

# Fiscal Federalism in Austria

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## **1. Goals of the existing system, according to existing legal order, design and/or tradition**

The system of fiscal federalism in Austria is relatively complex. This is mirrored by the fact that its relevant provisions can be found in many different layers of Austrian law. At its centre we find the federal constitutional law of 1920 (*Bundes-Verfassungsgesetz – B-VG*). Adopted in 1920, the B-VG is the most important act in the federal constitution of Austria, which consists of numerous federal constitutional laws and federal constitutional law provisions contained in simple federal laws. The B-VG distinguishes between three different territorial units: the federation, the 9 states and the municipalities. Although the B-VG was designed to distribute the competences for legislation, administration and jurisdiction between the federation and the states in all matters, the act does not do so for the field of taxation. Pursuant to Article 13 (1) B-VG, the competences of the federation and the states in the field of taxation will be prescribed in a special federal constitutional law. Based on this provision, the Fiscal Constitutional Law of 1948 (*Finanz-Verfassungsgesetz – F-VG 1948*) was adopted, which will be elaborated on below. Articles 51-52d B-VG govern the budgetary-law framework of the Federation. This framework consists of a layer of three types of federal laws: The Federal Budget Act (*Bundeshaushaltsgesetz – BHG 2013*), the Federal Finance Frame Act (*Bundesfinanzrahmengesetz – BRG*), the (annual) Federal Finance Act (*Bundesfinanzgesetz – BFG*). By contrast, the B-VG does not contain provisions on the budgetary laws of the states and the municipalities. For this reason, the main body of the budgetary-law framework for the states can be found in the form of state constitutional laws. The B-VG sets out the budgets of the federation, the states and the municipalities as being independent from each other. Apart from Article 13 (2) and (3) B-VG, the B-VG does not contain any provision regulating the budgetary framework of the federation, the states and the municipalities. Article 13 (2) B-VG obliges the federation, the states and the municipalities to aim at “an overall balance and sustainable balanced budgets in the conduct of their budgetary affairs”. Similarly, Article 13 (3) B-VG obliges them to “aim at the equal status of women and men in the budgeting”. These two provisions, thus, contain two goals for the budgeting of the federation, the states and the municipalities. Considering that Article 13 (2) sentence 2 B-VG obliges them to “coordinate their budgeting with regard to these goals, one can identify Article 13 (2) B-VG as a fundamental goal

for Austria's system of fiscal federalism. This goal was introduced in 2008. However, it has to be seen against the background of the so-called 'Empowerment Law' (*Ermächtigung des Österreichischen Gemeindebundes und des Österreichischen Städtebundes*)<sup>1</sup>. The Empowerment Law is a federal constitutional law that was adopted in 1998 in order to safeguard Austria's compliance with the EU framework on the budgetary discipline of its member states. The Empowerment Law provides for the possibility of legally binding agreements between the federation, the states and the municipalities to coordinate their budgets with the aim of complying with the EU requirements on budgetary discipline.<sup>2</sup>

The F-VG 1948 sets up the principles of taxation, revenue sharing, cost bearing and intergovernmental transfers and assigns the power to determine which taxes are to be levied by the different territorial levels (federation, states, municipalities), and how the tax revenues are to be shared between them, to the national parliament, more specifically to its first chamber, the National Council or *Nationalrat*. For this reason, the crucial competence to decide on the competence in this field lies in the hands of the simple federal legislator (i.e., the simple majority in the National Council<sup>3</sup>). This dominance is enshrined in § 3 para 1 F-VG, according to which 'the [simple] federal legislator regulates the division of rights and tax revenues between the federation and the states and can grant fiscal transfers from federal funds for their administrative expenses or subsidies for specific purposes'.

As a rule, the federal government opens negotiations with the state governments and representatives of the associations of municipalities about fiscal equalization (*Finanzausgleich*), but there is no constitutional guarantee for this. Thus, although the federation or, more precisely, the simple federal legislator has the *competence-competence* in this area (i.e., the competence to decide on the competence for the sharing of tax revenues in Austria), the federation enters into negotiations with the states and municipalities. Approximately 95 percent of the overall tax revenues are collected by organs of the federal government. Even after taking into account intergovernmental transfers, the bulk of the tax revenues, about 56 percent, goes to the federal government; 22 percent are allocated to the states (the *Länder*), excluding the capital city of Vienna, 9 percent to Vienna (which has a double status as state and municipality), and 9 percent

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<sup>1</sup> Federal Law Gazette I No 61/1998.

<sup>2</sup> See section 5.

<sup>3</sup> Pursuant to Art 31 of the Federal Constitutional Law 1920 (*Bundes-Verfassungsgesetz*, commonly abbreviated and hereafter referred to as B-VG), the adoption of a simple federal law, in general, requires the presence of at least one third of the MPs and an absolute majority of the votes cast. By contrast, the adoption of a federal constitutional law (e.g., the amendment of the F-VG or B-VG) requires the presence of at least half of the MPs in the National Council and a majority of two thirds of the votes cast (Art 44 para 1 B-VG).

to the other 2,094 municipalities.<sup>4</sup> To sum up, fiscal federalism in Austria emphasizes asymmetrically the rights of the federation vis-à-vis the states and the municipalities, which are treated like ‘agents’ by its ‘principal’ (Bös, 1980, pp. 726–8). For a formally ‘federal’ state, this is rather unusual.

The centralization of the system of fiscal federalism mirrors the centralization of the political system. In the scientific literature, Austria is typically described as ‘one of the most centralized [federations] with the constituent units often serving mainly as “agents” and “subordinates” of the federal government’ (Watts, 1999, p. 25), as more a decentralized unitary than a federal state (Öhlinger and Eberhard, 2016, p. 59) or as ‘a federation without federalism’ (Erk, 2004, pp. 3–4). The centralizing features go back to the founding years of the so-called ‘First Republic’ (1920–33). In 1920, the Federal Constitutional Law (*Bundes-Verfassungsgesetz – B-VG*), whose basic principles are still valid today, established a state structure which was federal in form, but centralized in substance as it assigned only minor responsibilities to the sub-national units (Erk, 2008, pp. 17–9; Fallend, 2013, pp. 235–6).

The system of fiscal federalism in Austria follows a restrictive and static understanding of fiscal equalization. The political tasks (competences) of the different territorial units, which are defined in the federal constitution, are taken as given. On this basis, the Fiscal Equalization Laws (*Finanzausgleichsgesetze*), which are passed by a simple majority vote of the National Council for periods of 4 to 6 years, only regulate the distribution of the tax revenues between the federation, the states and the municipalities and further equalization measures (Bröthaler, 2008, p. 214; Bauer and Thöni, 2017, pp. 55–56). They do not account for government expenditures, particularly for social protection, which in 2019 made up 41.6 percent of the overall public expenditures.<sup>5</sup> This creates a mismatch between revenue and expenditure responsibilities, often resulting in an inefficient provision of public services (Bös, 1980, p. 725; Matzinger and Pröll, 2010, p. 95).

The Fiscal Constitutional Law and the Fiscal Equalization Laws lay down only rather abstract, formal goals, like the equivalence between tasks and expenditures, the respect for the financial capacities of the respective territorial units, or balanced budgets. What is missing, however, are explicitly formulated policy goals, e.g., economic, social or environmental goals, and guidelines

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<sup>4</sup> Federal Ministry of Finance (2020). Fiscal Federalism. URL: <https://www.bmf.gv.at/en/topics/budget-economic-policy/fiscal-federalism.html>. See also Section 3.2 below.

