of GDP in 2018 and to 0.4% of GDP in 2019 (including flexibility clauses: –0.5% of GDP in 2018 and –0.4% of GDP in 2019). In line with the **European Commission's autumn 2018 economic forecast**, in 2018, the following **5 of the 19 euro area countries markedly** exceed the GDP-weighted structural budget deficit average (excluding flexibility clauses) of **0.7% of GDP**: Spain (–3.1% of GDP), France (–2.5% of GDP), Italy and Latvia (–1.8% of GDP each) and Belgium (–1.3% of GDP).

Window of opportunity for structural reforms used sparingly so far

Since end-2017, the new government has initiated several, partly **large-scale, structural reform projects** (including a reform of the responsibilities of federal, regional and local governments, social security reform, education reform, technology campaign) with a view to making government spending as well as spending on social security more effective and efficient over the medium term. Many of these projects have yet to be finalized, however. In its Draft Budgetary Plan 2019 of October 2018, the Austrian federal government confirmed its commitment to stability and growth in its fiscal stance. The government aims at **reducing** Austria's **debt level** of about 73% of GDP at year-end 2018 to some **60% of GDP** by the end of the parliamentary term in parallel with driving down the **tax ratio toward 40% of GDP**.

In October 2018, the government presented a **legislative package** to the Austrian parliament that aims at **disentangling competencies among the federal and regional governments, and at narrowing the scope of their mutual approval rights**. The goal is to reduce the number of topics where the federal government passes framework legislation and the regional governments are responsible for adopting implementing legislation.

A **two-thirds majority** is necessary both in the lower house (Nationalrat) and the upper house (Bundesrat) of the Austrian parliament for this legislative package to be adopted. The Austrian **school system** has seen some material changes essentially aimed at developing the basic competencies reading, writing and arithmetic (e.g. remedial German classes, sanctions against negligent parents, numerical grading in elementary school). In August 2018, the Council of Ministers moreover adopted a **campaign to foster research, technology and innovation**. The Austrian research and innovation system is meant to become more efficient by streamlining the competencies of relevant research and research-promoting bodies and by consolidating the numerous programs. The government plans to work out a process and schedule for drawing up its strategy by **spring 2019**. This notwithstanding, the government has yet to deliver on a **reform of federal structures** in key areas including **hospital services** and **education**, which the Fiscal Advisory Council has been advocating for several years.

The comprehensive **project on reforming the organization of social security funds** presented to the Austrian parliament in October 2018 has aroused political and technical **controversy**, even though streamlining the organizational and decision-making structures in the health care system **is basically considered to be vital**. In addition, it is very **difficult to estimate the medium- and long-term effects** such a reform will have **on the budget**. Following critical comments (e.g. from the Court of Audit) on the impact assessment during the consultation process, the original financial impact report by the Minister of Council was adapted or expanded in several areas. According to the Parliamentary Budget Office, the calculation of efficiency enhancements is still insufficiently documented, however. The **Fiscal Advisory Council** coincides in finding the documentation of the alleged (cumulated) **savings** – about EUR 1 billion by the year 2023 (linear rise in savings of up to 30% in staff costs and administrative expenses of social security funds without netting these costs against the costs of reorganization and merging according to the impact assessment) – to be **unclear and/or insufficient**. Generally speaking, however, a reorganization might increase transparency in the health care system and pave the way for further efficiency gains.

The Fiscal Advisory Council once again points to the current window of opportunity for **reallocating budget expenditures to forward-looking areas** such as research and development, education, infrastructure and climate protection. The low interest rate environment prevalent today, which provides for more fiscal leeway, will **not last forever** and should therefore not be taken for granted. At the same time, **demographic and socioeconomic developments** are expected to create **additional costs**.

Debt ratio to decline markedly by end-2019

The Fiscal Advisory Council projects the **general government debt ratio** to drop to **73.4% and 69.5% of GDP** in **2018** and **2019**, respectively, after 78.3% at end-2017. Two factors in particular are driving this **marked contraction** – by 4.9 (2018) and 3.9 percentage points (2019) – of the debt ratio: first, the **substantial negative difference between the average interest rate paid and nominal GDP growth** (interest rate-growth differential), and second, **primary surpluses**. The expected rise in nominal GDP alone (referred to as GDP denominator effect) will cut the debt ratio by 3.5 (2018) and 2.9 percentage points (2019).

