Evaluation of the General Government Budget Proposal for 2021-2023

Analytical paper

November 2020

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 (https://www.rozpoctovarada.sk).

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

Summary of the evaluation of the budget proposal

The government has submitted the General Government Budget Proposal for 2021-2023, presenting its budgetary objectives amidst a significant economic downturn caused by the COVID-19 pandemic and the ensuing worsened condition of public finances. Although the general government deficit was originally budgeted at 0.5 % of GDP for 2020, the government estimates that the deficit will increase to 9.7 % of GDP. In 2021, the budget proposal expects a year-on-year improvement of the deficit to 7.4 % of GDP. The budgetary objective for 2022 and 2023 is to reach a general government deficit of 5.4 % of GDP and, subsequently, a balanced budget. However, the government does not currently have measures in place for these years to achieve these targets. As implied by the current budget proposal setup, the deficit is expected to gradually decline to 5.7 % of GDP by 2023.

The budget proposal envisages a significant increase in gross debt from 48.5 % of GDP in 2019 to 62.2 % of GDP in 2020, with a subsequent rise to 69.4 % of GDP at the end of 2023. This is attributed both to the impacts of the pandemic, as well as the high levels of structural deficits caused by an increase in other public expenditure. The rise in debt will cause the debt to exceed the upper limit of the sanction zones under the Fiscal Responsibility Act from 2020 and remain there for the entire forecast period.

The purpose of opinions presented by the Council for Budget Responsibility (hereinafter referred to as the "Council" or CBR) is to offer an independent view on the budget and assess whether the current fiscal policy setup is sufficient in terms of achieving the defined targets, while identifying the potential risks which would have to be subsequently eliminated through the adoption of additional measures. In line with its mandate, the CBR also points at whether the present budget provides sufficient margins for ensuring the long-term sustainability of public finances and compliance with the national fiscal rules. With this objective in mind, the CBR highlights the main conclusions of its evaluation as follows:

- Long-term sustainability of public finances still remains within the high-risk zone. **The expected fiscal policy contributes to improving the long-term sustainability of public finances by 0.5 % of GDP.** In order to achieve long-term sustainability, it would thus be necessary to increase revenue and/or reduce expenditure by as much as EUR 7 billion (7.4 % of GDP) in the future.

- **Bringing the long-term sustainability safely from the high-risk zone to the medium-risk zone should be the main objective of the government in the medium-term horizon.** Therefore, the government is advised to publish, as soon as possible, a more detailed consolidation path by at least 1.5 % of GDP on a cumulative basis by the end of 2023, while also adopting further measures with a long-term impact – mainly in the pension system – aimed at improving the sustainability of public finances by an additional 1.5 % of GDP.

- The year 2020 is the baseline year for the preparation of the General Government Budget Proposal for 2021-2023. **Unless additional measures are adopted by the end of the year, the deficit may reach 7.7 % of GDP in 2020.** This means an improvement of the balance as compared to the government's most recent estimate, while the positive risk is primarily attributable to lower-than-expected expenditures for addressing the pandemic, as well as better fiscal performance of other general government entities.

- The budget proposal is prepared in accordance with the budgetary objective only in 2021, but not in the years to follow. As regards 2023, even though the budgetary objective formally respects the legislation (the requirement of a balanced budget under the debt brake provision), it is described as unrealistic. **It falls short of specifying which medium-term objectives would be considered realistic and which strategy for public finances should be followed beyond the 2021 horizon.**

- **In 2021, the Council estimates that the deficit could reach 7.1 % of GDP, followed by a drop to 6.2% of GDP in 2022 before rising to 6.3 % GDP in 2023.** The Council stresses the importance of a faster reduction of the deficit, but this trend is hindered by the structural balance worsening further in 2021 beyond the scope set for 2020, by the assumed impacts of military equipment purchases and by the absence of any consolidation measures between 2022 and 2023.

- **During the crisis years of 2020 and 2021, the structural deficit would gradually worsen from 2.3 % of GDP in 2019 to 5.7 % of GDP. After considering the temporarily high purchases in the defence sector between 2022 and 2023, the structural deficit would decline to 5.0 % of GDP by 2023.** The net contribution of the consolidation measures adopted by the government towards a permanent change of the general government balance will be negative and is expected to reach 0.3 % of GDP in 2023. In the post-crisis years of 2022 and 2023, the government's consolidation effort is close to zero.

- Based on estimating the trend in the general government balance, the CBR expects that the **debt might reach 62.1 % of GDP in 2020, thus exceeding the upper limit of the debt brake sanction zones.** In addition to the crisis, the debt will also be negatively affected by a sharp rise in the structural deficit as result of the pre-crisis economic policy. Without additional measures, the persistently high level of these deficits will cause the debt to rise by EUR 15.7 billion to 67.8 % of GDP at the end of 2023. Combined with a gradual reduction of the sanction zone ceilings, this would imply that the debt will remain above the upper debt brake limit and the distance from that limit will be increasing. **In terms of achieving long-term sustainability, it is now more important to have a medium-term strategy that will reduce, in the first step, the structural deficit down to 3 % of GDP in order to stabilise the debt.** The subsequent path towards a zero structural deficit at a later time would then manifest itself in a steep reduction of the debt also due to the impact of economic growth.

- **In the case of better-than-expected economic development, it is necessary to strictly reflect the impact of all positive factors into improving the fiscal performance.** The introduction of expenditure ceilings, or at least adherence to their principles, should significantly contribute towards achieving this objective. The financial resources from the EU Recovery and Resilience Facility[1] which could, apart from the

[1] At the EU level, it is the Recovery and Resilience Facility, through which Slovakia, as a country, will be able to draw funds based on the Recovery and Resilience Plan.

consolidation of the budget, significantly help mitigate the impacts of a worse-than-expected economic development, represent a good opportunity.

