

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

Adopted at the Fiscal Advisory Council meeting on December 3, 2018

### Austria set to comply with a neutral fiscal stance satisfying the “medium-term objective (MTO)” in 2019 and 2020

**Background:** For 2018, the Fiscal Advisory Council expects a **fiscal balance of 0.0%** of GDP in view of robust employment growth and high tax revenues. The forecast for the general government budget in 2019 is a **surplus of 0.2% of GDP**. The general government's **fiscal stance** for 2017 to 2019 is **neutral** and mostly avoids a procyclical fiscal policy. According to the Fiscal Advisory Council's current estimates, the **structural budget balance** will show a **deficit** of 0.7% of GDP in 2018 and 0.5% in 2019. Taking into account the **eligible “clauses”**, the structural general government budget balance in 2018 and 2019 is expected to reach **-0.4%** of GDP in each year; therefore, it will be just **slightly below the defined limit** (MTO of **-0.5%** of GDP). From today's perspective, **Austria will essentially comply with EU fiscal rules**. Despite a cost containment path and strict budget execution, some **expenditure items are increasing rapidly**, especially spending on **health care** and **old-age pensions**. The share of health-care spending in the general government expenditure aggregate has risen by 1.6 percentage points in the last five years, that of expenditure related to old-age pensions by 0.4 percentage points. If external factors change, e.g. if economic growth slows down or interest rates rise, and if dynamic growth persists in other areas, in particular as regards spending on health care and old-age pensions, it will become more difficult to comply with the MTO and the EU fiscal rules over the long term. Moreover, for the planned **substantial tax reform** that has been scheduled to enter into force in 2020, the counter financing measures (spending cuts and/or increases in revenues) remain unknown at this point. Without compensatory measures, the federal government's objective of conducting fiscal policy without building up new debt could be undermined, if the costs caused by granting the intended tax relief are not covered by the budget.

#### Recommendations:

- The **deficit-increasing effects of reforms planned** by the government should be estimated as precisely as possible and be balanced out by **compensatory measures**, where necessary, so as not to jeopardize the already reached goal of an almost **balanced structural budget (MTO)**.
- The government should continue to **persistently pursue the reduction of expenditure growth** from 3.6% in 2017 to 3.2% in 2021 agreed on in the target control agreement on **health care** to promote measures necessary to raise efficiency and to keep a lid on health-care spending.
- Taking on board the recommendations issued by international organizations regarding structural long-term measures to **make Austria's pension system more sustainable**, e.g. by implementing appropriate sustainability mechanisms, should remain a key priority.

### Ensuring a sustainable consolidation path through effective structural reforms (especially of federal structures, taxes, health care and pensions)

#### a) Reforming federal structures, fiscal sharing and task orientation:

**Background:** Many work packages and reforms outlined in the **fiscal sharing agreement for 2017 to 2021** are behind schedule or **have not been continued in the originally agreed form or have been put on hold**; examples include the preparation of a **reform of federal structures** based on the results of the

Austrian Convention (Österreichskonvent) or the implementation of pilot projects toward a **more task-based allocation of funding** in elementary and lower secondary education. The federal government has presented a legislative package that aims at disentangling competencies among the federal and regional governments and reducing the rights of mutual approval (this package needs to be approved by a two-thirds majority in both chambers of parliament, Nationalrat and Bundesrat). However, this package fails to address important areas that affect all levels of government, such as hospital services and education. Also the **spending reviews** of the Federal Ministry of Finance – which would support a systematic critical appraisal of tasks – have so far only reached the stage of pilot projects. All these developments show that the **complexity of the matter** requires a **comprehensive, long-term top-down process** that will change federal structures and fiscal relationships building on **previous findings** (e.g. Austrian Convention) and third-party expertise.

#### **Recommendations:**

- The Fiscal Advisory Council recommends – also with regard to the forthcoming negotiations about a new fiscal sharing agreement (new version from 2022) – that the government define a **binding reform process** as soon as possible; this process should promote a **reform of federal structures**, starting with disentangling the tasks of the different levels of government in cooperation with the responsible bodies.
- The reform needs to raise **allocative efficiency**, **bundle responsibilities for revenues, spending and tasks**, increase **transparency**, reduce **mixed financing** and simplify the **system of transfers**.

