CBR

COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of Medium-term Budgetary Objectives for 2018-2021

Summary

June 2018

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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 Stability Programme of the Slovak Republic for 2018-2021, the government approved its medium term objectives assuming a general government deficit reduction from 1.0 % of GDP in 2017 down to a balanced budget in 2020. The budget is expected to remain balanced also in 2021. In comparison with the approved 2018-2020 General Government Budget, the 2019 budgetary objective is slightly less ambitious. By meeting these objectives, the Ministry of Finance of the Slovak Republic expects the gross debt-to-GDP ratio to be reduced by 7.6 p. p. from 50.9 % in 2017 to 43.3 % in 2021. The Stability Programme contains mostly measures on the expenditure side, the aggregate effect of which, according to the Ministry of Finance, deteriorates the general government balance compared with the no-policy-change scenario. The Council for Budget Responsibility has prepared its opinion on the basis of the Stability Programme, as well as additional data from the Ministry of Finance.

The Council for Budget Responsibility (CBR) views positively that the new government has presented a budgetary framework that assumes continued deficit reductions towards meeting the medium-term budgetary objective and bringing the government budget into balance by 2020. The meeting of these objectives would contribute to improving the long-term sustainability indicator by 0.7 % of GDP[1]. Considering the present assumptions, attaining the long-term sustainability of public finances would require additional measures amounting to 0.4 % of GDP, which would imply setting the budgetary objective at a structural surplus level of 0.4 % of GDP in 2021. With an increase in state budget expenditures by 1.0 % GDP in 2019 in comparison with the approved General Government Budget for 2018 – 2020 and, simultaneously, with a worsened budgetary objective for 2019, the necessary improvement of Slovakia's fiscal position is being put off to the subsequent years. Slovakia's consolidation targets have been mostly defined, in the long run, on the basis of requirements arising from European rules. According to the CBR, this is insufficiently reflecting the requirements of national fiscal rules[2], in particular as regards faster reduction of the general government debt and ensuring the long term sustainability of public finances[3].

The general government deficit reached 1.04 % of GDP in 2017, which was below the level of the target standing at 1.29 % of GDP. This improvement was reflected in the 2018 balance estimate to a very limited extent because the positive impacts of higher-than-expected tax revenues and savings in social benefits will be reduced – according to the Ministry of Finance – by shortfalls in revenues arising from non-implementation of measures (the postponed effective date of changes in gambling, tax on non-life insurance and the fee for the management of emergency oil and oil product stocks) and by higher wage and capital

1 In the Report on the Long-term Sustainability of Public Finances for 2017 (April 2018), the CBR quantified the long-term sustainability indicator at 1.1 % of GDP. This value indicates the size of the necessary permanent measures ensuring that the gross debt of the general government does not exceed 50 % of GDP over the next 50 years. Improvement of the indicator by 0.7 % of GDP only reflects the assumption of compliance with targets set in connection with the general government balance. The final evaluation of sustainability may be changed following the adoption of specific measures influencing the projection of revenues and expenditures for the next 50 years (e.g., parametric changes in the pension system)

2 In evaluating the medium-term budgetary objectives for 2017-2020 (June 2017), the CBR noted that attaining the long-term sustainability of public finances would require a budgetary surplus of 0.4 % of GDP in 2020 (which corresponded to a structural surplus of 0.2 % of GDP). Following an update to the long-term sustainability indicator (April 2018), this would imply a structural deficit between 0.3 and 0.4 % of GDP in 2021 depending on the pace of consolidation.

3 Pursuant to Act No. 493/2011 Coll. on fiscal responsibility.

expenditures. In evaluating the balance in 2018, the CBR has identified several risks. This includes, in particular, a shortfall in non-tax revenues (dividends, CO2 allowances), higher local government expenditures, higher co-financing expenditures which are partly offset by a more favourable forecast of revenues from taxes and social contributions and by a reduction in state budget expenditures due to created reserves. **According to the CBR, if no additional measures are adopted, the general government deficit might reach 1.0 % of GDP in 2018**. In terms of complying with the rules it needs to be pointed out that the **CBR expects – as does the Slovak government and the European Commission – the budget expenditures to grow in 2018 above the level set by the expenditure benchmark.**

The budgetary objective set by the government for 2019 makes use of room allowed by the permitted deviation from the rules of the Stability and Growth Pact[4]. **Better economic developments** in comparison with the assumptions of the approved General Government Budget for 2018–2020 **did not translate into the improvement of the budgetary objective for 2019; quite the contrary, it has slightly worsened by 0.2 % of GDP**. This enabled the financing of as-yet unspecified state budget expenditures amounting to 1.0 % of GDP. At the same time, the budgetary risks related to underestimated drawdown of EU funds have increased (higher co-financing expenditures). The risks related to non-tax revenues and local government expenditures, as identified in the evaluation of the General Government Budget for 2018 – 2020, are still present. Other risks and possible sources of their coverage beyond the framework of budgetary reserves cannot be evaluated because, in this phase of the budgetary process, the details of all measures prepared by the government are not known yet.

