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COMMISSION STAFF WORKING DOCUMENT

Analysis of the updated draft budgetary plan of Austria

Accompanying the document

COMMISSION OPINION

on the updated draft budgetary plan of Austria

{C(2018) 2224 final}

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COMMISSION STAFF WORKING DOCUMENT

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COMMISSION OPINION

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1. INTRODUCTION

Austria submitted an updated Draft Budgetary Plan (hereafter: updated DBP) for 2018 on 21 March 2018. The update was prompted by the fact that the DBP submitted on 17 October 2017 in compliance with Regulation (EU) No 473/2013 reflected budgetary projections for 2018 on the basis of unchanged policies given the caretaker nature of the government in place at the time of submission. With respect to the no-policy-change DBP submitted by the caretaker government on 17 October 2017, the updated DBP includes the measures that have been adopted since then. For 2017, the updated DBP relies on non-validated outturn data compiled by Statistik Austria. Austria is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium term budgetary objective (MTO). As the debt ratio was 81.0% of GDP in 2013 (the year in which Austria corrected its excessive deficit), exceeding the 60% of GDP reference value, Austria was also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit. In this period, it needed to ensure sufficient progress towards compliance with the debt reduction benchmark. Following the end of the transition period in 2016, Austria is currently subject to the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the updated Draft Budgetary Plan and provides an assessment based on an ad-hoc Commission forecast. The following section presents the recent and planned fiscal developments, according to the updated Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission ad-hoc forecast. In particular, it also includes an assessment of the measures underpinning the updated Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2017-2018 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis on the composition of public finances and on fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 11 July 2017. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the updated DBP projects GDP growth to accelerate from 1.5% in 2016 to 2.9% in 2017, and to peak at 3.2% in 2018. This represents a significantly more positive assessment of GDP growth in both 2017 and 2018 compared to the 2017 Stability Programme, which expected an increase of 2.0% in 2017 and of 1.8% in 2018.

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The updated DBP growth projection is in line with the Commission ad-hoc forecast for the year 2017 of 2.9% and more optimistic for 2018, where the Commission expects a slight deceleration of GDP growth to 2.8%. Compared to the updated DBP, the Commission expects a somewhat weaker growth of private consumption in 2018.

Table 1. Comparison of macroeconomic developments and forecasts

	2016	2017			2018		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.5	2.0	2.9	2.9	1.8	3.2	2.8
Private consumption (% change)	1.5	1.3	1.4	1.4	1.2	1.8	1.5
Gross fixed capital formation (% change)	3.7	2.6	4.8	4.8	2.4	3.5	3.7
Exports of goods and services (% change)	1.9	3.6	5.7	5.7	3.4	5.5	5.2
Imports of goods and services (% change)	3.1	3.3	5.4	5.4	3.0	4.6	3.9
Contributions to real GDP growth:							
- Final domestic demand	2.0	1.5	2.1	2.1	1.4	2.0	1.9
- Change in inventories	0.0	0.2	0.5	0.4	0.0	0.5	0.0
- Net exports	-0.5	0.3	0.4	0.4	0.3	0.6	0.8
Output gap[1]	-1.1	-0.4	-0.3	-0.2	0.0	0.8	0.6
Employment (% change)	1.2	1.3	1.7	1.7	1.1	1.7	1.5
Unemployment rate (%)	6.0	5.9	5.5	5.5	5.9	5.2	5.3
Labour productivity (% change)	0.2	0.6	1.2	1.2	0.7	1.4	1.3
HICP inflation (%)	1.0	1.8	2.1	2.2	1.7	1.9	2.1
GDP deflator (% change)	1.1	1.4	1.5	1.5	1.5	1.7	1.7
Comp. of employees (per head, % change)	2.4	1.9	1.8	1.6	2.0	2.6	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.1	1.6	2.1	2.3	1.6	2.3	2.3

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2017 (SP); Updated Draft Budgetary Plan for 2018 (updated DBP); Commission ad-hoc forecast (COM); Commission calculations

Both the updated DBP and the Commission ad-hoc forecast expect GDP growth in 2018 to be mainly driven by domestic demand. Similarly, both the updated DBP and the Commission forecast project inflation in Austria to ease only slightly to 1.9% and 2.1%, respectively in 2018, as inflation in the services sector continues to be strong.

