



Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules for 2020 *(Summary)*

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

Summary

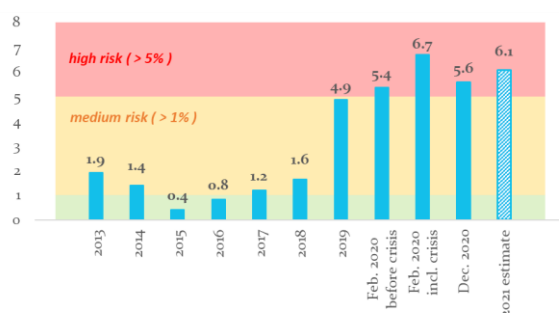
The Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules evaluates, as of 31 August, the previous year's compliance with the rules laid down in the Fiscal Responsibility Act¹. Apart from evaluating long-term sustainability development as the most important objective of the Act, the report also assessed compliance with the constitutional debt limit, as well as other statutory obligations, in particular as regards information disclosure, the debt of local governments and funding of their competencies.

In order for Slovakia to achieve a sustainable fiscal performance, an amendment to the constitutional Fiscal Responsibility Act needs to be adopted urgently

The ultimate objective for budgetary responsibility is to **achieve sustainable public finances**. The protection of long-term sustainability of the Slovak Republic in regard to compliance with the principles of transparency and public spending efficiency was also enshrined in an amendment to the Constitution of the Slovak Republic² in 2020.

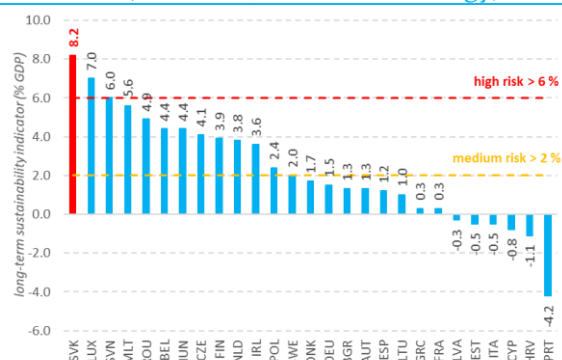
Even before the outbreak of the crisis, the long-term sustainability indicator has reached a high risk level and, therefore, was the worst since 2013. Due to the crisis, however, the situation has naturally deteriorated even further and Slovakia's sustainability of public finances is now the worst also within the EU.

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



Source: CBR

Chart 2: International comparison of the S2 indicator (% of GDP, EC's methodology)



Source: CBR, EC (Statistical Annex providing background data relevant for the assessment of the 2021 Stability and Convergence Programmes; SWD(2021) 501 final)

In 2020, the debt has significantly increased above all sanction brackets, including the upper limit, already during the first major crisis following the adoption of the constitutional act. The worst state of long-term sustainability of public finances since the date of entry into force of the act which occurred already before the outbreak of the crisis at the beginning of 2020, as well as problems with the financing of the state during the crisis, have **fully revealed that the current wording the constitutional Fiscal Responsibility**

¹ Act No. 493/2011 Coll. on fiscal responsibility.

² By means of constitutional Act No. 422/2020 Coll., Article 55a effective from 1 January 2021 has been added to the Constitution of the Slovak Republic No. 460/1992 Coll.

Act is partially non-functional. According to the CBR, the unconstitutional state of affairs³ when expenditure ceilings having a potential to significantly reduce the risk of such negative developments⁴ are not being implemented despite the requirements under the constitutional act, still persists. **For this reason, the government's commitment to implement expenditure ceilings as part of Slovakia's Recovery and Resilience Plan is welcome, but we consider their adoption in the form of a constitutional act to be important as well.**

Fiscal responsibility rules

In order to achieve a long-term sustainability of public finances, the act assumes the existence of expenditure ceilings and the upper debt limit. Both of these instruments are expected to prevent the debt from rising above the upper limit prescribed by the act during the upcoming decades.