According to the government's objectives, the structural balance will improve on a cumulative basis by 1.2 % of GDP by 2021. Without the government's intervention (the no-policy change scenario according to CBR) it would improve by a total of 0.5 % of GDP. The government would have to adopt consolidation measures amounting to 0.8 % of GDP in order to meet the budgetary objectives. If measures having a permanent impact are approved, the CBR estimates that the medium-term budgetary objective would be met in 2019, **thus fulfilling the balanced budget rule within the deadline set by the government**[5].

The gross debt-to-GDP ratio started declining after 2013, with 2017 being the first year when it declined as a result of the government's fiscal performance when taking into account one-off effects and economic growth. A sustainable downward trend of the debt is expected to continue even in the medium term due to the planned deficit reduction. **At the end of 2019, the gross debt-to-GDP ratio should drop below the sanction brackets of the debt brake even though their thresholds have been declining gradually since 2018**.

The evaluation of the medium-term budgetary objectives, in particular as regards the assessment of developments in expenditures, is distorted by several factors, thus reducing the transparency of the fiscal framework. Even though the comparability of reported and budgeted data[6] improved significantly in the past, full comparability has not been ensured yet. The budget neither reflects the commercial revenues and expenditures of public

[4] In 2019, the Ministry of Finance expects the structural balance to improve by 0.3 % of GDP, while the requirement under the Stability and Growth Pact is at least 0.5 % of GDP. A significant deviation means a situation where the deviation in a single year reaches at least 0.5 % of GDP or when the two-year average of such deviations is at least 0.25 % of GDP per year.

[5] The deadline was set by the Stability Programme of the Slovak Republic for 2016–2019 (April 2016).

[6] This includes, in particular, the budgeting of extra-budgetary accounts of the state budget and local governments.

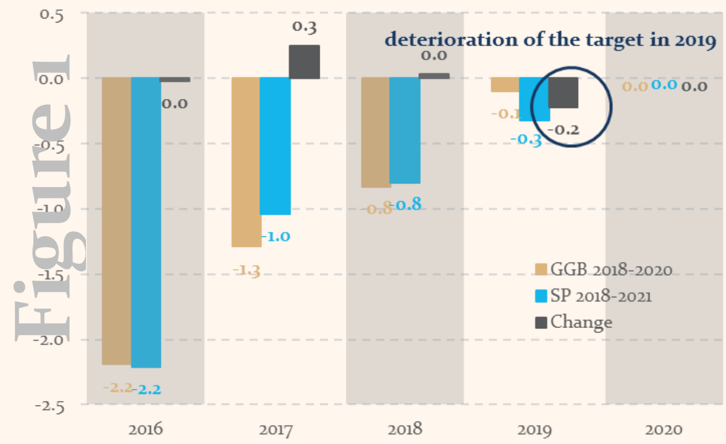
universities, nor those of several central and local government entities. The rate of growth in expenditures is also distorted by the fact that the expected reductions in the health insurance contributions paid by the state are not included among discretionary measures, which affects the evaluation of the expenditure benchmark[7]. The classification of several unspecified expenditures in 2019 is questionable as well, and this may also have an impact on the development in expenditures between individual years[8].

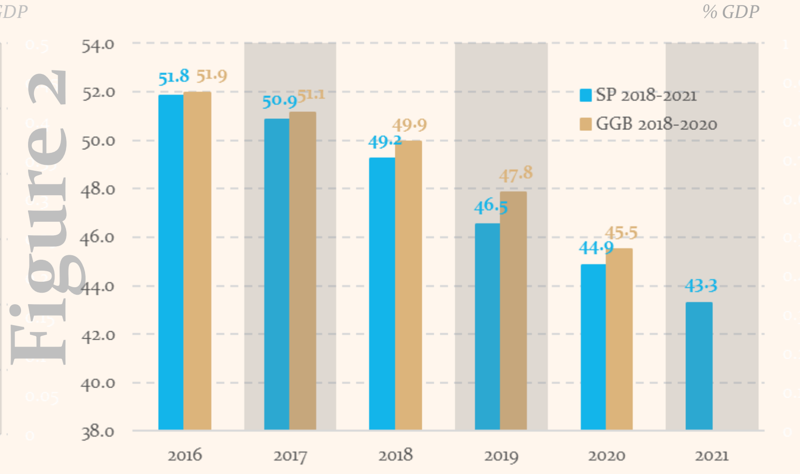
7 The measure has a neutral impact on the balance however affects the level of general government revenues and expenditures.