The updated DBP's macroeconomic assumptions for 2018 are somewhat more favourable than those underlying the Comission ad-hoc forecast. Both the updated DBP and the Commission forecast expect a more substantial contribution of net exports to economic growth compared to the projections of the Stability Programme due to improved expectations relating to the external environment. Based on the strong economic outlook, both the updated

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DBP and the Commission forecast expect strong employment growth and a consequently falling unemployment rate. However, the Commission projects the positive effects on private consumption to be less pronounced than the updated DBP, also due to the fading support of the 2016 tax reform.

Box 1: The macro economic forecast underpinning the budget in Austria

The updated DBP for 2018 submitted by Austria is based on the macroeconomic forecast published by the Austrian Institute of Economic Research (WIFO) on 16 March 2018. WIFO is a non-profit association under Austrian law, recognised for high-quality economic research and realistic and unbiased forecasts. It is a long-standing practice in Austria that the Ministry of Finance bases its fiscal plans on the macroeconomic forecast that WIFO produces four times a year following an established, pre-announced calendar.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The updated DBP reports the general government headline balance at -0.7% of GDP in 2017, revising upwards the projections of the Stability Programme (-1.0% of GDP). This is mainly the result of lower expenditures for social benefits in light of positive labour market developments and stronger than expected real GDP growth (1.5% as forecast in the Stability Programme, versus 2.9% in the updated DBP, which relies on outturn data) as well as lower interest expenditures. The Commission ad-hoc forecast also points to a -0.7% of GDP headline balance in 2017, which is in line with the updated DBP.

In 2018, the updated DBP expects the headline deficit to narrow further to -0.4% of GDP, which halves the projection of the Stability Programme. That narrowing is again due to an improved macroeconomic outlook, with expenditures (-1.8% of GDP) decreasing more than revenues (-1.3% of GDP). The Commission ad-hoc forecast indicates a narrowing to a marginally higher headline balance of -0.5% of GDP in 2018, reflecting the somewhat more conservative macroeconomic projections.

The main risks to the updated DBP budgetary projections relate to the favourable economic outlook underlying the revenue forecasts. On the expenditure side, two recently implemented active labour market policies, such as the "employment bonus" and the "action 20 000" have been discontinued and will hence result in lower than previously estimated budgetary costs. On the revenue side, a reduction of the statutory contribution to the unemployment insurance for low-income earners is foreseen to cause revenue shortfalls of approximately EUR 70 million in 2018 (0.2% of GDP).

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Austria currently standing at 0.7% [1]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the updated DBP, interest expenditure in Austria is expected to fall from 2.1% of GDP in

[1] 10-year bond yields as of 26 March 2018. Source: Bloomberg.