General government debt limit

In April 2021, Eurostat published the data on gross debt as at the end of 2020 at 60.6% of GDP⁵ and, in comparison with 2019, the debt increased by 12.4 p. p. while **surpassing the highest sanction bracket of the debt limit established under the constitutional act⁶.**

Due to applicable derogations from the imposition of stricter sanctions under the constitutional act⁷, **the debt level for 2020 is now linked with sanctions applicable to surpassing the second sanction bracket of the debt brake.** According to the sanctions, the government is required to submit to the parliament a proposal for debt-reduction measures and, as of 1 May 2021, the salaries of cabinet members should be reduced to the previous fiscal year's level, if their salaries were lower in the previous fiscal year. The salaries of cabinet members in 2021 are lower compared to the previous year, and the proposal for measures has not been submitted yet. **The submission of a specific proposal for debt-reduction measures is all the more important because the debt level is currently above the upper debt brake limit.**

³ GIBA, M., BUJŇÁK, V.: Ústavnoprávna analýza vybraných ustanovení ústavného zákona o rozpočtovej zodpovednosti (Constitutional-law analysis of selected provisions of the constitutional Fiscal Responsibility Act), 31 July 2020, pg. 29: "If no effective expenditure ceilings exist at present, as assumed by Article 7(3) in conjunction with Article 1 of the constitutional Fiscal Responsibility Act, such a situation means an unconstitutional state of affairs which is the responsibility of those entities that are required to create such ceilings in an adequate form. It is important that these entities be intensively reminded of this fact while emphasising that this is not a small thing but a question of respecting the constitutional order of the state."

⁴ According to CBR's analyses, had the governments complied with their own budgetary objectives and, at the same time, made use of good economic times (better revenue growth) for faster consolidation (the expenditure ceilings function), the debt level could have been lower by some 10% of GDP, without exceeding the upper debt brake limit. Along with the prepared change in net debt monitoring, the motivation to reduce the cash reserve of the state would have also been eliminated at the end of 2019, which subsequently complicated the financing of the state in 2020.

⁵ On 30 April 2021, GDP was revised by the Statistical Office of the Slovak Republic, thus reducing the debt-to-GDP ratio to 60.3%. This value is also used in other sections of the document describing the debt development and forecast. The updated debt-to-GDP ratio for 2020 (including the above revision of GDP and other changes, if any), which is relevant for assessing the debt brake rules, will be published by Eurostat in October 2021.

⁶ The value of the gross debt-to-GDP ratio will be definitively confirmed in autumn notification in October 2021.

⁷ The obligation to apply sanctions associated with exceeding the third, fourth and fifth sanction bracket of the debt brake does not apply to a period of 24 months from the adoption of the government's Manifesto. Because the parliament [approved](#) the Manifesto of the Government of the Slovak Republic for 2020-2024 on 30 April 2020 and subsequently [approved](#), on 4 May 2021, the Manifesto of the Government of the Slovak Republic for 2021-2024, the obligations arising from exceeding the aforementioned sanction zones under the constitutional Fiscal Responsibility Act can be applied as from May 2023 at the earliest.

In the medium-term horizon, the CBR estimates⁸ that gross debt could stabilise slightly above 60% of GDP due to economic recovery, faster drawing of European funds and a gradual reduction in cash reserves. At the end of 2024 it could reach a level of 60.5% of GDP. This means that debt would remain above the upper debt brake limit in each year, with an increasing need for measures to comply with the constitutional act as the upper limit will be gradually declining to reach a level of 53% of GDP in 2024⁹.

As regards the imposition of debt brake sanctions, the applicable legislation implies that, following the publication of the gross debt-to-GDP ratio for 2022 and after the applicable derogations cease to be valid in May 2023, the government will have to ask the parliament for a vote of confidence. At the same time, the government would have to submit to the parliament, by 15 October 2023, a general government budget proposal for 2024 with a balanced or surplus budget and without any increase in expenditures.

Public expenditure ceiling

The constitutional debt limit should serve as a last resort tool to ensure a sustainable debt level and the government should make use of all possibilities to implement an economic policy, including a counter-cyclical policy, within this limit. **In addition to the debt limit, the constitutional act had also envisaged introducing an operative fiscal management tool – expenditure ceilings – as an imperative component of responsible fiscal performance.** The expenditure ceilings lead to faster deficit reductions when the economy is booming and, conversely, provide a margin for fiscal expansion in times of economic slowdown or recession.