8 Investments cover nearly a half of unspecified expenditures (totalling EUR 953 million). Investments in the current year are included in the calculation of expenditures development only at one fourth of their value (reflecting their average for the years *t*-3 and *t*, were *t* is the current year), whereas current expenditures are included in their full amount.

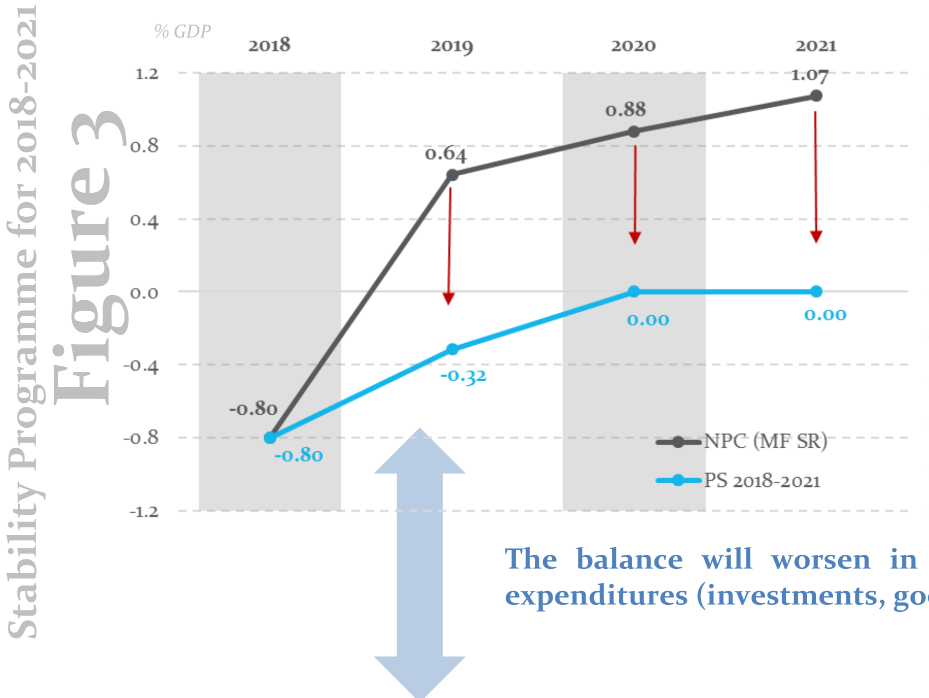
Evaluation of Medium-term Budgetary Objectives for 2018-2021

The objective of attaining a balanced budget by 2020 has remained unchanged. In comparison with the approved General Government Budget for 2018 – 2020, the objective for 2019 has slightly worsened. The gross debt forecast has been reduced in comparison with the General Government Budget for 2018-2020.





