Workshop on implementation of
expenditure ceilings in Slovakia
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Expenditure ceilings: CBR perspective

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Fiscal framework in Slovakia

- **Framework for fiscal policy in Slovakia set out in constitutional Fiscal Responsibility Act (adopted in 2011)**
- Main objective: achieving long-term sustainability of public finances in the Slovak republic
- The law was a result of broad political consensus, drafted by an expert parliamentary committee representing all parties
- Local ownership: the framework was proposed by Slovak economists and discussed with relevant stakeholders (incl. politicians) since early stages of its development

Expenditure ceilings in Slovak fiscal framework

- Fiscal Responsibility Act envisages introduction of expenditure ceilings

  "The procedure for setting the public expenditure limit shall be specified by law." (FRA, Article 7(3))

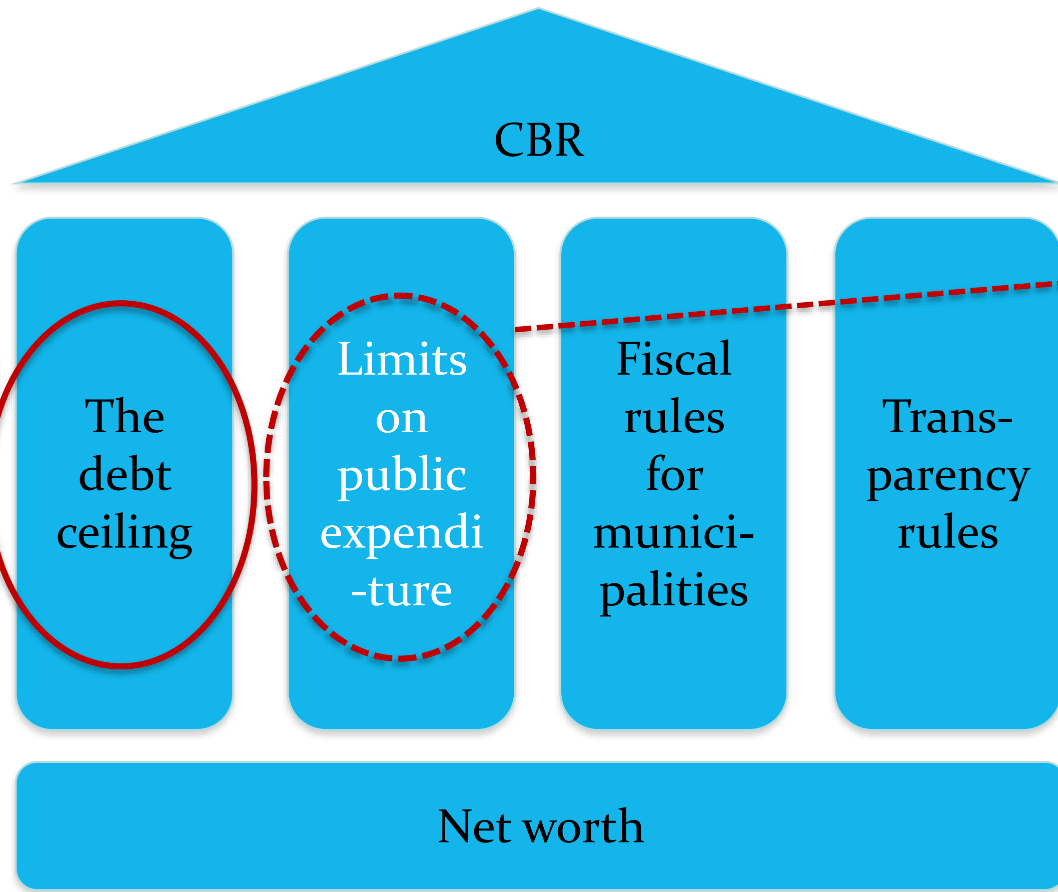
- They complement the debt limit rule and thus facilitate long-term sustainability of public budget

  "Introduction of expenditure ceilings is the most appropriate fiscal rule in the Slovak economy to ensure long-tern sustainability of public finances of the Slovak republic and acceptable level of indebtedness." (FRA, Explanatory report, Article 7)