In **2017**, **government debt for the first time in 20 years declined in nominal terms** (end-2017: EUR 289.7 billion; end-2016: EUR 295.8 billion). This was mainly due to the EUR 6.9 billion **reduction of nationalized banks' liabilities** by way of stock-flow adjustments (e.g. payment of HETA liabilities ahead of schedule, including the dissolution of Carinthia's special fund (EUR 4.8 billion), reduction of the liabilities held by immigon portfolioabbau ag (EUR 0.7 billion) and KA Finanz AG (EUR 1.4 billion). The winddown of nationalized banks, which reduces government debt, continues in 2018 and 2019 at a slower pace (2018: EUR 4.0 billion; 2019: EUR 3.1 billion, including repayment of prepayments made to the Free State of Bavaria and loan repayments of HETA to Bayerische Landesbank. The **overall effect** of the **banking package** on Austria's debt level is expected to decrease from 7.3% of GDP at end-2017 to 6.0% and 5.0% of GDP at end-2018 and end-2019, respectively.

Table 5: EU fiscal rules as applied to Austria

General government	European Commission estimate			Fiscal Advisory Council estimate			Federal Ministry of Finance estimate		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Maastricht deficit of no more than 3% of GDP	✓	✓	✓	✓	✓	✓	✓	✓	✓
MTO (incl. eligible clauses)[1)]	✓	✓	✓	✓	✓	✓	✓	⊗	✓
Government expenditure growth	✓	⊗	⊗	✓	⊗	⊗	✓	⊗	⊗
Reduction of debt ratio	✓	✓	✓	✓	✓	✓	✓	✓	✓
Austrian general government fiscal indicators (% of GDP)									
Budget balance (Maastricht definition)	-0.8	-0.3	0.0	-0.8	0.0	0.2	-0.8	-0.3	0.1
Structural budget balance	-0.8	-0.8	-0.4	-0.8	-0.7	-0.5	-0.8	-0.9	-0.5
Structural budget balance incl. eligible clauses	-0.4	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.6	-0.5
Total expenditure (nominal, adjusted, net of one-offs, change in %)	.	.	.	2.4	3.8	3.7	2.5	4.2	3.3
Gross debt (year-end figures)	78.3	74.5	71.0	78.3	73.4	69.5	78.3	74.2	70.5

Note: ✓... fiscal rule has been met, ⊗... fiscal rule has not been met, ⊗... fiscal rule has not been met and significant deviation
1) Tolerated deviation (0.25 percentage points) and eligible deviations, e.g. due to costs related to refugees or terrorist threat.
Source: MoF (Draft Budgetary Plan, October 2018), WIFO (Forecast, Sept. 2018), EC autumn forecast (November 2018) and own calculations.

The 2012 Austrian stability pact

Fiscal Advisory Council needs wider access to recent information; interpretation of 2012 Austrian stability pact still partly unclear

The **centerpiece** of the 2012 **Austrian stability pact** is **prescribing** the **federal government** (excluding social security funds as a rule), the **individual regional governments** and the **local governments per province budget targets** with a view to ensuring that the **general government** complies with the EU fiscal rules. Once **fully implemented**, the Austrian stability pact will be a **multidimensional fiscal framework** (nominal and structural budget rule, spending and debt rule, guarantee limits) that applies to the subsectoral and regional levels. Central, regional and local authorities must record **deviations** from their relevant **structural targets** in **control accounts**, and if they exceed specific thresholds, must **take remedial action** in the subsequent years. Moreover, a **sanctions mechanism** was established.

However, by end-November 2018, the contractual partners representing the federal, regional and local governments had **not** yet **reached agreement on important points** that determine how to interpret and implement the 2012 Austrian stability pact, even though **full implementation** had been envisaged for 2017 at the latest. Once the pact is fully implemented, the focus will be on compliance with a **structural budget target** of no more than –0.45% of GDP (central government and social security funds: –0.35% of GDP; regional and local governments: –0.10% of GDP) and the **establishment of control accounts** in which (positive and negative) deviations from the structural budget targets will have to be recorded.