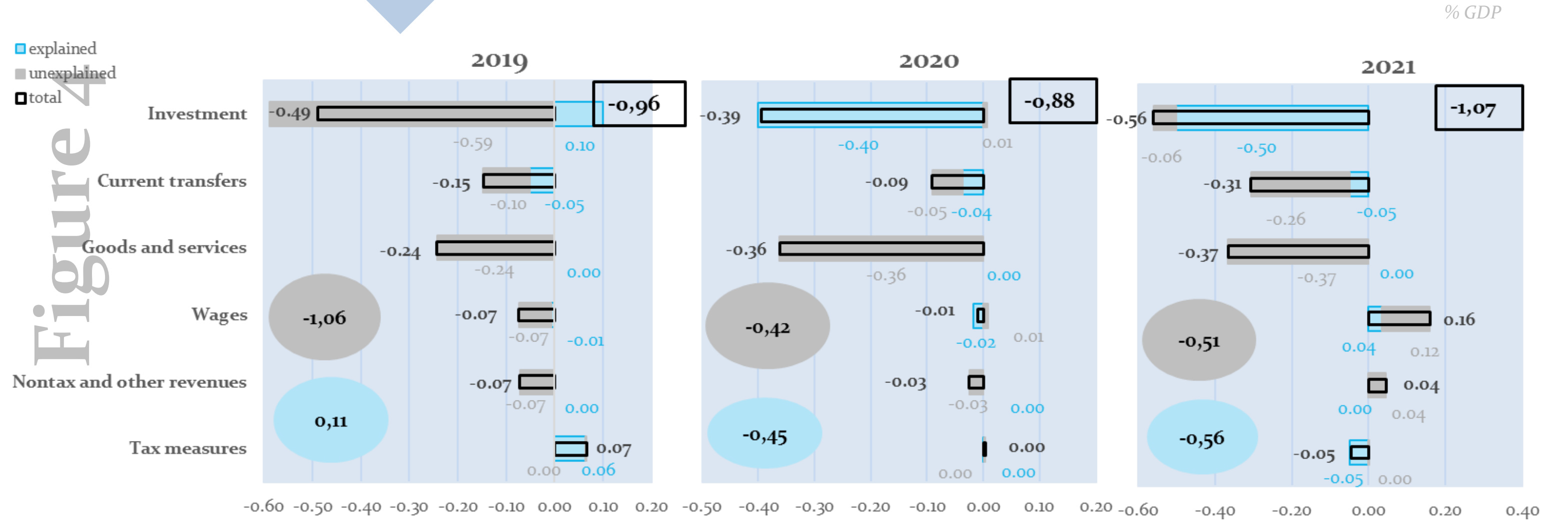
According to the Ministry of Finance, the overall effect of measures contained in the Stability Programme worsens the balance compared to the no-policy-change scenario.



- If the government took no new measures and public finances developed within the present legislative framework and macroeconomic assumptions, the Ministry of Finance expects a surplus of 1.1 % of GDP in 2021.
- Against this scenario, the budgetary objectives are less ambitious.

NPC – no-policy change scenario; SP - Stability Programme for 2018-2021

The balance will worsen in particular due to higher expenditures (investments, goods and services).



Source: Stability Programme of the Slovak Republic for 2018–2021 (April 2018), CBR

Evaluation of Medium-term Budgetary Objectives for 2018-2021

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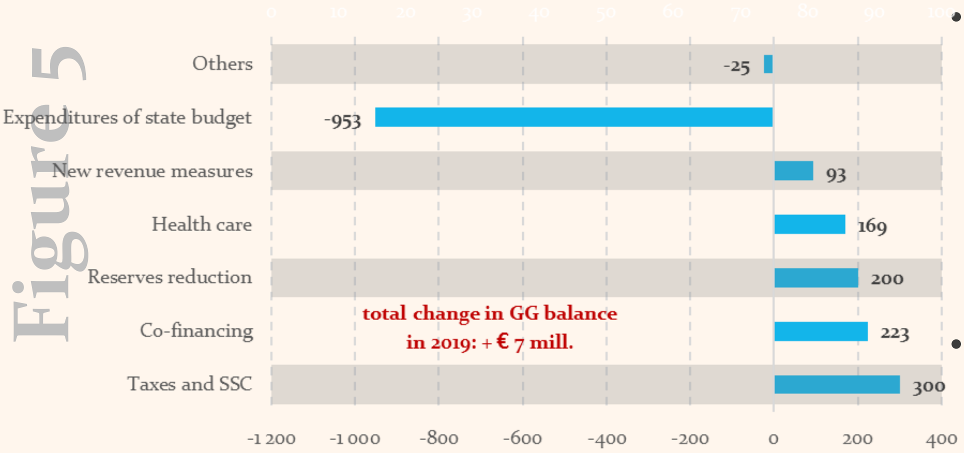
Better economic development since the approval of the GGB for 2018-2020 provided a margin for the financing of unspecified state budget expenditures in the amount of 1.0 % of GDP in 2019.

Figure 5



- Based on an updated estimate of taxes and social contributions, the revenues increased by EUR 300 million even after taking into account the impact of those measures (tax exemption of the 13th and 14th salary and of the employment contracts of pensioners) which were included in state budget expenditures as part of reserves.
- The budgetary risks related to underestimated drawing of EU funds have increased.

This involves a comparison between the 2019 revenues and expenditures based on the Stability Programme for 2018-2021 and the General Government Budget for 2018-2020.