- Expenditure ceilings are a missing operational tool of public finance management in Slovakia

Completing the fiscal framework

- Limit for boundary situations, when other tools for budget management were not used



- Operational fiscal rule promoting long-term sustainability

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General remarks on the proposal

- CBR welcomes publication of the proposal
- Commitment of the government would be strengthened by an official document (deadlines, involvement of other stakeholders)
- Effective distribution of new tasks requiring independent assessment among institutions is crucial
  - Competences, as well as overall methodology, should be defined clearly and based on sound assumptions, ideally before testing
- Strengthening the role of the CBR would increase credibility of the rule

Timeline of implementation

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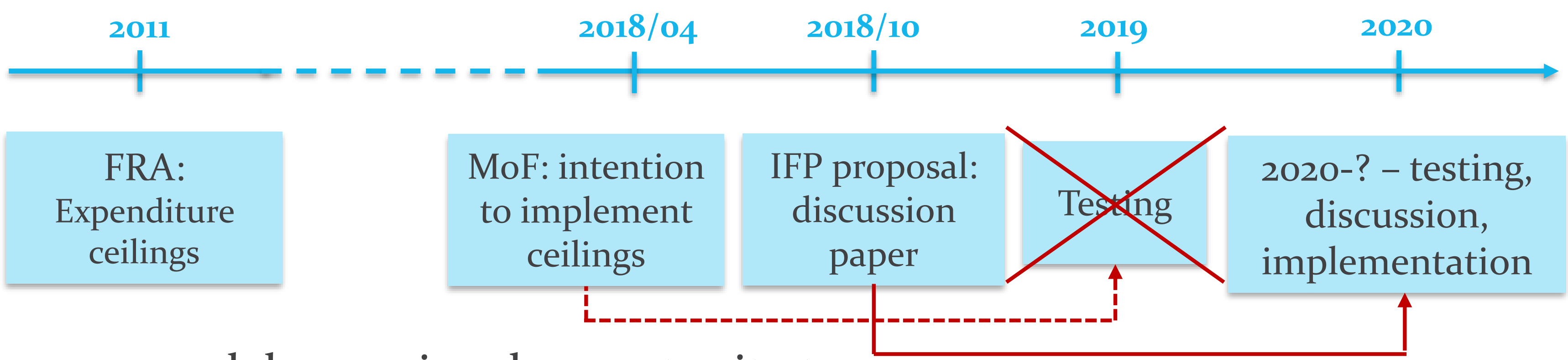
- Process of implementation consists of multiple steps



- 7 year delay = missed opportunity to strengthen Slovak fiscal framework
- Approval before elections in 2024 requires strong commitment of the government

2020-21 – simulation
2022-23 – implementation
2024 – elections
2025-28 – setting ceilings
2023-24 – ceilings if possible

- More ambitious timeline should be considered – ceilings in 2023-24

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Agreement on the main features of expenditure ceilings

1. Numerical formulation and link to the fiscal targets
   - ✓ Safe debt level --> medium-term objective --> trajectory set by the government
   - ✓ Binding fixed ceilings for 4 years set at the beginning of government term
   - ✓ Ceilings defined in levels (EUR)
   - ✓ Countercyclical policy (ceilings based on structural revenues)
   - ✓ Discretion in implementation of policies (ceilings adjusted for discretionary revenue measures, ex-post assessed revenue efficiency measures, measures with long-term impact)
   - ✓ Carry-over of a limited amount of expenditures (investments)

2. Coverage by items and sectors and the level of detail
   - ✓ Excluded GG subsectors and/or entities, excluded several expenditure items

3. Tools to absorb uncertainties in the medium-term planning/forecast
   - ✓ Contingency and planning margin (clear rules, independent institution involved)
   - ✓ Escape clauses

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Conceptual issues (1)

- The main fiscal anchor should be the long-term sustainability indicator
  - Basic requirement: improvement in the indicator – meeting the MTO set according to the SGP might not be enough
  - Consistency of the national framework (linking the ceilings with long-term sustainability in line with the intentions of the FRA)

- Need to define a rule preventing setting optimistic targets in 4th year
  - Implementation of the expenditure ceiling in 4th year might be to a large extent in responsibility of a new government (limit set by previous government)

