CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Report on the Long-term Sustainability of Public Finances at 18 May 2021

(extraordinary report based on the parliamentary debate on the Government Manifesto and a vote of confidence in the government of 4 May 2021)

June 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. 493/2011 on Fiscal Responsibility.

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

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

Main conclusions

The present extraordinary report on the long-term sustainability of public finances has been prepared by the Council for Budget Responsibility (CBR) as a follow-up to the parliamentary debate on the new government's Manifesto and a vote of confidence in the government held on 4 May 2021[1]. Because no significant changes have occurred since the publication of the previous report of 30 April 2021, the CBR focuses on updating the estimate of the long-term sustainability indicator in this report.

While the regular report published in April was based on the actual data on fiscal performance in the previous year, the current extraordinary report takes into account, in addition to the effects of the newly approved legislation, the development in public finances estimated by the CBR under the assumption that the government would not adopt any additional measures by the end of 2021. This is reflected **in the 2021 deficit estimated at a level of 7.7% of GDP**. The estimate does not take into account the final version of the amendment to the State Budget Act approved by the parliament on 28 May 2021[2].

In its report, the CBR evaluates whether public policies effective in May 2021, in conjunction with the macroeconomic development, have been set up in a sustainable manner in terms of public finances. **The Council notes that, in May 2021, public finances were not sustainable in the long term[3]. The long-term sustainability indicator at the level of 6.1% of GDP (EUR 6.3 bn) was in the high-risk zone** (see Figure 1)[4]**,** which means that in order to

[1] The Council draws up and publishes the long-term sustainability report, including the baseline scenario and determination of the long-term sustainability indicator, annually as of 30th of April and always within 30 days of the parliamentary debate on the Government Manifesto and the vote of confidence in the government.

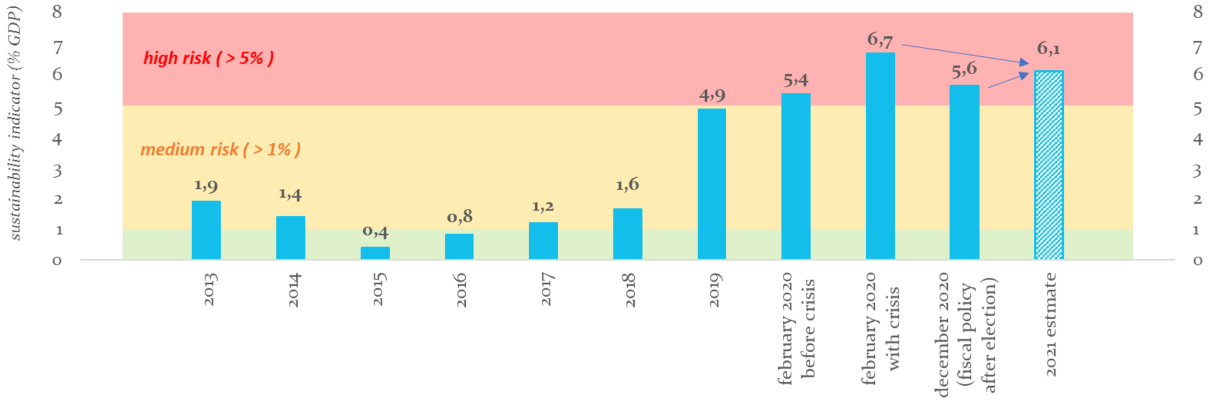
[2] Given the fact that, according to the preliminary calculations, the government-approved part of the amendment to the State Budget Act has only brought a more realistic picture of the current situation, including additional funding to cover the risks of which the CBR had already warned earlier, the amendment should not affect the CBR's deficit estimate for 2021, hence, it should have no impact on the current estimate of the long-term sustainability indicator. The amendment to the State Budget Act and the government's deficit estimate under ESA2010 do not take into account the savings which the CBR has identified in the state budget and in other general government entities based on the current fiscal development. At the same time, the amendment anticipates reserves for a potential stronger third pandemic wave, which has not been included in the CBR's baseline estimate because a strong third wave is not anticipated under the baseline macroeconomic forecast scenario either. The final higher expenditures anticipated in the amendment could increase the deficit to a level of 7.9% of GDP, according to the preliminary estimates. However, given that a major portion of this increase is of one-off nature, the change should have no significant impact on the indicator.