<sup>5</sup> In Section 3 below, we provide more details on this issue. See also Statistics Austria (2020). Expenditure of general government by function (COFOG-divisions and groups in million €) 2016-2019. URL: [https://www.statistik.at/wcm/idc/idcplg?IdcService=GET\\_PDF\\_FILE&RevisionSelectionMethod=LatestReleased&dDocName=053271](https://www.statistik.at/wcm/idc/idcplg?IdcService=GET_PDF_FILE&RevisionSelectionMethod=LatestReleased&dDocName=053271).

how these goals are to be accommodated. Instead, the system's history is characterized by a dominance of political power politics, the protection of vested interests and rights, a chaotic, non-transparent interlocking of transfers, a very limited autonomy of the sub-national units, negative incentives for competition between them and lacking evaluation procedures (Bauer and Thöni, 2017, pp. 59–61). The lacking definition of objectives does not destabilise the federal system as such, but it does hinder an efficient provision of public goods and services. Economists have criticized these deficits for decades and called for reforms based on a disentanglement of the interwoven responsibilities of the federal and the state governments and on the principle of 'fiscal equivalence', bringing together the responsibilities for expenditures, revenues and decision-making in one hand (Pitlik and Loretz, 2019, 87–9).

Reforms to create a new system with higher degrees of transparency and responsibility have failed so far. The state governments and the associations of the municipalities have viewed initiatives of the federal government in this direction with suspicion, as barely veiled attempts to supervise the budget decisions of the states and municipalities. On the other hand, most states are not interested in effective instruments of fiscal federalism because they profit from a situation in which they get financed by the federation, while at the same time they are exempt from raising the necessary, unpopular taxes (Bußjäger, 2015, p. 31). Rather than fighting for an extension of their tax autonomy, the states have preferred to fight for higher shares of the distributed joint taxes and of the federal transfers, for which they are not politically responsible (Dirninger, 2003, p. 237; Matzinger and Pröll, 2010, pp. 71–2).

## **2. How has the system emerged over time and what were the major bones of contention?**

### *2.1. Who were/are the driving forces in fiscal arrangements (institutions, relationship between them, 'system' of fiscal federalism)?*

Historically, the driving forces behind the centralization of the political and the fiscal system have been the major political parties. The federalist dynamic, which showed up in the aftermath of World War I, was only short-lived and soon superseded by a party dynamic, characterized by bitter, violent conflicts between the major 'camps' of the Christian Socials and the Social Democrats. The Christian Socials, who were the dominant governing party at the federal level during the First Republic, gradually renounced their traditional pro-federal position in order to curb the influence of the (traditionally more centrally minded) Social Democrats, dominating in the capital city of Vienna, where they tried to build up a model socialist 'state within the state' ('red Vienna') (Weber, 1997, pp. 40–52; Obinger, 2005, pp. 188–95).

After World War II, the need to re-build the devastated economy and to re-establish democracy prompted calls for a strong role of the ‘state’, which was translated by the key political actors, i.e., the major parties as well as leading state politicians, as a call for a stronger *federal* government. This resulted in an increased centralization of economic and social policies (Weber, 1997, pp. 54–5; Dirninger, 2003, 251). For a long time relying on a two-thirds majority in Parliament, which allowed them to change federal constitutional laws,<sup>6</sup> the two governing parties, the People’s Party (ÖVP, the successor of the Christian Socials) and the Social Democrats (SPÖ), changed the distribution of competences between the territorial levels at will. Some constitutional lawyers have regarded the continuous reduction of state responsibilities as a ‘creeping total revision’ of the federal constitution (Öhlinger and Eberhard, 2016, p. 59). As a matter of fact, in this period the states exhibited little individuality or distinct political cultures. Federal law was mostly replicated one-to-one by state legislators, a practice sarcastically labelled ‘rank-xerox federalism’ in the literature (Öhlinger, 2009, p. 52).

The system of fiscal federalism that was re-established in the post-war period was even more centralized than during the First Republic. The Financial Constitutional Law (*Finanzverfassungsgesetz*, F-VG) 1948 entitled the federal parliament to determine the distribution of the tax revenues by ordinary law (requiring only a simple majority) and eliminated safeguarding mechanisms for the states in case their financial position was hampered by federal decisions. In addition, the share of the revenues from joint taxes going to the federal government was increased and, instead of conceding a substantive tax autonomy to the states, the importance of federal transfers was enhanced (Dirninger, 2003, 248–50). Ever since, the system has retained this centralized character, even though since the 1960s the implementation of economic and social policies has increasingly been delegated to the states (Dirninger, 2003, 241, 286).

Critics have argued that a more intensive discussion between the major political actors about the goals of fiscal federalism and its performance would have been useful. As specific, policy-related goals are missing in the Fiscal Constitutional Law, the discrepancies between macro-economic goals and the goals of the different territorial units and their political actors have not even been noticed as a problem. Central criteria applied during the process, like a population-based key for the distribution of the tax revenues that favors larger over smaller municipalities (*abgestufter Bevölkerungsschlüssel*), simply have been prolonged in one negotiation about the Fiscal Equalization Law after another without discussing substantively what specific effects these criteria have on general living conditions (Bös, 1980, pp. 723–4).

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<sup>6</sup> Cf. Art 44 para 1 B-VG.

In addition, quite often major reforms are enacted by one territorial level without including representatives of affected other (usually lower) levels in the decision-making process, leading to inefficient solutions or problems. In 2013, a goal-oriented approach was introduced in health policy, where responsibilities and financing are organized in a particularly complicated way. Although the municipalities have important functions regarding child-care and sports facilities, they were not included in the relevant decision-making commissions. In the same vein, the federal parliament decided in 2017 to abolish the obligation of relatives to contribute to the costs of places for older people in care institutions without sufficiently considering the ensuing financial burdens for the states and the municipalities (Bauer and Biwald, 2019, pp. 63–9).

## 2.2. *Had there been ‘constitutional moments’ (wars etc.)?*

The collapse of the Habsburg monarchy at the end of World War I was undoubtedly the major constitutional moment for creating the Austrian Federal Constitution. With the main Federal Constitutional Law (B-VG) adopted in 1920, the Austrian Federal Constitution still follows the basic design shaped in the early 1920s. The Austrian authoritarian regime of the *Ständestaat* (1934–38) and the Nazi regime (1938–45) did not result in the adoption of a completely new Federal Constitution in 1945. The political parties decided to go back to the B-VG 1920, as amended in 1929. Tellingly, when drafting the articles on the separation of competences between the federation and the states, the founders of the B-VG 1920 only agreed to enact a special federal constitutional law on taxation issues later. This was done by means of the Financial Constitutional Law 1922, which in many respects resembles the current F-VG (1948). Already in 1922, the dominant position of the simple federal legislator was noticeable. The dominant position of the federation dates back to the Habsburg monarchy. Interestingly enough, it was the constitutional period (from 1867 onwards) of the Habsburg monarchy which saw the steady decrease of fiscal powers of the states, with autonomous state taxes such as spirits taxes (1901) being abolished and replaced by transfers from the central level. At the same time, the fiscal powers of the central state rose. The decisive turning point has been identified as the introduction of the central income tax in 1896. Under this system, the states were becoming more and more dependent on transfers from the central level. Thus, the Monarchy lay the roots for the current system of fiscal federalism in present-day Austria (Pernthaler, 1984, p. 111–2).

