



Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules for 2019

Summary

August 2020

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.

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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.

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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 compliance with the most important rule – the constitutional debt limit – the report also looks at how the other statutory obligations were respected, particularly in the areas of information disclosure, and the debt of local governments and funding of their competencies.

Fiscal responsibility rules

General government debt limit

The general government gross-debt-to-GDP ratio continued to decline throughout 2019. In April 2020, Eurostat released gross debt data for 2019 at just below 48.0 % of GDP², i.e., **the debt has dropped below the sanction brackets specified by the constitutional act** (Chart 1). The value of the gross-debt-to-GDP ratio will be definitively confirmed in the autumn notification scheduled to be published in October 2020, but given that it is nearing the first sanction bracket threshold, there is a high risk of exceeding the bracket threshold.

The debt fell outside the sanction brackets after seven years since it had exceeded them for the first time in 2012, when the debt had amounted to 51.8 % of GDP. Compared to the 2012 level, the 2019 debt-to-GDP ratio was 3.8 p.p. lower. The constitutional Fiscal Responsibility Act assumes that the government will adopt sufficient³ measures to bring the debt below the threshold of the sanction brackets of the so-called debt break in the shortest time possible. **According to CBR the measures implemented in 2019 failed to bring about a sufficiently swift reduction in the gross-debt-to-GDP ratio. There are several reasons like:**

- The reduction in the debt-to-GDP ratio, especially in 2013 through 2016, was mostly driven by government's one-off measures with an aggregate contribution of 4.8 % of GDP. Without the one-off measures, the government's fiscal performance contributed to an increase in debt by 2.9 %⁴.
- The 2019 decline in debt outside the sanction bracket thresholds was mainly driven by a reduction in the state's cash reserve in the course of 2019 (the lowest

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

² The gross public debt amounted to 47.9995 % of GDP in 2019, ending up just below the first sanction bracket under the constitutional Fiscal Responsibility Act which was set between 48 and 51 % of GDP in 2019.

³ GIBA, M., BUJŇÁK, V.: Ústavnoprávna analýza vybraných ustanovení ústavného zákona o rozpočtovej zodpovednosti zo dňa 31.07.2020 (*Constitutional-law analysis of selected provisions of the constitutional Fiscal Responsibility Act of 31.07.2020*), pg. 12. Analysis prepared under a contract with Comenius University in Bratislava, the Faculty of Law, dated 22.05.2020 "... if the conditions envisaged in Article 5(3) et seq. of the constitutional Fiscal Responsibility Act occur [debt amounts to 40 % of GDP and more] the government (as well as other entities, insofar as their competencies permit) is obliged to adopt, to the best of their knowledge and belief, all available measures to make the debt fall under the level of 40 % of GDP in the shortest time possible, i.e., that a debt reduction is achieved within the meaning defined in the Fiscal Responsibility Act."

⁴ The debt reduction between 2012 and 2019 was also driven by economic growth (contribution of 12 p.p.) and other factors; on the other hand, interest costs increased the debt by 11.3 p.p.

cash-reserve-to-GDP ratio since 2015)⁵; it means that the rule was only met in a rather formal way. A disproportionate reduction in cash reserve increases the risks to the financing of the state's needs as was also shown during the outbreak of the coronavirus pandemic and subsequent decrease in liquidity on financial markets.

