CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of Medium-term Budgetary Objectives for 2020-2023

Summary

July 2020

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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 2020-2023, the government approved medium-term objectives based on its estimate of the 2020 public finance deficit in the amount of 8.4 % of GDP. It represents an unprecedented surge in the deficit over a very short period of time when compared to the approved budget which assumed a deficit at a level of 0.5 % of GDP.

This surge has mainly been driven by the impacts of the coronavirus COVID-19 pandemic that adversely affects the economic development. The unrealistic budgeting of non-tax revenues and expenditures in certain domains of the general government in the approved 2020 budget along with the approval of the so-called 13th pension payments at the beginning of 2020 have also contributed to the growth in the deficit. According to the Stability Programme, the worsened financial performance in 2020 will also reflect in the estimated increase in gross debt which is expected to grow from the level of 48.0 % of GDP at the end of 2019 to as much as 61.2 % of GDP at the end of 2020.

According to the CBR, the general government deficit may amount to EUR 6,693 million (7.7 % of GDP) in 2020. This estimate is slightly below the assumptions included in the Stability Programme, mainly due to a lower amount of estimated expenditures on the measures adopted to boost the economy, better financial performance of local governments, as well as higher tax revenues anticipated under the most recent macroeconomic forecast (Chart 1)[1]. **The gross debt will increase sharply in 2020 and, according to the CBR, will amount to 62.5 % of GDP, the highest ever level of public debt in Slovakia, exceeding the upper debt limit of the Fiscal Responsibility Act.** In view of a high degree of uncertainty regarding the economic development and of the actual amount of expenditures associated with the extraordinary measures to boost the economy, the CBR considers the government's estimates for 2020 realistic.

If no additional measures were adopted, the CBR estimates the **deficit would reach 6.3 % of GDP in 2021 and 2022 and would subsequently grow to 6.9 % of GDP in 2023**[2] (Chart 2). The gross debt-to-GDP ratio would continue growing, approaching 70 % of GDP by the end of 2023 (Chart 3).

The government set an objective to reduce the general government deficit under 3 % of GDP by 2023, which could help prevent such a huge increase in debt. According to the CBR, measures with a total effect of 4.0 % of GDP need be adopted in order to meet the aforementioned budgetary objective. Measures amounting to 1.4 % of GDP will have to be adopted for 2021, the highest level since 2015. The figure is lower compared to the consolidation

[1] Following the approval of the Stability Programme by the government, an update to the macroeconomic forecasts was prepared in June 2020 which is reflected in the CBR's evaluation. Compared to the assumptions contained in the Stability Programme, the Macroeconomic Forecasting Committee expects worse economic development especially in 2022 and 2023. The Slovak economy will be approaching its potential level at a slower pace and this will translate into a lower collection of taxes and social security contributions which will only partly be offset by a slower growth in expenditures.

[2] The structural deficit will amount to 6.0 % of GDP in 2020, deteriorating 3.8 p.p. of GDP year-on-year. In the subsequent years, the structural deficit should remain at the level of 6.0 % of GDP until 2022 under the no-policy change scenario. The structural deficit is expected to worsen by 0.4 p.p. of GDP in 2023, mainly due to the expected delivery of contracted military equipment. If the state's own investments in 2023 stayed at the 2019 level, the estimated structural deficit for 2023 would be approximately at the level of 5.6 % of GDP.

of Slovakia's public finances after the global financial crisis in 2011 and 2013 when the size of the adopted measures exceeded 2 % of GDP[3].

Even if these budgetary objectives were met, the debt-to-GDP ratio would only decrease moderately by 2023, by 1.2 p.p. to 61.2 % of GDP. The level of gross debt will thus remain above the upper debt limit which represents the highest threshold of the debt brake sanction bracket. At the same time, in view of a two-year escape clause linked to the adoption of the new government manifesto, the sanctions associated with the third through fifth sanction bracket will not be applied before 2022. The activation of exceptional circumstances in connection with a decline in economic growth in 2020 may postpone the obligation to apply these sanctions as far as to 2026.

From the long-term point of view, the pace of consolidation set this way would significantly improve the long-term sustainability of public finances. **The long-term sustainability indicator would fall from the high-risk zone to the medium-risk zone** (Chart 4). The overall immediate need of adopting additional measures (beyond the government's objectives) to preserve the debt below the 50 % threshold over the next fifty years would drop from the level of approximately 8 % of GDP in 2020 to 4 % of GDP in 2023[4].