[3] The estimated development of the long-term sustainability indicator after incorporating the impact of the government's plans presented in the Stability Programme, along with the budgetary policy recommendations, will be published by the Council following the approval and analysis of the Stability Programme at the beginning of June.

[4] Indicator values below 1 % of GDP are considered by the CBR a slight deviation carrying a low level of risk for the long-term sustainability. This threshold corresponds to uncertainty associated with long-term projections when, as a result of standard updates to assumptions or improvements in methodology, the indicator may be subject to more significant changes. According to the CBR, indicator values between 1 and 5 % of GDP represent a medium risk. Indicator values above 5 % of GDP are considered by the CBR a high risk for the long-term sustainability. These thresholds are roughly aligned to the thresholds of the S2 indicator reported by the EC (the S2 indicator, as well as the high-risk threshold is increased by some 1 p. p. of GDP). By the same token, based on

keep the general government gross debt below the upper debt ceiling (50% of GDP) over the next fifty years, the public finance deficit would need to be improved by the same amount.

Figure 1: Long-term sustainability indicator (% of GDP)



Source: CBR

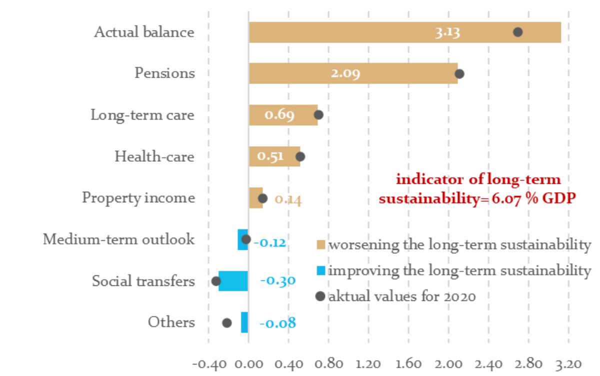
The preliminary deficit estimates for this year started deteriorating, according to the Budget Traffic Lights, from 6.8% of GDP in March to 7.7% of GDP in May. Compared to the sustainability evaluation for 2020, the long-term sustainability indicator worsened by 0.5% of GDP based on the most recent information. **It means that the budgetary policy has improved the long-term sustainability by mere 0.6% of GDP since the election.** This development is mainly driven by the changes in the 2021 budget which takes into account new legislative measures[5] (introduction of the contribution for *kurzarbeit,* new subsidies in the area of family support, provision of subsidies to support housing development and in the area of sport support, free bus transport planned in the budget to be introduced from this year), as well as non-legislative measures[6] (current development in expenditure compared to the assumptions contained in the baseline scenario) of the government, resulting in a worse public finance development than expected under a no-policy-change scenario.

the S2 indicator, Slovakia's long-term sustainability reached a high-risk level already before the outbreak of the pandemic in 2019.

5 Due to the absence of the final version of these measures, the evaluation of long-term sustainability does not take into account the impacts of introducing the so-called parental pillar or abolishing the fixed retirement age ceiling, as well as other changes announced in a draft constitutional act on adequate social security in old age (a right to the old-age pension after 40 years, awarding higher benefits for the time of taking care of a child, etc.). Equally, some other measures for which political support has been declared are not included either; for example, a one-off support to families with children in the autumn of 2021 and a permanently increased family support in subsequent years (EUR 200 per child).

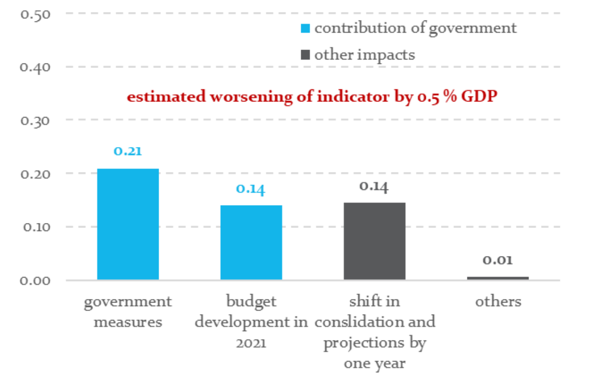
6 They mainly include budgetary measures in the state budget by which the Finance Ministry or the government adjust the anticipated development in budgetary revenues or expenditure against the plan. It also involves taking into account the current development in the fiscal performance under the state budget and in the performance of other general government entities, as estimated by the CBR (Budgetary Traffic Lights).