Once the constitutional act became effective, efforts should have immediately been made to implement the expenditure ceilings, because their absence means that the constitutional act is being breached¹⁰. From this perspective, the commitment of the government under its Manifesto to put the expenditure ceilings¹¹ into practice may be regarded as positive. On 30 September 2020, the government approved a draft amendment to the constitutional Fiscal Responsibility Act designed to introduce the public expenditure ceilings. However, the amendment has not been approved by the Slovak Parliament so far. In order for public finances to be governed by expenditure ceilings from 2023 as assumed by the government in its draft, it would have to be approved as early as possible this year. **The CBR views positively that the binding nature of the rule would be significantly reinforced with expenditure ceilings being enshrined in the Constitution.**

⁸ A debt forecast by CBR based on [An update to the medium-term fiscal outlook](#), July 2021 (available in Slovak only)

⁹ The reason is that sanction brackets have been falling by 1 p. p. a year since 2018.

¹⁰ GIBA, M., BUJŇÁK, V.: Ústavnoprávna analýza vybraných ustanovení ústavného zákona o rozpočtovej zodpovednosti (Constitutional-law analysis of selected provisions of the constitutional Fiscal Responsibility Act), 31 July 2020, pg. 29: "If no effective expenditure ceilings exist at present, as assumed by Article 7(3) in conjunction with Article 1 of the constitutional Fiscal Responsibility Act, such a situation means an unconstitutional state of affairs which is the responsibility of those entities that are required to create such ceilings in an adequate form. It is important that these entities be intensively reminded of this fact while emphasising that this is not a small thing but a question of respecting the constitutional order of the state."

¹¹ The [Manifesto of the Government of the Slovak Republic for 2020-2024](#), of 17 April 2020, pg. 56, and the [Manifesto of the Government of the Slovak Republic for 2021-2024](#), of 28 April 2021, pg. 56.

Specific provisions for municipalities and self-governing regions

In the case of rules for local governments, the following three areas are assessed: 1/ whether the state has intervened to cover the financial losses of local governments; 2/ whether the state has devolved new tasks and competencies without providing adequate financial coverage, and 3/ the amount of the local government debt.

- The CBR notes that the **state did not provide financial coverage for the losses incurred by local governments**. However, the state **continued helping out local governments¹² through the provision of loans on very favourable terms** (zero interest rate, no collateral required, with the possibility of forgiving their repayment). The rules for the provision of repayable grants from state financial assets (approval from the government, written contract and intended purpose) are now also governed by legislation. However, these changes will not prevent possible selective preferential treatment of local governments and their protection against insolvency in the future; for this reason, rules should also be set for those areas as well.
- **According to the information available to the CBR, no new tasks were assigned to the local government sector in 2020 which would have required funding from the state¹³**. According to the constitutional act, the obligation to ensure adequate financial resources does not apply to changes in the existing competencies of the local governments that have no significant financial effects, and mechanisms exist which a local government may use to obtain resources in another way (e.g., by increasing taxes or shifting the burden of costs on recipients of services)¹⁴.

An essential prerequisite for increasing transparency is the obligation to thoroughly quantify the impacts of new measures on local governments as part of impact clauses, along with stating if new tasks are being imposed on the local governments or their existing ones are being extended.

- Municipalities with excessive debt¹⁵ are currently facing administrative proceedings on the imposition of sanctions. **While all self-governing regions ended up with debts below the limit in 2019, administrative proceedings are pending against two of the initially identified 46 municipalities after legislative exemptions had been considered and reported values cross-checked**. There are currently 37

¹² In 2020, the government provided repayable loans to a total of 1,727 municipalities and self-governing regions for revenue shortfalls caused by the pandemic and to three self-governing regions (Bratislava, Trenčín and Košice) for the reconstruction of road infrastructure.

¹³ The provision of the constitutional Fiscal Responsibility Act on ensuring the adequate funding of local governments with respect to new tasks applies to new tasks in the performance of local governments' original powers. The funding of new tasks within the competencies devolved from the central government is guaranteed by the Constitution (Article 71(1) of the Constitution: "Performance of designated tasks of the local state administration may be devolved to a municipality or a higher territorial unit by law. The costs of performance of such powers devolved from the central government are paid by the state.").