Given its legal mandate (as laid down in Article 1 para. 1 no. 6 Federal Law Gazette No. 149/2013), the **Fiscal Advisory Council needs access to up-to-date entries made in the control accounts** as well as **information on recent budget developments at all subsectoral levels** in order to be able to **monitor the control accounts** and identify trends that might be problematic. Timely publication of the **control accounts** (preliminary data if need be) of the federal government, individual regional governments and local governments per province would moreover increase transparency.

Agreed regional fiscal rules to be tested for viability as Austria's 2012 stability pact is being fully implemented

Applying the 2012 Austrian stability pact in all its facets entails some **difficulties** which relate to **three issues** in particular: First, the **design of the EU fiscal rules, whose complexity increases even further at the regional level**. Second, **detailed regional targets** for which **in part no reliable ESA data** on the current budget situation for managing budget execution and for drawing up budget plans (especially for spending adjustments made in line with EU requirements) are available. Third, **diverging interpretation of the 2012 Austrian stability pact** by the contractual parties (federal, regional and local governments) inevitably leads to **compromise** that partly **conflicts with** the **EU fiscal rules**.[5]

In line with its previous recommendations, the **Fiscal Advisory Council finds** that the 2012 Austrian stability pact should **be revised** and radically **streamlined without putting into question the applicable targets laid down in the EU fiscal framework** and the **fiscal sharing arrangement** among the various levels of government that has been **agreed and determined** to ensure compliance with these targets.

To be able to identify **potential breaches** of the 2012 Austrian stability pact and of the EU fiscal framework in a fast and precise manner, also **administrative budget data at the level of regional and local governments** would have to be made available **in a timely fashion**. The **European Commission monitors compliance with fiscal rules** for the year t as early as in the **spring of the year t+1**. When assessing Austria's compliance with fiscal rules, the **European Commission as a rule no longer considers ex post revisions** of the ESA fiscal data by Statistics Austria.

Findings of studies produced by the Office of the Fiscal Advisory Council

Budget balance and structural budget balance equally suitable as a fiscal rule measure; forecast uncertainty is higher for the EU expenditure rule

For fiscal rules to be effective, it is important that, among other things, the **targets are clear and feasible** and that the **rules** are monitored based on **transparent and verifiable calculations**. It should be **straightforward to forecast** the fiscal measures subject to such rules, such as the Maastricht deficit, the structural budget deficit and government expenditure growth, and **forecast errors should be smal**l.

A recent study by Hauth et al. (2018) provides information on the f**orecasting performance regarding budget measures for Austria**. This study shows that the **estimation error** (mean absolute deviation of the spring and fall estimates 2014–2017 as at May 2018) for the **structural budget deficit ratio** (in percent of GDP) for Austria (0.40 to 0.55 percentage points on average) recorded for all three institutions examined in the study (Fiscal Advisory Council, Ministry of Finance and European Commission) is quite similar to that of the **Maastricht deficit ratio** (0.43 to 0.47 percentage points). More specifically, using the **structural budget balance** as a fiscal rule has the advantage of making the **procyclicality or anticyclicality of fiscal policy transparent**.

In the period under review (2014 to 2017), the **EU's expenditure rule** for Austria appeared to have been **largely inadequate** for use as fiscal rule for Austria owing to two cumulative effects (varying targets

[5] In the meantime, the contractual partners have reached agreement on most points of how to interpret the 2012 Austrian stability pact.

depending on trend growth and compliance with the structural fiscal rule; uncertainty surrounding government expenditure growth): In hindsight, the **varying targets** derived for Austria from the European Commission's forecasts with regard to the expenditure rule appear to have been too restrictive (underestimation of the targets averaged 0.51 percentage points). **Furthermore**, the **growth rates of (adjusted, nominal) public expenditure** were **overestimated** (forecasts of the Fiscal Advisory Council: 0.34 percentage points on average). The expenditure rule in the EU's fiscal framework provides an additional assessment criterion for the cyclical adequacy of the budget path under the preventive arm of the Stability and Growth Pact.