- **If the economic development is worse than expected, it is necessary to stimulate the economy by temporary targeted measures** without increasing the mandatory expenditures in the future.

In comparison with the previous years, the CBR has noticed a qualitative shift in the approach towards the budgeting process which can lead to higher spending efficiency and better value for money. The expenditure reviews are now interconnected with the budgetary process to a greater extent, because measures identified by reviews also in areas other than health care (reduced employment at universities, reduced numbers of police and civil servants) have been incorporated in the budget proposal as well. A shift in the approach towards the investment budgeting is also regarded positively, as its purpose is to take into account the preparedness and economic return of new investments. Furthermore, budgeting by area, including the identification of key indicators, could form a basis for a results-oriented budgeting process. On the other hand, the budget proposal presentation by area is not yet sufficiently transparent in terms of assessing the possible risks and incorporated measures (no distinction is made between the sources for financing the expenditures – also included are those expenditures which are not treated as expenditure under the ESA2010 methodology; and a description of development in 2021 is absent in several cases). Non-transparent budgeting of revenues from dividends still persists.

Fiscal framework

Government consolidation effort

The **structural deficit,** i.e. deficit adjusted for the impact of fluctuations in economic development and other one-off and temporary measures, will worsen during the crisis period between 2020 and 2021 against the pre-crisis year of 2019 by 3.4 % of GDP to 5.7 % of GDP. In the subsequent two years, the structural deficit will improve by 0.7 % of GDP to **reach 5.0 % of GDP in 2023**. At the end of the budgeting horizon it will still be more than twice as worse compared to the pre-crisis level in 2019.

One of the differences affecting the structural balance in comparison with the balance under the ESA2010 methodology is the expected impact of **military equipment purchases in the defence sector**[2]. Compared to the past, this involves the most prominent and clearly identifiable increase having an impact of nearly 1 % of GDP in 2023. The Council assumes that this impact is of temporary nature and, therefore, one-off costs of this kind should be treated correspondingly in the interpretation of the structural balance.

[2] This involves, for the most part, expenditure on the purchase of fighter jets which, under the ESA2010 methodology, will not affect the general government balance at the time of cash payments of advances, but in the years of their delivery, i.e., in 2022 and 2023.

Table 1: GG structural balance change from 2019 to 2023, according to CBR (ESA2010, % of GDP)

	2019	2020	2021	2022	2023
1. General government balance	**-1.4**	**-7.7**	**-7.1**	**-6.1**	**-6.3**
2. Cyclical component	1.0	-1.3	-0.5	-0.5	-0.4
3. One-off effects	0.0	-1.5	-0.9	0.0	0.0
4. Structural balance (1-2-3) (common approach)/Fiscal compact*	-2.3	-4.9	-5.7	-5.7	-5.9
5. Change in the structural balance (Δ4)/ Fiscal compact	**-0.3**	**-2.6**	**-0.8**	**0.0**	**-0.2**
6. One-off investments in the defence sector	0.0	0.0	0.0	-0.4	-0.9
7. Structural balance (4-6)	**-2.3**	**-4.9**	**-5.7**	**-5.3**	**-5.0**
8. Change in structural balance (Δ7)	**-0.3**	**-2.6**	**-0.8**	**0.4**	**0.3**
9. General government balance under NPC scenario		**-7.7**	**-6.7**	**-5.8**	**-6.0**
10. Structural balance under NPC scenario		-4.9	-5.3	-4.9	-4.7
11. Change in structural balance under NPC scenario			**-0.4**	**0.4**	**0.2**
12. Size of measures (1-9)			**-0.4**	**-0.3**	**-0.3**
13. Government consolidation effort (8-11)			**-0.4**	**0.0**	**0.1**
14. Other factors[3]	0.1	-0.2	-0.1	-0.1	0.0
- Measures with no impact on long-term sustainability	-0.1	-0.2	-0.2	0.0	0.0
- PPP projects	0.0	0.0	0.0	0.0	0.0
- Interest payments	0.1	0.0	0.1	0.0	0.0
15. Government measures having an impact on other factors**	0.0	0.0	-0.1	0.0	0.0
16. Change in structural balance after considering other factors (8-14)	**-0.3**	**-2.3**	**-0.7**	**0.5**	**0.3**
17. Refined consolidation effort of the government (13-15)			**-0.3**	**0.0**	**0.1**
18. Public investments (defence)	0.2	0.2	0.4	0.8	1.3

** The calculation of structural balance and its change based on the methodology for evaluating the balanced budget rule (Fiscal Compact).*
*** Including the effect of abolishing the levy payable by financial institutions as from 2021.*
Note: The crisis years are highlighted in grey.
Source: CBR

In order to assess the extent to which the estimated change in the structural balance has been affected by government's measures or by other external factors, it is necessary to compare the development with the no-policy-change scenario (the NPC scenario prepared by the CBR[4]). **Without the government's interventions, the structural deficit would improve by a total of 0.2 % GDP in 2023 as compared to 2020.**

The government's measures will contribute to the deficit increase by a total of 1% of GDP during the next three years. On the expenditure side, cuts will be realised under capital expenditures and compensations of employees, with a negligible amount falling under intermediate consumption. However, higher social transfers (social benefits, pension benefits, transfers to healthcare facilities) and subsidies, as planned by the government, are

3 This involves the factors with no impact on the long-term sustainability of public finances (the fully-funded pillar of the pension system, a levy imposed on selected financial institutions), the factors that are not directly related to the current development in public finances (debt interest payments) and the factors reported outside the general government sector which will worsen the fiscal performance in the future (construction of motorways through PPP projects).

