CBR
COUNCIL FOR BUDGET RESPONSIBILITY

2020 General Government Budget Results

Summary results

(based on the April notification of deficit and debt)

April 2021

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Basic information about CBR's positions

The Council for Budget Responsibility (CBR) was formed in 2012 as an independent body set up to monitor and evaluate the fiscal performance of the Slovak Republic. Its role is to provide professional, comprehensive and politically unbiased information to the public on the development of public finances. The purpose of CBR's opinions is to offer an independent view on the budget and assess whether the fiscal policy setup is sufficient in terms of achieving the targets set and identify those potential risks which need to be eliminated through the adoption of additional measures. In line with its mandate, the CBR also points out whether the present budget provides sufficient margins for maintaining the long-term sustainability of public finances and compliance with the national fiscal rules.

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.

1 Summary

The development in Slovakia's public finance was adversely affected by the COVID-19 pandemic throughout 2020. **The general government deficit[1] reached the level of 6.16% of GDP and, for objective reasons, it was impossible to achieve the target deficit of 0.49% of GDP as set under the approved budget[2].** The balance worsened by 4.8. p.p. of GDP year-on-year, with the deficit-to-GDP ratio having swelled up to the highest level since the crisis year of 2010.

The negative effect of the pandemic on the general government balance amounted to EUR 3.4 billion (3.9% of GDP[3]). With the pre-crisis setting of the economic policy, the deficit could have reached EUR 2.4 billion (2.5% of GDP), excluding the impacts of the pandemic, compared to the target deficit set at EUR 0.48 billion (0.5% of GDP). The deviation of EUR 1.95 billion (2.0% of GDP) from the approved target would thus have been the largest one since the crisis year of 2009, slightly exceeding the overall risks estimated by the Budgetary Traffic Lights at the level of EUR 1.9 billion[4] before the outbreak of the pandemic, too. The economic policy pursued after the election, crisis measures excluded, resulted in an additional decrease in the final deficit by EUR 0.2 billion (0.2% of GDP).

Table 1: Development in basic public finance performance indicators (in % of GDP)

	2015	2016	2017	2018	2019	2020
GG balance	-2.7	-2.6	-1.0	-1.0	-1.3	-6.2
Structural balance	-2.5	-2.4	-1.6	-2.0	-2.3	-3.4
Gross general government debt	51.9	52.4	51.5	49.6	48.2	60.6
Net general government debt	47.5	47.1	45.7	43.3	43.6	50.6
p.m. Cyclical component	-0.2	0.0	0.6	1.0	1.0	-0.8
p.m. One-off effects	0.0	-0.1	0.0	0.0	0.0	-2.0
p.m. Change in structural balance	-	0.1	0.8	-0.5	-0.3	-1.1
p.m. Fiscal impulse	-	3.2	1.0	-0.9	-0.4	-2.7

Source: Statistical Office, CBR

From the point of view of a medium-term burden on public finance, it is better to focus on the structural deficit indicator (i.e., a deficit that will automatically last even into the future, if no additional measures are adopted[5]). **The exceptional circumstances made it even clearer how unfit the pro-cyclical fiscal policy pursued over the past years had been[6].**

[1] For the purpose of assessing the development in public finance, the general government consists of the central government (state budget, organisations partly funded from the state budget, and other general government entities), the Social Insurance Agency and health insurance companies, and local governments (municipalities and self-governing regions).

[2] The State Budget Act was amended in July 2020 to respond to the negative impacts of the pandemic. Under this amendment, the Ministry of Finance presented an estimate of general government deficit at the level of 11.6% of GDP. This figure, however, was not approved as a new target deficit for the government, and no updated assumptions on the fiscal performance of entities outside the state budget were published. In light of the above considerations, the CBR assesses deviations from the original budget approved in December 2019 in this paper.

[3] After incorporating the effect of the change in denominator – a decline in nominal GDP compared to the budgetary assumptions.

[4] In February 2020, the Budgetary Traffic Lights estimated the deviation of the general government balance from the target approved in the budget to be at EUR 1.9 billion (1.9% of GDP).

[5] The structural balance does not include one-off and temporary measures that do not represent a burden on public finance in the future.