### 2.3. Relation of Austria's 'system' of fiscal federalism to its model of democracy

Although the federal government is not obliged to negotiate fiscal equalization with representatives of the states and the municipalities, and although the National Council has the right to pass the Fiscal Equalization Laws on its own, these laws would be hardly enforceable against the declared will of the most powerful of the regional decision-makers, that is the State Governors (Matzinger and Pröll, 2010, pp. 73–4). The State Governors (*Landeshauptleute*), who are elected by a majority of the members of the respective state parliaments, are the most powerful figures of state politics. They have an outstanding constitutional status (government head, head of the state bureaucracy, responsible agent for the so-called 'indirect federal administration', informal 'head of state') and, as leaders of the dominant party in the state and focus of media interest, they also dispose of major political resources (Fallend, 2006, pp. 979–981, 2010a, p. 182). By way of the informal Conference of the State Governors (*Landeshauptleutekonferenz*), which in effect has replaced the second chamber of the National Parliament (the Federal Council, *Bundesrat*) as primary institution for the representation of state interests,<sup>7</sup> the State Governors exert considerable influence at the federal level as well (Bußjäger, 2003; Karlhofer, 2011). Especially in the field of fiscal federalism, they act as 'relatively efficient counterbalance to the weight of the federal order of government' (Bußjäger, 2015, p. 16; cf. Matzinger and Pröll, 2010, pp. 74–5).

So far, all Fiscal Equalization Laws passed by the National Council have been supported by the states and the municipalities. The underlying pacts between the federal government, the state governments and the representatives of the associations of the municipalities have been interpreted by the Constitutional Court (*Verfassungsgerichtshof*) as proof that the financial capacities of the sub-national units have in fact been respected, as stipulated by the Fiscal Constitutional Law<sup>8</sup> (Matzinger and Pröll, 2010, p. 67; Öhlinger and Eberhard, 2016, p. 132).

Thus, the practice of Austria's system of fiscal federalism resembles the traditional, consensus-oriented style of political decision-making in Austria, called 'consociationalism' (*Konkordanzdemokratie*). This style is characterized by a general tendency of the political elites to attempt to reach consensus, to refrain from decisions before not all relevant actors have had a chance to articulate their positions and to use majority decisions only as last resort (Lehmbruch, 1967; Gerlich and Pfefferle, 2006, pp. 502–3). The so-called 'Consultation Mechanism', initiated

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<sup>7</sup> The status of the *Bundesrat* is discussed in more detail in section 8.3.

<sup>8</sup> See § 4 F-VG: 'The provisions foreseen in §§ 2,3 F-VG [i.e., the provisions contained in the Fiscal Equalization Law] shall be in conformity with the distribution of burdens of public administration and shall consider that the limits of capacity of the (...) [federation, states and municipalities] shall not be exceeded.'

in 1999, which legally obliges the federal and state governments to consult each other if they intend to pass a law that imposes financial burdens on the other territorial unit, is another example of this ‘federalism by negotiation’ (Bußjäger, 2015, p. 16). From a legal and democratic point of view it can be criticised that a body that is not even mentioned in the Federal Constitution – the Conference of the State Governors – has such an influential status. In this respect, the Conference is comparable to ‘Social Partnership’, the Austrian variant of neo-corporatism, which in the past has often acted as major player in economic and social policies, although it was not until 2007 that it was incorporated in the Federal Constitution (cf. Karlhofer, 2015, p. XXIV).

### **3. What are the distribution mechanisms regarding revenues and expenditures?**

#### *3.1. Revenue autonomy (tax base and tax rate)? Does it exist? For which level in the federation?*

Austrian fiscal federalism assigns only a very limited revenue autonomy to the sub-national units, and, in turn, large revenue competences to the central level (i.e., the right to establish new taxes and to assign the administering rights as well as the corresponding revenues to the sub-national units). Due to the dominance of the federation under § 3 F-VG, the states and municipalities are allowed to determine the tax base and/or the tax rate only for fees and smaller taxes (Pitlik *et al.*, 2012). The limited role of lower-tier jurisdictions in deciding to raise taxes and in designing the details of tax collection also translates in a low revenue share compared to the central level (Figure 1). Accordingly, the revenue shares of the states and local municipalities lie around 10 to 15 percent, a share that has remained more or less stable over the last decades (Dirninger, 2003, 250–1). The social security funds (SSF) are primarily financed by earmarked and income-related contributions of employers and employees under a pay-as-you-go-system. Its revenue share is around 25 percent, with a slight upward trend in recent years.



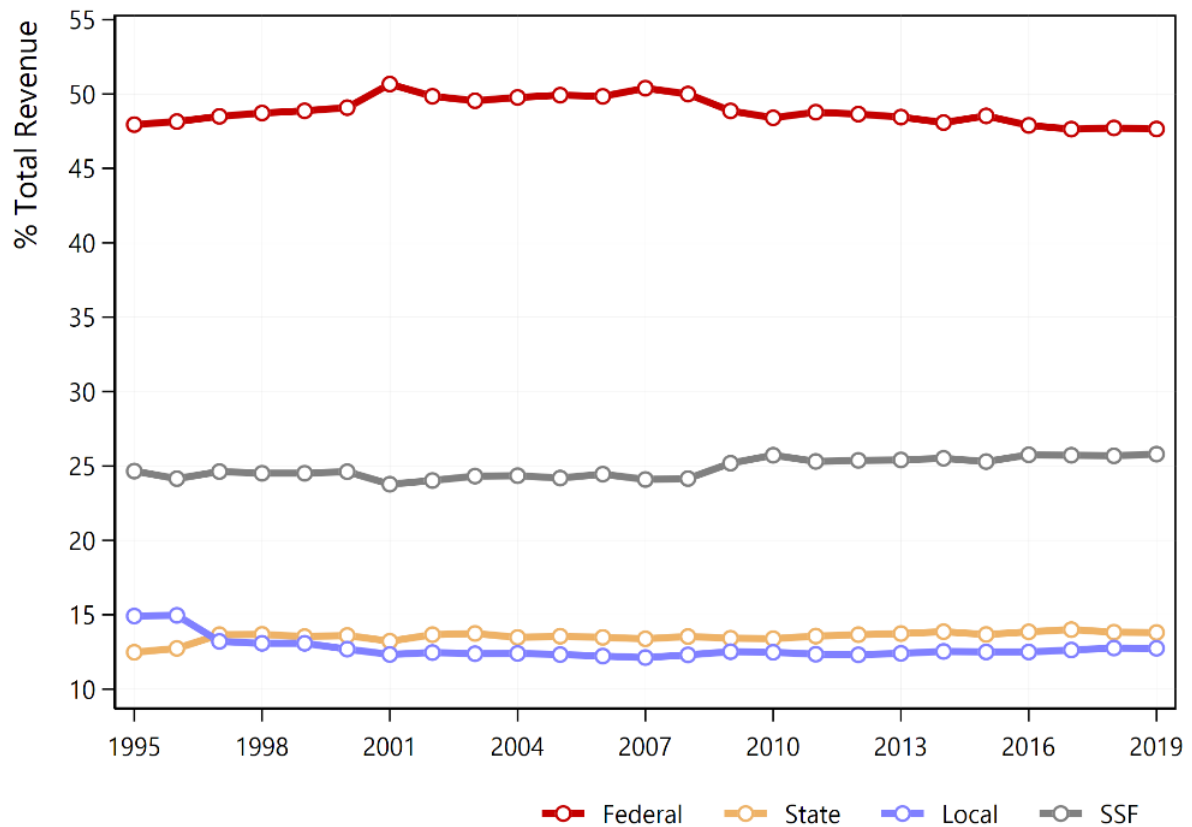


Figure 1: Revenue shares of federal, state and local jurisdictions as well as the social security funds on total tax revenue in Austria (Source: Eurostat database, own calculations)

### 3.2. The role and function of social security mechanisms (pensions, health care, unemployment)

Figure 2 shows the expenditure shares of the federal, state and local level as well as the SSF compared to the total public expenditure in Austria. First, we can see that the federal state disposes of about 50 percent of all expenditures. The corresponding shares of the state and local levels are relatively low, which mirrors the low revenue shares of these units (Figure 1).