4 Assuming that no new measures are taken by the government after 2020, that public finances develop upon the existing legislation and that the budgetary items are determined solely by macroeconomic development..

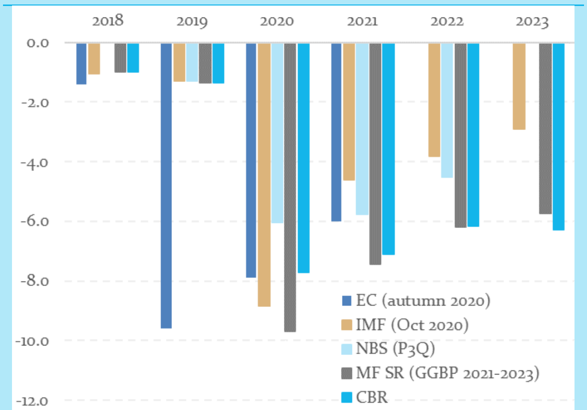
contributing to a more significant deterioration of the deficit[5]. The revenue-side measures will only partially offset the measures on the expenditure side.

The net contribution of the measures adopted by the government[6] towards a permanent change of the general government balance will be negative and is expected to reach 0.3 % of GDP in 2021. In the post-crisis years of 2022 and 2023, the government's consolidation effort is close to zero.

Box 1: Comparison of the general government balance and structural balance from 2018 to 2023

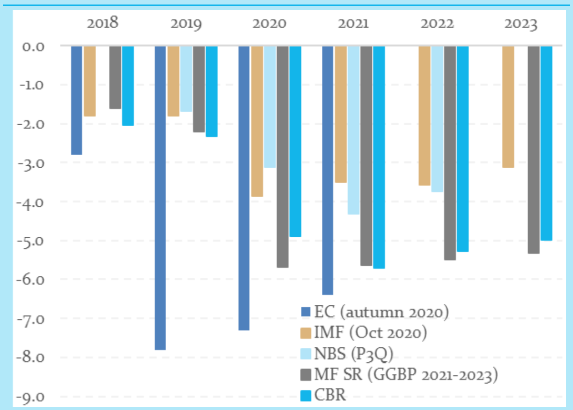
The following figures show the general government balance and estimates of the general government structural balance for 2018-2023 prepared by various institutions: EC (autumn forecast[7]), IMF, NBS, CBR and the Ministry of Finance of the Slovak Republic (General Government Budget Proposal for 2021-2023). For the sake of better comparability, the CBR typically provides the OECD forecast as well; however, a detailed country-specific OECD forecast (*Economic Outlook*) has not been published. The differences in the structural balance are caused by a different estimate of the deficit, a different estimate of the size of a cyclical component (output gap) and one-off effects taken into consideration. In the years ahead, the structural balance will be reaching relatively deep negative values.

Figure 1: GG balance in 2018-2023 (ESA2010, % of GDP)*



Source: CBR, MF SR, NBS, IMF

Figure 1: GG structural balance in 2018-2023 (ESA2010, % GDP)*



* IMF, CBR and MF SR estimates are available until 2023. Forecast by NBS (P3Q) and EC covers the horizon until 2022.

Source: CBR, MF SR, NBS, IMF

The current crisis caused by the COVID-19 pandemic has brought significant downturns in economic activity and is automatically reflected in the estimates of the potential output and, subsequently, of the output gap. Due to a significant uncertainty regarding the future trends, the differences between the individual institutions' estimates are even greater. The differing estimates of the output gap, as a non-measurable indicator, are therefore automatically reflected in different estimates of the cyclical component that is relevant for the estimate of the structural balance. In estimating the cyclical component, the CBR uses the so-called disaggregated approach that takes into account the changes in gaps in the relevant macroeconomic bases[8]. On the contrary, aggregated approach (used by the EC, IMF,

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5 By 0.5 % of GDP in 2021 and, respectively, by 0.6 % and 0.7 % of GDP in the subsequent years.

6 The 'government consolidation effort' indicator is linked exclusively to the contribution of government measures towards a permanent change in fiscal position. A detailed description of this indicator is provided in the CBR discussion paper No. 02/2014: How to measure public finance consolidation.

7 The EC forecast in 2022 is based on the so-called no-policy-change scenario.

8 More details can be found in paper titled *The "True" deficit*

Ministry of Finance, NBS) takes into account the overall budgetary elasticity and output gap. In the table below, the CBR provides a very simplified and alternative approach of factors with impact on the cyclical component estimate.

Table 2: Alternative calculation of the impact of the cycle on GG tax revenues (% of GDP)

	2020	2021	2022	2023
change in tax forecasts relevant for the cyclical component calculation*	-2.0	-2.0	-2.2	-2.3
(-) change in relevant legislation	-0.1	0.1	0.2	0.3
(-) effects caused by the year 2019	-0.1	-0.1	-0.1	-0.1
(-) change in taxes due to the "loss" of potential	-0.9	-1.4	-1.7	-1.9
effect on cyclical taxes	**-0.9**	**-0.6**	**-0.6**	**-0.6**

Source: CBR

	2020	2021	2022	2023
p.m. cyclical component of revenues (CBR)	*-1.1*	*-0.6*	*-0.5*	*-0.4*

**difference between the Tax Revenue Forecasting Committee's February and September forecasts (selected taxes considered in the calculation of the CBR's cyclical component)*

Consolidation measures

The size and structure of measures incorporated in the budget proposal, including the risks identified by the CBR, can be evaluated against the no-policy-change scenario (the NPC scenario) developed by the CBR. The NPC scenario takes as its baseline the CBR's estimate of the general government deficit in 2020 at 7.7 % of GDP[9].