#### **b) Tax reform and work incentives:**

**Background:** The government plans to increase **incentives to work** by **lowering the tax ratio** (about 40% of GDP at the end of the legislative period) and by **reforming** insurance benefits in the event of **unemployment** (unemployment benefits, assistance to the long-term jobless) and **means-tested minimum benefits**. Detailed proposals so far are only available for some areas; a reform package is currently being developed. It seems that, within the framework of the announced tax reform, the government intends to reform wage and income tax rates, including a new wage and income tax act and a cut in corporate income tax in Austria from 2020. Assistance to the long-term jobless could be merged with regular unemployment benefits in the reformed unemployment insurance system. According to the draft legislation dated November 30, 2018, the amount of means-tested minimum benefits to be paid out is to be made dependent on certain criteria, such as completed compulsory school education in Austria, sufficient command of the German language or housing costs.

#### **Recommendations:**

- The Fiscal Advisory Council advocates a comprehensive, **systemic (tax) reform package** that avoids isolated individual steering measures which could lead to conflicting effects in the overall system. In view of the broad scope of the reform envisaged, this seems feasible in principle. The package must take into account **compliance with stability criteria** and must reflect fiscal policy decisions that consider **economic cycle requirements**. In particular, the following should be taken into account:
  - Ensuring **compliance with EU-wide fiscal rules** should be made the **top priority** in the interest of sustainable public finances.

- The **timing of an** (expansionary) tax reform should be chosen as directed by **cyclical conditions**.
- The tax system, which contains some very complex elements whose effects are also hard to gauge, should be **generally simplified** (especially with regard to the definition and calculation of tax bases).
- The interplay of wage and income tax (including social security contributions) and the concepts behind unemployment benefits, assistance to the long-term jobless and means-tested minimum benefits and other regionally differentiated social transfers should ensure **unambiguous incentives to work** (discontinuities in the average tax rate or local effective marginal tax rates of 100% and higher etc. should be avoided).

### **c) Health-care and pension system:**

**Background: Health-care spending and expenditure related to old-age pensions** have recorded **above-average growth** in the last 5 years compared to aggregate spending. In the future, growth in these two expenditure categories will be additionally fueled by **considerable population aging** and innovative **developments in the area of medicine**. Statistics Austria, for example, projects that the population share of those aged 75 years or more – a group that accounts for a major portion of total health-care costs – will grow from 9.2% in 2017 to 17.4% in 2070. At the same time, the old age dependency ratio is expected to rise from 27.8% in 2017 to 49.6% in 2070. For this reason, under the current system, we need to expect an increase in the federal government’s contributions necessary to ensure the sustainability of the pension system. The European Commission’s 2018 Ageing Report predicts somewhat more pronounced population aging in Austria vis-à-vis the reference scenario than Statistics Austria’s current population forecast does. In recent years, Austria expenditure related to old-age pensions has remained below the path projected by the Austrian Pension Commission (“Kommission zur langfristigen Pensionssicherung”); this points to uncertainties in pension revenue and expenditure estimates.

#### **Recommendations:**

- Sustainable public finances will require **medium- to long-term cost estimates regarding health care and old-age pensions**. Against this background, the Fiscal Advisory Council urgently calls on the government to **quickly set up the planned, new commission on old-age pensions (“Alterssicherungskommission”)**. This commission needs to provide current estimates of medium- and long-term developments based on various scenarios and publish its findings in the interest of broad social debate.
- The government needs to **address medium- or long-term financing problems** identified by these analyses **in a timely fashion** to ensure that any further development of the entire system is effective but consistent. All related measures must be prepared and implemented very carefully so as to meet legitimate expectations and to avoid any destabilization of these expectations.
- In the health-care sector, the government should use comparative studies on Austria’s provinces as well as international findings to **identify best practices** regarding efficient service provision and develop recommendations for action on this basis. **Uniform service standards** that are sensible from the point of view of health-care policy need to be developed and analyzed to determine their fiscal impact.

