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A New Revenue Sharing Act and a New Stability Pact for Austria – No Fundamental Changes

The new Austrian domestic Stability Pact sets ambitious budgetary targets for states and municipalities in particular. The new revenue sharing agreement will not change fiscal relations fundamentally. Ecological accents within the promotion of residential building will be strengthened and federal transfers for state teachers as well as need-based transfers to states and municipalities will be increased. Shared federal taxes will gain in importance. Within the horizontal apportionment of revenue shares across municipalities, redistribution toward small municipalities will take place. The revenue autonomy of subnational levels of government will remain very limited.

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In late 2004, a new Revenue Sharing Act and a new domestic Stability Pact for Austria were adopted for the period from 2005 to 2008. They replace the preceding agreements, which covered the years 2001 to 2004. Concerning the revenue sharing system, this article focuses on important developments over the last few years and sketches some reform proposals. As detailed information is not yet available, only the basic and most important elements of the 2005 Revenue Sharing Act can be presented here[1].

Since 1999, the contributions of the three governmental levels to the attainment of the total government's budget targets have been fixed within a legally binding agreement[2]. Like the Revenue Sharing Act, the Austrian Stability Pact is a temporary agreement; the duration of both agreements is identical[3]. Both agreements cannot be viewed independently of each other, and they were not negotiated independently of each other: the financial endowment of the individual governmental levels (shares in shared federal taxes, own tax revenues, and intergovernmental transfers), which to a great extent is determined by the Revenue Sharing Act, has a crucial impact on their possibilities to fulfil the budget targets set by the Stability Pact. This is particularly true for the states and municipalities, whose tax autonomy is very limited. Such a package deal is not unproblematic: it adds to the political difficulties of implementing a far-reaching reform of the Austrian revenue sharing system, the necessity of which is hardly disputed in theory as well as in economic policy[4].

The 2005 Stability Pact

The 2005 Stability Pact fixes the yearly stability contributions the individual governmental levels have to make during the four-year-period from 2005 to 2008 to ensure the realisation of the consolidation path outlined in the Austrian stability programme submitted in November 2004 (*Federal Ministry of Finance,* 2004): the total government's Maastricht-relevant deficit is to be reduced from 1.9 percent of GDP in 2005

[1] A detailed presentation of the 2005 Revenue Sharing Act will follow in a later article in WIFO Austrian Economic Quarterly.

[2] In 1996, an informal agreement was concluded between the levels of the state, which was supposed to support the budget consolidation required because of Austria's accession to the EU.

[3] More precisely: after termination of the 2005 Stability Pact, the "old" Stability Pact of 1999 (which aims at a deficit of 3 percent of GDP for the total government) will come into effect again, should the governmental levels not agree on a new Stability Pact.

[4] For details, see the last section of this article.

to zero in 2008. At the federal level, a Maastricht-relevant deficit of 2.4 percent of GDP is stipulated for 2005, which is to decrease to 0.75 percent of GDP until 2008 (Table 1).

Table 1: Austrian Stability Pact 2005 to 2008 – budget deficits and surpluses at the levels of government

	2005	2006	2007	2008
	As a percentage of GDP			
Total government	– 1.9	– 1.7	– 0.8	± 0.0
Federal level	– 2.4	– 2.2	– 1.4	– 0.75
States (including Vienna)	+ 0.6	+ 0.6	+ 0.7	+ 0.75
Municipalities (excluding Vienna)	± 0.0	± 0.0	± 0.0	± 0.0
Social security institutions	– 0.1	– 0.1	– 0.1	± 0.0

Source: Federal Ministry of Finance. – . . . budget deficit, + . . . budget surplus.

The states (including Vienna) are obliged to realise budget surpluses, which are to increase from 0.6 percent of GDP in 2005 and 2006 to 0.7 percent of GDP in 2007 and to 0.75 percent of GDP in 2008. The municipalities (excluding Vienna) are to balance their budgets in each year. In contrast to the 2001 Stability Pact, temporary overruns of the stipulated stability contributions within certain limits, which can be compensated in the following years, will be ruled out for the years 2005 and 2006. Compared to the 2001 Stability Pact, the flexibility of public budgets will be restricted further at all levels of the state: together with the envisaged consolidation path, which is to lead to a "zero deficit" in 2008, these provisions will reduce the effectiveness of the automatic stabilisers and the room for discretionary measures intended to stabilise business cycle fluctuations. Thus the new Austrian Stability Pact, to a larger extent than the old one, may well exert procyclical effects. It must also be pointed out that the 2005 Stability Pact is considerably less flexible and leaves less room for manoeuvre than the European Stability and Growth Pact.

