CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of compliance with the balanced budget rule in 2020

Summary

July 2021

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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. 523/2004 on the General Government Budgetary Rules and Act No. 493/2011 on Fiscal Responsibility.

This publication is available at the CBR's website (http://www.rrz.sk).

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

Evaluation of compliance with the balanced budget rule in 2020

The CBR prepared its first evaluation of compliance with the balanced budget rule for 2020 based on the deficit and debt data published by Eurostat in April 2021. It also contains the CBR's response to the evaluation published by the Ministry of Finance of the Slovak Republic on 30 June 2021, as well as its opinion on non-application of the correction mechanism for 2021 and 2022, as approved by the government on 30 June 2021. No change has been made in the methodology of evaluation[1]. The CBR's approach to evaluation was influenced by the fact that, on 24 June 2020, the government declared exceptional circumstances because of Slovakia's economy being hit by the pandemic of coronavirus. Therefore, in the present evaluation, the CBR quantified the applicable indicators for 2020 without assessing whether a significant deviation from the balanced budget rule has occurred[2].

The **structural deficit reached 3.8% of GDP in 2020**, having deteriorated by 0.4% of GDP year-on-year when taking into account unexpected revenue shortfalls. The expenditure growth rate significantly outpaced the potential economic growth and contributed to a deterioration of the deficit by 1.2% of GDP.

The declaration of exceptional circumstances has temporarily suspended the application of the correction mechanism adopted by the government in January 2020, based on which a balanced budget was supposed to be attained in 2020. In 2021, the economic situation in Slovakia has improved and the most recent forecasts expect the Slovak economy to grow. For this reason, the government approved the **end of the duration of exceptional circumstances as at 30 June 2021 which, according to the CBR, means that, considering the condition of public finances, the correction mechanism should be triggered again after this period[3]. The correction mechanism should consist in setting a public expenditure ceiling as from 2022 for the entire duration of the correction.** It will take into account the **adjustment path towards the structural balance improvement determined by the government** and the fulfilment of the medium-term budgetary objective **based on the updated estimate of the structural deficit for 2021, which the CBR currently estimates at 3.7% of GDP[4]. Considering the positive economic development, the CBR would prefer consolidation to commence as from 2022[5].**

However, along with ending the exceptional circumstances, the government also decided not to trigger the correction mechanism even in 2022, referring to non-

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1 CBR, Methodology for the evaluation of the balanced budget rule, version 1, December 2019.

2 The Ministry applied the same approach in its evaluation as well.

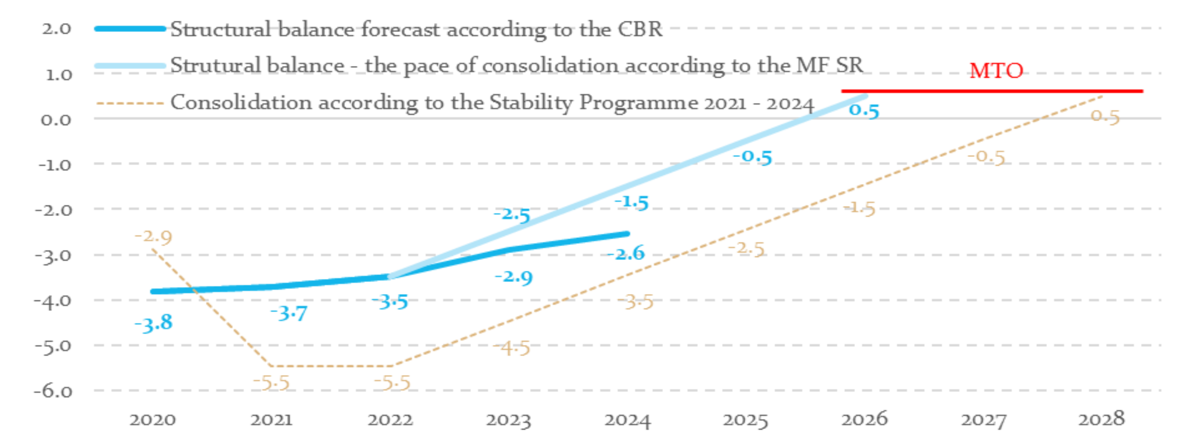
3 Since the government has ended the duration of exceptional circumstances, the CBR is of the opinion that the provisions under the rule requiring to follow an adjustment path towards a balanced budget should start to apply again, despite the fact that, at the EU level, the rules under Stability and Growth Pact would not be applied until the end of 2022. At the proposal of the Ministry of Finance, the government may approve an earlier application of the rules in Slovakia even before they begin to apply across the EU. A similar situation occurred in November 2019 when the Ministry of Finance identified a significant deviation based on the fiscal performance results for 2018 and suggested that the government triggers the correction mechanism, even though the Council of the European Union did not observe a significant deviation for 2018.

4 CBR, An update to the medium-term fiscal outlook, July 2021 (available in Slovak only)

5 The legislation does not specify in detail how the public expenditure ceilings should be set. It only says that the correction should be proportionate to the size of the identified deviation from the medium-term objective. This precludes neither structural balance improvement starting as late as in 2023 in line with the plan of the Ministry of Finance based on the Stability Programme, nor an earlier consolidation starting in 2022, which would be preferred by the CBR, (the reasons allowing an earlier start of consolidation are described in the CBR's report, Medium-term fiscal outlook for 2021 to 2024, June 2021, an analytical paper, Box 3, pg. 23) (available in Slovak only).

application of the Stability and Growth Pact by the European Commission due to exceptional circumstances. **Ending the exceptional circumstances without the Ministry of Finance subsequently submitting a proposal to trigger the correction mechanism is, according to the CBR's opinion, in conflict with the balanced budget rule and the correction mechanism principles**[6], because the obligation not to apply the correction mechanism is only imposed throughout the duration of exceptional circumstances which ended this year. The government may decide not to apply the correction mechanism, but its decision must be preceded by the correction mechanism proposal of the Ministry of Finance.

Chart 1: General government structural balance from 2020 to 2028 (% of GDP)



Source: CBR, MF SR

Taking into account the current developments in public finances in 2021, the medium-term tax revenue forecasts and the government-planned improvement of the structural balance, the CBR estimates that a **structural surplus of 0.5% of GDP, as a new medium-term objective of the government, should be achieved in 2026** (Chart 1), i.e., two years earlier than planned by the government in the Stability Programme. In the event that a significantly lower deficit in 2021 materialises (i.e., the continuing improvement of the economic situation and the absence of significant negative impacts of the third wave of the pandemic on Slovakia's economy), the government should apply its consolidation plans based on the adjustment path "Structural balance – the pace of consolidation according to the Ministry of Finance" as presented in the above chart, because this will constitute the basis for the ex-post evaluation.

Even though the level of the medium-term objective set by the government is stricter than the minimum value required by the rule, achieving a budget with a slight surplus would not suffice in terms of the long term sustainability of public finances, unless significant structural reforms in areas sensitive to population ageing are implemented simultaneously. Without implementing such reforms (in particular the pension system, the provision of healthcare and long-term care services) and without increasing the competitiveness and productivity in other sectors of the Slovak economy, a structural surplus of around 2% of GDP would be necessary in order to significantly push the long-term sustainability risks down to the low-risk zone[7].

6 The balanced budget rule is provided for in §30a of Act No. 523/2004 Coll. on the General Government Budgetary Rules and the principles are specified in the [Common principles on national fiscal correction mechanisms] published by the EC on 20 June 2012.

7 CBR, [Report on the Long-term Sustainability of Public Finances as at 18 May 2021], June 2021.

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