Table 3: Size of measures in CBR's balance estimate against the NPC scenario (% of GDP)

	2020	2021	2022	2023
1. General government balance under NPC	-7.7	-6.7	-5.8	-6.0
2. General government balance estimate (including CBR risks)	-7.7	-7.1	-6.1	-6.3
3. Size of measures (2-1)	**0.0**	**-0.4**	**-0.3**	**-0.3**

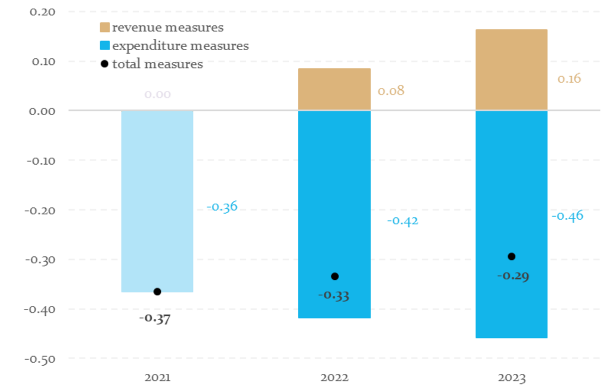
Note: The 2020 estimate was taken as the baseline in preparing the NPC scenario. *Source: CBR*

According to the CBR, the government's plan envisages measures causing the balance to worsen against the NPC scenario by 0.37 % of GDP in 2021. In the subsequent years, the worsening will account for 0.33 % of GDP or 0.29% of GDP. This is primarily due to expenditures on social benefits (in particular, pension benefits under the old-age and disability insurance), subsidies and lower taxes on production and on imports (abolishment of the special levy payable by selected financial institutions). They should be partially offset by cuts in compensations and investments, as well as by higher tax revenues (taxes on labour - personal income tax and social security contributions; and corporate income tax)[10].

[9] The Ministry of Finance estimates the 2020 general government deficit at 9.68 % of GDP.

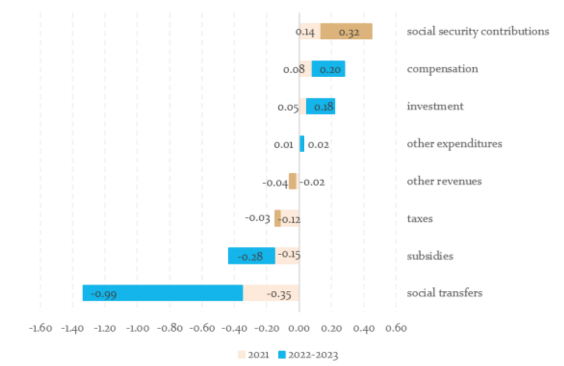
[10] In its forecast, the CBR took into account the announced austerity measures in wage expenditures of the state budget (SB) through a zero y-o-y growth in the overall volume of such expenditures in 2020. The austerity measures in expenditures on goods and services as per the SB have not been incorporated due to the lack of detailed specification of their implementation.

Figure 3: Impact of measures incorporated in CBR's estimate of GG balance against the NPC scenario (% of GDP)



Source: CBR

Figure 4: Contribution of government measures in individual years (% of GDP)



Note: (+) improving and (-) worsening the GG balance

Source: CBR

Figure 4 shows which areas are considered by the government to be a priority in the budget proposal, because their planned funding is higher than the funding under the NPC scenario. On the expenditure side, this primarily involves higher expenditures on social benefits, specifically the pension and sickness benefits. Simply put, those who will be better off in the upcoming years are senior citizens and beneficiaries of sickness insurance benefits. The situation will also be better for beneficiaries of subsidies (subsidies for children's playgrounds, support for housing and support for free-of-charge suburban bus services). On the contrary, state employees who will be laid off as part of spending cuts will be facing more difficult times. As regards the revenue side of the budget, the situation will worsen for tax-paying employees and companies and for smokers (higher excise on tobacco products). Selected financial institutions that will not have to pay the special levy will be better off as well.

During the crisis year of 2021, a part of new measures (12 %) will be provided in the form of recurring current mandatory expenditures[11]. This involves, in particular, social measures such as the introduction of pregnancy benefits, increased compensation for persons with severe disability and maintenance payments or the introduction of free-of-charge bus transport for selected groups of the population. On the other hand, **one-off expenditures for addressing the pandemic represent 74 % of the total amount of the stimulus in 2021**.

Table 4: Structure and size of measures in CBR's estimate of the balance (in € million)

	2020	2021	2022	2023
1. General government balance under NPC scenario (CBR)	**-6,873**	**-6,421**	**-5,790**	**-6,289**
2. CBR's forecast of the general government balance	**-6,873**	**-6,769**	**-6,123**	**-6,598**
Measures (2.-1.)	0	-348	-333	-309
Current expenditures with a permanent effect, of which:		-163	-276	-341
Current expenditures aimed towards the younger generation		*-190*	*-214*	*-219*

[11] The entire volume of the stimulus amounting to EUR 1,357 million is determined as the sum of the amount of measures against the no-policy-change scenario and measures related to the pandemic.