2016 to 1.8% in 2017 and is projected to decrease further in 2018 to 1.6% of GDP, and hence well below the 2.7% recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Austria's plans is confirmed by the Commission ad-hoc forecast.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2016	2017			2018			Change: 2016-2018
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**49.1**	**49.5**	***48.6***	**48.5**	**49.4**	***48.1***	**48.1**	**-0.9**
of which:								
- Taxes on production and imports	14.4	14.5	*14.1*	14.1	14.2	*13.8*	13.8	-0.6
- Current taxes on income, wealth, etc.	13.0	13.3	*13.1*	13.1	13.5	*13.2*	13.1	0.2
- Capital taxes	0.0	0.2	*0.2*	0.0	0.2	*0.2*	0.0	0.2
- Social contributions	15.3	15.4	*15.2*	15.2	15.4	*15.0*	15.0	-0.3
- Other (residual)	6.4	6.1	*6.0*	6.2	6.1	*5.9*	6.1	-0.4
Expenditure	**50.7**	**50.6**	**49.3**	**49.2**	**50.3**	**48.5**	**48.6**	**-2.2**
of which:								
- Primary expenditure	48.6	48.6	47.5	47.4	48.5	47.0	47.1	-1.6
of which:								
Compensation of employees	10.7	10.7	10.6	10.6	10.6	10.4	10.4	-0.3
Intermediate consumption	6.4	6.4	6.3	6.2	6.4	6.1	6.1	-0.3
Social payments	23.1	23.2	22.6	22.8	23.3	22.2	22.4	-0.8
Subsidies	1.4	1.4	1.4	1.4	1.4	1.5	1.5	0.1
Gross fixed capital formation	3.0	3.0	3.0	3.0	3.0	3.0	3.0	0.0
Other (residual)	4.0	3.9	3.6	3.5	3.8	3.8	3.7	-0.2
- Interest expenditure	2.1	2.0	1.8	1.8	1.8	1.6	1.6	-0.5
General government balance (GGB)	**-1.6**	**-1.0**	**-0.7**	**-0.7**	**-0.8**	**-0.4**	**-0.5**	**1.2**
Primary balance	**0.5**	**0.9**	**1.1**	**1.1**	**1.0**	**1.2**	**1.1**	**0.7**
One-off and other temporary measures	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1
GGB excl. one-offs	**-1.6**	**-1.0**	**-0.7**	**-0.7**	**-0.8**	**-0.4**	**-0.5**	**1.2**
Output gap[1]	-1.1	-0.4	-0.3	-0.2	0.0	0.8	0.6	2.0
Cyclically-adjusted balance[1]	-1.0	-0.8	-0.5	-0.6	-0.8	-0.9	-0.8	0.1
Structural balance (SB)[2]	**-0.9**	**-0.8**	**-0.5**	**-0.6**	**-0.8**	**-0.9**	**-0.8**	**0.0**
Structural primary balance[2]	1.2	1.2	1.3	1.2	1.0	0.7	0.7	-0.5

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2017 (SP); Updated Draft Budgetary Plan for 2018 (updated DBP); Commission ad-hoc forecast (COM); Commission calculations

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Based on the information provided in the updated DBP, the structural balance[2] is reported to have improved from -0.9% of GDP in 2016 to -0.5% of GDP in 2017. The improvement broadly reflects the change in the headline balance, which is slightly dampened by a delayed impact of the 2016 tax reform. In 2018, the (recalculated) structural balance is expected to deteriorate to -0.9% of GDP, Such deterioration could be observed already in the no-policy-change DBP and appears largely due to the negative impact of discretionary measures, which is expected to increase by 0.4% of GDP . These include the expected remaining cost of the discontinued "employment bonus", as it is granted for up to three years as well as several other expansionary measures to support investment in education and research. The Commission ad-hoc forecast projects the structural balance at -0.6% of GDP in 2017 and -0.8% of GDP in 2018. Against the background of falling interest expenditure, the projected improvement in 2017 and deterioration in 2018 of the structural balance (+0.4% of GDP and -0.4%, respectively) is accompanied by a smaller improvement and a larger deterioration of the structural primary balance (+0.1% of GDP and -0.6%, respectively).

The headline deficit reported in the updated DBP both in 2017 and 2018 is driven by the deficit of the central government (-0.7% of GDP and -0.4%, respectively), while federal states and municipalities are expected to have balanced accounts and social security funds to produce a small surplus in both years. The updated DBP does not specify the expected contributions of the different government subsectors to the structural balance. The national fiscal rules embedded in the 2012 Austrian Stability Pact require Austria to achieve a structural balance of -0.45% of GDP from 2017 onwards, with the upward limit set at -0.35% of GDP for the federal government (including social security funds) and -0.1% of GDP for federal states and municipalities.

The Austrian authorities indicated in the 2017 Stability Programme that the budgetary impact of the additional costs related to the exceptional inflow of refugees and the terrorist threat is significant and should be considered as an unusual event outside the control of the government, as defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. The updated DBP, which relies on outturn data, reports no further increase for security costs (leading to a cost of 0.04% of GDP in 2017) and an increase of 0.04 ppts for costs related to refugees (leading to a cost of 0.51% of GDP in 2017) compared to 2016.

The Commission provisionally assessed Austria to be eligible for an allowance of 0.02% of GDP in 2017 in relation to the incremental costs considered by the Commission to have a clear and direct link to refugee inflows and security. The carry-forward effect of these costs in 2018 is estimated at 0.02% of GDP. The Commission will make a final assessment, including on the eligible amounts, in the course of the assessment of the 2018 Stability Programme and on the basis of Eurostat validated EDP data.