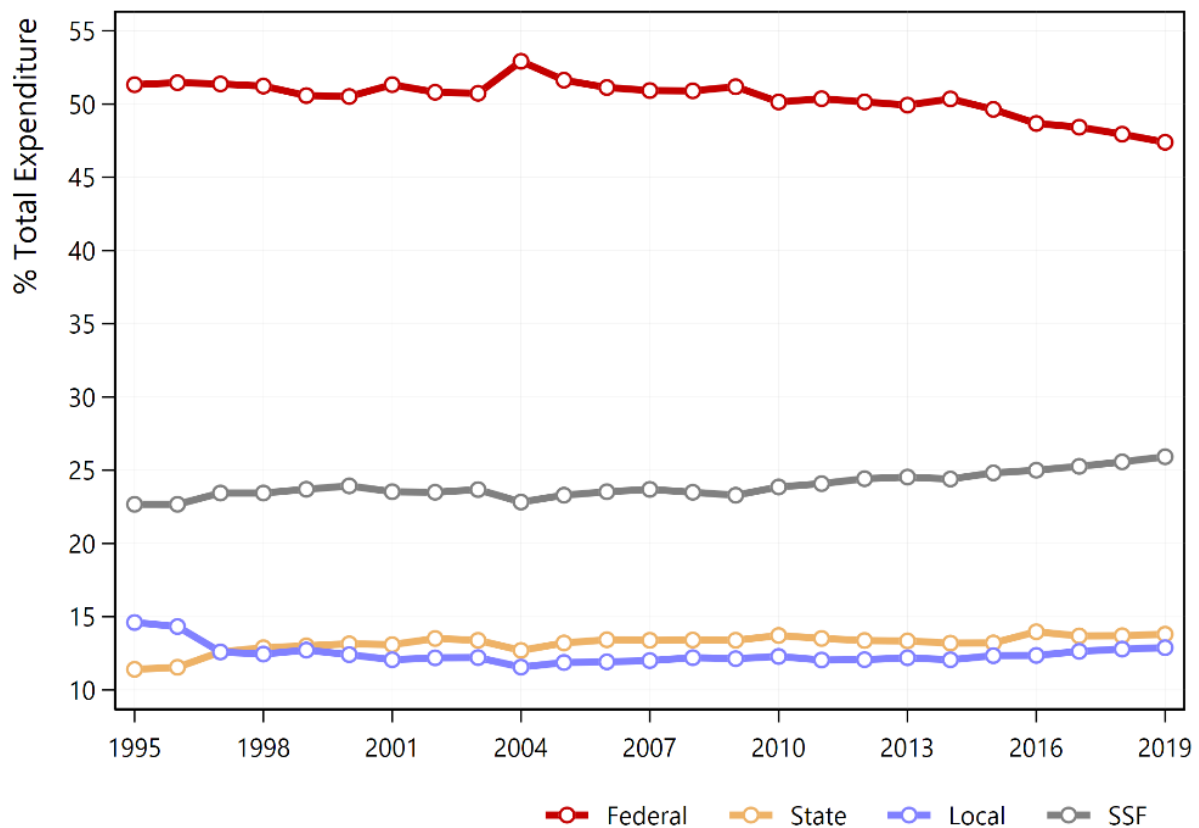


Figure 2: Expenditure shares of federal, state and local jurisdictions as well as the social security funds on total tax revenue in Austria (Source: Eurostat database, own calculations)

Again, we observe a larger and increasing expenditure share of the SSF, which is an autonomous institution in Austria. It covers a mandatory insurance for pension, health and occupational accident and today is organized in five (until 2018 in 22) insurance institutions. The unemployment insurance is also part of the social security system. It is organized in a separate administrative body and is financed by compulsory contributions from employees and employers. All the benefits of the social security system are financed by own contributions. The only exemption is the pension insurance, which receives public subsidies in case of deficits. The share of state pension subsidies on the total expenditures for pensions is about 20 percent (BMASK 2020, p. 68).

Although the federal level is clearly dominant in the regulation of social security policies, the states and, to a lesser degree, the municipalities have residual competences. What is more, they play an important role in the administration of the respective federal laws. As a result, public policy in these areas is characterized by a high degree of interwovenness between the territorial levels, necessitating constant and comprehensive coordination to function properly. This system

of ‘(cooperative) implementation federalism’ may, in theory, profit from the closeness of the responsible administrative bodies to the citizens so that their decisions can be tailored to the citizens’ preferences in the respective regions or local communities. In Austria, however, it is predominantly a system of hierarchical steering, in which typical principal-agent problems, like a lack of congruence between political and administrative goals or deficient information flows, occur rather often. Especially in the field of indirect federal administration (see below) divergences of interests and information asymmetries between the decision-making bodies of the involved territorial levels can be expected (Pitlik and Loretz, 2019, pp. 90–5).

#### **4. How are fiscal mechanisms related to the distribution of ‘substantive’ competences?**

As regards substantive competences (to be understood roughly as competences other than those on fiscal issues), it is remarkable that the Austrian Federal Constitution draws a line between the financial constitution and the other constitutional provisions on the separation of competences between the federation, states and municipalities. While the financial constitution is governed by a special federal constitutional act in form of the above-mentioned *Finanzverfassungsgesetz* (F-VG) 1948, the other provisions on the separation of competences between federation and states are contained in the B-VG and, thus, in the main federal constitutional act, primarily in Arts 10–15 B-VG. Under this system, it is either the federation or the states that is/are competent for legislation and/or public administration in a specific area.<sup>9</sup> By means of simple federal or state laws the competences for public administration may be conferred on municipal authorities.<sup>10</sup> Under this system, the most important competences in the field of legislation and public administration are in the hands of the federation. However, as regards public administration, not all of these areas are also administered by federal authorities themselves (i.e., direct federal administration). Apart from areas such as the maintenance of public security, military affairs, customs, asylum and administration of justice, most of the areas falling in the competence of federal public administration are administered by state authorities under the supervision of the competent federal minister (i.e., the indirect federal administration).<sup>11</sup>

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<sup>9</sup> For example, pursuant to Art 10 para 8 B-VG 1920, the federation is competent for the legislation and public administration in matters pertaining to trade and industry. That is why the relevant provisions are contained in a single federal law (i.e., *Gewerbeordnung* – the Austrian Commerce Code). Furthermore, the federation is competent for the public administration of the Austrian Commerce Code.

<sup>10</sup> A prominent example is building. Each state has its own building codes (i.e., state building laws). In general, the public administration of building rests with the municipalities. Therefore, it is usually the mayor of a municipality who has the competences to decide upon the issuing of building permissions.

<sup>11</sup> That is why the Austrian Commerce Code is actually administered by state and certain city authorities (i.e., district administration). If somebody wants to take up, for example, the business of a restaurant, this person has to register it with the competent district administration authority.