During the preceding Stability Pact period (2001 to 2004), the federal level, but also the states were less and less able to reach the stipulated budget targets (*Schratzenstaller,* 2005). Note, however, that the deficits or surpluses of the governmental levels determined according to the Austrian Stability Pact may deviate from those notified to Eurostat. For example, the budget deficits and surpluses relevant for the Austrian Stability Pact are determined according to the accounting rules of ESA 95 of 16 October 2000, which are less strict than the currently applied ones. A final evaluation of the individual governmental levels' performance during the period from 2001 to 2004 is only possible when the outturns for all levels of government are available. For this evaluation, the whole period covered by the agreement is relevant, because non-compliance with yearly targets in single years within certain limits is admissible if these deviations are compensated in the following years.

The new Austrian Stability Pact sets ambitious deficit targets. At the state level, a certain portion of the surpluses realised up to now rests on one-off measures and the targeted design of specific budgetary transactions (e.g., sales of real estate, replacing transfers to state hospitals by loans)[5], only a part of which will be sustainable in the long run. For the municipalities, too, balancing their budgets in the future represents a considerable challenge. To a large extent, the consolidation successes achieved in the past years date back to the restructuring of public entities (*Stübler,* 2004) and to leasing transactions as well as to the decrease in public investment (Table 2; *Staatsschuldenausschuss,* 2004A).

Moreover, the budget deficits or surpluses for the years 2007 and 2008 must be determined according to the stricter current accounting rules of ESA 95. In this context it must also be pointed out that the total public sector is becoming more and more intransparent as a result of restructuring and outsourcing public entities at all governmental levels (*Schratzenstaller,* 2005).

[5] For such options and measures at the state level, see also *Smutny* (2002), *Staatsschuldenausschuss* (2004A).

It should also be noted that the achievement of the budget targets for the total government is contingent on reducing the deficit of the social security institutions (which is estimated at 0.1 percent of GDP for the years 2005 to 2007) to zero in 2008. Here a significant role pertains to the realisation of the envisaged saving potentials by measures to reduce costs and to increase efficiency in the health sector.

Table 2: Gross investment at the levels of government (including spin-offs) in Austria

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
	Percentage shares of overall public investment									
Federal level	26.3	25.7	26.8	27.6	26.6	28.8	34.3	33.5	33.6	30.1
States	13.7	13.6	13.3	13.6	16.0	16.1	17.1	19.2	20.6	22.4
Municipalities	58.0	58.9	57.0	56.9	55.5	52.7	47.0	45.4	44.0	45.7
Social security institutions	2.0	1.9	2.9	1.9	1.9	2.3	1.6	1.9	1.8	1.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	As a percentage of GDP									
Federal level	0.8	0.7	0.8	0.8	0.7	0.7	0.8	0.8	0.8	0.7
States	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Municipalities	1.8	1.7	1.6	1.6	1.5	1.2	1.1	1.1	1.1	1.0
Social security institutions	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Total	3.1	2.9	2.8	2.7	2.6	2.4	2.3	2.4	2.4	2.3

Source: Federal Ministry of Finance, WIFO calculations.

The 2005 Revenue Sharing Act

Increasing centralisation of the public sector

Different indicators that capture the degree of (de-)centralisation of Austria's public sector and a comparison with other OECD federal states show that for a federal state Austria is relatively strongly centralised (Table 3): in terms of the shares of the subnational governments (states and municipalities) in overall public expenditures and employment as well as in terms of their shares in overall public revenues and taxes. At the same time – comparing the years 1985 and 2001 – the degree of centralisation of Austria's public sector remained roughly constant (measured by the shares of states and municipalities in overall public expenditures and employment) or even increased (in terms of the shares of subnational governments in overall revenues and taxes), while the other OECD federal countries altogether show an increasing degree of decentralisation over time (see also *Kramer,* 2004). Thus, Austria is more and more turning into a "federal system with a high degree of centralisation" (*KDZ,* 1999, p. 12).