¹⁴ The current wording of the constitutional act contains no objective criteria the CBR could use to clearly assess compliance with the constitutional act. The impact of the devolved competencies on the budgets of local governments cannot be objectively assessed due to the lack of a comparative basis. In order to make the constitutional act effective in this area, an audit needs to be carried out to assess the current situation concerning the competencies of local governments and their financial coverage by the state. Among other things, the CBR considers it important to evaluate the effects of measures in the context of a longer period of time, as well as with regard to how these tasks change over time, including in relation to their financial resources.

¹⁵ Overrunning the debt limit of 60% of current revenues in the previous year. The exact definition of this indicator is included in Annex 4.

municipalities at risk of sanctions for 2020; the values they reported are now under review. Forty-three more municipalities were contacted because they had not submitted the required financial reports. In 2020, too, the debts of all self-governing regions stood below the statutory limit.

The Ministry of Finance assessed the compliance with the local government debt rule, with the possibility to impose sanctions, for the first time for 2015, but not a single evaluation has been disclosed so far. **The CBR recommends that the Ministry of Finance disclose¹⁶ all information related to reviewing the amount of local government debts, and imposing the sanctions, in a transparent manner.**

Fiscal transparency rules

The fiscal transparency rules defined by the constitutional act were fulfilled almost in full extent from a formal point of view.

Macroeconomic and tax revenue forecasts were approved by competent independent committees and published within the deadlines specified in the constitutional act. The 2021-2023 general government budget contained all the data required by law, except for the information about a majority of companies with capital participation of the Ministry of Health of the Slovak Republic. The 2019 summary annual report contained all the data required by law.

In addition to the requirements defined by law, the CBR also assesses the budget transparency in terms of comprehensibility and quality of the information contained in the assessed documents, consistent application of the ESA2010 methodology, and the extent of parliament's control over the approval and fulfilment of the budget. These areas were also covered by the **CBR's recommendations contained in its August 2020 report¹⁷. Improvements were achieved in several areas in 2020 compared to the previous years, yet some negative aspects have survived.**

The government's plans formulated in its Manifesto¹⁸, which have gradually been implemented in the budgeting process, can be regarded as positive. Their implementation may lead to a significant improvement in the quality of the budgetary framework in Slovakia, which has been stagnating since the adoption of the constitutional Fiscal Responsibility Act in 2011:

- Since the beginning of 2021 **the forecasts prepared by the Tax Revenue Forecasting Committee (TRFC) have been expanded to include selected items of non-tax revenues and expenditures** (sickness benefits, unemployment benefits, tax revenues from the sale of emission allowances, and non-tax revenues of Národná diaľničná spoločnosť (*National Motorway Company*)). The Ministry of Finance intends to further expand the list of items subject to review by the independent TRFC, which the CBR views positively.

¹⁶ Even though repeatedly requested, the CBR still does not have at its disposal the revised final data on the size of debt of the municipalities, which the Ministry of Finance collected by verifying the reported values in the identified municipalities.

¹⁷ Evaluation of the fulfilment of the CBR's recommendations is included in Annex 2 (available in Slovak only).

¹⁸ They include, for example, enhancing the binding nature of the budgetary framework, expanding the scope of revenues and expenditures forecasted by the Tax Revenue Forecasting committee (TRFC), introducing the obligation to use the forecasts approved by the TRFC throughout the entire budgetary process, setting the rules for the creation of reserves, and more frequent and comprehensible provision of information about the budget.