As a result, state and municipal authorities are considerably engaged in the field of federal administration. This raises the question of which level has to bear the costs for this system. The answer to this question can be found in § 2 F-VG. According to this provision, the federation, states and municipalities have to cover the expenses caused by the execution of their tasks unless provided otherwise by the competent legislator. Pursuant to § 2 F-VG, the federation, therefore, would also have to bear the costs for the areas of indirect federal administration, because these areas – though being actually administered by state authorities – are, legally speaking, tasks of the public administration of the federation. However, § 2 F-VG allows for divergent provisions taken by the competent legislator. This being said, it needs to be mentioned that the simple federal legislator has included a provision in the Fiscal Equalization Law (§ 1 para 1 FAG), according to which the states have to bear the costs for staff and material expenses in the field of indirect federal administration. Thus, § 1 para 1 FAG again shows the dominance of the federation in the field of the fiscal constitution, which finds its expression, above all else, in § 3 F-VG. Despite this, the power of the simple federal legislator is not without constitutional restrictions. § 4 F-VG states: ‘The provisions foreseen in §§ 2,3 F-VG [i.e. the provisions contained in the Fiscal Equalization Law] shall be in conformity with the distribution of burdens of public administration and shall consider that the limits of capacity of the (...) [Federation, states and municipalities] shall not be exceeded.’ Therefore, by means of a Fiscal Equalization Law, the federal legislator may not overburden the respective territorial levels. In such a case, the respective provision would violate the federal constitution and could be annulled by the Austrian Constitutional Court.

In order to make sure that such overburdening does not take place several instruments have been developed: First, as mentioned above, prior to the adoption of a Fiscal Equalization Law, informal intergovernmental negotiations take place. Though this pact does not have the character of a legally binding treaty, it is nevertheless of importance, though the consensus of the different territorial levels shows that the Fiscal Equalization Law modeled on the pact is presumably in accordance with §§ 2,3 F-VG and, therefore, not unconstitutional.

Second, there is also the more formal instrument of the Consultation Mechanism. As its name implies, the Consultation Mechanism is basically about information exchange concerning legislative measures of one territorial level (e.g., federation) possibly producing costs for other territorial levels (e.g., states or municipalities). The Consultation Mechanism is a legally binding treaty between federation, state and municipalities, based on the Empowerment Law. Under this system, the federation/the states have to send their drafts of laws and administrative regulations to the other territorial levels. This has to be done together with an assessment of the fiscal effects of the prospective acts. The Consultation Mechanism is not only a tool for the sake of information.

Each of the involved territorial levels can call for negotiations in a consultation committee. If a consensus cannot be reached in this procedure, the territorial level that has adopted the respective act, as a rule, has to cover the costs related to its administration (Berka, 2018, pp. 138–9). It may be assumed that the mere existence of the Mechanism prevents, or at least reduces the likelihood of, excessive financial burdens for the lower territorial units. Conflicts arising out of the Mechanism are to be resolved by the Constitutional Court. However, the Court only very rarely has been appealed to in this matter. In 2014, e. g., it stipulated that the Mechanism had been violated by the federal government in the case of costs for railway crossings in the municipalities (Bußjäger, 2015, p. 16–7).

To conclude, the overwhelming power of the simple federal legislator is nevertheless limited. These limits take the form of constitutional provisions but also of political restraints (i.e., the political power of the states and their governors).

#### **5. How is control of financial stability exercised on the various levels? Ability and autonomy/limits for borrowing?**

The Austrian territorial levels have the power to borrow. There is no debt break in the Federal Constitutional Law, as a recent attempt to create such a provision failed in the fall of 2019. Thus, from a constitutional perspective, the states do not need the approval of the federation before making debts. In addition, there is also no control of state debts by the federation. By contrast, the fiscal room of manoeuvre of the municipalities is more limited. According to § 14 F-VG, the incurring of debts by the municipalities is governed by state laws. Thus, there is some sort of control of municipal debts by the states.

However, with Austria's accession to the European Union in 1995, it was necessary to develop a system in order to comply with the requirements of fiscal discipline under the EMU-framework of the EU. Prior to the 3<sup>rd</sup> stage of EMU (01 January 1999), Austria had to find a way on how to avoid excessive government deficits (now: Art 126 para 1 TFEU), an obligation that refers to government expenditures at all levels and comprises central, regional or local government as well as social security funds, to the exclusion of commercial operations (Art 2 first indent EDP Protocol). The problem was that under the Federal Constitution the competences for public expenditure and revenues are divided between the federation, the states but also the municipalities. In brief, there is no single competence for regulating the government sector. Instead, there is a bundle of competences of actors forming the government sector.

The approach chosen by the federal constitutional legislator was to coordinate the legal entities belonging to this sector. This was done by a special federal constitutional law: the above-mentioned 'Empowerment Law'. The Empowerment Law provides for the possibility of legally binding agreements between the federation, the states and the municipalities. Non-compliance with such agreements could be controlled in a special procedure before the Constitutional Court, which can be called upon by the contracting parties.<sup>12</sup> So far, this has never happened.

Besides the Consultation Mechanism, the Empowerment Law also provided for the conclusion of the Austrian Stability Pact.<sup>13</sup> This pact contains the obligations of the territorial levels to meet the criteria of budgetary discipline imposed by EU Law on the public households of Austria (i.e., federation, states, municipalities). Thus, the Austrian Stability Act is the main tool to safeguard compliance with Art 126 TFEU and the European Stability and Growth Pact (SGP). Since then, several Austrian Stability Acts have been passed, with the Austrian Stability Act 2012 being the most recent one.<sup>14</sup>

It has to be pointed out that the competence to implement EU law (as well as public international law) follows the general division of legislative/executive competences between the federation and the states. This is why the Austrian Stability Pact 2012 coordinates the respective competences of the federation, the states and the municipalities<sup>15</sup> in the field of budgetary law. In order to meet the obligations imposed by European law, the Austrian Stability Pact 2012 was agreed upon. Art 4 ASP 2012 contains a rule to transpose Art 3 of the European Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) – the debt break – into Austrian law.

Art 4 ASP 2012 is referred to as Austrian debt break, a rule that splits up the structural deficit allowed under Art 3 TSCG among the federation, the states and the municipalities. The overall structural deficit shall not exceed 0.45 per cent of the gross domestic product, which shows that the Austrian debt break is even stricter than Art 3 TSCG. Although Art 4 ASP 2012 ranks below Federal Constitutional Law, this provision is binding on the federation, the states and the municipalities as contracting parties when they take decisions on their respective budgets. Consequently, the National Council, being an institution of the federation, as federal budgetary

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<sup>12</sup> The key provision is Art 138a para 1 B-VG, according to which the Constitutional Court can be requested to decide whether such an agreement exists and whether the obligations arising from such an agreement, except as far as it is a matter of pecuniary claims, have been fulfilled. For pecuniary claims Art 137 B-VG is applicable.

<sup>13</sup> The terminology is reminiscent of the Stability and Growth Pact at the EU level.

<sup>14</sup> Federal Law Gazette I No 30/2013. In section 8.2 below, we show some figures on the division of debt between the Austrian jurisdictions.

<sup>15</sup> The states have the competence to adopt the legislation for the set-up of local communities.

legislator is bound by Art 4 ASP 2012. As the ASP is to be regarded as lacking direct effect, a federal law violating the ASP is not unconstitutional. Because of this, a party, like a state, cannot make an application to the Austrian Constitutional Court to declare, for example, the annual federal budget (which is adopted as a simple federal law) as unconstitutional.