The expected favourable macroeconomic development by 2021 will improve the structural balance by a total of 0.5 % of GDP. The net contribution of the public sector (government) over the same period represents 0.8 % of GDP.

CBR's evaluation

Figure 6

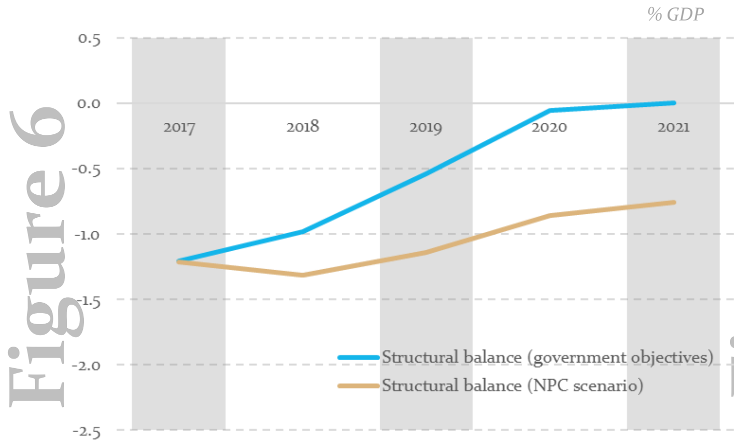
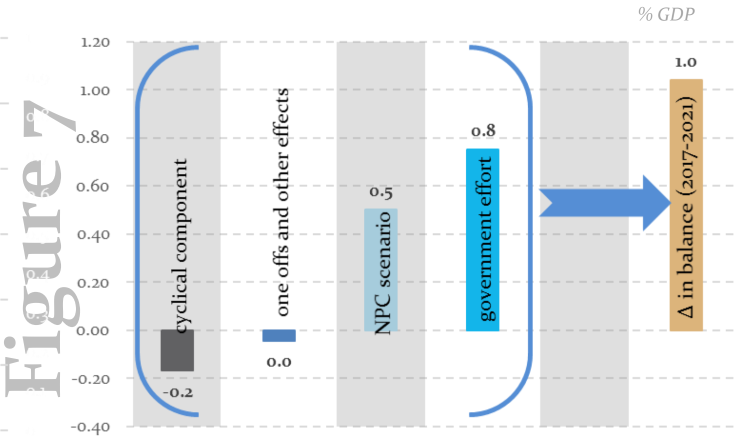


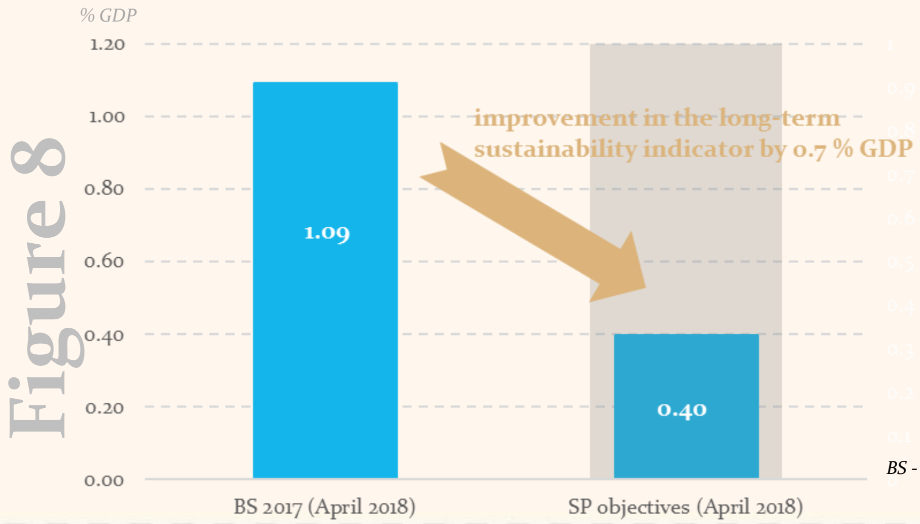
Figure 7



The calculation of the structural balance, NPC scenario and the government's consolidation effort is in line with the CBR's methodology.

In order for the public finances to be sustainable in the long-term, the structural balance would have to be additionally improved by 0.4 % of GDP on top of the government's current objectives.

Figure 8



- Considering the current development in public finances and the defined medium-term objectives, the long-term sustainability may be expected to improve by 0.7 % of GDP.

BS - Baseline scenario

Source: Stability Programme of the Slovak Republic for 2018–2021 (April 2018), CBR

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