A **0.5% of GDP forecast error in connection with the Maastricht budget balance**, as recorded for Austria, may be **considered low by international standards**. According to budget balance estimates of the European Commission (Fioramanti et al., 2016), forecast errors were higher in almost all EU countries for the period between 1969 and 2014, coming to around 1% of GDP or more.

Accuracy of economic forecasts used by federal government to draw up budget plan

In his study, Schuster (2018) evaluates the **macroeconomic forecasts of the Austrian Institute of Economic Research (WIFO)** for the years **2005 to 2017** that served as **inputs for the official government budget forecasts by the Austrian Ministry of Finance** (Stability Programmes and Draft Budgetary Plans), and the **fiscal forecasts made by the Ministry of Finance**. This study confirms earlier findings, namely that (1) **forecasts of different institutions** (European Commission, Institute for Advance Studies, IMF, OECD, OeNB) **are much more correlated with each other than with actual outcomes** and (2) forecasts **are smoother** than outcomes in the sense that upswings and downturns tend to be underestimated. The differences in the forecast errors do not allow to rank the forecasting performance of the different institutions.

The following is broadly true for **all or almost all institutions reviewed: Private consumption** and **investment** tended to be overestimated while **public consumption** and **net exports** tended to be underestimated. **GDP growth (real and nominal)** was **not** found to be **significantly biased** for **any institution**. For the GDP **components by the income approach**, which are of considerable importance as inputs for subsequent fiscal projections, it was found that the **compensation of employees** was **underestimated**, while **gross operating surplus** was **overestimated**. The former partly explains the **significant overestimation of the budget deficit** by all institutions, **including the Ministry of Finance**. Interestingly, the budget balance is the only variable for which the bias for the current-year estimate is larger than that for the next-year forecast.

Subsidies in Austria: definitions, spending levels and suggestions for improving efficiency

Lack of transparency with regard to the objectives, amounts and **actual impact of subsidies** is one of the key reasons why the **Austrian system of subsidies** has repeatedly been presented as a prominent example of an area where tasks and expenditures are shared across all levels of government. In his study, Grossmann (2018) analyzes subsidies from various perspectives (definitions, volumes, transparency, room for improvement). **Depending on the subsidy definition and sectoral classification systems used**, **recorded central government subsidies** ranged from EUR 6.9 billion (based on the European System of Accounts (ESA) 2010) to EUR 15.7 billion (based on the framework of the Federal Budget Act 2013) in **2016**.[6] In line with the ESA 2010, subsidies basically refer to **direct subsidies** and transfers to the **corporate sector** (private sector excluding households), while the Federal Budget Act 2013 mostly refers

6 BHG – Bundeshaushaltsgesetz, VRV – Voranschlags- und Rechnungsabschlussverordnung, Transparenzdatenbankgesetz – TDBG, ESVG – Europäisches System Volkswirtschaftlicher Gesamtrechnungen.

to indirect subsidies (above all tax breaks like lower tax rates provided by the Value Added Tax Act), which account for some 75% of the overall volume. The amount of **regional and local government** subsidies to the corporate sector recorded for **2016** ranges from EUR 1.4 billion (based on the 1997 Budgeting and Accounts Regulation) to EUR 7.5 billion (based on the ESA 2010).

The "**transparency database**," launched in 2010 on the initiative of the Federal Ministry of Finance, operates on the basis of a very broad definition of subsidies, serves a number of different objectives and identifies individual and corporate beneficiaries. Designed as a comprehensive information, monitoring and control tool, the database has repeatedly been **criticized** – e.g. by the Austrian Court of Audit and some regional governments – for the way it has been **organized and implemented so far**. Information on **subsidies** related to the environment and energy that have been provided to **regional governments** became available in April 2018. Moreover, the Federal Ministry of Finance is trying to come up with a solution for also registering subsidies granted to local governments while keeping administrative costs at a reasonable level. In October 2018, it made public the **levels of federal subsidies** that have been paid out since the year 2013, and the amounts of **environment- and energy-related regional subsidies** that have been disbursed since the year 2017.

The **regulatory impact assessment pursuant to the Federal Budget Act 2013** is an additional instrument that could also be applied to all significant subsidy measures and programs, even – in a simplified form – to those provided by regional and local governments. However, there is a need to improve both **ex ante regulatory impact assessments and ex post evaluations**, e.g. in terms of uniform quality standards, choice of impact indicators and methodological changes in ex post evaluations.