For these reasons, other ways of ensuring compliance with the ASP were created: In order to ensure the compliance with the Austrian debt break (and other ASP 2012 provisions), the ASP 2012 set up a Committee, involving representatives from the contracting parties, that can sanction ASP 2012 violations. As a last resort, it is also possible to bring such a dispute before the Austrian Constitutional Court. However, this mechanism has not been used yet. Also, the recent fine imposed on Austria for the manipulation of the debt data in the state of Salzburg<sup>16</sup> has not triggered a sanction procedure under the ASP 2012 yet.

Another important step was the creation of the Austrian Fiscal Advisory Fiscal Council<sup>17</sup> (*Fiskalrat*) by a simple Federal Law.<sup>18</sup> The Fiscal Council is an expert body with monitoring tasks concerning the fiscal policies in Austria. Apart from that, the Fiscal Council can also make recommendations on fiscal policy and carries out fiscal policy studies. The Fiscal Council is independent,<sup>19</sup> a feature that shows that the Fiscal Council is designed to be the independent body in the national budgetary surveillance framework as required by Art 5 Regulation 473/2013/EU. Since its inception, the Austrian Fiscal Advisory Fiscal Council has been very active in performing its tasks and has produced several studies and recommendations.<sup>20</sup>

## **6. What is the role of the concept of solidarity?**

Solidarity, defined as the mutual duty of assistance of federal units in budgetary emergencies, is not explicitly laid down either in the F-VG or in the B-VG (Sutter and Pfalz, 2017, p. 600). However, the F-VG at least implicitly contains this notion for two reasons. First, by determining the financial resources needed by the fiscal authorities to provide public goods and services. Apart from this financing function, an intergovernmental equalization can also be derived from the notion of realizing somewhat equivalent living conditions (see Section 8 below on this issue). The pooling of tax revenues and their subsequent distribution among the territorial authorities might

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<sup>16</sup> Council Implementing Decision (EU) 2018/818 *imposing a fine on Austria for the manipulation of debt data in Land Salzburg*, O.J. L 137/23.

<sup>17</sup> See also <https://www.fiskalrat.at/en> (03.04.2019).

<sup>18</sup> Federal Law Gazette I No 143/2013

<sup>19</sup> Section 1 para 2 Fiscal Council Act.

<sup>20</sup> See <<https://www.fiskalrat.at/en>> (03.04.2019).

be viewed as one approach to achieve this goal. The resulting definition of a minimum level of public services mainly demonstrates the solidarity in the Austrian federalism (Sutter and Pfalz, 2017).

Several studies have demonstrated that the system of financial equalization has a levelling effect between ‘net payers’ and ‘net receivers’ among the states (Dirninger, 2003, 243). Overall, the system brings about a strong redistribution from the richer to the poorer municipalities (Bröthaler, 2008: 235–36). Now and then, the redistribution mechanism between the municipalities has created conflicts between the two associations representing their interests. While the Association of the Austrian Cities (*Österreichischer Städtebund*) favors higher transfers to bigger municipalities, arguing that because of their function as regional centres they have disproportionately higher expenditures, the Association of the Austrian Municipalities (*Österreichischer Gemeindebund*), comprising above all smaller municipalities, opposes this argument (Matzinger and Pröll, 2010, p. 84).

## **7. ‘One size fits all’ monetary policy**

As monetary policy falls in the exclusive competence of the EU, Austria no longer has competences in this field. Monetary policy is conducted by the European Central Bank.<sup>21</sup> The Austrian National Bank only organizes the money supply in the Austrian economy. Thus, there is no monetary policy competence at the level of the states and municipalities, which can be justified by the public goods character of monetary policy.

## **8. Merits and deficiencies of Austrian Fiscal Federalism – measured against its ‘goals’**

### *8.1. Impact on equalization in the federation*

In contrast to Germany, where the uniformity of living conditions is explicitly laid down in the constitution (*Grundgesetz*), the Austrian federalism lacks a formal statement of fiscal equalization (Sutter and Pfalz, 2017, p. 498). However, there are also weak elements in the Austrian fiscal federalism that are intended to balance living conditions, especially covered by special funds for financially weak municipalities in rural areas (*Finanzzuweisungen*). However, these funds are allocated on a discretionary basis and not according to clear rules, making it hard to show empirically how they have contributed to a financial equalization between municipalities. Apart

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<sup>21</sup> Even before joining the Eurozone, the monetary competences were exclusively with the Austrian National Bank. Therefore, also in this period the states and municipalities had no competences in monetary policy.



from this, a significant equalization effect is not to be expected due to the low quantitative significance of these funds.

8.2. Macro-economic effects on the federation and its entities

As shown in Figures 1 and 2, most of the budget responsibilities are held by the federal state. In addition, Figure 3 shows that the bulk of the annual net deficit is attributable to the central government. States and local municipalities can only get into debt within very narrow limits that are consistent with the requirements of the Austrian Fiscal Pact. From this, one would expect only moderate macroeconomic effects of their fiscal policies.

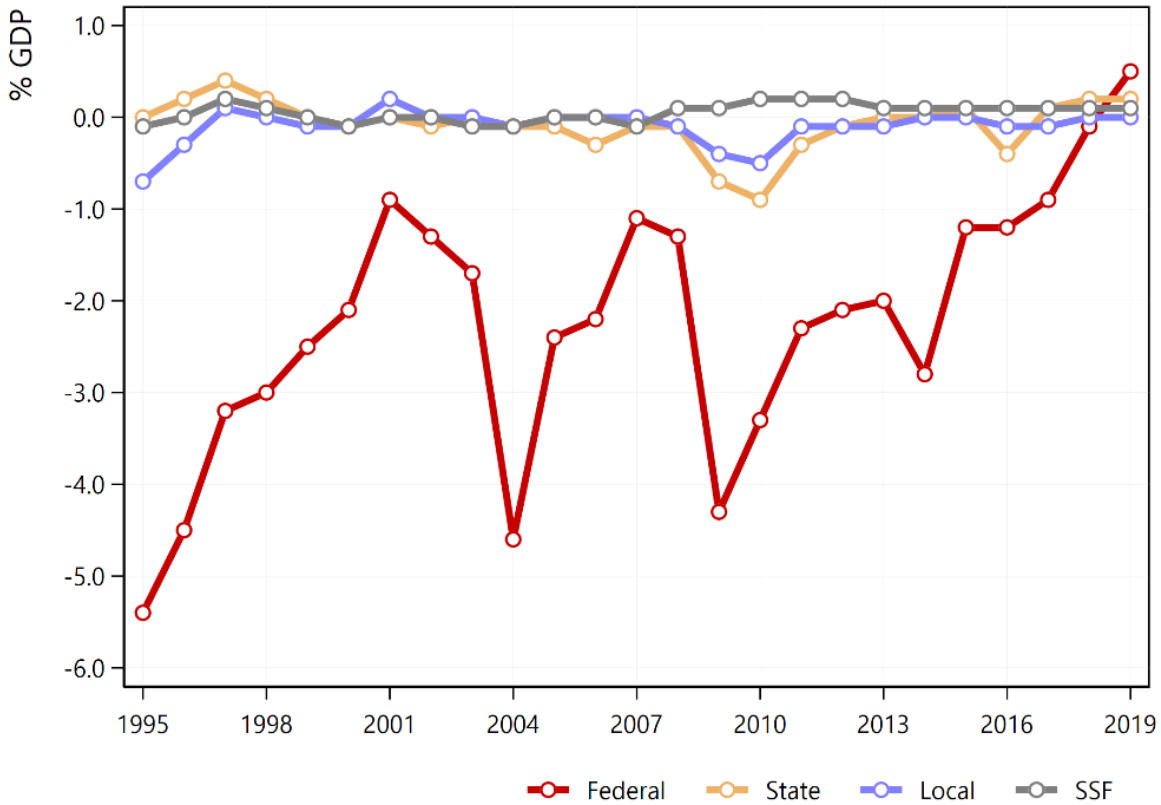


Figure 3: Net deficit shares of federal, state and local jurisdictions as well as social security funds in Austria (Source: Eurostat database, own calculations)

8.3. The system’s democratic legitimacy

The Fiscal Equalization Laws as the primary output of the system of fiscal federalism are legitimized by the fact that they are passed by the democratically elected National Council. As the enactment of these laws is preceded by negotiations between the federal government and representatives of the states and municipalities, it can also be claimed that they are based on the

support of the sub-national units – even though ‘[i]n reality, the *Länder* and the local governments have no real alternative but to accept the determination of fiscal relations by the federal government’ (Bußjäger, 2015, p. 30).