Current expenditures aimed towards the older generation		*-35*	*-112*	*-135*
Other current expenditures with a permanent effect		*62*	*51*	*14*
Current expenditures with a temporary effect		-105	-105	-105
Capital expenditures		0	43	47
Tax measures		-65	3	68
Other measures		-14	2	22
<u>Memorandum items:</u>				
Measures associated with the pandemic (part of NPC scenario)	*-1,189*	*-1,009*		

Note: The 2020 estimate was taken as the baseline in preparing the NPC scenario *Source: CBR, MF SR*

Box 2: Intergenerational transfers due to the COVID-19 pandemic

The long-term impacts and intergenerational distribution of the costs associated with the COVID-19 crisis are analysed by Ľuboš Pástor in his article. As is the case with many countries, Slovakia will also face a significant debt accumulation in the upcoming years as one of the consequences of the current crisis. This means that the burden of paying the costs incurred in addressing this crisis will be borne, for the most part, by the younger generation.

The costs and benefits resulting from the restrictions on movement and other bans imposed by the state are not evenly distributed among generations. The costs associated with the restriction on movement that are borne by the young are much higher compared to older generations, because young people are facing a higher risk of losing their job and the subsequent loss of income. This is also confirmed by the initial findings of the Eurostat showing that young people aged 16-24 were at the highest risk of losing their job during the first wave of the pandemic. The loss of human capital is another important negative effect because pupils and students now have a more difficult access to education. This may negatively affect their earnings from work in the future.

Epidemiological restrictions are more useful for the older generations that are prone to a higher risk of a severe course of the disease. Moreover, as they receive pensions, they are not at risk of losing their income, nor do they face the threat of losing their jobs[12].

According to Pástor, this leads to an intergenerational transfer from the young to the old generation which is, of course, acceptable in this case. The long-term consequences will be borne predominantly by the younger generation.

The CBR also deems that solidarity between the present and future generations is important. So far, it is not possible to calculate the amount of intergenerational transfer from the young to the old generation, but the conclusions from the Eurostat's analysis also hold true for Slovakia. In Slovakia's case, we estimate the debt to rise by 20 p.p. of GDP between 2019 and 2023. Despite that the submitted general government budget proposal will favour the older generation even more, assuming that expenditure on pensions would grow faster due to the government's additional measures (Figure 4). But it will be employees, i.e., the younger generation in particular, who will be paying higher taxes and contributions. This means that the transfer from the young to the older generation will be even higher than that necessitated by the pandemic alone; therefore, the **budget does not have a stabilising effect on intergenerational equity**.

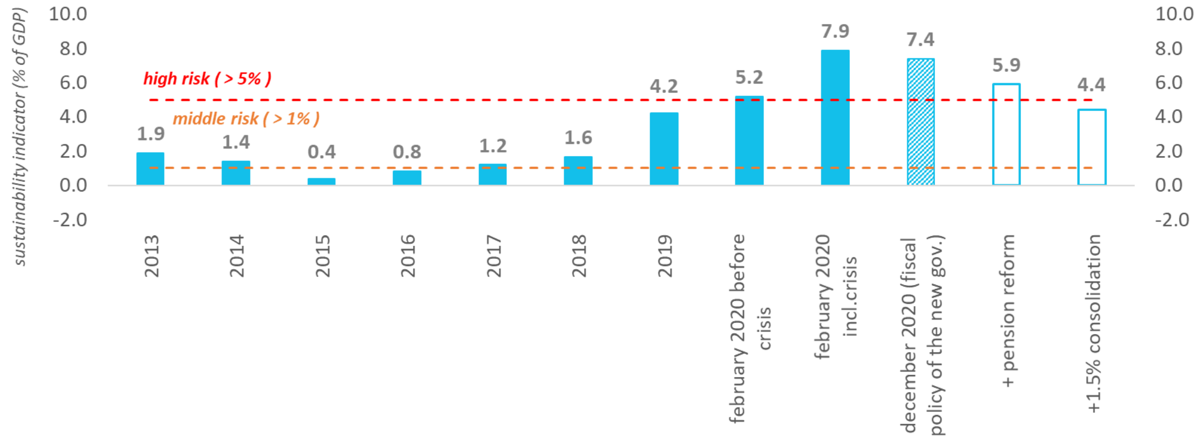
[12] At the same time, epidemiological restrictions in certain areas, such as reduced accessibility of health care, are negatively affecting the older generation to a greater extent.

Impact on long-term sustainability

The long-term sustainability of public finances has been worsening significantly since 2018 and is now dwelling deep in the high-risk zone. In addition to the government's worse-than-expected fiscal management in the current period and the impacts of the pandemic, this development has also been significantly driven by legislative measures (2.1 % of GDP). Due to the absence of a detailed specification of the planned pension reform along with the lack of the government's consolidation plan, the presented budget (including measures in the pension system) contributes only little to improving the long-term sustainability of public finances (0.5 % of GDP) and remains in the high-risk zone.

Additional measures need be adopted in order to bring the risk down below the upper limit of the medium-risk zone (i.e., by more than 2.4 % of GDP). This could be achieved, for example, by implementing the pension reform[13] (1.5 % of GDP) in combination with additional consolidation of the budget by the end of the current election term (1.5 % of GDP).

Chart 5: Long-term sustainability development (% of GDP, including the recommended scenario)



Source: CBR

[13] The changes introduced in the pension system in 2019 and early 2020 (introduction of retirement age ceilings; increase in minimum pensions; reduced curtailment of pensions paid from the social insurance scheme to savers in the fully funded pillar; introduction of the 13th pension payments in full amount) contributed some 2.1 % of GDP to the worsening of the sustainability of public finances (*ceteris paribus*; i.e., not taking into account the worsened macroeconomic development caused by the effect of the decreased participation in the labour market on other ageing-related expenditures). If the correction measures in the amount of 0.6 % of GDP are factored in (13th pension payment adjustment and freezing the minimum pension), the sustainability of public finances would have to improve by additional 1.5 % of GDP if we wanted to revert the state of the pension system to the 2018 level from the sustainability perspective.

