CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of Medium-term Budgetary Objectives for 2017-2020

Summary

June 2017

www.rozpoctovarada.sk

This report presents the official positions of the Council for Budget Responsibility in line with its mandate laid down in Act No. 493/2011 on Fiscal Responsibility.

This publication is available at the CBR website (http://www.rozpoctovarada.sk).

Any suggestions or comments on the report are welcome at sekretariat@rrz. sk.

Summary

In the 2017-2020 Stability Programme, the government approved its medium term objectives which assume general government deficit reductions from 1.7 % of GDP in 2016 down to a balanced budget in 2019. The budget is expected to remain balanced also in 2020. According to the Ministry of Finance, the meeting of these objectives should steer the debt by the end of 2020 outside the debt sanction zones, despite the gradual decrease in sanction thresholds from 2018 onward. In comparison with the approved 2017-2019 general government budget, the 2018 and 2019 budgetary objectives are slightly less ambitious. The Stability Programme contains mostly measures on the side of expenditures, the aggregate effect of which, according to the Ministry of Finance, deteriorates the government balance compared with the no-policy change scenario.

The Council for Budget Responsibility (CBR) views positively that the government has presented a budgetary framework that assumes continued deficit reductions toward meeting the medium-term budgetary objective and bringing the government budget into balance by 2019. The meeting of these objectives is a prerequisite for the long-term sustainability of public finances. However, provided that the 2020 objective is met and the present assumptions remain unchanged, the keeping of public finances sustainable in the long run will require additional measures worth 0.3 % of GDP[1]. This means that, in the medium term, the government should use both the favourable economic conditions and savings through measures adopted in the pay-as-you go pension system's pillar to attain a surplus of 0.4 % of GDP by 2020 and reduce public debt to 43.5 % of GDP[2].

The medium-term budgetary framework is based on realistic assumptions of the development of macroeconomic environment and tax revenues and social contributions, as approved by the respective committees in February 2017.

Assuming that no new measures are adopted beyond 2016, that public finances development is based on the existing legislation and that the budget items are determined solely by macroeconomic development, the CBR expects the deficit to decline gradually, from 1.7 % of GDP in 2016, and swing into a surplus of 0.4 % of GDP in 2020. In comparison with this scenario, the meeting of the 2018 and 2019 budget objectives will require a consolidation effort worth 0.1 % of GDP in 2018 and 0.2 % of GDP in 2019. On the other hand, the **calculations by both the CBR and the Ministry of Finance show that the 2020 budget objective is less ambitious and the measures planned by the government will worsen the overall fiscal position.**

The CBR has identified a number of risks which, even with positive effects taken into account, necessitate the adoption of additional measures for the objectives to be met[3].

[1] CBR, Report on the Long-term Sustainability of Public Finances, April 2017. The meeting of the objectives contained in the Stability Programme would, compared with a situation where the government makes full use of the favourable economic development to reduce public debt, worsen the long-term sustainability of public finances.

[2] As the 2016 Report on the Long-term Sustainability of Public Finances was published at a later date than the 2017-2020 Stability Programme, the government was unable to reflect its conclusions in the fiscal framework.

[3] The estimate of the risks and sources of their coverage reflect the actual 2016 result, updated government estimates for 2017, as well as the measures described in the Stability Programme and those specified following its adoption.

Thus, unless the government adopts additional measures, the CBR estimates that deficit may reach 1.5 % and 1.1 % of GDP in 2017 and 2018, respectively, and then gradually decline to 0.2 % of GDP by 2020[4]. In order to meet its objectives defined in the Stability Programme, the government will have to adopt (by 2019) additional measures with permanent effect to the tune of 0.6 % of GDP. As the objective remains unchanged, the need for additional measures in 2020 will drop to 0.2 % of GDP.

- The risks are mainly associated with the **repeated overestimation of certain non-tax revenues** (from dividends and the sale of CO_2 allowances), **underestimation of expenditures in the healthcare sector and in the state budget** (capital expenditures) and **unbudgeted expenditures related to the financial corrections to EU funds**. The **local government sector** also runs the risk of exceeding its budgeted expenditures as the drawing of EU funds is expected to pick up (pre-financing and co-financing) and capital expenditures might rise compared to the low 2016 baseline level. With the current estimates of revenues from taxes and social contributions for the year 2016 plus the first four months of 2017 taken into account, the 2017 **tax revenues** (CIT, PIT, VAT, Agency for Emergency Oil Reserves) are expected to decline; the shortfall should be partially offset by higher social contributions due to favourable labour-market developments.