3.2. Debt developments

According to the updated DBP, government debt has declined markedly from 83.6% of GDP in 2016 to 78.1% of GDP in 2017 and also in absolute terms. The decline is mainly driven by

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

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a large negative stock-flow adjustment related to the wind-down of the bad banks included in government accounts.

Table 3. Debt developments

(% of GDP)	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**83.6**	**80.8**	**78.1**	**78.5**	**78.5**	**74.5**	**75.3**
Change in the ratio	-0.8	-2.8	-5.5	-5.0	-2.3	-3.6	-3.2
Contributions[2] :							
1. Primary balance	**-0.5**	**-0.9**	**-1.1**	**-1.1**	**-1.0**	**-1.2**	**-1.1**
2. "Snow-ball" effect	**0.0**	**-0.7**	**-1.8**	**-1.8**	**-0.8**	**-2.0**	**-1.8**
Of which:							
Interest expenditure	2.1	1.9	1.8	1.8	1.8	1.6	1.6
Growth effect	-1.2	-1.6	-2.3	-2.3	-1.4	-2.3	-2.1
Inflation effect	-0.9	-1.0	-1.2	-1.2	-1.2	-1.3	-1.3
3. Stock-flow adjustment	**-0.3**	**-1.1**	**-2.6**	**-2.1**	**-0.5**	**-0.3**	**-0.3**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source:

Stability Programme 2017 (SP); Updated Draft Budgetary Plan for 2018 (updated DBP); Commission ad-hoc forecast (COM); Commission calculations

In 2018, government debt is expected to decline further to 74.5% of GDP, supported again by the divestment of impaired assets from bad banks included in the government accounts (0.3% of GDP). Both in 2017 and 2018, the decline of government debt projected by the updated DBP is also supported by the declining interest expenditure, the contribution of the primary balance and the strong nominal GDP growth (denominator effect). Based on the Commission ad-hoc forecast, government debt is expected to follow similar dynamics, declining to 78.5% of GDP in 2017 and to 75.3% of GDP in 2018. The decline is somewhat slower compared to the DBP projections, due to the slightly more conservative projections of the primary balance and nominal GDP growth.

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3.3. Measures underpinning the draft budgetary plan

Due to the ongoing government formation at that time following the general elections on 15 October 2017, Austria submitted on 17 October a Draft Budgetary Plan based on the assumption of unchanged policies for 2018, not underpinned by additional measures. Nevertheless, the no-policy-change DBP reported several deficit-increasing measures approved since the submission of the 2017 Stability Programme with an estimated overall budgetary impact in the order of magnitude of 0.1% of GDP in 2017. The measures aimed at stimulating labour demand, supporting the integration of long-term unemployed in the labour market, and strenghtening research and development as well as investment in education. With the entry into office of the new government, two of the previously implemented measures with the highest expected budgetary impact i.e., the "employment bonus" and the "action 20,000" were discontinued as of January 2018, which implies downward revised budgetary costs. In addition, the updated DBP announces several cost-saving measures with an estimated total budgetary relief of EUR 2.5 billion (0.7% of 2017 GDP, including the cost-saving from the two discontinued measures), without, however, specifying whether these will be implemented in 2018 or 2019. On the revenue side, the updated DBP announces a reduction of the contribution to the unemployment insurance for low-income earners as of July 2018 with an estimated budgetary impact of 0.02% of GDP.The updated DBP does not report one-off measures over 2017-2018.[3]

4. Compliance with the provisions of the Stability and Growth Pact

Austria is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 2 reports the latest country specific recommendations in the area of public finances. Austria is also subject to the debt reduction benchmark.

Box 2. Council recommendations addressed to Austria

On 11 July 2017, the Council addressed recommendations to Austria in the context of the European Semester. In particular, in the area of public finances the Council recommended that Austria take action in 2017 and 2018 to pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which entails achieving its medium-term budgetary objective in 2018, taking into account the allowance linked to unusual events

The Council recalled that in 2018, based on the Commission 2017 spring forecast, Austria should ensure that the nominal growth rate of net primary government expenditure does not exceed 2.2%, corresponding to an improvement in the structural balance by 0.3 % of GDP. However, in view of the ad-hoc forecast that Austria will be at its MTO in 2017 and in line with the arrangements in place for updating the fiscal requirements contained in the country-

[3] Discretionary revenue and expenditure measures taken by general Government could not be compiled because the information was not submitted in accordance with the Code of Conduct.