Table 3: Indicators of fiscal decentralisation in OECD federal countries

	Subnational expenditures and employment				Subnational revenues				Fiscal gap[1]	
	1985	2001	1990	2001	1985	2001	1985	2001	1985	2001
	Total expenditures		Total employment		Total revenues[2]		Total taxes			
	Percentage shares				Percentage shares				Percentage points	
Federal states average	37.0	39.0	78.7	81.1	31.2	31.1	25.1	26.7	– 5.8	– 7.9
Austria	28.4	28.5	62.6	62.3	24.6	21.4	23.8	18.9	– 3.8	– 7.1
Australia	.	.	76.7	83.3	.	.	18.6	17.2	.	.
Belgium	31.8	34.0	.	.	11.4	11.3	4.8	28.6	– 20.4	– 22.7
Germany	37.6	36.1	87.6	88.5	31.9	32.4	30.8	29.2	– 5.7	– 3.7
Canada	54.5	56.5	84.7	86.0	50.4	49.9	45.4	44.1	– 4.1	– 6.6
Mexiko	.	.	.	.	.	.	1.0	3.1	.	.
Switzerland	.	.	.	.	.	.	44.1	40.4	.	.
USA	32.6	40.0	81.8	85.5	37.6	40.4	32.7	31.7	5.0	0.4

Source: *Joumard – Kongsrud* (2003), WIFO calculations. – [1] Difference between expenditure and revenue shares in percentage points. – [2] Excluding transfers from other governmental levels.

As already mentioned, comparatively constant expenditure shares of subnational levels are combined with decreasing revenue shares in Austria. As a result, the fiscal

gap at the subnational levels is widening[6]: therefore the dependency of states and municipalities on transfer payments made by other governmental levels (particularly by the federal level) is increasing, and states and municipalities are exposed to a rising debt and/or consolidation pressure.

Table 4: Total tax revenues

	Shared federal taxes[1]	Exclusive federal taxes	Exclusive state taxes	Exclusive municipal taxes[2]	Total
			Million €		
1990	24,561	5,736	241	2,399	32,938
1991	26,961	6,186	240	2,482	35,869
1992	29,236	7,074	253	2,722	39,285
1993	29,821	6,823	260	2,780	39,685
1994	31,946	5,993	285	3,031	41,256
1995	31,752	6,000	277	3,050	41,080
1996	35,402	7,090	273	3,115	45,881
1997	37,356	7,946	288	3,175	48,765
1998	42,835	5,842	294	3,199	52,170
1999	43,667	4,997	293	3,256	52,213
2000	45,018	5,359	263	3,190	53,830
2001	50,628	5,571	237	3,010	59,446
2002	49,312	5,634	241	3,034	58,222
2003	48,237	5,261	269	3,125	56,892
			Percentage shares		
1990	74.6	17.4	0.7	7.3	100.0
1991	75.2	17.2	0.7	6.9	100.0
1992	74.4	18.0	0.6	6.9	100.0
1993	75.1	17.2	0.7	7.0	100.0
1994	77.4	14.5	0.7	7.3	100.0
1995	77.3	14.6	0.7	7.4	100.0
1996	77.2	15.5	0.6	6.8	100.0
1997	76.6	16.3	0.6	6.5	100.0
1998	82.1	11.2	0.6	6.1	100.0
1999	83.6	9.6	0.6	6.2	100.0
2000	83.6	10.0	0.5	5.9	100.0
2001	85.2	9.4	0.4	5.1	100.0
2002	84.7	9.7	0.4	5.2	100.0
2003	84.8	9.2	0.5	5.5	100.0

Source: Annual federal accounts; Statistics Austria, Gebarungsübersichten; WIFO. – [1] According to Chapter 52 of the federal budget, excluding trade tax. – [2] Including trade tax, excluding charges for the use of local government facilities.

Especially at the municipal level, the consolidation pressure exerted by the targets set in the Austrian Stability Pact as well as the growing fiscal gap seem to result in the cutback in public investment mentioned above, as the most disposable expenditure category. Table 2 shows that even if investment of outsourced public entities is included, public gross investment in Austria as a percentage of GDP has fallen markedly since the middle of the 1990s: from 3.1 percent in 1995 to 2.3 percent in 2004. At the same time, the gross investment ratio remained constant at the federal and the state level, whereas a marked decline occurred at the municipal level (from 1.8 to 1.1 percent of GDP). As a direct consequence, public investment activities are becoming more and more centralised in Austria. The municipalities' share in overall public investment decreased from 58 percent in 1995 to about 46 percent in 2004. In the long run, this development may be harmful to economic growth: recent surveys on municipalities' expenditure needs indicate that financial shortages are to an increasing extent restraining a sufficient level of municipal investment (*Fleischmann,* 2003, *Staatsschuldenausschuss,* 2004A).