  The risks identified above do not take into take into account the additional measures announced by the government after the adoption of the 2017-2020 Stability Programme, which have not been included in the fiscal framework.

- The potential **sources for the coverage of risks** include the **unrealised expenditures on co-financing** due to the slower uptake of EU funds compared with the government's estimates[5] and lower expenditures on social benefits in the medium term. **The lower transfers to the EU budget in 2017** will also have a positive effect. **Budgeted reserves** represent an additional source for the coverage of risks in 2017.

- The total risks in 2017, compared to the approved 2017 budget, represent EUR 962 million (1.1 % of GDP), yet they may be partly offset by positive effects amounting EUR 747 million (0.9 % of GDP). The amount of risks and sources for their coverage will be lower in the following years. Negative risks are estimated to reach EUR 589 million[6] (0.7 % of GDP) in 2018, EUR 679 million (0.7 % of GDP) in 2019, falling to EUR 363 million (0.4 % of GDP) in 2020. Potential positive risks have been quantified at EUR 122 million (0.1 % GDP) in 2019 and EUR 174 million (0.2 % of GDP) in 2020.

The debt forecast presented in the Stability Programme assumes that the debt-to-GDP ratio will fall to 46 % of GDP by the end of 2020, which means that even as the sanction-triggering thresholds defined in the Fiscal Responsibility Act continue to decline, gross debt will get out of

4 The European Commission estimates the deficit at 1.3 % of GDP in 2017 and 0.6 % of GDP in 2018.

5 Except for 2018 when the CBR expects faster drawing than what the government estimates. The estimation of risks also reflects the effects of the use of EU funds on macroeconomic development and tax revenues. However, these effects are minimal because the CBR estimates the drawing of EU funds at about 98 % of the value incorporated in the macroeconomic forecast of the Macroeconomic Forecasting Committee from February 2017.

6 The sum of risks from Tab 1 and expected higher co-financing of projects funded from EU funds (indentified by a minus sign in the list of risk-coverage sources).

the sanction zone for the first time since it exceeded the threshold in 2012. The risks identified by the CBR suggest that **in the absence of additional measures the debt might not fall below the first threshold by the end of 2020 and could reach 47.5 % of GDP.**

The CBR estimates that structural deficit will improve by 1.6 % of GDP by 2020 if no additional measures are taken. **The expected favourable macroeconomic development, coupled with continuously low interet rates on financial markets, will improve the structural balance by 2 % of GDP, while the net contribution of government measures[7] will worsen the balance by 0.4 % of GDP on a permanent basis.**

A view of the fiscal framework from the prism of net worth[8] enables to identify those budgetary items that develop differently in the medium term compared to the long run. The expected budget balance improvement (structural balance including) due to the improving balance of the National Nuclear Fund and revenues from a special levy payable by selected financial institutions until 2020 will, in the long run, be reflected in increased budget expenditures[9]. The next group of items are those which may have a positive or neutral impact on the general government's balance in the medium-term, yet their negative effects on the budget will be felt in the long run. These include, for example, the traditionally loss-making state corporations and the implementation of a new PPP project.

The CBR has prepared its opinion based on the 2017-2020 Stability Programme, as well as the additional information made available by the Ministry of Finance[10]. In order to make the Stability Programme more transparent and comprehensible, it would be most appropriate if it presented how the current estimates/actual outcomes deviate from the budget assumptions, without the impact of transfers from EU budget and other transactions that affect revenues and expenditures (and their structure) but not the overall deficit. We also recommend that the list of the one-off effects[11] (and the method used for their selection) used for the complilation of the no-policy change scenario be specified in greater detail.

7 The indicator 'government consolidation effort' relates solely to the contribution of government measures towards permanent change in fiscal balance. Its detailed description can be found in CBR discussion paper No. 02/2014: How to measure public finance consolidation.

8 Also other net worth components are affected by public finances, such as environmental debt and natural wealth. Due to the absence of data and methodology for their quantification, the CBR's evaluation does not include these components.