The CBR considers the set pace of deficit reduction adequate to the present circumstances. In the case of a more favourable macroeconomic situation and, also, if Slovakia will have an opportunity in this period to draw the extraordinary EU funds intended for the overcoming of the consequences of the coronavirus-related crisis, **the government should make use of it in order to speed up deficit reduction even more**. At the same time, it is necessary that the government effectively and fully utilises the EU funds available under the ending third programming period in order to ease the negative effects of the consolidation of public finances on the Slovak economy.

The lack of specific measures is, according to the CBR, the greatest risk for achieving the budgetary objectives set by the government. For this reason the CBR is unable to assess how realistic they are. Therefore, it is important that **the government presents within the next few months a credible general government budget proposal for the next three years, supported by measures.**

The CBR positively acknowledges the plans the government presented with the aim of improving the long-term sustainability of the pension system and enhancing

3 The Stability Programme of the Slovak Republic for 2011-2014 (April 2011), The Stability Programme of the Slovak Republic for 2014-2017 (April 2014) and the commentary by the Institute for Financial Policy (No. 2012/22): Analytical View of the 2013-2015 Budget (updated) - available only in Slovak. The size of the necessary measures compared to the NPC scenario amounted to 2.5 % of GDP at the time the 2011 budget was approved; the same size was quantified by the Ministry of Finance also after the publication of the actual 2011 data. In the case of 2013, the size of the measures quantified in the budget amounted to 3.3 % of GDP, while their actual size was 2.2 % of GDP.

4 If the government's budgetary objectives were met through measures with permanent effects, it would translate into a decrease in the structural deficit from 6.0 % of GDP in 2020 to 2.4 % of GDP in 2023. Over the three years, the structural balance would improve by 3.5 % of GDP in total, being just 1.9 % of GDP away from the balanced budget at the end of the forecast horizon. Such improvement in the structural balance would also lead to an improvement in the long-term sustainability of public finances, moving it from the high-risk zone to the medium-risk zone.

transparency and management of public finances[5]. In its medium-term budgetary strategy, however, the government should also take into consideration the need of boosting the competitiveness of Slovakia's economy, as well as the urgent need to deal with the issue of population ageing that increases the budgetary costs every year, including outside the pension system, e.g., in the healthcare sector or long-term care.

[5] They include, for example, the introduction of expenditure ceilings, enhancing the independent committees in the budgetary process, a new government debt management strategy, enhancing the position of the Council for Budget Responsibility, improvements in the management of investments, and increased transparency and comprehensibility of the budget.

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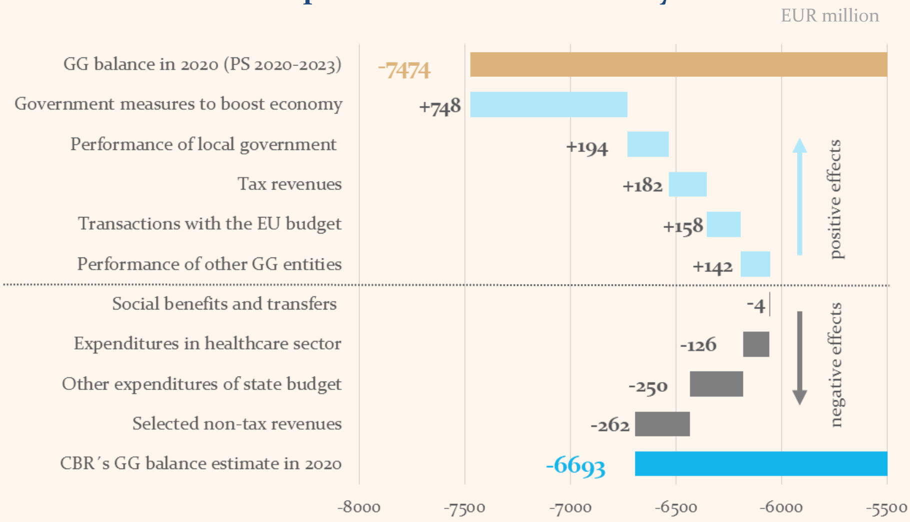
The general government deficit may amount to EUR 6,693 million (7.7 % of GDP) in 2020, better than expected under the Stability Programme, mainly due to a lower amount of estimated expenditures on the measures adopted to boost the economy.

FIGURE 1



- The savings, compared to the Stability Programme, on the measures to boost the economy are mainly driven by the difference in the anticipated amount of expenditures to be reimbursed from EU funds.
- A better financial performance of local governments and other entities, higher tax revenues, and a positive effect of transactions with the EU budget contribute to an expected improvement in deficit.
- Besides the pandemic, the risks also include the overestimated non-tax revenues and underestimated state budget and healthcare expenditures.