Public finances are deep in the high-risk zone of long-term sustainability

The approval of 13th pension payments[14] in **February 2020 along with the growth in wages in the public sector have pushed the long-term sustainability of public finances up to the high-risk zone, and the long-term sustainability indicator swelled up to 5.2 % of GDP**[15] (the introduction of 13th pension payments contributed 0.5 % of GDP to the increase).

The subsequent outbreak of the global COVID-19 pandemic then adversely affected the macroeconomic situation throughout the world, including in Slovakia. According to the April 2020 estimate, the **economic impacts of the pandemic** may contribute further 2.7 % of GDP toward the worsening of the long-term sustainability of public finances. The long-term sustainability indicator could then **rise to 7.9 % of GDP**. In order to achieve the long-term sustainability, revenues need be increased and/or expenditures decrease in a volume (for illustrative purpose) exceeding 1.2-times the expenditures in the health sector. The presented estimates, however, are still to be quantified more precisely in a long-term sustainability report to be published in the spring of 2021, following the evaluation of the 2020 fiscal performance.

In October 2020, before the 13th pension payments could be paid out for the first time,[16] the parliament approved a 13th pension payment adjustment[17], improving the public finance sustainability by 0.3 % of GDP (the negative impact on sustainability shrunk from 0.5 % of GDP to 0.2 % of GDP). Decreasing the retirement-age ceiling for certain birth-year cohorts of mothers[18], as approved by the parliament at the end of September 2020, will temporarily increase pension system's expenditures (by EUR 105 million a year, according to the government's estimates). However, as they are bound to be decreasing swiftly, the negative impact on the long-term sustainability will be small, not exceeding 0.02 % of GDP.

Impact of the pension-related measures included in the budget but not yet approved by the parliament

At the time of preparation of this document, the parliament passed to the second reading **a government's proposal to freeze the minimum amount of old-age pensions**[19] **at the level of 2020** and to reinstate the qualified period of pension insurance. The measure had

[14] In February 2020, the parliament approved so-called 13th pension payments as a component of the pension system (Social Insurance Act) to replace the so-called Christmas bonus (a benefit paid under a separate law). The 13th pension payment should be paid to each pensioner in the amount of an average pension benefit of the particular type of pension regardless of the size of the pensioner's income.

[15] https://www.rozpoctovarada.sk/download/infografika03.pdf

[16] The 13th pension payments should have been paid out in December 2020 for the first time.

[17] The adjustment to the 13th pension payment was adopted by a separate law (i.e., it is not longer included in social insurance), while its mechanism is very similar to that of the former Christmas bonus. The maximum amount of the 13th pension payment is 300 euros, and has been set to gradually decrease as a pensioner's total pension income increases. However, every pensioner will receive at least 50 euros.

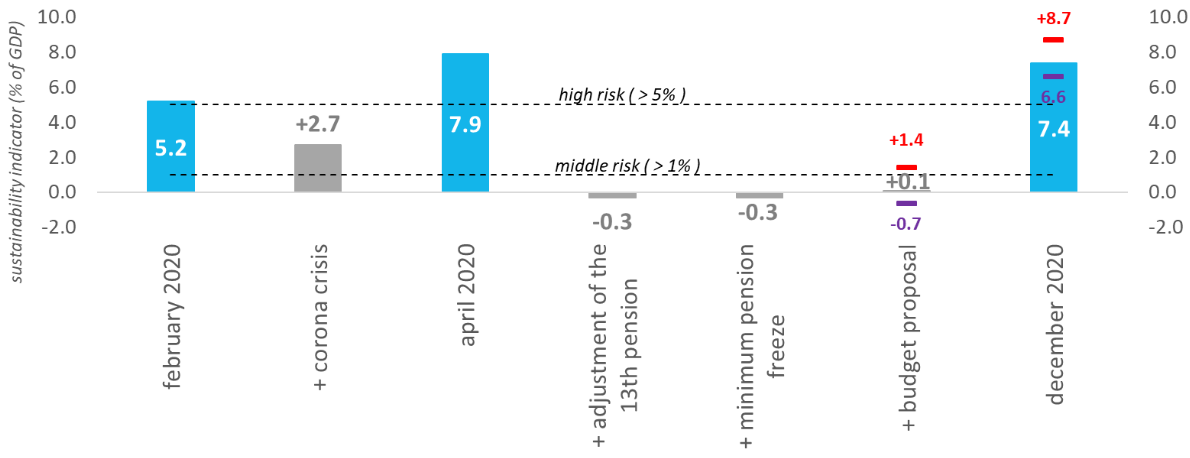
[18] Under an MP (member of parliament) proposal, the retirement age for women who raised children has been reduced so that a six-month retirement age ceiling differentiation (where the retirement age should gradually converge in future for individual categories) could instantly (even retroactively) apply to the current retirement age of the women concerned.