The allocation of tax revenues across governmental levels mainly rests on the centralised system in Austria[7]; the revenue side of the public sector is characterised by a

[6] The fiscal gap can be defined as the difference between expenditure obligations of subnational levels and their revenue-raising potential (*Joumard – Kongsrud,* 2003); it can be calculated as the difference between subnational expenditure and revenue shares.

[7] In a centralised system, one governmental level (as a rule the federal level) is responsible for tax legislation and collection, and total revenues are distributed to the individual governmental levels based on an appor-

high degree of centralisation. By far the largest – and increasing – portion (almost 85 percent in 2003) of total tax revenues is levied as shared federal taxes. Their yields are distributed to the governmental levels according to a vertical apportionment formula which provides for fixed revenue shares and is stipulated in the Revenue Sharing Act (Table 4).

Revenues from taxes which are exclusively assigned to only one of the governmental levels are becoming less important: in 2003, about 9 percent of total tax revenues went to the federal level, 5.5 percent to the municipalities, and 0.5 percent to the states.

The 2005 Revenue Sharing Act will strengthen the dements of the centralised system, as some of the hitherto exclusive federal revenues (tobacco tax, energy-related taxes, duty on vehicles based on fuel consumption, capital transaction taxes, licence levy, insurance tax) will be converted into shared federal taxes, which accordingly will further gain in importance.

From 2005 on, the vertical apportionment formula will provide for uniform revenue shares for most shared federal taxes. The revenue shares stipulated in the 2001 Revenue Sharing Act will remain uncharged for the advertisement tax, the real estate transfer tax, and the tax on vacant plots, the lion's share of which accrues to the municipalities. The uniform revenue shares of the individual governmental levels in the total amount of shared federal taxes (net of certain deductions made before distribution) will be fixed at a level which will hold constant their 2004 shares in total revenues according to the outturn for 2004[8]. Table 5 shows the vertical distribution of shared federal taxes to the federal level, the states, and the municipalities. Net of various deductions from some taxes made before distribution, € 46.2 billion were available for distribution among the federal levels in 2003.

Table 5: Vertical distribution of shared federal taxes

		2000	2001	2002	2003
		Million €			
	Revenues of shared federal taxes, gross total[1]	45,018	50,628	49,312	48,237
–	Deductions[2]	– 1,799	– 1,911	– 1,970	– 2,085
	Amount available for vertical distribution	43,218	48,717	47,342	46,152
	Federal government	29,694	34,040	33,158	32,432
±	Deductions[3], and additions[4]	– 2,032	– 1,841	– 1,861	– 1,727
=	Remaining federal share	27,662	32,199	31,297	30,705
	States (including Vienna as a state)	7,508	7,968	7,743	7,478
–	Deductions[3]	– 585	– 724	– 733	– 739
=	State share available for horizontal distribution	6,923	7,244	7,009	6,739
	Municipalities (including Vienna as a municipality)	6,016	6,709	6,442	6,242
–	Deductions[3]	– 285	– 300	– 295	– 292
=	Municipality share available for horizontal distribution	5,731	6,409	6,147	5,951

Source: Annual federal accounts, Federal Ministry of Finance, WIFO calculations. – [1] According to Chapter 52 of the federal budget, excluding trade tax. – [2] Payments to the Family Burden Equalisation Fund, shares in VAT for health promotion and according to the Health and Social Sector Allowances Act, share in vehicle tax for the federal government, reimbursement of the federal government for levying the art promotion contribution. – [3] Contributions to the EU budget, consolidation contributions by the states and municipalities, contribution by the municipalities to hospital funding, tax shares for the Family Burden Equalisation Fund and the Disaster Relief Fund, share for the residential water management system. – [4] Contributions to the EU budget and consolidation contributions by the states and municipalities, share in vehicle tax, reimbursement of the federal government for levying the art promotion contribution.

The 2005 Revenue Sharing Act won't reverse the shift in revenues from shared federal taxes from the subnational governments to the federal level, which took place during the period covered by the 2001 Revenue Sharing Act (Table 6); this is so because the harmonised revenue shares, which have yet to be determined, will be oriented at the 2004 shares of the individual governmental levels in overall shared federal taxes. Nevertheless, uniform revenue shares can be assessed as positive for two rea-

tionment formula. In contrast, in a decentralised system tax autonomy is assigned to all levels of government which finance themselves by own taxes.

[8] Revenue shares will be fixed as soon as the outturn for 2004 has been determined, but by the end of September 2005, at the latest.

sons: first, a long-term shift in revenue shares in shared federal taxes across the governmental levels as a result of differing revenue elasticities of individual shared federal taxes will be precluded in the future. Second, the resistance of subnational governmental levels to reforms in individual shared federal taxes will be lowered.