[6] More details can be found in Zdravé a dlhodobo udržateľné verejné financie - novela ústavného zákona o rozpočtovej zodpovednosti (*'Sound and Sustainable Public Finance – Amendment to the constitutional Fiscal*

Even though there had been enough room to achieve a balanced budget in the previous years, the **structural deficit** – before the outbreak of the pandemic, at the end of the good times with unemployment attacking the historic lows – amounted to as much as 2.4% of GDP and **had a major share (71%)** in the last year's overall negative structural balance. The pandemic increased the structural deficit by 1.2% of GDP, whereas the economic policy after election improved the deficit by moderate 0.2% of GDP.

Table 2: Factors affecting the general government fiscal performance in 2020

	nominal balance		structural balance	
	EUR million	in % of GDP	EUR million	in % of GDP
Fiscal performance	**-5,609**	**-6.2**	**-4,371**	**-3.4**
Economic policy prior to election*	-2,429	-2.5	-2,198	-2.4
p.m. fiscal performance in 2019	*-1,249*	*-1.3*	*-1,604***	*-1.7***
Effect of the pandemic (including measures)***	-3,393	-3.9	-1,126	-1.2
Economic policy after election	213	0.2	213	0.2

** - fiscal performance without additional austerity measures*
*** - estimated taking into account pre-crisis assumptions on economic development*
****- including the effect of the change in denominator – decrease in GDP – on the economic policy prior to election*
Source: Statistical Office, CBR, Ministry of Finance, Ministry of Health

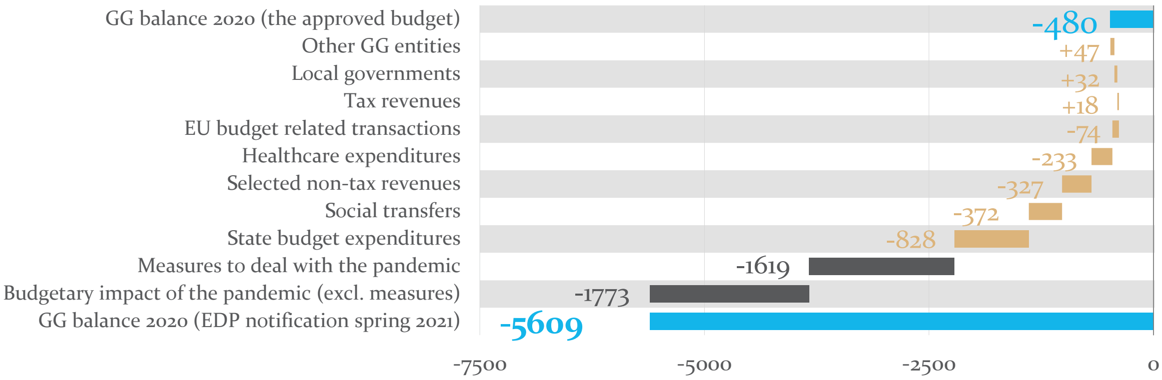
The Slovak public finance had not been prepared for the crisis, neither in terms of the size of deficit nor the level of public debt. We entered the crisis with an estimated deficit at the level of 2.5% of GDP, dangerously approaching the threshold Maastricht deficit of 3% of GDP. At this level, there is not enough manoeuvring room to cope with larger cyclical fluctuations in the economy, let alone with serious crises. If the medium-term objective of having a structurally balanced budget had been achieved before the outbreak of the crisis, which the government had repeatedly postponed, the overall deficit would have been EUR 2.2 billion lower (2.4% of GDP) in 2020. **Alternatively, we could have afforded to provide an accordingly larger one-off incentive in the year of crisis, while having the public finance in considerably better conditions in terms of long-term sustainability.**

Gross debt amounted to 60.6% of GDP, the highest-ever level of Slovakia's public debt. The year-on-year increase in debt by 12.3 p.p. of GDP also **means that the debt overshot the highest sanction bracket of debt break set at 57% of GDP.** However, in addition to the high budgetary deficit, the year-on-year increase in debt was also driven by an **increase in the government's cash reserve amounting to 5.3 p.p. of GDP**. Therefore, if we want to assess development in debt, it is more advisable to look at **net debt** which showed **a lesser increase by 7 p.p. to 50.6% of GDP.**