9 The accumulated funds of the National Nuclear Fund should be used in the future towards the cost of decommissioning nuclear facilities. The funds raised from the special levy are earmarked to cover future risks in the financial sector.

10 Ministry of the Economy did not provide answers to CBR's questions concerning estimated revenues from dividends.

11 For example, according to the MoF Manual (available only in Slovak) for the compilation of the no-policy change scenario, those capital revenues that exceed the minimum limit of 0.05 % of GDP are classified as one-off revenues. However, no such rule exists for capital expenditures.

CBR
COUNCIL FOR BUDGET RESPONSIBILITY

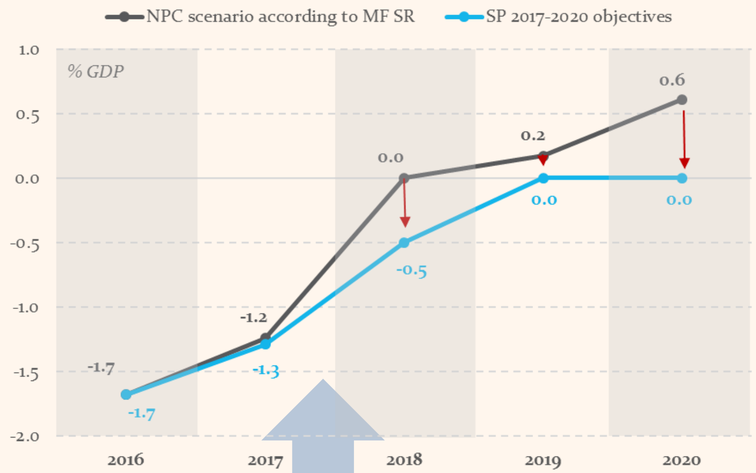
Evaluation of Medium-term Budgetary Objectives for 2017-2020

What does the Stability Programme of the SR for 2017-2020 say

According to the MoF, the overall effect of the measures contained in the Stability Programme worsens the balance compared to the NPC scenario.

NPC – no-policy change scenario

FIGURE 1

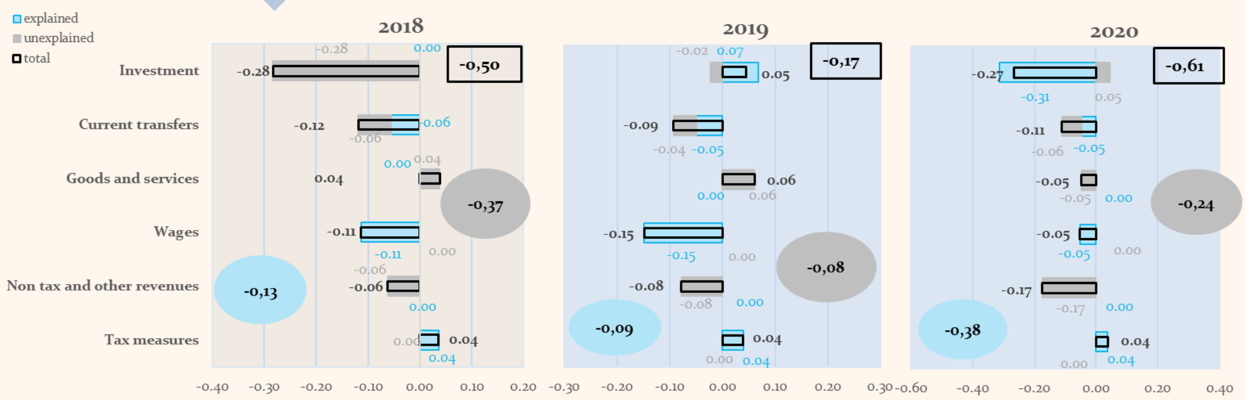


- If the government took no new measures and public finances developed within the present legislative framework and macro-economic assumptions, the MoF expects a surplus of 0.6 % of GDP in 2020.
- Budgetary objectives are less ambitious compared to this scenario

Source: Stability Programme of the SR for 2017-2020 (April 2017), CBR

Balance will worsen under the influence of lower non-tax revenues and higher expenditures (wages, investments in the defence and transport sectors, increase in pensions of the pensioners, who retired before 2004). The tax measures will have the opposite impact.