From a constitutional and political perspective it seems also problematic that the whole process is heavily dominated by the executives of the involved territorial units, with little or no participation of the respective parliaments. The second chamber, the Federal Council, which is designated by the federal constitution to represent the interests of the states, is in no position to fulfil this task. On the one hand, in general it cannot veto, but only delay bills passed by the first chamber, the National Council. On the other hand, its members are not directly elected by the people, but delegated by the state parliaments. As a consequence, they are more dependent on the political parties that have nominated them than their counterparts in the first chamber, the National Council. Most of them seem to view themselves less as representatives of their states than as representatives of their parties, which also dominate the decision-making process in the second chamber. The parliamentary groups of all parties are characterized by high party discipline. In each party the positions and decisions of the members of the parliamentary groups of both National and Federal Council are determined in common sessions. As a result, in the law-making process the Federal Council is clearly subordinated to the National Council (Fallend, 2010b, pp. 176–80; Karlhofer, 2015, p. 25).

To what extent the system of fiscal federalism is supported by the Austrian citizens is hard to tell. General surveys dealing with questions of federalism are rare; surveys dealing with questions of *fiscal* federalism are completely missing. A survey of 2009 found that, on average, 40.3 percent of the respondents felt emotionally attached primarily to Austria (as a nation), 20.4 percent to their municipality, 19.9 percent to Europe and 19.3 percent to their region (*Land*) (Bußjäger and Seeber, 2010, p. 34). A survey in 2019 showed similar trends: 37 percent of the respondents stated that they feel primarily as citizens of Austria; 24 percent named their municipality, 16 percent the European Union and 14 percent their state (the rest did not answer the question) (Perlot, 2020, p. 150). As far as the evaluation of the federal system is concerned, a survey carried out in 2017 revealed that only 27 percent of the respondents agreed that the federal system (defined as ‘distribution of competences between several levels’) works very or rather well, while 55 percent qualified its workings as rather bad or very bad (Filzmaier, 2020, p. 141).

#### 8.4. Control

Although Austria's system of fiscal federalism, in many respects, is the product of informal, legally non-binding negotiations between the different territorial levels, the core elements of this system (i.e., the F-VG, the Fiscal Equalization Laws, the Consultation Mechanism and the ASP) take the form of legally binding instruments. However, this does not mean that compliance with the legal duties of the territorial levels can be fully controlled by the Austrian Constitutional Court. There are a series of rulings on whether or not a certain provision in a Fiscal Equalization Law (i.e., a simple federal law) complies with the F-VG or other parts of the federal constitution. Hereby the aforementioned § 4 F-VG is of prime importance, for it restricts the margin of manoeuvre of the federal legislator obliging it to take into the consideration the distribution of burdens of public administration and the limits of capacity of the territorial units. However, in its settled case law<sup>22</sup> the Constitutional Court holds that the federal constitution grants a large room of appreciation to the federal legislator and only imposes little substantive barriers on it. The Constitutional Court stresses the importance of informal negotiations before the adoption of a FAG: If the FAG has been adopted after such negotiations, one may assume that the requirements of § 4 F-VG, as a rule, are complied with. More importantly, these cases can be read in a sense that the federation is obliged to enter into informal negotiations with the other territorial units. The existing case-law does not deal with constellations in which there have not been any negotiations at all. Rather, the case law concerns constellations in which a FAG has been adopted although there has not been reached a full consensus on all points. But even this does not necessarily lead to a violation of § 4 F-VG. In such a constellation, the Constitutional Court will engage in an individual assessment, which does not mean, however, that the Constitutional Court examines the contested provision in the FAG in a particularly strict manner - an aspect which is criticized in the literature (Kofler, 2011, para 10).

Likewise, there are also a few cases concerning compliance with the duties under the Consultation Mechanism. By contrast, there are no such rulings as regards the compliance of the territorial levels with the ASP. This is due to the fact that compliance with the ASP shall be safeguarded by means of committees, an instrument that in many respects is a sleeping beauty. To conclude, the picture of control in this system is rather inhomogeneous.

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<sup>22</sup> This case law started in 1990 in a case dealing with the staged population key in the FAG, see VfSlg 12.505/1990.

### 8.5. *Legitimacy and efficiency of conflict resolution*

The system of fiscal federalism in Austria is very stable, if not static. About 85 percent of the total revenues fall under the category of the joint federal taxes. They are distributed between the different territorial levels according to uniform keys, which basically do not change over time (Matzinger and Pröll, 2010, pp. 75–8). As mentioned above, the fact that the Fiscal Equalization Laws are regularly negotiated between representatives of the different levels gives legitimacy to the system and provides for efficient conflict resolution.

However, it may be doubted whether this ‘efficiency’ can be claimed under economic terms as well. A general problem is that inter-governmental transfers have reached such amounts and their structure is so complex and non-transparent that even economists, let alone political decision-makers, have major difficulties in determining their allocative or distributive impacts (Bauer *et al.*, 2012, p. 947). What is more, since the 1970s federal governments have increasingly resorted to making transfers to state governments for specific purposes or projects dependent on co-financing by the latter. As a result, the transfers have become a dirigiste instrument in the hands of the federal government, and competition among the state governments for their allocation has increased. Quite frequently, such transfers have been allocated less on the basis of clear national policy goals, objective criteria or needs, but for (party) political reasons. In the long run, the limited tax autonomy of the states and their growing dependence on federal transfers have impeded rational fiscal policies and increased the danger of liquidity problems in the state budgets (Dirninger, 2003, 236–41, 276).

The financial grants (*Finanzzuweisungen*) of the federal government to the municipalities with below-average financial capacity may serve as an example for an obviously inefficient result: According to calculations of the Ministry of Finance, only about 40 percent of these grants reach the targeted municipalities. The rest is distributed by the governments of the financially better-off states to ‘their’ municipalities. As a consequence, it is missing in structurally weak regions, especially in the states of Burgenland, Carinthia and Styria (Matzinger and Pröll, 2010, pp. 89–90). The low amount of the means for the financially disadvantaged municipalities, the lack of solidarity between the states and the complicated regulations are listed in the literature as reasons why the envisaged equalization between richer and poorer municipalities works only to a limited degree (see, e. g., Sutter and Pfalz, 2017, 585). The fact that the teachers in the compulsory primary and secondary schools are financed by the federal government, but are employees of the respective state government, is often cited as classic example for the unwelcome incongruence

between task, expenditure and revenue responsibilities (Matzinger and Pröll, 2010, pp. 96–7; Bauer *et al.*, 2012, p. 948; Bußjäger, 2015, p. 30; Sutter and Pfalz, 2017, pp. 564–5).