Budgetary measures for 2017 and 2018

The **federal government's activities** during the **26th legislative period focus** on the following **targets** (Strategy Report of the Ministry of Finance, 2018):

- The Austrian federal government has committed itself to pursue sustainable, stability- and growth-oriented, sound budget policies at all levels of government and to comply with the EU's fiscal rules. Procyclical economic policy measures are to be terminated.

- Reaching a balanced structural budget for the period 2018 to 2022 is the overarching objective. In addition, government expenditures are to expand at a slower pace than GDP.

- Any budgetary room for maneuver is to be used for support and relief measures, to finance future challenges and to maintain both social security and security in general. The tax ratio is to be reduced to 40% of GDP.

- Investment in research and development, education, digital infrastructure and national security is to be stepped up.

To implement this strategy, the current government has continued **tax and expenditure-side measures** initiated by the previous government, launched **new measures and reform projects** and **revoked or suspended measures** that have already been adopted.

In the following, we will outline the **most important measures** and their **budgetary impact** as expected by the federal government. These measures will also influence budgetary developments in many areas in the years that follow.

- The **2015/16 tax reform**, which took effect on January 1, 2016, has resulted in a **tax relief,** through

wage and income taxes, of EUR 5 billion. It has to be noted that full pass-through of the relief and funding measures will be a multi-annual process. In addition, the tax burden on the corporate sector was lowered by increasing the **research premium** and the tax allowance for the issue of **employee shares**. The tax reform is to be **funded** primarily **by revenue-side measures to combat tax fraud** in the order of EUR 1.9 billion (in particular by obliging businesses to use a cash register and issue receipts and by empowering fiscal authorities to inspect bank accounts), through **tax increases** (e.g. partial VAT increase, increase in the capital gains tax on real estate sales and in the tax on capital gains and dividends, and abolition of tax exemptions) and through **self-financing** effects of the tax reform (i.e. increased tax revenues through higher growth).

- **Reduction of nonwage labor costs:** Since 2017, the employer contributions to the **family burden equalization fund** have been reduced in two stages from 4.5% (2016) to 4.1% (2017) and to 3.9% as from 2018 (2017: –EUR 0.5 billion; 2018: –EUR 0.8 billion). The **"employment bonus" program** (covering half of the nonwage labor costs for additional employees as from July 2017 for a three-year period) and the **"startup package"** (e.g. an exemption of nonwage labor costs for the first three employees) were **rescaled** on grounds of the current economic situation ("procyclical measures"). The costs are expected to reach some EUR 0.6 billion by 2019. In 2019, the employers' contributions to the **general accident insurance (AUVA)** will be lowered from 1.3% to 1.2% (–EUR 0.1 billion).

- **Business incentives, further tax cuts and deregulation act:** The 2018/19 federal budget envisages resizing the **investment subsidies for SMEs and large businesses**, which had been planned to total EUR 140 million from 2017 to 2019. Moreover, the **bank levy** was overhauled (de facto cut by EUR 0.6 billion per annum as from 2017 in return for a one-off payment of EUR 1.0 billion). The increase of the **value-added tax on tourist overnight stays** from 10% to 13%, which had been implemented as part of the tax reform 2015/16, has been canceled starting from November 2018 (–EUR 120 million). Moreover, the **air transport levy** was cut in half and the **tax on residential lease agreements** was abolished in 2018 (–EUR 60 million each). The **act on the fundamental principles of deregulation** stipulates, among other things, that as from mid-2017, for any new regulation that requires additional bureaucratic effort or has an additional financial impact, a comparably complex regulation be suspended (if possible).