Table 6: Revenue shares of the governmental levels for horizontal distribution

	2000	2001	2002	2003	2000	2001	2002	2003
	Million €				Percentage shares			
Federal government	27,662	32,199	31,297	30,705	68.6	70.2	70.4	70.8
States (including Vienna as a state)	6,923	7,244	7,009	6,739	17.2	15.8	15.8	15.5
Municipalities (including Vienna as a municipality)	5,731	6,409	6,147	5,951	14.2	14.0	13.8	13.7
Total	40,316	45,852	44,454	43,395	100.0	100.0	100.0	100.0

Source: Annual federal accounts, Federal Ministry of Finance, WIFO calculations.

Further changes in the revenue sharing system

Besides the assignment of taxes (understood as the sum of shared federal taxes and exclusive federal, state, and municipal taxes) to the federal levels, the vertical revenue sharing system also comprises intergovernmental transfers, primarily from the federal level to the subnational governments.

Federal financial transfers to the municipalities for local public transportation, as well as to the states for local public transportation and environmental and energy-saving measures, which up to now were determined as percentage shares in taxes on natural gas, electricity, and mineral oil, will from 2005 on be granted as a percentage share in those overall shared federal taxes which will be distributed according to uniform revenue shares. The percentage shares for the period from 2005 to 2008 will also be determined according to the outturn for 2004 and therefore according to the level of 2004. Thus the absolute volume of these transfers will remain constant in the short run. In the long run, their development will depend on the growth dynamics of the new base (the sum of shared federal taxes distributed according to uniform revenue shares) in comparison to the old base (taxes on electricity, natural gas, and mineral oil). An assessment of the future development based on the past is difficult, due to the manifold changes within the tax system which have been implemented since the middle of the 1990s. Based on the tax projections within the 2005 federal budget proposal, revenues from those taxes which will be levied as shared federal taxes with uniform revenue shares from 2005 on will increase by 25 percent between 1997 and 2005. In comparison, yields from the mineral oil tax will increase by 47 percent, yields from energy-related taxes (including coal tax from 2004 on) by 38 percent.

The promotion of residential building is regulated in the 2001 Earmarked Transfers Act, but is also part of the Revenue Sharing Act. As the 2001 Revenue Sharing Act, the new Revenue Sharing Act will grant an earmarked transfer to the states, which will be labelled as "investment contribution for residential building, environment, and infrastructure". The 2001 Earmarked Transfers Act, which represents the legal framework for the investment contribution, will be changed: the investment contribution is to be dedicated to a larger extent to the realisation of the Kyoto targets. In particular, incentives to improve heat insulation and efficient provision of energy in the stock of old houses ("thermic-energetic reconstruction") and in new buildings as well as for the use of renewable energy and environment-friendly long-distance heating are to be strengthened. The states are obliged to report to the federal level about the adopted measures and the reductions actually realised in climate-relevant greenhouse gases every two years. Effectively intensifying ecological accents within residential building, however, would also require concrete targets and an effective control of their attainment.

The whole amount which can be used for the investment contribution and the need-based federal transfer to sustain or regain a balanced budget to the states is derived as follows: 8.346 percent of corporate tax and income tax revenues (excluding interest tax) and 80.55 percent of the receipts from the contribution for the promotion of residential building. The percentage shares used for the calculation of

these transfers will not be changed by the 2005 Revenue Sharing Act. The ceiling for the earmarked transfer for the promotion of residential building of € 1,780.5 billion, which was introduced in 1996, will remain constant. The amount by which the shares in taxes on income and in the contribution for the promotion of residential building (which originally were exclusively reserved for the promotion of residential building) exceed the ceiling for the earmarked investment contribution, will be distributed to the states as a discretionary need-based federal transfer to sustain or regain a balanced budget.

The tax cuts provided for by the 2004-05 tax reform will dampen revenues from the corporate and income tax which, i.a., form the base for the investment contribution and the need-based federal transfer to sustain or regain a balanced budget. Nevertheless, the volume of the need-based federal transfer to sustain or regain a balanced budget will increase strongly in the medium run, due to the base's high revenue elasticity. While the need-based federal transfer to sustain or regain a balanced budget amounted to € 155 million in 1996, it will reach € 691 million according to the 2005 budget proposal. In addition, the 2005 Revenue Sharing Act provides for the increase in the need-based federal transfer to sustain or regain a balanced budget to the states by a yearly lump sum of € 100 million.