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specific recommendations,[4] the nominal growth rate of net primary government expenditure should not exceed 3.2%, corresponding to an allowed deterioration of the structural balance by 0.2% of GDP.

4.1. Compliance with the debt criterion

As its public debt exceeds the 60% of GDP reference value of the Treaty, Austria needs to comply with the debt reduction benchmark. The updated DBP does not include sufficient information to assess compliance with the debt reduction benchmark in 2017 and 2018. According to the Commission ad-hoc forecast, Austria is expected to meet the debt reduction benchmark both in 2017 and 2018, as its debt-to-GDP ratio is expected to be below the debt benchmark with a gap to the debt benchmark of -5.1% of GDP in 2017 and -4.9% of GDP in 2018.

Table 4. Compliance with the debt criterion*

	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	83.6	80.8	78.1	78.5	78.5	74.5	75.3
Gap to the debt benchmark [1,2]		-3.1	n.a	-5.1	-3.1	n.a	-4.9
Structural adjustment [3]	-0.8	0.2	0.4	0.3	0.0	-0.3	-0.2
To be compared to:							
Required adjustment [4]	-1.1						

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2017 (SP); Updated Draft Budgetary Plan for 2018 (updated DBP); Commission ad-hoc forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the Member States concerned providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack.

[4] Those arrangements, known as the 'unfreezing' principle, are referred to in the Opinion of the Economic and Financial Committee of the Council on "Improving the predictability and transparency of the SGP: A stronger focus on the expenditure benchmark in the preventive arm", of 29 November 2016, and have been specified further in subsequent discussions with the Member States.

4.2. Compliance with the required adjustment path towards the MTO

In 2015, Austria was granted a temporary deviation from the adjustment path towards the MTO amounting to 0.09% of GDP in relation to the exceptional inflow of refugees. In 2016, an additional temporary deviation of 0.25% of GDP was granted in relation to the exceptional inflow of refugees as well as 0.04% of GDP for security measures related to the terrorist threat.[5] The cumulative carry-forward effect of those costs amounts to 0.38% of GDP in 2017 and 0.29% of GDP in 2018. As discussed in section 3.1, the authorities have requested an additional temporary deviation for 2017. This latter request will be addressed in the assessment of the 2018 Stability Programme i.e., according to usual procedures.[6]

[5] By analogy to the implementation of the structural reform clause and the investment clause, temporary deviations granted on behalf of the unusual events clauses are carried forward for a total of three years as an allowed distance from the MTO. This is to ensure that Austria benefits from the granted temporary deviation similarly to Member States not yet close to their medium-term budgetary objective.

[6] The outturn data underlying the updated DBP have been notified by Statistik Austria on 27 March and thus too late to be taken into account in the assessment of the updated DBP. An ex-post assessment regarding the additional request for flexibility will be provided in the course of the assessment of the 2018 Stability Programme according to the applicable procedures and taking into account final EDP data to be validated by Eurostat and be released on 23 April 2018.

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Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-0.9	-0.6		-0.8	
Structural balance based on freezing (COM)	-0.9	-0.6		-	
Position vis-a -vis the MTO[3]	At or above the MTO	Not at MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.4		0.0	
Required adjustment corrected[5]	-0.9	0.0		-0.2	
Change in structural balance[6]	-0.8	0.4	0.3	-0.3	-0.2
One-year deviation from the required adjustment [7]	0.1	0.4	0.3	-0.1	0.0
Two-year average deviation from the required adjustment [7]	0.5	0.2	0.2	0.1	0.2
Expenditure benchmark pillar					
Applicable reference rate[8]	2.9	1.1		3.2	
One-year deviation adjusted for one-offs [9]	-0.4	0.3	0.2	-0.3	-0.5
Two-year average deviation adjusted for one-offs [9]	0.0	-0.1	-0.1	0.0	-0.1
PER MEMORIAM: One-year deviation [10]	-0.1	0.3	0.2	-0.3	-0.5
PER MEMORIAM: Two-year average deviation [10]	-0.1	0.1	0.1	0.0	-0.1
Conclusion					
Conclusion over one year	Overall assessment	Compliance	Compliance	Overall assessment	Overall assessment
Conclusion over two years	Compliance	Overall assessment	Overall assessment	Compliance	Overall assessment

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2016) was carried out on the basis of Commission 2017 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Updated Draft Budgetary Plan for 2018 (updated DBP); Commission ad-hoc forecast (COM); Commission calculations.