- **Education reform and family support measures:** According to the **Education Investment Act** promoting the development of **all-day schools**, from 2018 to 2032 (this period has been extended), a total of EUR 428 million are to be allocated to infrastructural measures for afternoon childcare at primary and lower secondary schools, EUR 248 million to covering teacher costs at primary and lower secondary schools, and EUR 74 million above all to academic secondary schools. As to **elementary pedagogy**, in line with the provisions laid down in Article 15a of the Federal Constitutional Law, earmarked federal subsidies for expanding childcare services, for fostering early childhood language development and for funding compulsory kindergarten childcare in the final pre-school year have been merged and are to be continued from 2018 to 2022 (totaling EUR 143 million). The **family allowance** was raised by 1.9% in 2018. From 2019 onward, the family allowance (as well as the family allowance for children living abroad) will be indexed to national living expenses (expected annual decrease: EUR 0.1 billion). Pursuant to the Austrian Annual Tax Act 2018, a family tax credit amounting to a maximum of EUR 1,500 per child and year (EUR 500 for dependents over 18 years of age) will take effect in 2019 (**"family bonus plus"**; EUR 750 million in the first year, and **EUR 1.5 billion per annum** thereafter). The child tax exemption and the deductibility of childcare costs (EUR 0.3 billion per annum) will be abolished in return.

- **Tertiary education and research:** Additional funding has been earmarked for **universities and uni-**

versities of applied sciences from 2016 to 2020 (EUR 1.1 billion in total). In mid-**2017**, the **performance agreement** for the 2019 to 2021 period was concluded with the universities, providing for a rise in funding by EUR 1.35 billion in total. Moreover, a 2018 amendment of the Universities Act allows for funding per university place that differentiates between teaching and research and for imposing measures on account of capacity constraints. Starting in fall 2019, universities have the right – in addition to existing admission restrictions – to introduce entry examinations for people wishing to study law, foreign languages and pedagogy. Furthermore, it will be possible to implement caps on university places for overcrowded university courses at specific sites. In October 2018, the Council of Ministers adopted a development and funding plan for universities of applied sciences for the period 2018/19 to 2022/23. This plan envisages topping up the planned increase of federally funded university places at universities of applied sciences by 3,100 places. As from 2024, universities of applied sciences will therefore offer training for close to 57,700 students. In addition, the existing funding per university place will not be reduced as from January 1, 2020, but will be kept at the current level until December 31, 2023.

- **Infrastructure investment and security package:** Funding of EUR 1 billion ("**broadband billion**," extended until 2021) has been provided for upgrading the broadband network in Austria. To date, this funding has been tapped to a limited extent (Court of Audit, 2018). Moreover, central government funds have been made available for 2017 and 2018 to **local governments** to invest in the modernization of infrastructure, similar to the additional investment premium for SMEs. Subsidies per investment project cover a maximum of 25% of the total costs of local infrastructure projects. Furthermore, both the budget and personnel for internal security will increase.

- **Pensions, social security and labor market:** A gradual **increase in the eligibility age** for phased retirement as from 2019 is meant to restrain participation in **subsidized part-time working schemes for older employees** and the concomitant rise in subsidies (both had gone up considerably; – EUR 100 million). Both 2018 and 2019 see **special pension adjustments**, with small pensions benefiting from disproportionately stronger raises. In 2017, means-tested benefits ("Ausgleichszulage") supplementing very low pensions were increased for people having made pension contributions for at least 360 months. In July 2018, **long-term jobless benefits** were **decoupled from partners' incomes** (–EUR 140 million). A fundamental reform of means-tested minimum benefits, long-term jobless benefits and unemployment benefits is still pending. Changes to the **means-tested minimum benefits** (e.g. differentiation by education, command of German) were adopted by the Council of Ministers at the end of November 2018. In 2018, the **training guarantee** for young adults who are unemployed was raised to the age of 24, and a **skilled workers scholarship** for up to three years was granted to people who have only completed compulsory education. The budget funds for the **professional integration of persons with disabilities** has been doubled to EUR 90 million as from 2018. **Boarding costs for vocational students** are to be covered by funds from the insolvency contingency fund. As from 2020, the EUR 124 **fee on terminations of employment contracts** will cease to be charged. Moreover, it was decided to broadly **align blue-collar workers' rights to those of white-collar workers**; however, the majority of these alignments will only be implemented as of 2021. Key issues here are the improvement of the level of protection from dismissal and uniform rules for the continued remuneration in the event of illness. The **50+ employment initiative for the long-term jobless** ("Aktion 20,000"; 100% reimbursement of wage and nonwage labor costs for public and nonprofit institutions), which has been terminated in light of the current economic situation, continues to apply in case the application had been submitted by end-2017 (2018 to 2019: –EUR 170 million). To strengthen incentives for labor market participation, in mid-2018, **contributions to unemployment insurance** were reduced for low-paid workers (–EUR 140 million).