The system by which the states are reimbursed by the federal level for the costs of state teachers will remain unchanged in principle. The states will receive an additional € 12 million. This additional amount is designed to cover extra expenditures caused by structural problems resulting from the decreasing number of pupils and for special education at statutory schools (primary and general secondary schools). In principle, these extra payments are granted for the whole four-year period, but they are to be evaluated and changed if necessary after two years.

The need-based federal transfer to sustain or regain a balanced budget paid to the municipalities will be increased from € 18.74 million to € 118.74 million. The additional transfer of € 100 million per year partially is intended to compensate for the losses incurred by the municipalities with more than 10,000 inhabitants due to the reform of the modulated population apportionment (for details see below). The additional need-based federal transfer to sustain or regain a balanced budget will be allocated to the municipalities according to the number of their inhabitants: municipalities with up to 10,000 inhabitants will receive € 19.5 million, larger ones € 80.5 million.

Table 7: Hospital financing package

	Million €
Increase of tobacco tax (+ € 0.18 per packet)	90
Increase of health insurance contributions (+ 0.05 percentage point for employers and dependent employees each), limitation to 4 years	120
Increase of the upper earnings limit for health insurance contributions for dependent employees (+ € 90 to € 3,540 per month)[1]	30
Increase of hospital fees (+ € 2.02 to € 10 per day), entitlement of states	maximum 15
Increase of prescription fees (+ € 0.10 to € 4.45)	10
Cut of allowances for glasses and contact lenses	35
Total volume (maximum) p.a.	300

Source: Federal Ministry of Finance. – [1] + € 105 for self-employed.

Agreement on the financing of hospitals

A special agreement was made to secure the financing of hospitals. The hospital financing package will amount to additional revenues and expenditure cuts of an annual maximum of € 300 million[9] (Table 7). In addition to an increase of the tobacco tax, the package includes the increase of fees and of health insurance contributions as well as cuts in medical services. These measures, which will be borne to a large part by private households, will partially compensate the tax cuts of the 2004-05 tax reform (€ 2.1 billion altogether) and will therefore reduce the expected positive impulse on GDP somewhat. At the same time, the increase of health insurance contributions will raise supplementary labour costs. The financing package is to be allocated equally to the state funds for hospital financing and to the social

[9] The states may decide on the increase of hospital charges.

security institutions. It is to be complemented by measures to dampen costs and to increase efficiency in the health sector amounting to the same volume.

Horizontal distribution of subnational revenue shares

The allocation of states' and municipalities' overall revenue shares to the individual states and municipalities (horizontal distribution) is based on various criteria (Table 8).

Table 8: Criteria for horizontal distribution of revenue shares

	1990	1995	2000	2003
	Percentage shares			
States				
Population	76.7	80.0	80.3	77.2
Fixed apportionment formulas	0.0	5.2	17.7	20.6
Yield	18.9	10.7	0.4	0.4
Others	4.4	4.2	1.6	1.9
Total	100.0	100.0	100.0	100.0
Municipalities				
Population	16.6	14.4	14.0	13.0
Modulated population apportionment	53.4	59.2	58.1	55.8
Fixed apportionment formulas	0.0	0.0	20.3	23.7
Yield	18.7	18.0	7.5	7.5
Others	11.3	8.4	0.0	0.0
Total	100.0	100.0	100.0	100.0

Source: Federal Ministry of Finance, WIFO caluclations.

Total state revenue shares are distributed to the individual states according to population (number of residents), tax yield, fixed apportionment formulas, and other criteria. For the municipalities, these criteria are complemented by the so-called modulated population apportionment, i.e., a multiplier is applied to the number of residents which is increased with municipalities' size. Despite of losing in importance since the introduction of the 2001 Revenue Sharing Act, modulated population apportionment still has the largest weight within horizontal distribution of revenue shares among municipalities. The 2005 Revenue Sharing Act increases the multiplier for the smallest municipalities (up to 10,000 inhabitants) from $1^1/_3$ to 1½, so that the relation between the smallest and the largest municipalities (the latter having a multiplier of $2^1/_3$) will be lowered from 1 : 1.75 to 1 : 1.55. The additional revenues of € 114 million resulting for the smallest municipalities from the increase of the multiplier will partially be compensated by the abolishment of the base payment of € 72.66 per inhabitant. Thus, the smallest municipalities will realise additional revenues of € 61 million net. The losses incurred by the larger municipalities will be compensated by the increase of the need-based federal transfer to sustain or regain a balanced budget already mentioned.