FIGURE 2



Source: Stability Programme of the SR for 2017-2020 (April 2017), CBR

CBR´s evaluation and comparison

The CBR has identified a number of negative risks which, even with the positive effects taken into account, necessitate the adoption of additional measures for the objectives to be met.

FIGURE 3

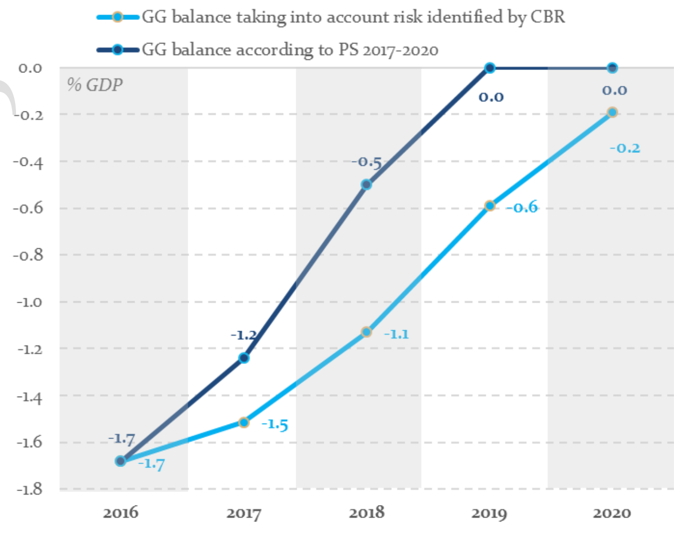
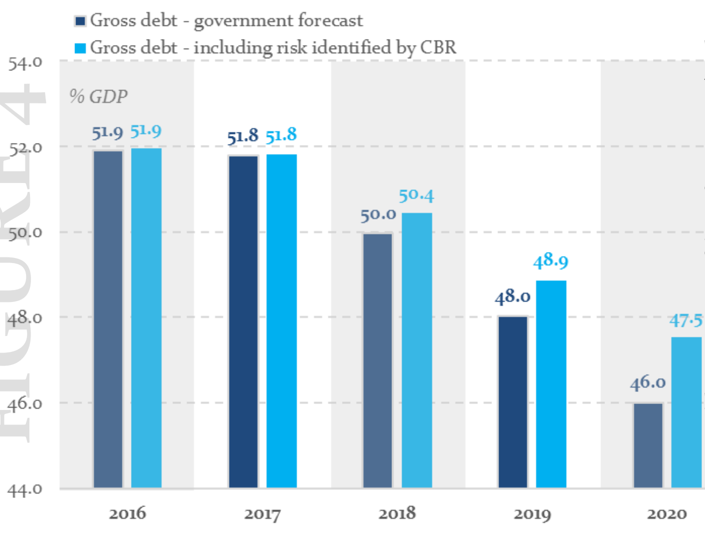


FIGURE 4



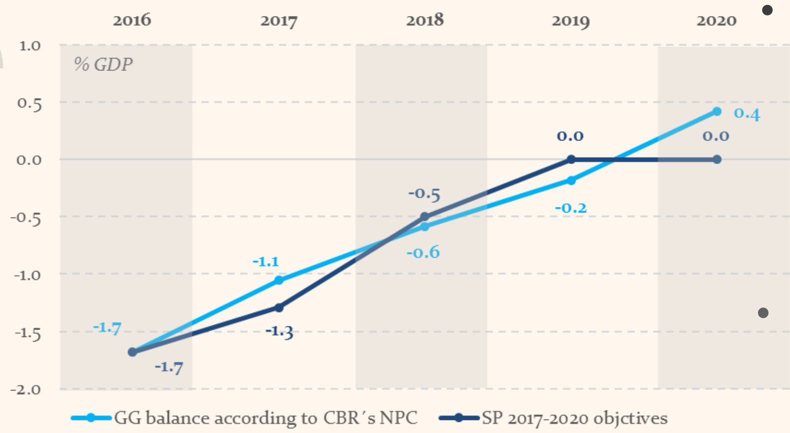
Source: Stability Programme of the SR for 2017-2020 (April 2017), CBR

Evaluation of Medium-term Budgetary Objectives for 2017-2020

What does the CBR´s evaluation say

FIGURE 5

Simularly to the MoF, the CBR has calculated that the measures adopted by the government worsen the overall fiscal position.