- Assign new tasks requiring independent assessment to institutions
  - If assigned to existing committees (macroeconomic, tax revenue forecasting), increased requirements on members with uncertain impact on quality of outputs
  - Need to change governance rules of the committees (status and leadership of committees, using forecast in budget process)

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Conceptual issues (2)

- Strengthening the role of the CBR would increase credibility of the rule
  - Proposed recommendatory role of the CBR creates a risk of inefficient functionning of the rule (similarly as in the case of the balanced budget rule)

- Expenditure ceilings should be corrected for slippages
  - Exceeding the ceiling in one year should affect the ceilings in the following years (to neutralize the impact on debt)

- CBR would welcome an ambitious schedule of implementation
  - Testing should starts as soon as possible and lasting no longer than 2 years
  - Historical data should be used as well
  - Implementation phase (assessment of the ceilings, drafting the legislation) could also last not more than 2 years

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Technical issues (1)

- Extend the independent assessment to all revenues
  - Budgetary risks regularly concentrate in non-tax revenues (dispersed over growing number of items) and changes in committee-aprroved tax forecasts
- Need to select the approach to estimation of cyclical component
  - MoF uses two approaches depending on the target audience
  - CBR prefers its approach (taking into account estimates of other institutions and using several methods), included also in the long-term sustainability assessment
- Special attention should be devoted to measures affecting public finances beyond the horizon of expenditure ceilings
  - Assessed by an independent authority, asymmetric approach (cautious approach concerning measures improving structural primary balance)

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Technical issues (2)

- Need to select the approach to identification of one-offs
- Modify the currently used simplified approach to estimate the impact of tax revenue efficiency measures
- Size of the contingency reserve should be based on rigorous analysis
  - Taking into account economic development in Slovakia and sensitivity of public expenditure to economic shocks
- Escape clauses during extraordinary events should afterwards allow to align expenditure limits with new revenue levels
- Changes in sector classification should not be automatically translated into the limit
  - There is a need to examine the reasons for change in classification, as it might be a consequence of government policy

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Technical issues (3)

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- Need to fine-tune the scope of the ceilings
  - Expenditures under the control of the government which have no impact on the GG balance should be excluded (healthcare contributions paid by the state on behalf of certain groups)
  - Carryover of expenditures should be treated symmetrically (postponing investments should increase limits in next years, but decrease in current year)

- Full comparability of budgeted and reported data should be achieved
  - Need to budget some previously unbudgeted entities and transactions (smaller central government entities, entrepreneurial revenues of universities, FISIM)
  - Unifying bridge tables (from budgetary classification into ESA2010) between the budget and financial reports
  - Changes in budgetary classification to identify transactions excluded from the ceiling and better define EU funds

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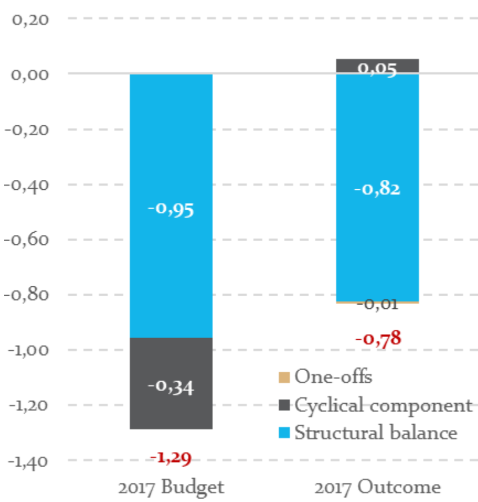
Illustrative example of 2017

Basic assumptions:

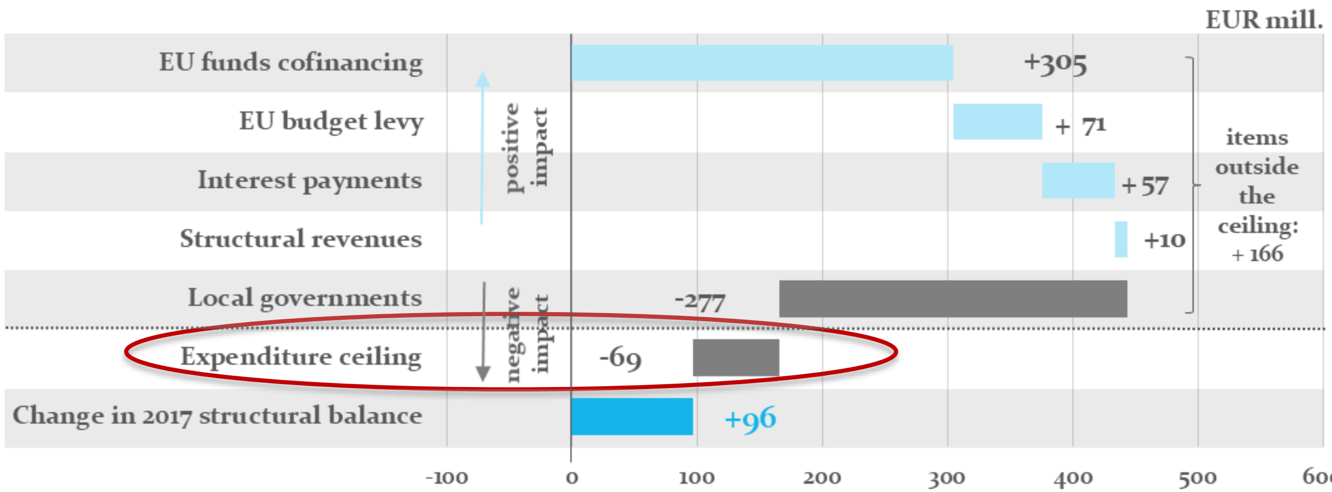
- Ceilings derived from the targets of the 2017-2019 GGB and projected revenues and expenditures
- Cyclical component calculated by the MoF (DBP 2017 and 2019)
- Proposed definition of ceilings with one modification (neutral items potentially affected by government policies excluded)
- Assessment based on October 2018 notification
- Source data: budget – RIS; outcomes - own database of GG revenues and expenditures (cash administrative data complemented with publicly available data)

Comparison of the budget with outcomes

GG balance (% of GDP)



Decomposition of the improvement in structural balance



- Structural balance improved in 2017 compared to the budget by 0.13 % of GDP (EUR 96 mill.)
- The main drivers are excluded from the ceiling, ceiling was exceeded by EUR 69 mill. - **comparability issues and other factors** (see next slide)

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Assessment of the ceiling

Securing comparability of the budget with outcomes

Symmetrical treatment of unspent expenditures

Space for additional expenditures

Assessment of expenditure ceiling in 2017 (EUR mill.)

	outcome - budget
1. Expenditure ceiling	**-69**
2. Unbudgeted entities/items	-173
3. Carry over of expenditures	381
4. VAT increased efficiency	-175
Analytically adjusted ceiling (1-2-3-4)	**-103**

Source: CBR

- In 2017, the ceiling was exceeded by EUR 103 mill.
- Meeting the ceiling would decrease the GG deficit to 0,66 % of GDP.

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Expenditure ceiling in 2017

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Expenditure ceiling in 2017 (EUR mill.)

	budget	outcome	difference
1. GG structural balance	**-796**	**-700**	**96**
2. GG structural revenues (a-b-c)	**33 723**	**33 399**	**-324**
- a. total GG revenues	33 450	33 444	-6
- b. cyclical component	-273	45	318
- c. one-off revenues	0	0	0
3. Items excluded from the ceiling (a+b+c+d+e)	**5 332**	**4 564**	**-768**
- a. interest payments	1 127	1 179	53
- b. EU funds	1 149	632	-517
- c. co-financing from the state budget	528	223	-305
- d. EU budget levy	673	602	-71
- e. items with no impact on balance	1 856	1 928	72
4. Entities excluded from the ceiling (a-b-c)	**3 834**	**4 112**	**277**
- a. revenues of local governments and CBR (consolidated)	1 558	1 392	-166
- b. structural balance of local governments and CBR (consolidated)	-3 640	-4 185	-545
- c. transfers to local governments and CBR	1 364	1 466	102
Expenditure ceiling (-1+2-3-4)	**25 353**	**25 423**	**69**

Source: CBR