The increase of the multiplier for the smallest municipalities, combined with the abolishment of the base payment, will raise the weight of the modulated population apportionment at the expense of the number of inhabitants. Revenues will be redistributed towards the smallest municipalities, which may decrease the incentives to intensify inter-municipal cooperation that would save costs particularly in the case of public goods and services associated with high fix costs.

Necessities and perspectives for reforming the Austrian revenue sharing system

The 2005 Revenue Sharing Act – as the preceding ones – is tantamount to only incremental changes in existing fiscal relations across governmental levels in Austria. Once again, no changes in the fundamental structure of the revenue sharing system, which would be required for several reasons (see, e.g., *Beirat für Wirtschafts- und Sozialfragen,* 1992, *Rossmann,* 2002), were implemented. Future reforms should aim at the assignment of tasks or expenditures and revenues to the federal levels as well as the design of intergovernmental transfers.

Rethinking the assignment of tasks and expenditures to the levels of government

A more rational design of the Austrian revenue sharing system requires rethinking the existing division of tasks and expenditures among the federal level, the states, and the municipalities, which forms the basis for the distribution of revenues to the individual levels of government. The renegotiation of the revenue sharing agreement after termination of the 2001 Revenue Sharing Act would have offered a concrete

option for such an approach in two areas: first, concerning the health sector (more exactly, the financing of hospitals), and second with regard to the distribution of tasks among the governmental levels. Political reasons impeded the utilisation of this option: due to the linkage of the Revenue Sharing Act and the Stability Pact mentioned above, the Revenue Sharing Act, which primarily governs the revenue-related fiscal relations between the governmental levels, had to be concluded and adopted before concrete and binding expenditure-related reforms could be negotiated.

To secure the financing of hospitals, the financing package mainly increased financial means for hospitals. Only in a second step will expenditure needs and their re-adjustment within measures to increase efficiency and to realise expenditure savings be determined: the envisaged health reform aims at expenditure savings the volume of which is to equal the volume of the financing package. However, if the expected effects are to materialise it is indispensable to concretise expenditure-saving and efficiency-enhancing measures further and to enforce them politically.

Similar problems arise with regard to the distribution of tasks between the three governmental levels, which is intended to be fundamentally reviewed based on the results that are yet to be worked out by the Austrian Convention. Within the revenue sharing negotiations, the negotiators agreed on resuming further negotiations on reform measures (taking into account the suggestions made by the Austrian Convention) in spring 2005, which are expected to allow considerable expenditure savings at the federal and the state level. Currently, however, it is not clear that the work done by the Austrian Convention will bring about concrete results and the political consensus required for their implementation.

Reinforcing the task-orientation of the revenue sharing system

The design of the horizontal revenue sharing system should be guided by a stronger orientation of the revenue sharing system at the assigned tasks and responsibilities. First, certain long-term developments will change the structure of tasks which have to be fulfilled at the municipal level: of particular importance seems the demographic development, which will increase the need for health and long-term care services, but also for child care and (adult) education, as well as the rising need for integration measures caused by immigration and the liberalisation of labour markets. Moreover, the growing differentiation of regional economic structures (*Kramer,* 2004) may result in expenditure needs which may vary across individual municipalities. These changing and differentiating task and expenditure profiles should be taken into account by "special burden indicators" (*Thöni,* 2002), as an additional criterion which attenuates the existing predominance of the number of inhabitants. Second, it has to be examined if and how the increasing suburbanisation will influence the financial needs of core cities and "city regions" and of adjacent municipalities, respectively (*Schönbäck – Bröthaler – Sieber,* 2002).

Strengthening tax autonomy at the subnational levels

Further reform necessities result from the gap between expenditure and revenue responsibilities at the subnational levels of government (*Smekal,* 2002). Tax autonomy at the level of states and municipalities is extraordinarily small in Austria. The subnational levels primarily finance their tasks by shares in shared federal taxes and by intergovernmental transfers (need-based federal transfer to sustain or regain a balanced budget, cost reimbursements, earmarked transfers, financial transfers, etc.), which they cannot influence. Efficiency gains can be expected from reinforcing the link between tasks or expenditures and revenue responsibility at the subnational levels of government (*Bayer et al.,* 2001), which in principle also the Austrian Convention considers necessary[10].