Reducing the general government deficit to 2.9 % of GDP by 2023 will require measures with an overall impact of 4 % of GDP. If this objective is achieved, the gross debt would stabilise and subsequently fall to 61.2 % of GDP at the end of 2023.

FIGURE 2

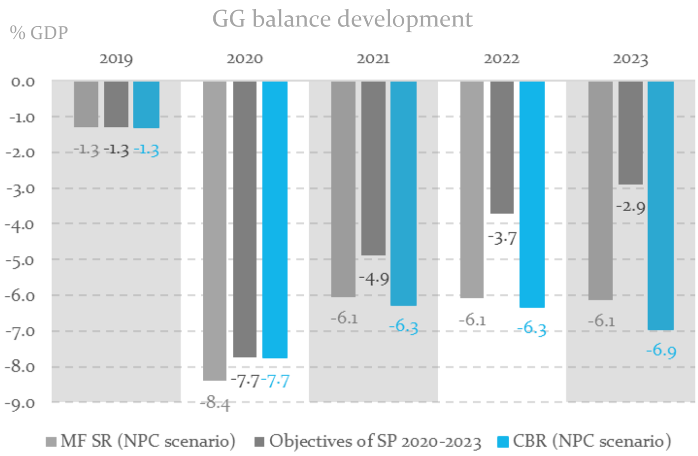
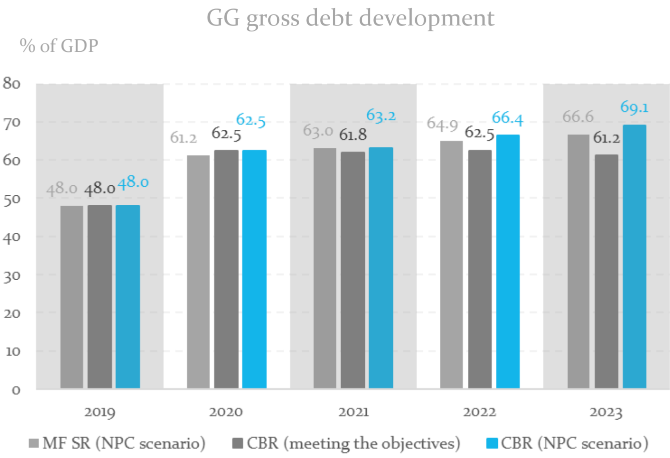


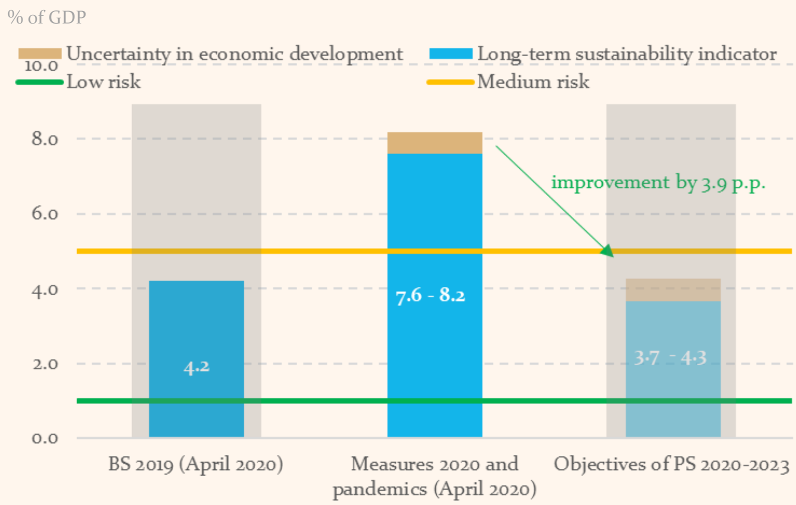
FIGURE 3



NPC scenario = no-policy-change scenario
SP = Stability Programme

Meeting the medium-term budgetary objectives through measures with permanent effects would improve the long-term sustainability, bringing it to the medium-risk zone.

FIGURE 4



BS = baseline scenario

- Reducing the general government deficit below 3 % of GDP by 2023 through measures with permanent effects would improve the long-term sustainability of public finances by 3.9 p.p.
- The long-term sustainability indicator would drop below 5 % of GDP, that is, below the threshold of high risks associated with the long-term sustainability.

Source: Stability Programme of the Slovak Republic for 2020-2023 (April 2020), CBR

Council for Budget Responsibility

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