[19] The minimum pension amount for 2020 (after its increase) is at the level of 33 % of average wage in Slovakia from two years ago, if a person paid pension insurance for 30 years. For additional years of career beyond 30 years, its value increases by 2 % of subsistence minimum for each year until 39 years and by 3% of subsistence minimum for each year beyond this limit.

already been incorporated in the budget, too. The draft legislation implicitly assumes permanent "freezing", however, its explanatory memorandum says that increasing the minimum amount of old-age pension should resume once the minimum amount of old-age pension achieves the level set in the original rules applicable before 2020[20]. The CBR applied the same assumption for the purposes of long-term projections of pension expenditures, too. Under this assumption, **the freezing of the minimum old-age pension will contribute to improving the long-term sustainability of public finances by 0.3 % of GDP.**

With respect to the pension system expenditures, **the general government budget envisages the current, temporary mechanism of "minimum" indexation of pension benefits to continue beyond 2021 as well.** Pensions should continue increasing by a percentage of pensioners' inflation, while the increase in a given type of pension benefit must not be less than 2 % of the average benefit of that type of pension. It means the budget **implicitly expects a future change in legislation** which would cancel percentage-based indexation by pensioners' inflation that was approved in 2012 but has never been applied in practice (currently expected to apply from 2022 onward). According to the CBR's preliminary estimates, **the continued application of this indexation mechanism would not necessarily have a significant negative impact on the long-term sustainability** given the fact that a major part of the effect of the pension increase will be offset by lower co-payments to minimum pensions and to benefits for pensioners in material need. Given the objective limits of the CBR's pension model, the measure will need be verified using microeconomic data.

Figure 6: Impact on long-term sustainability (% of GDP)



** risk scenario for the second wave of the pandemic shown in red; scenario including the drawing of funds from the Recovery and Resilience Facility shown in violet*

Source: CBR

Compared to the CBR's evaluation contained in the long-term sustainability report of April 2020 (7.9 % of GDP), **the long-term sustainability of public finances may improve by 0.5**

[20] Representing 136 % of the minimum subsistence amount for a single adult – exceeds the amount of 334 euros and 30 eurocents. At the same time, a transition period has been defined for people who are awarded the minimum pension under the rules applicable until December 2020 (the eased qualified periods requirement). The minimum pension is assessed using the original rules in the case of these persons.

% of GDP (to 7.4 % of GDP). The major contribution (-0.6 p.p.) comes from the adjustment of 13th pension payments and freezing of minimum pensions, which help slow down the fast growth in expenditures over the long term. By contrast, the medium-term development planned in the budget (adjusted for the effects of pension-related measures)[21] has a slightly deteriorating impact on the long-term sustainability[22] (+0.1 p.p.).

A positive, albeit non-quantified, impact on the long-term sustainability may come from a qualitative shift towards the value for money approach in the budgeting process. Especially assessing investments from the point of view of their economic return, too, may enhance effectiveness of allocation of limited resources and positively contribute to a higher long-term growth of the economy potential. In addition to its positive effect on the living standard of the population, **a higher productivity is also beneficial to the sustainability of public finances** (see sensitivity scenarios in the long-term sustainability reports).

A positive risk also comes from the drawing of finances from the EU Recovery and Resilience Facility which could have a positive impact on macroeconomic development and general government's fiscal performance. From the perspective of its effects on the long-term sustainability, such a development scenario could lead to improving the sustainability by 0.8 % of GDP to the 6.6 % of GDP level. By contrast, if the risk scenario for the second wave of the pandemic is fulfilled, the sustainability of public finances could deteriorate by additional 1.3 % of GDP, rising the sustainability indicator to 8.7 % of GDP.

Despite the 0.05 % of GDP improvement, additional 2.4 % of GDP will still be missing in order to reduce the high risk. The changes in the pension system alone cannot bring about a considerable improvement in the sustainability of public finances; therefore, in addition to the consolidation of public finances, it is necessary to seek and find measures in other areas, too (health care, long-term care, boosting the potential growth, e.g., through the changes in the tax mix or a school reform).

Box 3: Measures in the pension system are not sufficient to reduce the high risk (constitutional act on the pension system)

A constitutional pension system act is currently being drafted, supposed to anchor the basic principles for the operation of all pension system pillars and stabilise the system. Despite the uncertainty concerning the final version of the constitutional act and the subsequent wording of implementing legislation (specifically the parameters of individual measures), we may be quite sure that **merely adopting the following constitutional principles without additional consolidation efforts will not be sufficient to reduce the high risk of sustainability of public finances (more in Annex 1)**.

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[21] The effect of the budget on the long-term sustainability of public finances is evaluated against a no-policy-change scenario in order to properly assess the contribution of the government's medium-term fiscal performance towards the change in sustainability. Since the effect of the measures adopted in the pension system (included in the budget) is usually evaluated and presented separately, it is necessary to analytically adjust the medium-term fiscal development for their effect (otherwise it would be factored in twice, or could be overestimated).

[22] If we assessed the 2021 general government budget proposal (i.e., we did not take into account the medium-term development until 2023), the budget's negative effect on the long-term sustainability would increase from 0.1 % of GDP to 0.25 % of GDP.

The positive effect of linking the retirement age to average life expectancy (-1 % of GDP) would likely be erased in full by the negative effects of introducing a parental bonus (+0.8 % of GDP) and other measures that undermine the sustainability of public finances (higher pension claims for the period of parenthood, extraordinary indexation).

With respect to the retirement age, an introducing of a so-called individual retirement age ceiling is also being pondered (which is a different form of early retirement enabling people to retire after having worked for 40 years). However, here it will be extremely important to include an obligation in the constitutional act to apply actuarial principles when awarding this type of pension (to curtail it the way the early pensions are). Otherwise, this measure will have a considerable negative effect as it will significantly extend the period of receiving pension benefits without adequately reducing their amount.

The constitutional act's contribution towards the sustainability of public finances will thus probably rest, in particular, on the setting of automatic correction mechanisms whose final form will eventually be defined by the actual implementing legislation on social insurance.