## Clarifying the future funding of long-term care

**Background:** Cost increases in the long-term care sector could **exceed** the annual maximum of 4.6% prescribed by the **cost containment path** until 2021 – in particular because of the abolition of public long-term care providers' recourse to patients' assets. Moreover, at present it is difficult to estimate the budgetary effects of the **abolition of public long-term care providers' recourse to patients' assets** in terms of institutional long-term care because some of Austria's provinces are registering increased demand for institutional long-term care, but there are no valid current data for Austria as a whole. In addition, the **federal government has earmarked subsidies to regional and local governments** under the long-term care fund act only until 2021 (EUR 417 million).

### Recommendation:

- The disadvantages and advantages of the different **funding models** for long-term care need to be analyzed based on different scenarios and need to be made transparent. On this basis, a **fundamental decision** on the design of sustainable funding for long-term care in Austria will have to be taken.
- National and international **best practices** for ensuring high-quality and efficient long-term care services need to be identified and used as a basis for devising alternative approaches and recommendations.
- Compliance with cost containment targets should be facilitated by reviewing current incentives for inpatient and outpatient long-term care, promoting in-home care and mobile care services and identifying efficiency potential.
- The central, regional and local governments must reach agreement on **long-term care expenditures that are eligible for refunding** by the central government (as the option of recourse to patients' assets has been abolished).

## Strengthening strategic budgeting in spring

**Background:** The reform of the legal framework for budgeting at the federal government level made **medium-term federal government budget planning** mandatory; the **Federal Medium-Term Expenditure Framework Act (MTEF)** put this requirement into practice. The **MTEF** for each planning period must be accompanied by a budget **strategy report**, which should provide all the information necessary to explain the figures recorded in the multi-annual mandatory budget plan. So far, however, the MTEF bill presented **in the spring** has usually **focused on fiscal details** instead of outlining strategic fiscal policy targets, which had been the original intention. Moreover, in its current form, the budget **strategy report** explains the government's **policy strategies in the individual chapters and their fiscal impact only to a limited extent**. Therefore, in April 2018, parliament decided that both the presentation and adoption of the MTEF and the Federal Finance Act bills would take place in the fall in order to avoid duplication and overlaps (such as budget debates in parliament both in the spring and the fall, adjustment of expenditure ceilings in sub-chapters).

By comparison, the **central government budgeting process in Sweden**, which is often used as a benchmark, relies on a comprehensive strategic planning exercise in spring that focuses on medium-term objectives, their long-term sustainability and potential risk scenarios and establishes the central government's budget path for high-level fiscal aggregates, while at the same time avoiding two parliamentary debates on the same budget.

**Recommendations:**

- With a view to enhancing strategic budget planning at the federal government level and strengthening the role of parliament (Nationalrat) in the budgeting process, both a comprehensive **debate on the federal government’s fiscal strategy and the discussion and adoption of strategic and economic policy objectives** should take place in the spring (with the latter including, e.g., the central government Maastricht budget balance, the overall fiscal stance, economic policy priorities, sustainability, etc.).
- This process should involve a **clear specification of the government’s strategic and economic policy objectives (i.e. fiscal quantification)**; also, the impact of the planned fiscal stance on the budget as well as potential scenarios should be made transparent.
- **Enhancing strategic budget planning** would be called for also at **other levels of government**.