- **Long-term care:** As of the beginning of 2018, **regional governments** may **no** longer make **claims** for **compensation** from the assets of **residents of long-term care institutions or their relatives** (constitutional provisions in the General Social Security Act). According to draft legislation, the federal government pledges to compensate for the loss of revenue by providing up to EUR 340 million (instead of EUR 100 million). A **value adjustment** of +4.5% per annum is to apply to the **long-term care fund** (2017: EUR 350 million) from 2018 to 2021. As a **cost containment path** for long-term care, a maximum annual increase of 4.6% of costs was agreed upon for the period from 2017 to 2021. The issue of long-term funding of long-term care remains unresolved.

- **Health care:** The newly adopted health sector arrangement between the central, regional and local authorities for the period from 2017 to 2021, in accordance with Article 15a of the Federal Constitutional Law (B-VG), is in large part similar to previous agreements. The Austrian Health Care Structure Plan (ÖSG) and the Regional Health Care Structure Plans (RSG) are the key planning tools for providing health care services on both the federal and the regional level. What is new is that compliance with the ÖSG und RSG will now be **compulsory for primary care doctors as well**. The establishment of primary care units (PVEs) will in future be guided by the RSG. PVEs are to be established in the form of practice networks, but also as central group practices or as PVEs that are integrated into hospitals. The **central and complex question of cross-sectoral financing** was not resolved. The **cost containment path** for the **health sector**, however, was extended as part of the fiscal sharing negotiations. The current maximum rise in expenditure of 3.6% per annum is to be reduced to 3.2% per annum by 2021. The regional health insurance funds (Gebietskrankenkassen) have largely **harmonized their services,** which is expected to cost an additional EUR 84 million per annum. The **act on the organization of social security funds** moreover envisages, in the years ahead, a merger of the existing five social security funds and the establishment of a new umbrella association to replace the current Association of Austrian Social Security Institutions. The federal government expects efficiency gains to result in cumulated savings of EUR 1 billion by 2023 (not including any costs of the merger).

- **Fiscal sharing arrangement:** In 2016, a new **fiscal sharing arrangement** was adopted for the period from 2017 to 2021, which, beginning in 2017, provides **additional funds** for regional and local governments amounting to EUR 300 million a year, as well as one-time funding of EUR 125 million in 2017 for expenses related to migration and integration. Beginning in 2018, setting rates for employers' and employees' **contributions to the promotion of residential building** will be entirely the responsibility of regional governments. At the same time, **building regulations** are to be unified throughout Austria. Early steps toward greater **task orientation** were planned as well. The amount of funding for **kindergartens**, for example, was to be tied to certain criteria, as from 2018; and the same is to apply to **primary and lower secondary schools** starting in 2019. Yet, as the reform of the responsibilities of regional governments is still pending, the issue of greater task orientation has been postponed. In addition, **harmonized guarantee limits**, together with a uniform calculation method, have been agreed upon for all government levels as of 2019 and a **ban on speculation** has also been agreed upon. However, the chosen objectives of disentangling joint tasks, mixed funding and transfers of funds as well as defining ways to strengthen the regional governments' autonomous tax management have not been adequately reflected in the current fiscal sharing arrangement for 2017 to 2021. Nonetheless, central, regional and local governments have agreed, inter alia, to prepare a **federal government reform** by the end of 2018, based on the work of the Austrian Convention, and to further analyze the question of **tax autonomy** in several working groups.

- **Debt brake**: The **2012 Austrian Stability Pact** (2012 ÖStP) envisages a multidimensional system of **national fiscal rules ("debt brake"), to be fully effective as of 2017 at the latest.** These national fiscal rules, which support compliance with EU requirements, establish not only subsectoral and regional contributions to the maximum permissible structural deficit (central government and social insurance institutions: 0.35% of GDP; regional and local governments: 0.1% of GDP), but also a budget buffer (“control account”) that can be used to temporarily fund a structural deficit overrun of up to 1.6% of GDP.

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