- The revisions of expenditures are now more interconnected with the budgeting process because measures identified by revisions in areas other than the healthcare sector have also been incorporated in the budget proposal (decrease in employment at tertiary schools, reduced number of police force members and civil servants). The approach to investment budgeting has also changed in order to reflect the readiness and economic return of new investments. **These changes may lead to more effective public spending and a higher value for money.**
- **The presentation of measures in the healthcare sector is also regarded positively.** It is the only area of expenditures where the three-year budget is compiled on the basis of a no-policy-change scenario to which the effects of new measures are added. Individual measures are also described in detail. **In the future, it would be necessary to extend this approach to other components of the general government budget as well.**
- **The comparability of budgeted data against final outcome has improved** by incorporating assumptions on revisions made by the Statistical Office of the Slovak Republic. There still is room for improvement of data comparability in the form of budgeting the expected effect of EFSF, business activities of tertiary schools (a legislative amendment is necessary) and revenues and expenditures of some central government organisations¹⁹. The revenues from emission allowances presented in the budget were already estimated in compliance with the ESA2010 methodology. **Interest revenues and payments associated with the issue of state debt are still not reflected in the budget in line with ESA2010.**
- **Legislative changes were made with respect to the rules for the creation and use of reserves in the state budget.** The law is now more specific about what types of reserve can be created in the budget. The responsibility for making decisions on the use of individual types of reserves has also been defined and an obligation introduced for the government to report to the parliament on how these reserves are used, including what the report should contain.
- **The CBR also appreciates an improved access to data from the Statistical Office of the Slovak Republic** which has mainly been reflected in an early publication of the assessment of fiscal performance for 2020. The change took place on the basis of a four-party agreement on the exchange of information to improve the quality of data notified to Eurostat for Slovakia, signed in 2020 by 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. The CBR thus became a member of the Statistical Office's working group on methodical aspects of public finance reporting, which it had sought since its establishment.

In addition to the aforementioned positive developments, the CBR has also identified certain issues, resolving which could lead to further qualitative enhancements in fiscal transparency and the entire budgeting process.

¹⁹ Even though these items were not included in the budget, their effects from previous years were presented for the sake of illustration.

- **Among the problems with the three-year budget is that it was compiled in accordance with the budgetary objective only for 2021, but not for the years to follow²⁰.** For 2022 and 2023, specific measures designed to achieve these objectives are missing. Even though the 2023 budgetary objective formally respected the legislation (the requirement of a balanced budget under the debt brake), it was described as unrealistic. The budget thus lacked **the information on which medium-term objectives are deemed realistic and what the public finance strategy beyond the horizon of the current budget should be.**
- **Revenues from dividends were once again budgeted in a non-transparent manner** because their estimate was based on unreasonably optimistic expectations concerning the profit to be achieved by certain state-owned enterprises. **The planned change to subject the forecasts of dividend income to approval by an independent committee can be viewed positively in this respect.**
- The government again approved **important legislative changes even after it had adopted and submitted the draft budget to the parliament**, without incorporating the effects of those additional measures in the budget. **Less transparent decision-making as regards inclusion of measures in the general government budget makes it difficult to evaluate the budget in terms of achieving the declared budget balance targets.**
- **The existing legislative framework governing the budget approval procedure in the parliament does not fit the scope and content of the documents that are being approved.** Approving a cash-based state budget by the parliament for the next year is based on a historical tradition, but is no longer sufficient to capture the key monitored parameters of public finances and all changes in public finances in accordance with ESA2010 and the best international practice²¹. This, in turn, hinders better discussion, for example, on an amendment to the state budget²², as well as easier implementation of expenditure ceilings²³.
- The comprehensibility of the budget could be enhanced through **addition of the missing data** (hospitals under the Ministry of Health's chapter and MH Manažment enterprises) **and explanatory information about state-controlled enterprises.** Estimates of the planned economic performance of state-controlled enterprises are an important source of information to assess potential risks of the budget.
- **The information value of the net worth indicator could be enhanced by the valuation of net worth components not yet quantified.** A broader analysis of the impact of government measures on the net worth will require the adoption of appropriate technical arrangements for the collection of data and the definition of methodology (in collaboration with the CBR) for linking the net worth change to the budget balance.