Responsibility Act') (slide 10): *"If the 2013-2019 governments had met their own budgetary commitments, the country's 2019 debt could have been almost 10% of GDP lower (at 39.1% of GDP) and we would have been better prepared for the crisis."*

CHART 1

Factors contributing to the deviation in GG balance from the approved budget (ESA 2010, EUR million)



Source: Statistical Office, Ministry of Finance, Ministry of Health, CBR

If no measures were taken by the government, larger and longer lasting negative consequences of the crisis could be expected as a result of the pandemic. The aim of the government's measures was to prevent the spread of the infection even at the cost of temporarily restricting economic activity, while, at the same time, helping to compensate the affected groups for the negative impact of the pandemic. Given that the crisis was not caused by economic imbalances, the protection of economic potential through support schemes for the private sector has become, in addition to the usual counter-cyclical policy, a legitimate objective of the economic policy.[7]

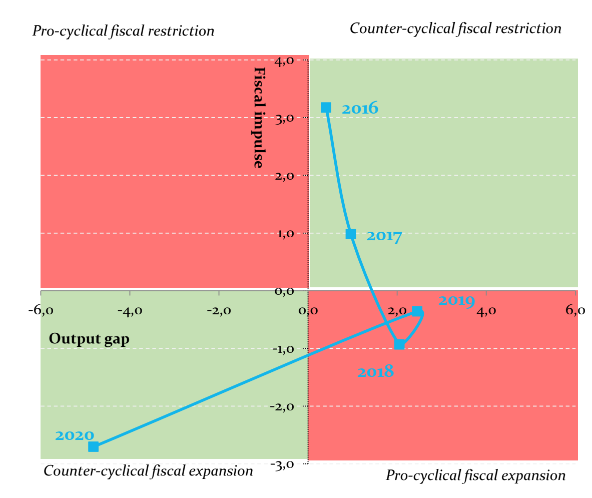
The government's measures gave an additional boost to the economy at a level of 2.3% of GDP in 2020. It means that the fiscal policy was rightly counter-cyclical, with the support provided mainly by means of temporary measures targeted at addressing the consequences of the pandemic. Temporary measures are best suited to respond to this type of crisis because once the crisis is over, these measures expire as well and will not burden public finance over the long term. The government's counter-cyclical measures thus contributed to a lesser economic downturn and to an output gap reduction approximately by 1 p.p.[8]

7 According to an NBS's estimate, the anti-crisis support saved around 60,000 jobs, significantly contributing to a much lesser decline in employment compared to the financial crisis, see chart (Strednodobá predikcia NBS, P4Q-2020, Graf A, pg. 23).

8 Without the adoption of direct fiscal measures to prevent the negative impacts of the pandemic in the amount of nearly 2% of GDP, the growth in real GDP would have been almost 1 p.p. lower. This estimate is based on the compensation package for wages (*kurzarbeit*, active labour market measures), for social transfers to households, subsidies for businesses and tax deferrals. These measures reduced companies' workforce costs and lead to a one-off increase in income of some households. The better-than-expected economic development compared to the initial estimates from the first half of 2020 (an 8 to 10% slump in GDP) was also largely driven by coordinated monetary policy measures around the world and macroprudential measures taken by central banks. In addition, a strong driver behind the smaller-than-originally-estimated decline in GDP was the fact that the Slovak economy is based on export performance (foreign demand) which exceeded expectations in 2020.

CHART 2

Total fiscal impulse in 2020 (% of GDP)	-2,7
A. Impacts on revenue and expenditure due to the loss of potential (higher deficit due to a decrease in income while original expenses remain the same)	**-0.4**
B. Government's measures	**-2.3**
- measures excluding the pandemic's impact	*-0.5*
- measures related to the pandemic	*-1.8*
C. Drawing of EU funds (unrelated to the pandemic)	**0.1**



(-) expansion (+) restriction

Responsible fiscal policy is always trying to be counter-cyclical (green colour) in order to stabilise the economy.