NPC – no-policy change scenario

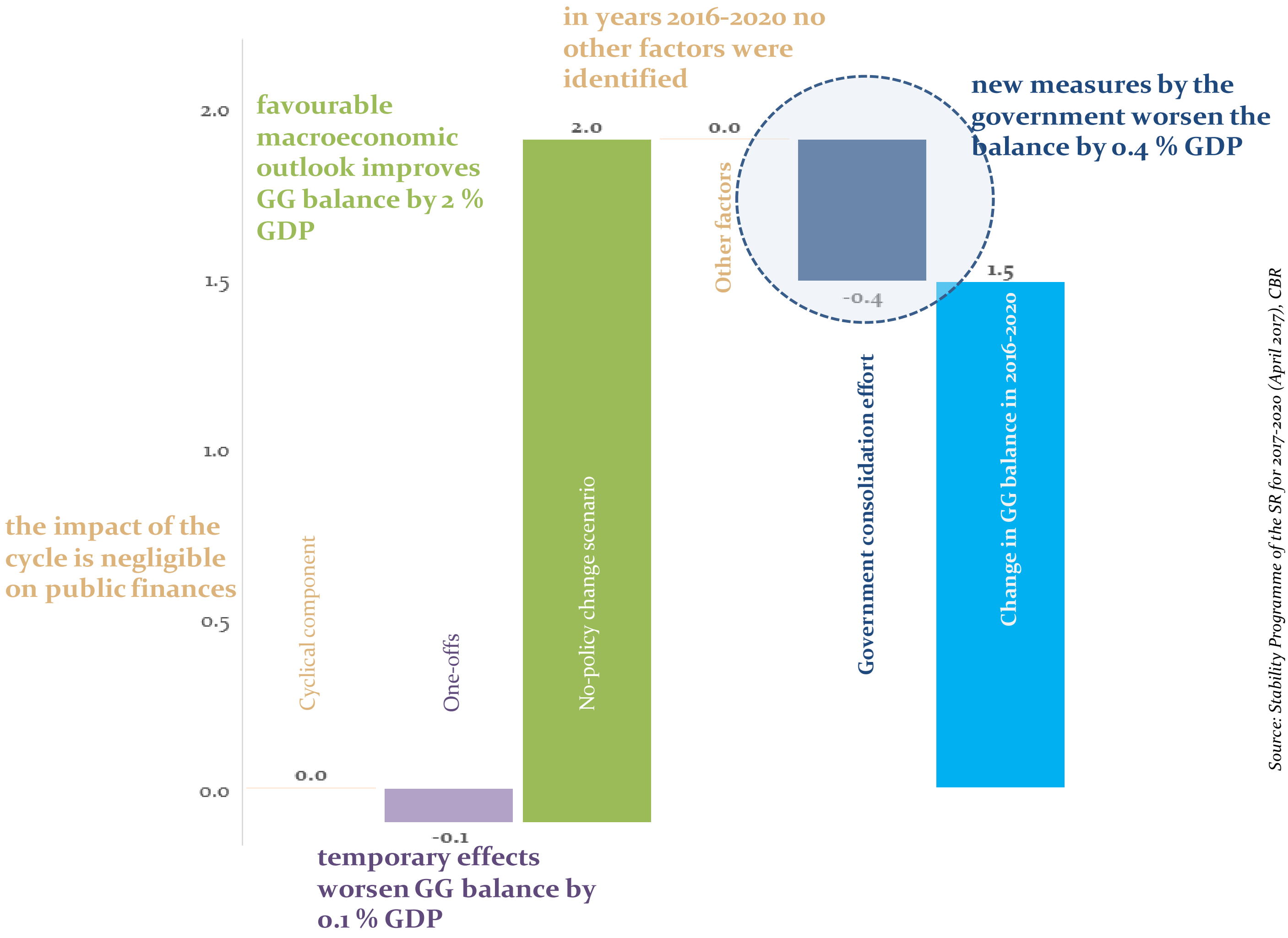
- According to the CBR, the meeting of the 2018-2019 budget objectives will require the adoption of consolidation measures worth 0.1 % of GDP in 2018 and 0.2 % of GDP in 2019. Similarly to the MoF, the CBR has calculated that the measures adopted by the government in 2020 worsen the overall fiscal position.
- Against the medium-term objectives set by the government, additional measures worth 0.3 % of GDP will have to be implemented after 2020 to make public finances sustainable in the long run.