Estimated development in 2021 through 2023 – budget risks

Table 5: Risks and sources of their coverage in 2021 through 2023 (ESA2010, € million)

	2021	2022	2023
Budget balance in the 2021-2023 GGB proposal (€ million)	**-7,118**	**-6,174**	**-6,025**
Budget balance in the 2021-2023 GGB proposal (% of GDP)	**-7.44**	**-6.18**	**-5.72**
Impacts on general government balance – total:	**348**	**51**	**-573**
- % of GDP	**0.37**	**0.05**	**-0.55**
1. Measures taken to combat the pandemic	**32**	**0**	**0**
2. Revenues from taxes and social security contributions	**238**	**424**	**562**
- new legislation not included in the GGB proposal	72	78	83
- other revenues from taxes and social security contributions	166	346	479
3. Non-tax revenues	**-129**	**-73**	**8**
- dividends – state budget and MH Manažment	-97	-91	-32
- levy on gambling	-42	-33	-22
- emission allowances	12	28	37
- other non-tax revenues (other non-tax revenues to state budget, EOSA fee)	-3	23	25
4. Social benefits and transfers:	**81**	**127**	**112**
- expenditures of the Social Insurance Agency	93	126	92
- social benefits of the Ministry of Labour, Social Affairs and Family	-12	1	21
5. Transactions with the EU budget	**230**	**459**	**202**
- transfer to the EU budget	0	0	0
- co-financing expenditure	141	353	96
- reserve for contributions to the EU budget and EU funding	107	107	107
- financial corrections from EU funds drawdown	-18	0	0
6. State budget expenditures:	**-296**	**-1,119**	**-1,609**
- current reserves (excl. wages)	141	131	131
- wage costs of the state budget (incl. reserves)	-23	-127	-304
- goods and services (excl. reserves)	61	43	40
- current transfers to general government entities	-578	-728	-879
- other current expenditures	-58	-84	-118
- capital expenditures	161	-354	-480
7. Financial performance of local governments (excl. tax revenues):	**220**	**335**	**341**
- municipalities	273	363	371
- self-governing regions	-53	-28	-31
8. Expenditures in the healthcare sector:	**-21**	**-89**	**-154**
- health care expenditures	-33	-74	-123
- repayment of liabilities to shareholders of private health insurers	-30	-50	-50
- financial performance of hospitals	66	61	50
- operating costs of health insurance companies	-24	-25	-31
9. Financial performance of other general government entities:	**-18**	**-25**	**-36**
- ZSSK railway company (freight transport)	-74	-78	-79
- organisations partly funded from the state budget	21	2	-2
- Environmental Fund	-55	-35	-41
- public universities	51	47	40
- Jadrová a vyraďovacia spoločnosť (nuclear decommissioning company)	16	8	5
- Other entities	23	30	40
10. Other effects	**12**	**11**	**1**
Budget balance reflecting the CBR risks (€ million)	**-6,769**	**-6,123**	**-6,598**
Budget balance reflecting the risks noted by CBR (% of GDP)	**-7.10**	**-6.15**	**-6.29**

Note: a plus or minus sign is used to show the impact on the general government balance. *Source: MF SR, CBR*

Year 2020: Updates to budget balance risks

Table 6: Overview of budget balance risks for 2020 (€ million)

	December 2019	June 2020	November 2020
Impacts on general government balance – total:	**-1,274**	**-6,212**	**-6,393**
- % of GDP	**-1.30**	**-7.18**	**-7,.16**
1. Revenues from taxes and social security contributions	**-29**	**-2,978**	**-2,234**
2. Non-tax revenues	**-226**	**-394**	**-528**
- revenue from dividends (SPP, VSE)	-67	-169	-208
- administrative revenues of the state budget	5	5	-52
- levy on gambling	-14	-30	-65
- capital revenues of the state budget	-40	-33	-35
- other non-tax revenues of the state budget	26	1	11
- emission allowances	-104	-136	-136
- EOSA fee	-32	-31	-43
3. Social benefits and transfers:	**-183**	**-1,053**	**-808**
- social benefits of the Ministry of Labour, Social Affairs and Family	-160	-1142	-590
- expenditures of the Social Insurance Agency	-23	89	-218
4. Transactions with the EU budget	**12**	**-186**	**-265**
- transfer to the EU budget	95	102	42
- co-financing expenditure	-156	-188	-185
- reserve for contributions to the EU budget and EU funding	80	80	80
- financial corrections from EU funds drawdown	-6	-180	-201
5. State budget expenditures:	**-457**	**-1,077**	**-2,098**
- current reserves (excl. wages)	200	200	200
- wage costs of the state budget (incl. reserves)	-54	4	-73
- goods and services (excl. reserves)	-24	-246	-250
- other current expenditures	-213	-566	-1001
- capital expenditures (incl. reserves)	-366	-469	-974
6. Financial performance of local governments (excl. tax revenues):	**-215**	**-80**	**-270**
- municipalities	-195	-66	-154
- self-governing regions	-20	-14	-116
7. Expenditures in the healthcare sector:	**-138**	**-245**	**-135**
- health care expenditures	-13	-14	55
- repayment of liabilities to shareholders of private health insurers	-50	-50	-55
- financial performance of hospitals	-49	-150	-123
- operating costs of health insurance companies	-26	-32	-12
8. Financial performance of other general government entities:	**-32**	**-198**	**-52**
- Social Insurance Agency's Administrative Fund	-23	-76	-91
- ŽSR railway company (passenger transport)	-10	-28	-23
- ZSSK railway company (freight transport)	-27	-90	-48
- NDS (National Motorway Company)	36	-22	25
- organisations partly funded from the state budget	7	12	52
- Environmental Fund	-12	-24	-24
- public universities	1	-45	39
- Jadrová a vyraďovacia spoločnosť (nuclear decommissioning company)	28	41	-10
- Other entities	-31	34	28
9. Other effects	**-8**	**-1**	**-3**

Source: MF SR, CBR

CBR

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