## **9. Covid-19 Crisis – testing the resilience of fiscal federalism**

The outbreak of the Covid-19 pandemic in March 2020 triggered severe government measures to contain it and to cope with the ensuing economic recession. The measures reflected some of the basic features and deficits of Austria’s federal and fiscal system. The federal government was the major actor in the crisis, and the anti-pandemic measures were highly centralized, especially in financial terms. Overall, the economic relief measures passed in March and April amounted to 39,4 billion Euros. Of this sum, 38 billion Euros were to be covered by the federal government, while the nine state governments together were to contribute only 1,4 billion Euros (Loretz *et al.*, 2020, pp. 356–7). Several state governors used their leeway to enact region-specific measures and, for example, closed schools in certain regions. In September, a ‘Corona traffic light’ system was introduced with the aim to set region-specific measures based on certain criteria, like the development of new infections or the capacities of the health care system in the different regions. The new system was of limited use only, as already in October the whole of Austria was to be colored uniformly ‘red’, indicating no possibility for regionally differentiated measures.

The pandemic also left its mark on the FAG. In 2021,<sup>23</sup> the share of the municipalities in the income tax was raised by 400 million Euros. Furthermore, the municipalities got a special advance for their shares amounting to 1 billion Euros to be repaid after 2023 and the structural fund was increased by 100 million Euros. This was done because the liquidity of the municipalities was badly hit by the decrease in the revenues from the municipal tax against the background of state laws restricting the powers of the municipalities to take out loans. This support of the municipalities has also been decided to promote their role as investors in infrastructure. All in all, this support of the federation amounted to 1.5 billion Euros.<sup>24</sup> By contrast, the major instrument to cope with budgetary discipline required by EU law - the ASP - has not been amended. More importantly, the application of the ASP has been de facto suspended: Article 15 paragraph 1 ASP commits the federation, the states and the municipalities to medium-term budgeting in accordance with the obligations under ASP and to an effective medium-term budgetary framework complying with the requirements of EU law. This commitment is also the subject of reporting requirements

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<sup>23</sup> Federal Law Gazette I No 29/2021.

<sup>24</sup> Cf. the legislative materials of the federal government accompanying the amendment bill of 2021, available at <file:///C:/Users/AK123993/AppData/Local/Temp/XXVII\_I\_630\_4\_Materialien.pdf> accessed 8 September 2021.

of the federation, the states and the municipalities to the Austrian coordination committee and, respectively, to the states coordination committees. The deadline for these annual reports is August 31. Against the background of the COVID-19 crisis, the Austrian coordination committee made use of power pursuant to Art 14 (5) ASP to amend the respective deadline. This was done twice<sup>25</sup>, with the reporting requirements being suspended till February 2021.

The pandemic necessitated an intensive coordination between the different territorial levels and actors of the federal and fiscal system to produce efficient and effective policies. Even though the Institute of Federalism (Innsbruck) claimed in August 2020 that Austrian federalism had successfully passed the ‘Corona test’, and that the states and the municipalities had fulfilled their tasks in a markedly diligent manner (Institut für Föderalismus, 2020), the crisis management, above all the interaction between the federal government and the provincial governments, was criticized time and again, however, notably by opposition parties and media. Likewise, a report by an independent committee, which was set up to investigate the crisis management in the state of Tyrol, especially concerning the early ‘Corona hotspot’ in the municipality of Ischgl, arrived at rather devastating conclusions. The federal Ministry of Health was blamed for providing only inadequate legal foundations for the subordinate administrations, which had to execute the federal pandemic law and its amendments within the rules of indirect federal administration. The state government of Tyrol was, among other things, accused of unlawfully delegating political responsibility to the head of the state administration and of lacking a sufficiently prepared crisis management system (Bericht der Unabhängigen Expertenkommission, 2020, pp. 138–41).

The coordination problems between the federal government and the state governments were exacerbated by political differences, especially between the federal conservative-green coalition government and the social democratic government in the state and capital city of Vienna. When a draft for a new decree of the Ministry of Health with new restrictive measures was only sent out to the state governments of the conservative ÖVP for consultation, the social democratic SPÖ fumed. Sometimes, ÖVP governors protested against being not adequately involved as well, however, for example when the government announced that it was determined to organize Covid mass tests in November. On the contrary, the governing parties insisted that the state governments had been included in the decision-making process to an unprecedented degree.

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<sup>25</sup> Austrian coordination committee, Beschluss (im Umlauf) einer Fristverlängerung für die Meldung gem. Artikel 15 ÖStP 2012 bis 27.12.2020, GZ. 2020-0.447.730, available at <https://www.bmf.gv.at/dam/jcr:8cf25fa3-7eb7-4a62-a75d-f6db04da45cd/UmlaufbeschlussMiFri2020.pdf>; Beschluss (im Umlauf) einer Fristverlängerung für die Meldung gem. Artikel 15 ÖStP 2012 bis 27.02.2021, GZ. 2021-0.076.629, available at <https://www.bmf.gv.at/dam/jcr:7ece0617-5f1a-46a0-8745-c928e643f725/ZweiterUmlaufbeschlussMiFri2020.pdf>.

## **10. Dos and Don'ts: What Can the EU Possibly Learn from Fiscal Federalism in Austria**

### *10.1. Deficiencies – negative example(s)*

The Austrian system of fiscal federalism displays some major deficiencies. First, it is strongly centralized in the sense that the federal state has the dominating budgetary power. The central parliament also regulates the revenue autonomy of the subordinate jurisdictions. Despite their lack of regulative competences and their financial dependence on federal decisions, the states and municipalities play a prominent role in the administration of public good provision, though. Second, the distribution of public responsibilities is strongly rooted in historical circumstances, but is neither based on economic considerations (public goods or spillovers) nor does it account for the specific revenue situation of the respective jurisdictions. This in turn suggests that the principle of fiscal equivalence, according to which those who profit from a public service should also be those who contribute to its financing, is achieved only to a very limited extent. Third, Austrian fiscal federalism lacks clearly defined goals and performance criteria. This makes it difficult to evaluate public policies, including their contribution to fiscal equalization and the realisation of somewhat equivalent living conditions, and to design them in more efficient ways. Fourth, the relevant political actors are little inclined to discuss general principles or to engage in substantial reforms. Rather, political pragmatism rules.

### *10.2. Achievements – positive example(s)*

The Austrian federalism is generally characterized by a political consensus ensuring a balance of interests, especially at the level of the states. Even though the federal government, based on the centralization of legislative responsibilities and the financial superiority of the federal level, clearly dominates the decision-making process, it can hardly enforce decisions if the states, represented first and foremost by the state governors, unite to resist them. Moreover, the implementation of federal laws often depends on the collaboration of the subordinate state and local administrations. The consultation mechanism, which was designed to protect the subordinate level(s) from a financial overload by the upper level(s), can be regarded as an indication of this basic consensus orientation. In a similar vein, the Stability Pact established joint debt coverage rules, which in turn increased the fiscal transparency of the jurisdictions and created pressure to use public funds more efficiently.

## **11. Conclusion**

The Austrian system of fiscal federalism is deeply rooted in historical regards and embedded in a wider political system characterized by a high degree of consensus orientation and political pragmatism. Specific goals regarding fiscal equalization and the realisation of somewhat equivalent living conditions are missing. That is why Austria seems not to be a good case to design an efficient and equalizing federalism in the European Union.



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