Source: Stability Programme of the SR for 2017-2020 (April 2017), CBR

While the expected favourable macroeconomic development by 2020 will improve structural balance by 2 % of GDP, the net contribution of government measures will worsen it by 0.4 % of GDP.

FIGURE 6

Contributions to change in GG balance in 2016-2020 (% GDP)



Source: Stability Programme of the SR for 2017-2020 (April 2017), CBR

Tab 1: Overview of budgetary risks and their coverage in 2017-2020 (ESA2010, € million)

	2017 B	2017 E	2018	2019	2020
GG balance in the 2017-2020 SP (€ million)*	**-1 083**	**-1 049**	**-447**	**0**	**0**
GG balance in the 2017-2020 SP (in % of GDP)*	**-1.3**	**-1.2**	**-0.5**	**0.0**	**0.0**
Risks - total:	**-962**	**-833**	**-500**	**-679**	**-363**
1. Overestimated non-tax revenues:	-197	-197	-171	-175	-174
- revenues from dividends (SPP, VSE, ZSE)	-119	-119	-112	-118	-118
- revenues from the sale of CO2 allowances	-61	-61	-59	-57	-56
- revenues from administrative fees (ŽSR)	-17	-17	0	0	0
2. Financial corrections to EU funds	-186	-154	no quantification		
3. Underestimated state budget expenditures	-291	-138	0	-225	0
- increased wages in state administr. and education sector	-161	0	0	0	0
- expenditures on goods and services	14	0	0	0	0
- other current expenditures	-8	0	0	0	0
- capital expenditures	-136	-138	0	-225	0
4. Underestimated healthcare expenditures	-263	-225	-178	-116	-17
- healthcare expenditures and fin. performance of hospitals	-238	-200	-153	-91	8
- payout of retained profits by private health ins. companies	-25	-25	-25	-25	-25
5. Impact of higher expenditures of municipalities	15	0	no quantification		
6. Revenues of the Emergency Oil Stocks Agency	-30	-4	-30	-36	-36
7. Tax revenues and social contributions	-11	-114	-120	-128	-136
8. Impact of EU funds on other GG entities (except the state budget)	no quantification				
9. Defense expenditures under secrecy	no quantification				
10. Recapitalisation of the traditionally loss-making state corporations	no quantification				
11. Postponement in the reconstruction of national gallery	no quantification		no quantification		
Coverage - total:	**747**	**603**	**-60**	**122**	**174**
1. Savings in co-financing	167	167	-89	100	125
2. Savings in state social benefits	46	56	28	22	48
3. Risk coverage from reserves:	493	332	0	0	0
- reserve on the coverage of new legislative initiatives	22	22	-	-	-
- reserve on 2017	50	50	-	-	-
- reserve on EU funds drawdown and financial corrections	186	186	-	-	-
- reserve on financial performance of hospitals	74	74	-	-	-
- non-specified reserves	161	0	-	-	-
4. EU budget levy savings	41	25	0	0	0
5. Other factors**	0	23	0	0	0
Change in interest expenditure due to risks and savings	**20**	**0**	**0**	**-5**	**-5**
Overall impact on the GG balance:	**-188**	**-223**	**-561**	**-562**	**-193**
GG balance adjusted for CBR net risks (€ million)	**-1 278**	**-1 278**	**-1 007**	**-562**	**-193**
GG balance adjusted for CBR net risks in % of GDP)	**-1.5**	**-1.5**	**-1.1**	**-0.6**	**-0.2**

** In 2017, the differences are shown vis-à-vis the 2017-2019 GG budget (deficit of 1.29% of GDP - column 2017 B) and the government estimate shown in the Stability Programme (deficit of 1.24 % of GDP - column 2017 E).*

*** Factors with a relatively low impact compared to the government estimate.*

Note: (+) positive and (-) negative impact on the GG balance *Source: CBR*

Council for Budget Responsibility

Imricha Karvaša 1
Bratislava 1
813 25
Slovakia