According to the information provided in the updated DBP, in 2017 the real growth rate of net government expenditure fell below the applicable reference rate (deviation of +0.3% of GDP), pointing to compliance.[7] The (recalculated) structural balance is expected to improve by 0.4% of GDP (to -0.5% of GDP), in compliance with the required adjustment (gap of 0.4% of GDP). Over 2016 and 2017 together, the expenditure benchmark points to a risk of some deviation (gap of -0.1% of GDP), while the (recalculated) structural balance points to Abetween the two indicators is largely driven by the different underling estimates of potential growth. While the 10-year average of potential growth underpinning the expenditure benchmark appears more robust, the structural balance is flattered by a more favourable reading of economic potential and supported by the declining interest expenditure, although negatively affected by a small revenue shortfall. In consideration of all those factors, the expenditure benchmark appears to more adequately reflect the fiscal effort. Thus, the overall assessment points to compliance in 2017 and to some deviation for 2016 and 2017 together. That conclusion is confirmed based on the Commission ad-hoc forecast, and would not change if the additional budgetary impact of the inflow of refugees and the exceptional security measures in 2017 were excluded from the assessment.

Based on the information provided in the updated DBP, in 2018 the nominal growth rate of net primary government expenditure will exceed the applicable expenditure reference rate (deviation of -0.3% of GDP), pointing to a risk of some deviation.[8] Similarly, the (recalculated) structural balance is expected to deteriorate by 0.3% of GDP (to -0.9% of GDP), pointing to a risk of some deviation from the required adjustment (deviation of -0.1% of GDP). The overall assessment points to similar drivers as in 2017, thereby pointing to some deviation in 2018.

Based on the Commission ad-hoc forecast, both in 2018 and over 2017 and 2018 together, the expenditure benchmark points to a risk of some deviation (one-year deviation of -0.5% of GDP), while the structural balance points to compliance. Similarly to the projections of the updated DBP, the difference between the two indicators is driven by the different assumptions on potential growth, with the structural balance being also supported by declining interest expenditure and negatively affected by revenue shortfalls. Considering all those factors, the expenditure benchmark appears to more adequately reflect the fiscal effort. Therefore, the overall assessment based on the Commission ad-hoc forecast points to a risk of some deviation both in 2018 and for 2017 and 2018 together. That conclusion would not change if the carry-over of the additional budgetary impact of the inflow of refugees and the exceptional security measures in 2017 were excluded from the assessment for 2018.

[7] Net government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a fouryear period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

[8] As part of the agreement on the EFC Opinion on "Improving the predictability and transparency of the SGP: a stronger focus on the expenditure benchmark in the preventive arm", which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