- The government had repeatedly postponed attaining a balanced budget and meeting the medium-term budgetary objective set as a structural deficit of less than 0.5 % of GDP; the original deadline scheduled for 2017 was postponed to 2019. The balanced budget was not achieved in 2019 either, the deficit amounted to 1.3 % of GDP and the structural deficit stood at 2.1 % of GDP. The government considerably deviated from these objectives⁶, with the deviation growing even more compared to that in 2018.
- A failure to meet its own budgetary objectives despite the fact that no new negative circumstances occurred, combined with a failure to use the better-than-expected economic development over the recent years to accelerate the reduction of deficit and debt compared to the government's objectives, resulted in gross debt being approximately 10 % of GDP higher at the end of 2019 than it would have been if the government had factored this development in its fiscal management efforts.
- Every year, the preparation of the general government budget relied on unrealistic expectations about the development of certain revenues and expenditures⁷. The size of negative risks in the 2020-2022 budget approved in December 2019 – which had been identified by the CBR prior to its approval – were considerably higher than in the previous years. Instead of consolidation efforts, the approved budgets thus included a covert, though unidentified contribution to the growth in public debt.
- Over the period when the debt stayed within the sanction brackets, the government kept adopting new measures with negative effects on deficit and debt, thus preventing the debt from decreasing at a faster pace. Even though adopting measures, e.g., in the social sector, or increasing other expenditures is a legitimate part of the government's and parliament's work, they failed to consider the need to reduce debt below the sanction thresholds as quickly as possible.

The insufficient pace and size of debt reduction after 2012 needs be perceived in the context of the likely occurrence of the next potential crises and shocks which the Slovak economy will have to face. Due to the impacts of the 2009 financial crisis, Slovakia's debt grew by more than 20 p.p., from below 30 % of GDP in 2008 to more than 50 % of GDP in 2012. In the subsequent years of a largely positive economic growth, the debt decreased by mere 3.8 p.p. It was exactly this period when a more considerable debt

⁵ In 2019, the decrease in the gross-debt-to-GDP ratio was mainly driven by a year-on-year decline in cash funds held in the state accounts, from 6.0 % of GDP at the end of 2019 to 4.8 % of GDP at the end of 2019.

⁶ CBR, [Evaluation of compliance with the balanced budget rule for 2019](#), July 2020. "If the rule had been complied with, the balanced budget could have been achieved as early as 2018, but the government used tax revenue windfalls and lower interest costs to accelerate the growth in expenditures instead of intensifying its efforts to consolidate public finances."

⁷ Starting with the 2013-2015 general government budget, the CBR has been assessing the risks of the approved budget on a yearly basis. The risks regularly repeat, involving mainly overestimates of non-tax revenues and underestimated expenditures of the state budget, local governments, and health expenditures.

reduction should have been accomplished in order to create fiscal space to absorb shocks in the case of a future crisis or unexpected development without a significant impact on the stability and sustainability of public finances and without creating the need to trigger more stringent sanctions under the debt break mechanism.

The debt is expected to sharply overshoot the level of 60 % of GDP in 2020 due to the economic downturn in Slovakia caused by the coronavirus pandemic; it means the debt will exceed the highest sanction bracket of the debt break. If no additional measures are adopted, the CBR expects the debt to attack 70 % of GDP by 2023. The estimated sharp rise in debt compared to the 2019 level proves that a faster pace of debt reduction in favourable economic times is required. The exceptional situation in which the public finances have found themselves requires a higher level of transparency in the approach to expenditures. Given the situation in public finances, expenditures not related to pandemic should be considered more prudently.

Public expenditure ceiling

The constitutional debt limit should serve as a last resort tool to ensure a sustainable level of debt 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 essential 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. Compared to the current development, effective expenditure ceilings could have also contributed to a faster reduction of debt below the sanction brackets.

Efforts to implement the expenditure ceilings should have been made immediately after the constitutional act became effective, including the determination of a binding date for their adoption that has still not been set. The first step in a discussion on the introduction of the expenditure ceilings was made by presenting an analytical study in 2018. In its Stability Programme in April 2019⁸, the government had announced a plan to work out variant options for the setting of expenditure ceilings by the end of the previous election term (i.e., by March 2020), but failed to do so. The commitment of the new government under its Manifesto to put the expenditure ceilings into practice may be considered as positive.⁹

However, from the perspective of the constitutional act requirement, the government has not taken any binding measures aimed at implementing the expenditure ceilings yet. **The absence of binding ceilings on the expenditures of the general**

⁸ [Stability Programme of the Slovak Republic for 2019-2022](#), page 39, April 2019.

