In response to the inquiry on proposals for Scotland's Fiscal Framework, the Austrian Parliamentary Budget Office (PBO) provides a short overview on three aspects of the Austrian Fiscal Framework: First, we discuss the Austrian system of fiscal equalisation, which allocates the tax revenues to the three governmental layers (the federal government, the nine Laender (provinces; regional level), and the more than 2000 municipalities (local level)). Second, we describe the Austrian Stability Pact, which involves all levels of government in the consolidation of public finances and prescribes deficit/surplus targets to the federal, regional and local governments. Third, we briefly discuss the Austrian medium-term expenditure framework (MTEF), which concerns only the federal government.

The process of fiscal equalisation in Austria

The Austrian Federal Constitutional Law lays down three principles of intragovernmental fiscal relations in Austria. First, the competences of the federal government and the Laender in the field of taxation are prescribed in a special federal constitutional law, the Constitutional Finance Law (Finanz Verfassungsgesetz 1948). Second, the federal government, the Laender and the municipalities must aim at the securement of an overall balance and sustainable balanced budgets in the conduct of their economic affairs and have to coordinate their budget management in accordance. And third, the federal government, the Laender and the municipalities have to aim at the equal status of women and men in their budget management.

The Constitutional Finance Law sets the basic principles for financial relations between the governmental layers (federal government, Laender and municipalities), which includes basic rules on taxation, tax sharing, intergovernmental transfers and cost bearing. In Practice taxies are only levied at the federal level or by the municipalities.

The Constitutional Finance Law stipulates that – in absence of other rules – each governmental unit carries the expenses arising out of its duties. However, in many cases this principle is eroded by other rules, the majority of which are laid down in the
Fiscal Equalisation Law or in so called Article 15a Agreements (of the Austrian Federal Constitutional Law) drawn up between the federal government and the Laender (provinces) on a specific administrative area.

The Fiscal Equalisation Law (Finanzausgleichsgesetz) details the rules of tax sharing, intergovernmental transfers and cost bearing between the federal government, the Laender and the municipalities. It usually stays in force for only a few years after which it is replaced by new regulations, which are the result of negotiations between the federal Minister of Finance and representatives of the Laender and the local governments. Although horizontal equalisation is not regulated by the federal government, the system does contain some elements with horizontal effects.

The process of fiscal equalisation in Austria is divided into three steps. The first step allocates those taxes that have been defined as shared taxes among the federal government, the Laender, and the municipalities. This is achieved through a vertical fiscal equalisation between the three governmental layers, followed by a horizontal fiscal equalisation between the Laender and between the municipalities. The distribution of revenue in the process of fiscal equalisation is either guided by tax revenues or by a demographic criterion. This means, tax revenues are usually either distributed according to the regional or local revenue of a tax or according to the number of inhabitants of a Land or municipality (with a correction mechanism that favours large municipalities, as they usually also have to provide services for the inhabitants of the surrounding municipalities). Additionally, some parts of the shared taxes are allocated according to fixed quotas.

Intergovernmental transfers mark the second step of fiscal equalisation. For example, this includes quota allocation funds or grants to cover special needs or purposes, transfers to equalize the average revenue of Laender and municipalities (paid by the federal government, horizontal effect), transfers for housing development, environmental purposes and infrastructure, as well as transfers from the federal natural disasters fund.

Finally, the third step of fiscal equalisation applies all other rules for transfers across public legal entities which are not contained in the Fiscal Equalisation Law, but are part of other federal or state laws or Article 15a Agreements (of the Austrian Federal
Austrian Parliamentary Budget Office

Constitutional Law) drawn up between the federal government and the Laender (provinces).

From the PBO’s viewpoint an efficient system of financial equalisation should be guided by three principles: First, the principle of fiscal equivalence, which states that the beneficiaries of public services within a limited area should also bear the costs related to the provision of these services. Second, the principle of connexity, which says that the competencies for functions and financing should coincide. And third, the principle congruence, which recommends the local identity of the beneficiaries of public services and the decision makers for the provision of these services. The fact that none of these principles is sufficiently met in the current Austrian system suggests the need for reform. The next Fiscal Equalisation Law that will enter into force from 2017 onwards should therefore be based on a new system that is stronger related to tasks allocated to the different layers of government. Negotiations to reach this goal will start soon.

In addition to gearing the system towards meeting the above principles, improving transparency should be a central task for future reforms. The introduction of accrual-based accounting rules at the federal government level has been an important step into this direction. However, the harmonization of accounting systems, including the introduction of accrual-based accounting, across all governmental layers would be central for a further improvement of transparency.