**Comprehensive and transparent estimations of the fiscal effects of complex reform plans under the fiscal impact assessment exercise (“costing”)**

**Background:** The establishment of **impact-oriented budget management** through the adoption of the 2013 **Federal Budget Act** intended to bring about a fundamental change in budgeting with a new steering approach: managing public expenditures based on their contribution to strategic targets; the Fiscal Advisory Council has welcomed this reorientation, which supports evidence-based decision-making and effective impact monitoring. Ex ante **impact assessments** of legislative bills as well as their ex post evaluations have become mandatory. However, **impact assessment reports have varied greatly in terms of their informative value and the verifiability of results**. In his study “Subsidies in Austria: definitions, spending levels and suggestions for improving efficiency,” Grossmann (2018) identified some need for improvement, such as greater transparency and methodological improvements in cost estimates. 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. The **bill on the organization of social security funds** (Sozialversicherungs-Organisationsgesetz) is a **current example** of how the fiscal impact assessment works in practice. Following critical comments (e.g. by the Court of Audit) on the impact assessment during the consultation process, the financial impact as presented in the ministry’s proposal was adapted or elaborated on in several areas (while the savings resulting from the reform were put at EUR 350 million until 2026 in the initial draft, a later version saw savings of EUR 1 billion until 2023). In its analysis, the parliamentary budget office said that the fiscal effects of the bill continue to be **insufficiently verifiable**.

**Recommendations:**

The Fiscal Advisory Council deems it necessary that in particular **complex, large-scale reforms** that can be expected to have a financial impact and may trigger changes in households’ and businesses’ behavior are subjected to an assessment that is based on **strict impact-oriented criteria under the Federal Budget Act**. Such criteria may include:

- taking into account the complex fiscal and economic effects of tax and transfer reforms (interaction between taxes and transfers, incentive effects) by applying tried and tested models (micro simulation models, macro models, combined models);
- ensuring the **verifiability and transparency of cost estimates and assumptions** of the
  - estimates of direct and indirect fiscal effects (increases in costs, savings) and macroeconomic effects,

- estimations of staff and administrative costs and the
- cost structure until the reform has attained full effectiveness;
- providing **scenarios** to specify the upside and downside risks to the cost estimate (ranges);
- providing mandatory **cost estimate evaluations by independent external bodies for reforms whose costs exceed a certain amount, which has to** be specified in addition;
- taking appropriate measures to ensure that bills put forward through parliamentary motions are also subjected to a high-quality impact assessment process.

### **Extensive simplification of the Austrian Stability Pact (2012 ÖStP) and improved access to information for the general public and Fiscal Advisory Council**

**Background: Applying the 2012 Austrian Stability Pact (ÖStP) in full** entails some **difficulties** which relate to **three issues** in particular:

- the design of the **EU fiscal rules**, whose **complexity** increases even further **at the regional level**; and
- **detailed regional targets** for which **in part no reliable ESA data** are available on the current budget situation for managing budget execution and for drawing up budget plans (especially for the adapted government expenditures in line with EU requirements).
- And although the application of the 2012 ÖStP has become easier after the contracting parties – central, regional and local governments – reached **agreement on the pact’s interpretation** at the end of November 2018, the fiscal framework remains inherently complex.

To be able to identify **potential breaches** of the 2012 ÖStP and of the EU fiscal framework in a timely and reliable manner, **administrative budget data at the regional and local government level** would also have to be made available **in a timely fashion**.

Under the 2012 ÖStP, central, regional and local authorities must record deviations from their relevant **structural budget targets in control accounts**, and if they exceed specific thresholds, they must take remedial action in the subsequent years. Therefore, the **Fiscal Advisory Council needs to have access to control account records** and information about **recent budget developments** at all government levels in order to be able to monitor changes in the control accounts and identify potential rule breaches as early as possible.

#### **Recommendations:**

- The 2012 ÖStP **should be reviewed and greatly simplified without** fundamentally **challenging the current targets** under the EU fiscal framework, joint responsibilities for meeting these targets and the distribution arrangement agreed between the levels of government to ensure compliance with these targets. The Fiscal Advisory Council considers the **Maastricht budget balance or the structural budget balance** to be suitable as “**central steering indicators**” for monitoring compliance with fiscal rules at the regional and local government level.

- For **greater transparency**, it would be useful if the **control accounts** of the central, regional and local governments were published without substantial time lags (even if the data were preliminary).
- The Fiscal Advisory Council should be given **timely access to control account records** as well as all relevant information about **recent budget developments at all government levels** and should be **involved in the Austrian Coordination Committee** (nonvoting participation in meetings, access to meeting documents).