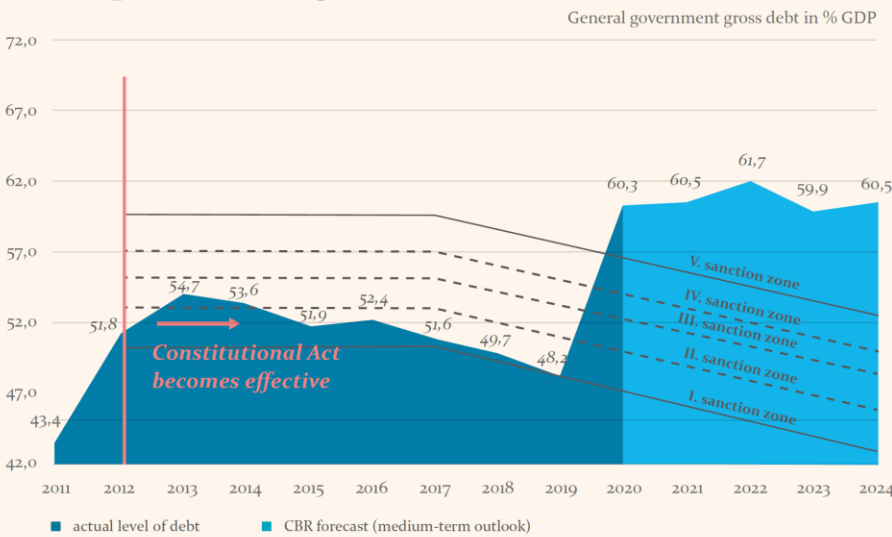
²⁰ The reason given by the Ministry of Finance was the considerable macroeconomic uncertainty associated with the outbreak of the Covid-19 crisis and estimates of its development.

²¹ Several OECD member countries (for example, Australia, New Zealand, Austria, Denmark, UK, Switzerland) compile their budgets using the principles of accrual accounting (according to [Accrual practices and reform experiences in OECD countries](#), Results of the 2016 OECD Accruals Survey, OECD Journal on Budgeting, Volume 2016 Issue 1).

²² The missing quantification of the deficit under ESA2010.

²³ Expenditure ceilings are defined in ESA2010.

Development of the gross debt since 2011

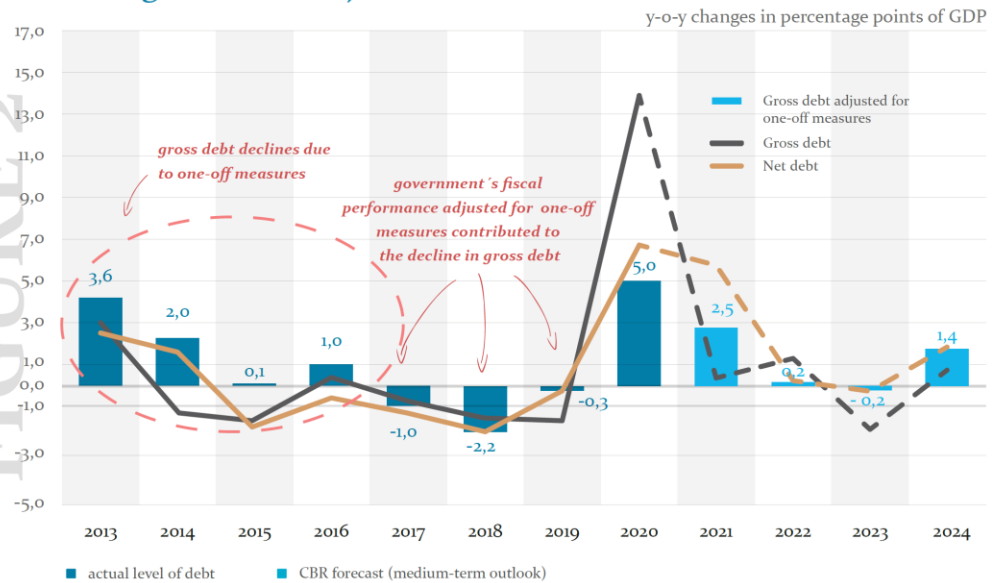


Gross public debt reached 60,6% of GDP in year 2020 and thus surpassed the upper limit of the debt brake. After the revision of GDP the ratio of debt to GDP decreased to 60,3%.

The level of public debt reached is associated with sanctions of the first and the second sanction zones. The government is temporarily exempt from sanctions that result from breaching the third, the fourth and fifth sanction zone, since a Manifesto of the Slovak government was passed in 2020 and 2021.

CBR expects that due to the considerable negative impact of the coronavirus pandemic on the Slovak economy the level of gross public debt is going to remain above the upper limit of the debt brake throughout the medium-term horizon.