⁹ In July 2020, the Institute for Financial Policy of the Ministry of Finance of the Slovak Republic released a discussion paper ([Štátna kasa na uzde](#)) in which it published a new proposal for multi-annual expenditure ceilings.

government in legislation is in breach of the constitutional act¹⁰ and it should be a priority of the current government to implement binding multi-annual expenditure ceilings as soon as possible.

Specific provisions for municipalities and self-governing regions

As for the rules applicable to local governments (municipalities and self-governing regions), three aspects are considered: 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 – on a selective basis – certain local governments¹¹ through the provision of loans on very favourable terms** (zero interest rate, no collateral required), **as well as by forgiving the financial assistance already provided.** The CBR, therefore, recommends that the rules are defined for the provision of repayable grants from state financial assets to local governments in order to avoid their selective preferential treatment and to protect them against possible insolvency.
- **According to the CBR, no new tasks were assigned to the local government sector in 2019 which would have required funding from the state¹².** 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).

The current wording of the constitutional act contains no objective criteria the CBR could use to clearly assess compliance with the constitutional act. 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

¹⁰ This conclusion follows from a legal analysis of selected provisions of the constitutional Fiscal Responsibility Act, commissioned by the CBR (GIBA, M., BUJŇÁK, V.: Ústavnoprávna analýza vybraných ustanovení ústavného zákona o rozpočtovej zodpovednosti zo dňa 31.07.2020 (*Constitutional-law analysis of selected provisions of the constitutional Fiscal Responsibility Act of 31.07.2020*), pg. 29. Analysis prepared under a contract with Comenius University in Bratislava, the Faculty of Law, dated 22.05.2020). Even though the act is silent about the deadline by which such framework should have been enacted, the ceilings were supposed to be implemented without undue delay.

¹¹ In 2019 and in the first half of 2020, the government provided non-repayable grants to the city of Kežmarok, and to the self-governing regions of Banská Bystrica, Prešov, Trnava, Nitra, and Žilina. In 2019, the government forgave the repayment of two repayable grant provided to the city of Bratislava.

¹² 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 competence. 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.").

as with regard to how these tasks change over time, including in relation to their financial coverage¹³. 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.

- The local governments with excessive debts¹⁴ were sanctioned. **While all self-governing regions ended up with debts below the prescribed limit in 2018, one of the initially identified 65 municipalities was effectively fined after legislative exemptions had been considered and reported values cross-checked.** A high error rate in the reporting by local governments leads to the uncertainty about the quality of the data necessary to evaluate compliance with the debt rule for other municipalities that reported debts below 60 % of their previous year's current revenues. **There are currently 29 municipalities at risk of sanctions for 2019; the values they reported are now under review. In 2019, too, the debts of all self-governing regions stood below the statutory limit.**

The Ministry of Finance evaluated the compliance with the local government debt rule, with the possibility to impose a fine, for the first time for 2015, but not a single evaluation has been disclosed so far. **The CBR recommends that the Ministry of Finance disclose¹⁵ all information related to reviewing the size of local government debts, and imposing the fines, in a transparent manner.**

¹³ Every year, the CBR notes in its evaluation that 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.

¹⁴ In excess of the debt limit of 60 % of current revenues in the previous year. The exact definition of this indicator is included in Annex 6.

¹⁵ 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.

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 2020-2022 general government budget contained all the data required by law, except for the information of companies mainly with capital participation of the Ministry of Health of the Slovak Republic. The summary annual report for 2018 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 size 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 2019 report; apart from the continuation of the revision of expenditures, no further significant progress has since occurred**¹⁶.

In terms of the budget comprehensibility, **the communication of the estimate of the balance development in a current year improved**, since the estimated differences against the budget were also described from the perspective of the factors with the most significant impact on the balance development. **The presentation of measures in the healthcare sector is also regarded positively.** It is the only area where a 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 detailed. This approach allows to transparently compare the budget assumptions with the actual development, including a detailed identification of the causes of possible differences, if any.