Extending tax autonomy at the lower governmental levels is the precondition for disentangling the tight net of mixed financing and thus the "intergovernmental transfer chaos" (*Thöni,* 2002), which makes the Austrian revenue sharing system more and more intransparent and impedes the identification of its allocative and distributive effects. Finally, the obligation to consolidate state and municipal budgets, which fol-

[10] The *Staatsschuldenausschuss* (2004B), too, in its most recent recommendation, suggests that the tax autonomy of states and municipalities be reinforced and that the responsibilities for expenditure and financing decisions be combined.

lows from the Austrian Stability Pact, requires a larger degree of fiscal autonomy and thus more room for manoeuvre for the subnational governments to influence their revenues.

Regarding tax autonomy, the 2005 Revenue Sharing Act will not bring about any changes on the state level and only minor changes for the municipalities. Municipalities will be allowed to share revenues from the local authority tax in order to consider joint municipal investment undertaken to create or to sustain firm establishments. Moreover, municipalities will be more autonomous in designing parking levies from 2006 on.

While in principle the centralised revenue sharing system should be maintained given its numerous advantages (*Beirat für Wirtschafts- und Sozialfragen*, 1992), it seems advisable to convert certain shared federal taxes into exclusive state or municipal taxes to strengthen the decentralised elements within the revenue sharing system. In particular, the following taxes are suitable as exclusive state or municipal taxes:

- taxes on immobile tax bases, which are not likely to trigger interregional tax competition and thus cannot be eroded in the long run;
- taxes which are not sensitive to business cycle fluctuations, so that they yield stable revenues and thus do not encourage procyclical spending behaviour;
- taxes on tax bases which are not distributed (too) unevenly across regions.

For instance, all property-related taxes (besides the tax on real estate, which already is designed as an exclusive municipal tax, the real estate transfer tax and the tax on vacant plots) could be assigned to the municipalities; at the same time a certain autonomy concerning the tax base and/or tax rate could be granted. Vehicle-related taxes (vehicle tax and duty on vehicles based on fuel consumption) could be considered as exclusive state taxes.

Disentangling intergovernmental transfer relations

The 2005 Revenue Sharing Act does not contribute to the disentangling of intergovernmental transfer relations and the decrease of the strong transfer dependency of states. Thus, on the state level the link between expenditure and financing responsibilities won't be strengthened. In this context, particularly the need-based federal transfer to sustain or regain a balanced budget (besides a fiscal motivation, there is no objective justification for not cutting this transfer), the investment contribution for residential building, environment, and infrastructure, as well as the reimbursement of costs for state teachers have to be discussed. An extended tax autonomy at the subnational levels and the shift of tax revenues from the federal level to states and municipalities, which this change would imply, would be the precondition for replacing federal transfers and reimbursement payments by own revenues.

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A New Revenue Sharing Act and a New Stability Pact for Austria – No Fundamental Changes

Summary

In late 2004, a new revenue sharing system and a new Stability Pact for Austria were adopted for the period from 2005 to 2008. The new Austrian Stability Pact aims at reducing the Maastricht-relevant overall government deficit from 1.9 percent of GDP to a "zero deficit" in 2008. The federal deficit is to decrease from 2.4 percent to 0.75 percent of GDP. States and municipalities are obliged to achieve budget surpluses, which are to increase from 0.6 percent to 0.75 percent of GDP. Particularly for the states and the municipalities, the goals of the new Stability Pact are rather ambitious. The surpluses attained in the last few years partly rest on one-off measures and on the specific design of budgetary transactions (e.g., spin-offs of public entities, property sales, leasing transactions). This consolidation strategy cannot be expected to be sustainable in the long run. The municipalities markedly retrenched on their investment outlays, which may reduce the long-term growth potential.

The new revenue sharing system will not change fiscal relations across governmental levels fundamentally. Several exclusive federal taxes will be converted into shared federal taxes. Most of the shared federal taxes will be distributed vertically according to uniform revenue shares. The promotion of residential building and the system of federal reimbursement of the costs for state teachers will basically remain untouched. The states will receive additional federal transfers for state teachers to the amount of € 12 million per year. A package for the financing of hospitals was adopted, with a volume of € 300 million per year, which is to be matched by savings of an identical volume (health reform). Need-based transfers to states and municipalities will be increased by € 100 million per year each. The multiplier for the modulated population apportionment formula will be raised for the smallest communities, with the effect that financial means will be redistributed towards the smallest communities within the horizontal apportionment of revenue shares across communities. The new revenue sharing system will not reduce the strong dependency of states on federal transfers. Moreover, it will not increase tax autonomy at state and municipal level, which would be another precondition for strengthening the link between expenditure and fiscal responsibility and thus for increasing the efficiency of public spending.