Changes in debt adjusted for one-off measures



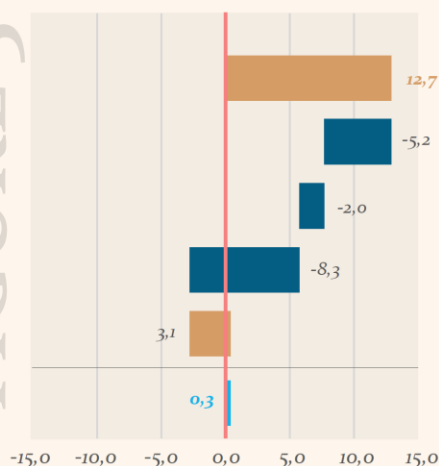
Without changes in the level of cash and without any one-off measures the debt would increase by 5,0 percentage points in year 2020.

Low initial levels of cash in state accounts at the beginning of 2020 and the uncertainty stemming from the effects of the pandemic on the Slovak economy led to increases in cash reserves, which added 5,2 p. p. to the level of debt.

The one-off measure were mainly used to deal with the consequences of the pandemic and added 1,8 p. p. to the increase in debt.

Contributions of selected factors to the changes in debt in years 2020 - 2024

Cumulative effects in GDP percentage points



Permanent effect of fiscal policy*

Liquid financial assets

Other factors

Difference between the growth of GDP and interest rate

One-off measures

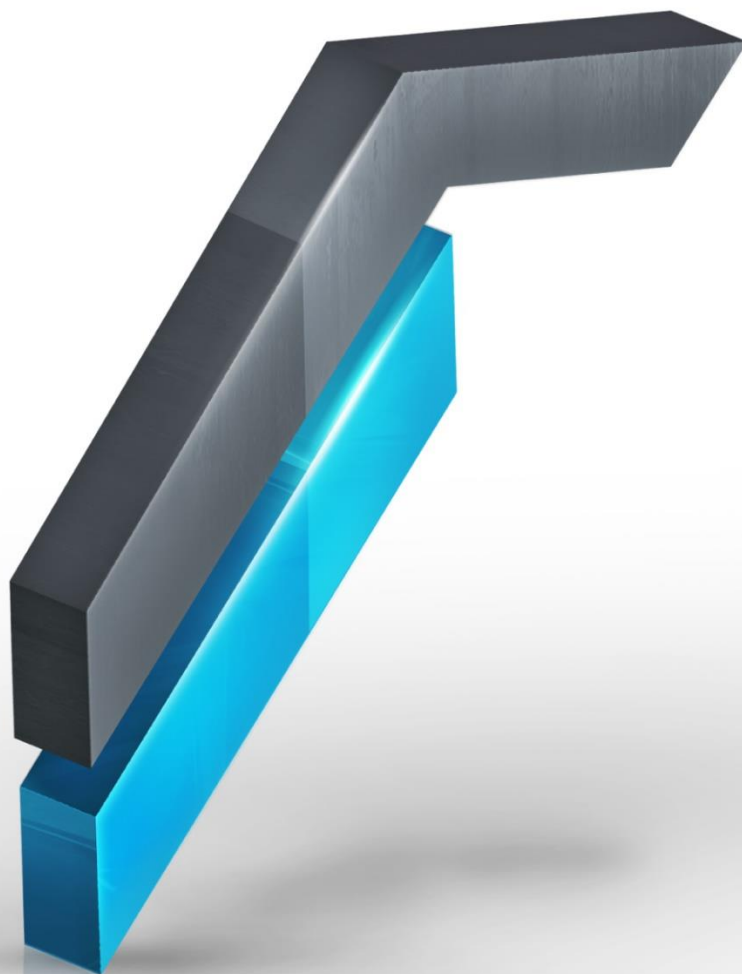
Combined change in debt

*Primary balance (without one-off measures)

According to CBR the gross public debt will increase by 0,3 p. p. of GDP between years 2020 and 2024.

GDP growth (adjusted for interest rate expenses) and the decline in liquid financial assets are expected to have positive impact on the level of debt.

We expect that fiscal policy (expressed through primary deficit) and one-off measures that deal with negative consequences of the pandemic will contribute to the increase in debt between years 2020 and 2024.



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