Austrian Stability Pact and debt brake

The introduction of the Austrian Stability Pact (ASP) was part of Austria’s preparation for entering the Euro area, which required significant fiscal consolidation, and was established through an intrastate treaty in 1999. The Austrian Stability Pact involves all levels of government in the consolidation of public finances and prescribes deficit/surplus targets to the federal, regional and local governments. It provides for legally enshrined budgetary commitments across various government levels, and thereby is a step towards solving the asymmetry between the high degree of decentralization of fiscal responsibilities at the national level created by the process of fiscal equalisation and the highly centralized responsibilities of the federal level towards the European Union. In case of non-compliance the ASP includes a sanction mechanism in the form of an interest-bearing deposit, that is transferred to the
governments in compliance if the target is missed for two years in a row and reimbursed otherwise. So far, however, sanctions have never been used.

The Reform of the EU budgetary surveillance and the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) required a reform of the ASP, which was implemented with the ASP 2012 and remains in force for an unlimited period (the previous ASP treaty had to be renewed every four years). The reform included the introduction of a debt brake as a part of the intragovernmental fiscal governance, which sets upper limits for the deficits of the federal government, Laender and the municipalities. According to the rule the Austrian budget has to be structurally balanced by 2017, meaning that the structural deficit of the federal level has to be below 0.35 % and that of Laender and municipalities together below 0.1 % of nominal GDP. This adds up to an upper limit for the structural deficit at the general government level of 0.45 % of GDP. Furthermore the ASP foresees an expenditure rule where annual expenditure growth of all governments must not exceed a rate below a reference medium-term rate of potential GDP growth, and an appropriate adjustment towards the medium-term objective must be ensured unless the excess is matched by discretionary revenue measures. The ASP also requires a reduction of the government debt level, actually considerably above 60 % of the GDP: The federal and the sub-national governments obliged themselves to reduce the gap between Austria's debt level and the 60 % reference by 1/20 annually (on average over three years).

The Austrian Stability Pact includes the setup of an Austrian Coordination Committee (Representatives of the Ministry of Finance, the Laender and the associations of municipalities and cities), as well as the setup of a coordination committee for each regional government (Land). The Austrian Coordination Committee coordinates the budgetary affairs among the federal government, the Laender and municipalities, organizes the necessary information exchange on budgetary developments (i.e. on deficit and debt data, staff capacity and medium-term budgetary planning) and discusses and enacts the new fiscal rules. In case of signs for deviance of the fiscal rules, the Committee can present recommendations on corrective actions to the government body concerned and is also responsible to present steps to comply with EU obligations.

In the monitoring process, the Austrian Statistical Office is responsible for calculating
the relevant fiscal data and reports to the Austrian Coordination Committee and the Court of Audit, explicitly stating any non-compliance. If this non-compliance is confirmed by the Court of Audit, an arbitration panel is required to convene. This panel consists of two representatives of the Ministry of Finance, two representatives of the Laender, one representative of the association of the cities, and one representative of the association of the municipalities. The panel requires the concerned government body in non-compliance to present corrective measures within a limited period of time, and can impose the sanctions provided for in the Austrian Stability Pact in case of continuing non-compliance.

From the PBO’s viewpoint the ASP represents a useful tool for involving all levels of government in the process of budgetary consolidation.

The Medium-Term Expenditure Framework

The medium-term expenditure framework (MTEF), which was introduced in 2009, established medium-term budgetary planning at the federal level by setting legally binding expenditure ceilings for 4 years in advance on a rolling basis (n+4 is added annually). The ceilings are set for 5 main headings,¹ which cover several ministries, and 30 ministry specific budget chapters. These ceilings are binding for budgetary planning and execution at the main heading level for n+1 to n+4 and at the budget chapter level for n+1 (and n+2). The ceilings are composed of a fixed part (approx. 75 %) and of a counter-cyclical variable part (approx. 25 %), which varies according to the sensitivity to the business cycle or other variables. This second part is particularly relevant for those expenditures that are strongly correlated to the business cycle (e.g. unemployment benefits). In addition, the MTEF comprises an upper limit for the staff capacity at each department. The Federal Medium-Term Expenditure Framework Act, which is the law setting the expenditure ceilings, is accompanied by a strategy report explaining the main budgetary and economic policy objectives of the federal government and providing an overview on the federal government's expectations with regards to the economic development and the development of revenues and expenditures. The Austrian fiscal framework includes

---

¹ The main headings are "Law and security", "Labour, social affairs, health and family", "Education, research, art and culture", "Economy, infrastructure and environment" and "Cash and interest".
the possibility to build up (unearmarked) reserves out of any unused financial appropriations at the end of the fiscal year, which can then – after approval of the federal Minister of Finance – be used in subsequent years. Reserves are only financed, if they are actually needed.

From the view of the PBO, the framework seems to have contributed to a general government deficit lower than anticipated during the last couple of years, in particular as it helped to introduce a more medium or long-term oriented policy debate and thereby, was an important step towards making the budgetary process more predictable and towards fostering fiscal discipline. However, the effectivity of the MTEF is to some extent limited due to the fact that every year the parliament is always able to modify the expenditure ceilings for the following years what happened frequently so far. The possibility to build up reserves was an incentive to operate economically and reduce deficits in the past, but may cause some risk in the future when the possibility of using reserves is limited due to consolidation efforts or has deficit-increasing effects.