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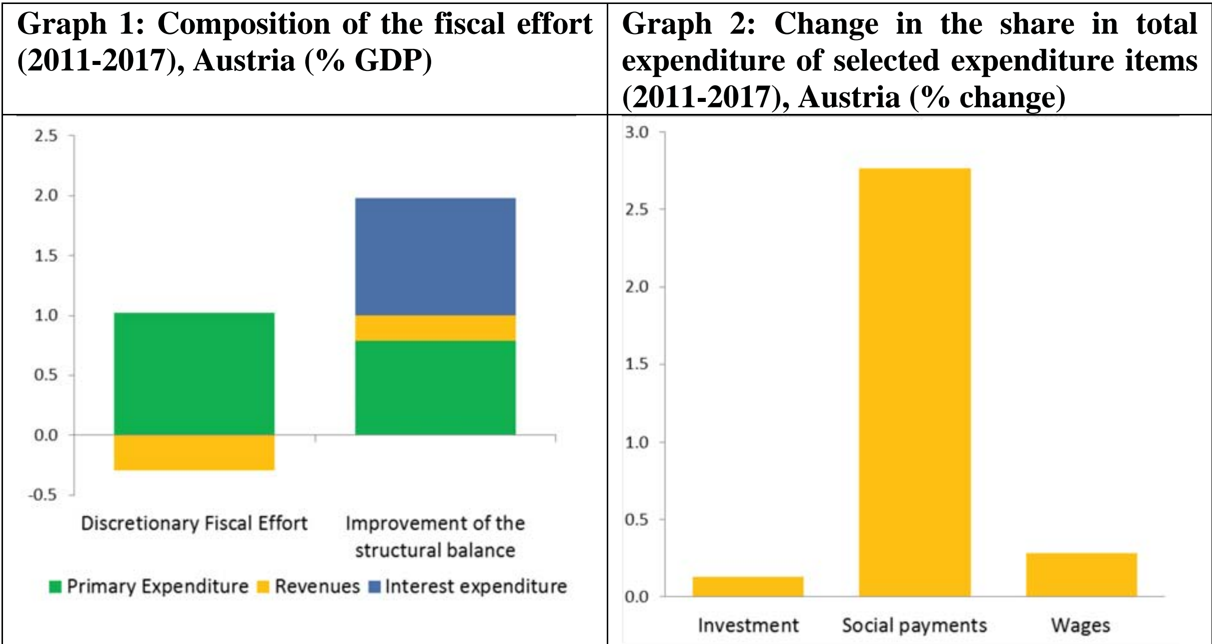
An overall assessment based on the updated Draft Budgetary Plan and the Commission ad-hoc forecast points to a risk of some deviation from the required adjustment path towards the MTO in 2016 and 2017 taken together and in 2018.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The decline in the general government balance projected by the updated DBP for 2018 is driven by a stronger decline of expenditure with respect to revenues as a percentage of GDP, with revenues expected to decline by 0.5% of GDP and expenditure by 0.8% of GDP (to 48.1% and 48.5% of GDP in 2018, respectively). Similarly, over 2011-2017 the projected improvement of the structural balance is largely driven by declining expenditure, mainly due to lower interest spending but also linked to a reduction in primary expenditure. Revenue growth played also an important role in supporting the structural balance over 2011-2017, and was so strong to more than offset the impact of legislated tax cuts.

Based on the updated DBP projections, in 2018 public investment is expected to remain broadly stable at 3% of GDP, which is the same rate observed since 2011. Also expenditure for public wages is expected to remain broadly constant as a percentage of GDP at the same rate observed since 2011, while a strong increase in social payments is expected over 2011-2017.

Graph 1: Composition of the fiscal effort (2011-2017), Austria (% GDP)	**Graph 2: Change in the share in total expenditure of selected expenditure items (2011-2017), Austria (% change)**



Source:

Updated Draft Budgetary Plan 2018, European Commission ad-hoc forecast.

Note:

Graph 1 shows the Discretionary Fiscal Effort (DFE) which combines a top-down approach on the expenditure side with a bottom-up or narrative approach on the revenue side. In a nutshell, the DFE consists of the increase in primary expenditure net of cyclical components relative to economic potential on the one hand, and of discretionary revenue measures on the other hand. See European Commission (2013): Measuring the fiscal effort, Report on Public Finances in EMU, part 3.
http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee-2013-4.pdf

Overall, Austria's tax structure relies heavily on taxes on labour, with social security contributions and yields from income taxes paid by households representing a relatively high share of total revenues. The no-policy-change DBP presented several measures implemented since the 2017 Stability Programme that could contribute to improve the growth-friendliness of the tax system. On the business side, the research bonus for corporations has been increased as from 2018, while a temporary investment bonus for large companies was implemented in 2017. In addition, the tax on flight tickets is halved from 2018. On the labour side the discontinued "employment bonus" will nonetheless temporalily reduce employer social security contributions. The updated DBP announces a reduction of the contribution to the unemployment insurance for low-income earners as of July 2018 and a tax relief for families as of 2019 ("family bonus plus"). Those measures may contribute to lowering the tax wedge (see Box 3).