Source: CBR

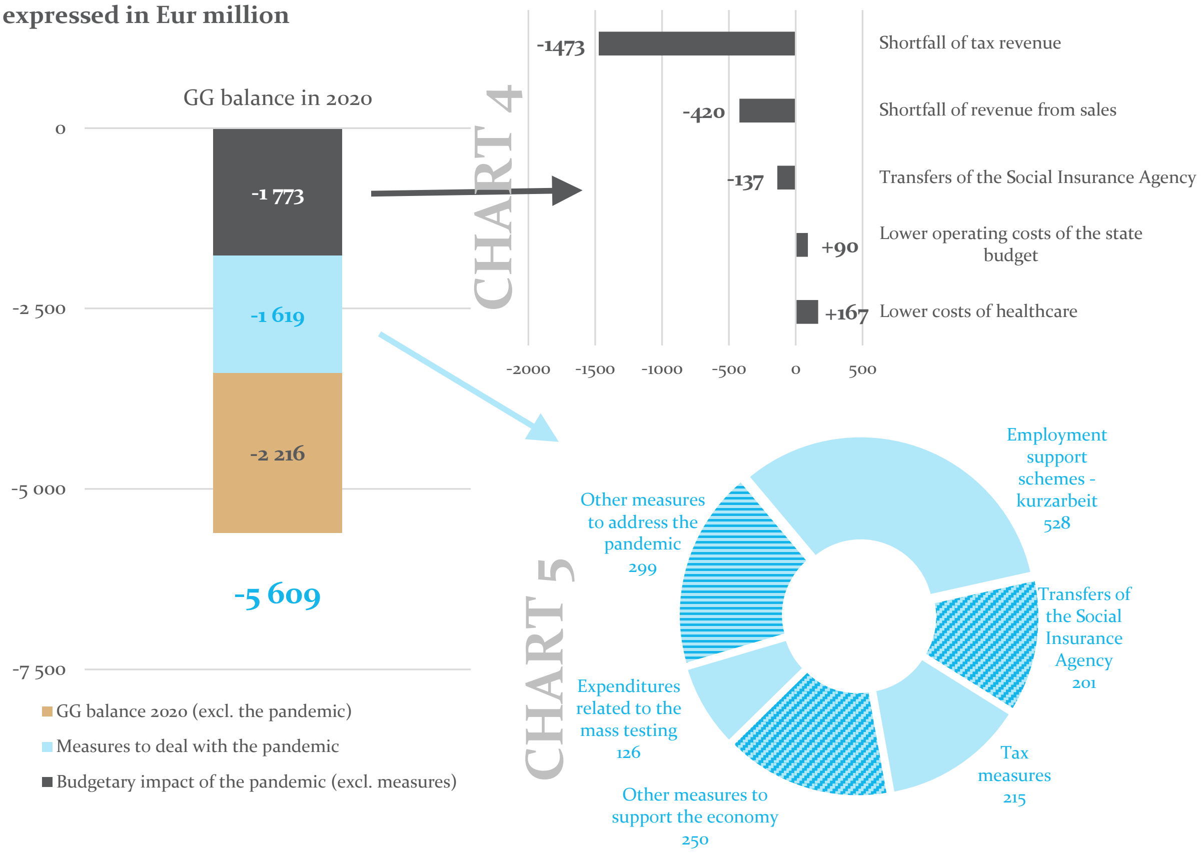
The government's measures to address the pandemic have increased the deficit by EUR 1.6 billion (1.8% of GDP). Support schemes for sustaining employment (the so-called kurzarbeit) have brought higher spending in transfers, thus affecting the balance by EUR 528 million. Within the category of the Social Insurance Agency expenditure, **new sickness benefits received under quarantine or for taking care of a family member during the pandemic** have been introduced, while also **extending the duration of entitlement for unemployment benefits**, with the overall impact of these measures on the budget standing at EUR 201 million. The government adopted **several measures to support the economy also in the area of revenues from taxes and social contributions** (abolishment of the bank levy, remission of social contributions, amortisation of losses), while their negative impact on the deficit represented EUR 215 million. Other measures aimed at boosting the economy, implemented in the form of subsidies for rent, through changes in social benefits or in the form of support for employment in kindergartens, have resulted in a budgetary impact of EUR 250 million. **The government also incurred costs in connection with the purchase of medical supplies,** in particular emergency stocks, in a total amount of EUR 138 million. **Expenditures related to the mass testing**[9] have increased the deficit by EUR 126 million. **Other measures to address the pandemic**, including expenditure for refunding the costs to general government entities and for bonuses paid to front line workers, increased the budget by EUR 161 million. Expenditure in the health care sector had a negative impact of EUR 86 million on the balance, in particular due to the worsened fiscal performance of hospitals and the transfers of private health insurance companies to their shareholders.