Figure 2: Long-term sustainability indicator in 2020 (% of GDP)



Note: Actual balance means the impact of the initial budgetary position, i.e. structural primary balance and gross debt in 2020. Medium-term outlook – items with own indexation within the medium-term part of the baseline scenario. Source: CBR

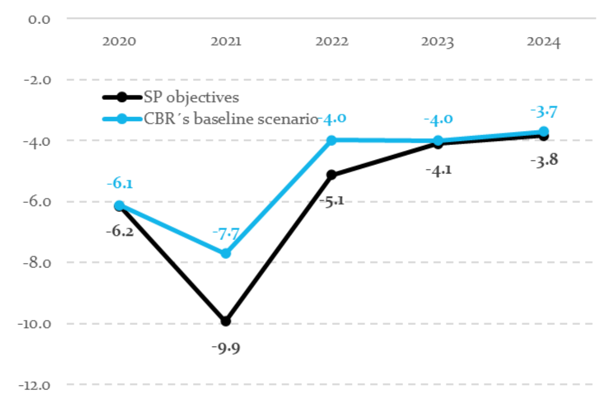
Figure 3: Factors contributing to the change in the long-term sustainability indicator between 2020 and 2021 (% of GDP)



Source: CBR

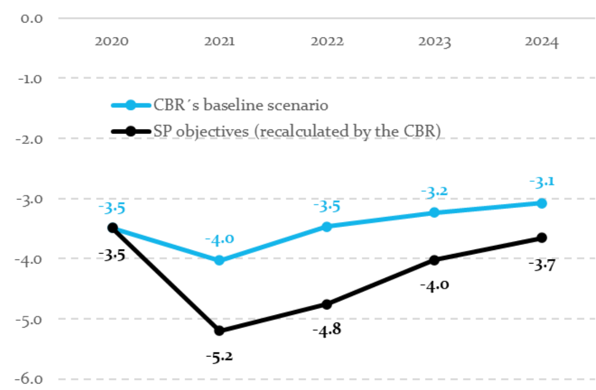
If the present policies are preserved, population ageing will increase expenditures sensitive to demographic changes to as much as 5.6% of GDP. **The debt would remain permanently above the upper threshold of the debt limit and would continue to rise rapidly to unsustainable heights:** the 100% of GDP mark would be exceeded in 2039, the 150% of GDP mark in 2047, and the 200% of GDP mark in 2053. On top of that, the calculation already incorporates the passive, no-policy-change (NPC) scenario which automatically decreases the deficit from the estimated level of 7.7% of GDP in 2021 **to 3.7% of GDP in 2024. In order to improve the long-term sustainability** in the absence of other measures with long-term effects (such as, for example, a pension reform), **it would be necessary to keep deficits below** this adjustment path assumed under the NPC scenario. **Unfortunately, the approved Stability Programme has no such ambition.**

Figure 4: Comparison of GG deficit under CBR's baseline scenario against Stability Programme targets (% of GDP)



Source: Finance Ministry, CBR

Figure 5: Comparison of GG structural deficit under CBR's baseline scenario against Stability Programme targets (% of GDP)



Note: The structural deficit corresponding the general government deficit target under the Stability Programme has been recalculated using the CBR's estimate of cyclical component. Source: CBR

In order to essentially curb the long-term sustainability risks down to the low-risk zone, a structural surplus of as much as 2.1% of GDP would need to be achieved in the medium term. A lower surplus could be sufficient if other measures with long-term effects were adopted too, ones which would enhance the sustainability through a responsible countercyclical fiscal policy and improve the revenue-expenditure balance in future, mainly in the pensions system, healthcare and long-term care sectors on the expenditure side, and by structural reforms with a positive impact on the economic potential on the revenue side. **Any delays in the adoption of expenditure ceilings and pension system reform with a considerably positive impact on the system's sustainability may thus translate into more extensive consolidation efforts necessary in the future to restore the stability of public finances.**

CBR
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Imricha Karvaša 1
Bratislava 1
813 25
Slovakia

www.rrz.sk