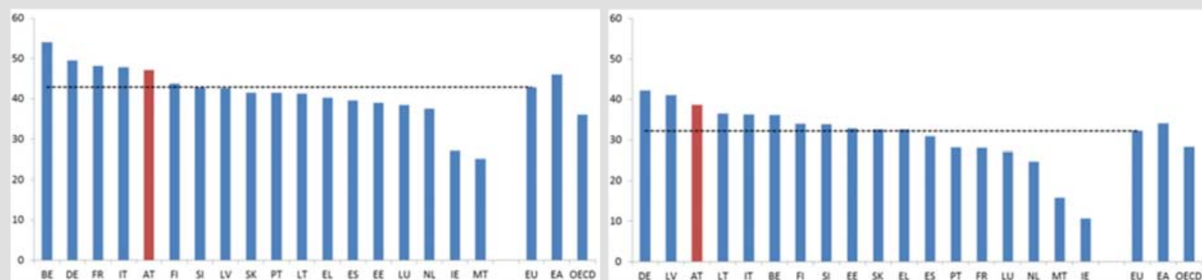
The no-policy-change DBP reported several measures addressing the fiscal-structural part of the country-specific recommendations. Concerning streamlining of fiscal relations and responsibilities across the various layers of government, the no-policy-change DBP reported two Parliamentary decisions taken since the Stability Programme 2017. In particular, the autonomy of federal states in setting the rate for the contributions to house subsidies has been ratified, while educational boards were created as a cross-regional intergovernmental authority for education. Common education boards represent a positive step towards harmonising education policies across federal states and streamlining intergovernmental responsibilities in the area of education. Nevertheless, the measure does not affect the general misalignment between managing and funding responsibilities of federal states. The same applies to the increased tax autonomy of federal states, which remains small compared to their spending powers. Several other initiatives included in the 2017 Financial Equalisation Law appear as more promising and deserve a thorough implementation. They include spending reviews, benchmark systems and task-oriented financing at the subnational level as well as a general reform of inter-governmental competencies. Concerning the sustainability of the healthcare system, the no-policy-change DBP reported the ratified plan to expand the provision of primary care, which could contribute to reduce the size of the hospital sector and improve efficiency in the medium term. Neither the no-policy-change DBP nor the updated DBP includes new measures concerning the sustainability of the pension system.

Box 3 – Addressing the tax burden on labour in the euro area

In the euro area, the tax burden on labour, which weighs on economic activity and employment is relatively high. Against that background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate those numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is composed of personal income taxes, employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Austria for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Austria at the average wage and at low wage (2016)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting process. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be budget neutral i.e., fully offset by revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2017 European Semester, and in particular in recital 12 of the country-specific recommendations to Austria, it was mentioned that the tax wedge on labour in Austria remains relatively high despite the 2016 tax reform, while more growth-friendly sources of revenue, such as recurrent property taxes, are underutilised.

Against that background, Austria has recently undertaken or announced several policy measures. The recently implemented "employment bonus", which foresees a reimbursement

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of half of the social security contributions born by employers for newly hired employees, has been discontinued by the new government as of January 2018. The updated DBP foresees a reduction of the employee contribution to the unemployment insurance for low-income earners, which may improve labour supply incentives. A new tax credit ("family bonus plus") is foreseen as of 2019, which reduces the annual personal income tax liability by about EUR 1,500 per child. However, according to the government programme, that measure is partly financed by an abolition of the child allowance and the deductibility of child care cost granted under the personal income tax, the latter of which may bear negative labour supply incentives especially for female workers.

6. OVERALL CONCLUSION

Based on the Commission ad-hoc forecast, Austria is expected to meet the debt reduction benchmark both in 2017 and 2018.

According to the information provided in the updated DBP, the projected structural adjustment points to a risk of some deviation for 2016 and 2017 taken together as well as in 2018. The conclusion is confirmed by an assessment based on the ad-hoc Commission forecast which however also points to a risk of some deviation for 2017 and 2018 taken together. These conlusions would not change in case the current estimate of the budgetary impact of the exceptional inflow of refugees and security measures in 2017 is excluded from the assessment.

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