9 Overall expenditure covers the procurement costs of antigen tests, bonuses for medical workers, personnel expenditures of the members of the Armed Forces of the Slovak Republic, the police corps, members of the fire and rescue brigades, and other personnel and operating costs of the defence and interior sectors, as well as of local governments.

CHART 3

Impacts of the pandemic on the general government balance in 2020

expressed in Eur million



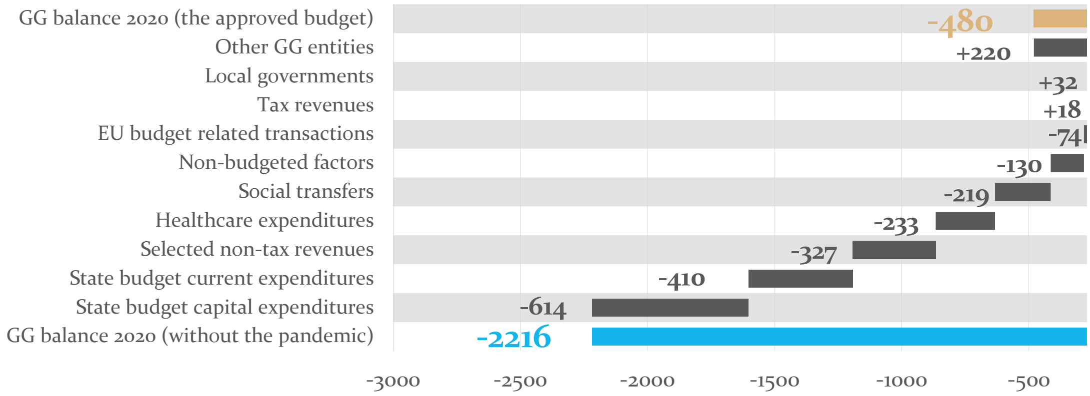
Budgetary impacts of the pandemic excluding the government's measures amounted to EUR 1.8 billion (1.9% of GDP). The most significant impact can be attributed to a shortfall in revenues from taxes and social contributions amounting to EUR 1.5 billion as a result of an economic slowdown and restrictive epidemiological measures. A decline in revenues due to the pandemic was seen predominantly in corporate income tax, by EUR 534 million, and in taxes on labour, by EUR 490 million. Furthermore, **selected non-tax revenues,** in particular revenue from sales of the state budget, local governments and entities providing transport services (railway companies ZSSK and ŽSR, transport companies, the National Motorway Company) fell by EUR 420 million**.** Higher **spending** was also reported in **benefits from the Social Insurance Agency linked to economic development**, in particular sickness insurance and unemployment benefits.

On the other hand, the budget deficit was reduced by EUR 167 million **in connection with lower costs of healthcare,** where the impact of lower spending due to the temporary suspension in healthcare provision, quantified at EUR 325 million, surpassed the additional costs associated with the treatment of COVID-19 totalling EUR 158 million. The smaller scope of health care provision unrelated to COVID-19 will probably translate into an increase in avoidable mortality, while the overall scope will depend on the ability to make up for non-provided clinical interventions in 2021 or 2022. When compared to standard development, this will necessitate an increase in allocations for the health care sector, which will have a negative impact on the deficit. Reductions amounting to EUR 90 million were also observed in **lower operating costs of the state budget** because of limited operation due to restrictive epidemiological measures (e.g., travel expenses, overheads, expenses for cleaning services).

The budget contained significant risks already at the time of its approval. In December 2019 the CBR identified negative impacts in the approved budget on the expenditure side as well as in non-tax revenues with a total impact on the balance amounting to 1.3% of GDP. Before the outbreak of the crisis, the deviation increased to as much as 1.9% of GDP. Several risks were based on the fact that, in certain items, the budget neither reflected the correct methodology of recording[10], nor the most recent developments[11] in the relevant items of the general government performance or the approval of the 13th pension payments not covered by the budget. **In the course of 2020, the risks identified by the CBR have materialised, and in the case of certain items, their negative impact on the balance even surpassed the original expectations of the CBR.** This included, for the most part, lower-than-budgeted non-tax revenues, in particular, income from dividends and emission allowances, higher growth in state budget expenditure, in particular capital expenditures, and the growing expenditure in the healthcare sector.

CHART 6

Factors contributing to the deviation in GG balance from the approved budget, without the pandemic (ESA 2010, in EUR million)



Source: Statistical Office, Ministry of Finance, CBR

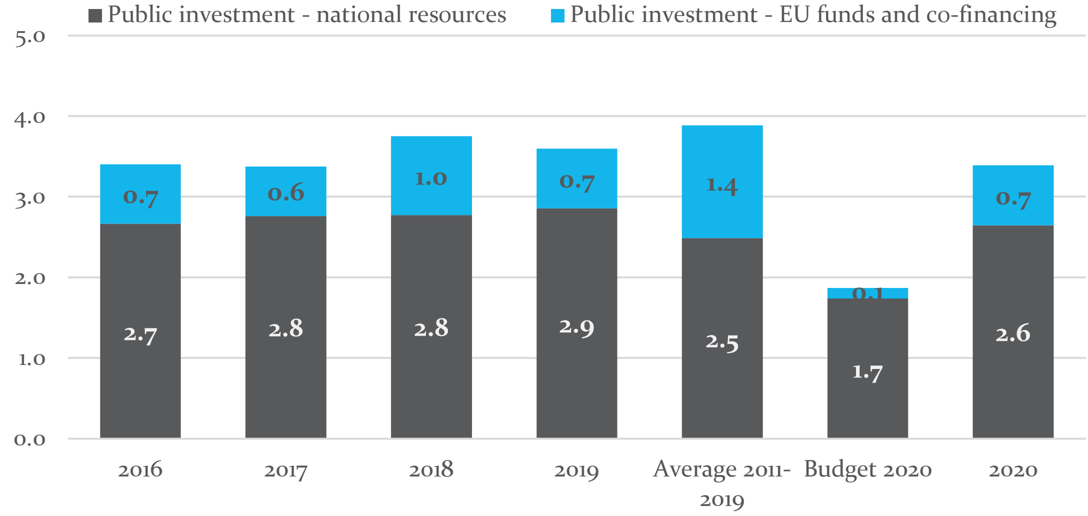
From the perspective of long-term sustainability, the long-term economic growth is important. It can be supported by the formation of new capital through effective public investments. Because the flow of European funds depends on a longer-term spending plan, the development of domestic public investments will be interesting to observe. **The fact that even during the crisis year of 2020 such investments rose slightly above the historical average since the previous crisis can be regarded positively.** The spending of investments has not declined significantly despite having been budgeted at lower levels, as the CBR pointed out already during the approval of the budget.

[10] Disregarding the correct methodology of recording in the budget is giving rise to, for example, a recurring risk in the shortfall of revenues from emission allowances and income from dividends of certain state corporations, as explained in more detail in sub-chapter 3.2 Selected non-tax revenues.

[11] The budget contained optimistic assumptions in comparison with the historical development, e.g., in the area of capital expenditures of municipalities or revenues from the sale of state assets.

CHART 7

Development in public investments (ESA 2010, in % of GDP)



Source: Statistical Office, CBR, Ministry of Finance

Most of the risks in the budget have also been identified by the CBR in the previous years and have indeed materialised on a regular basis. These involve the risks that did not arise from uncertainty in developments, but rather from changes in the budget that were intended to make more room for expenditures, thus reducing the realistic nature of the defined budgetary objective. For this reason, the **CBR welcomes the initiative of the Ministry of Finance to extend the mandate of the Tax Revenue Forecasting Committee** which will be independently assessing the assumptions for the budgeting of the most important non-tax revenues and selected general government expenditures. Also, the **CBR welcomes the opportunity to become a member of the working group of the Statistical Office of the Slovak Republic,** as it has been striving for such membership since its establishment, thus making it possible to present this report to the public on the day on which the data is published[12].

[12] In the years between 2015 and 2019, the CBR did not have access to detailed information about the profit/loss of general government entities under the ESA2010 methodology. In 2020, a quadripartite agreement between the Statistical Office of the Slovak Republic, the Ministry of Finance of the Slovak Republic, the National Bank of Slovakia and the CBR/the CBR Secretariat concerning the exchange of information with a view to improving the quality of data notified to Eurostat for Slovakia was signed.

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