The drawback of the three-year budget is that it did not cover all measures necessary to meet the objectives set¹⁷. At the same time, **all indicators (gross debt, structural deficit and expenditure growth rate) that are relevant to assessing the budget were calculated based on the assumption that the budgetary objectives would be fulfilled.** This way of presenting the budget is creating an unreasonably more positive image of the future development of public finances while the information about the actually budgeted values and their consequences for the fulfilment of the European and national fiscal rules are pushed into the background.

The comprehensibility of the budget could be enhanced further through presentation of all budgeted tax and social contribution revenues of the general government in one place¹⁸, and through addition of the missing data (hospitals under the Ministry of Health's budgetary chapter and MH Manažment undertakings) and explanatory information about state-controlled undertakings.

¹⁶ Evaluation of the fulfilment of the CBR's recommendations is included in Annex 2.

¹⁷ In order to meet the objectives set for 2021 and 2022, the approved 2020-2022 General Government Budget lacked measures totalling EUR 770 million and EUR 1.246 million, respectively.

¹⁸ This involves a TRFC forecast, additional adjustments, including changes in methodology, and other taxes and social contribution revenues that are currently not covered by TRFC's forecasts.

The information value of the net worth indicator could be enhanced by the valuation of net worth components not yet quantified and by the elimination of methodological discrepancies in its reporting. 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.

In addition to improving the actual content of the documents and presentation of the budget, **the process of compiling the budget, its approval and implementation during the budgetary year are also important.**

- **The approved budgets repeatedly contain risks of revenue shortfalls that also materialise to a great degree.** Revenues from dividends, especially in the case of SPP and VSE Holding, are recurrently budgeted in a non-transparent manner¹⁹. This situation could improve if the forecasts prepared by the Tax Revenue Forecasting Committee (TRFC) were extended to include all tax revenues under the ESA2010 methodology, as well as selected non-tax revenues. Another issue with the transparency is a **repetitive²⁰ increase in tax revenues above the TRFC's forecasts.** In order to prevent this, it would be necessary to enact an obligation to apply the TRFC's forecasts throughout the entire budgeting process.
- In some areas, the budget **did not respond to the actual development in 2019 that differed from the assumptions used in the approved 2019 budget, and it reflected in the estimate of risks in 2020** (undervalued development in expenditures of the Social Insurance Agency). At the same time, **it contained positive effects of the measures that are highly unlikely to be implemented in 2020** (revenues from the fuel marking system using nanomarkers and the increase in the fee for the storage of emergency oil stocks).
- **The CBR has repeatedly noted that the revenues from the sale of emission allowances and interest costs of government debt are not recognised in the budget in accordance with the ESA2020 methodology, as also follows from the data presented in Eurostat notifications.** At the same time, only some of the effects related to the benchmark revision of national accounts were included in the budget. **The fact that the budget does not contain the effect of the subsidising scheme for electricity from renewable energy sources, as it increased tax revenues and expenditures on subsidies by 0.7 % of GDP in 2018, is a significant shortcoming.**
- **The existing legislative framework governing the budget approval procedure in the parliament does not fit the scope and content of the**

¹⁹ The values budgeted for 2020 through 2022 did not reflect the worse-than-expected development in the actual amount of dividend payouts; the CBR found no reasons for optimistic expectations regarding their development based on the data included the budget nor on the basis of the data additionally requested from the Ministry of Finance and the Ministry of Economy.

²⁰ The increase occurred in 2013 through 2015, and in 2018 and 2019.

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 ESA2010²¹. At the same time, it would be advisable to amend the legislative framework in a way that will reinforce the binding nature of the approved budget, including through the **setting of binding rules for preparation, use and publication of the information about all budgetary reserves**²². A large volume of reserves impairs the parliamentary control over budget expenditures, especially if they are not specified in sufficient detail.

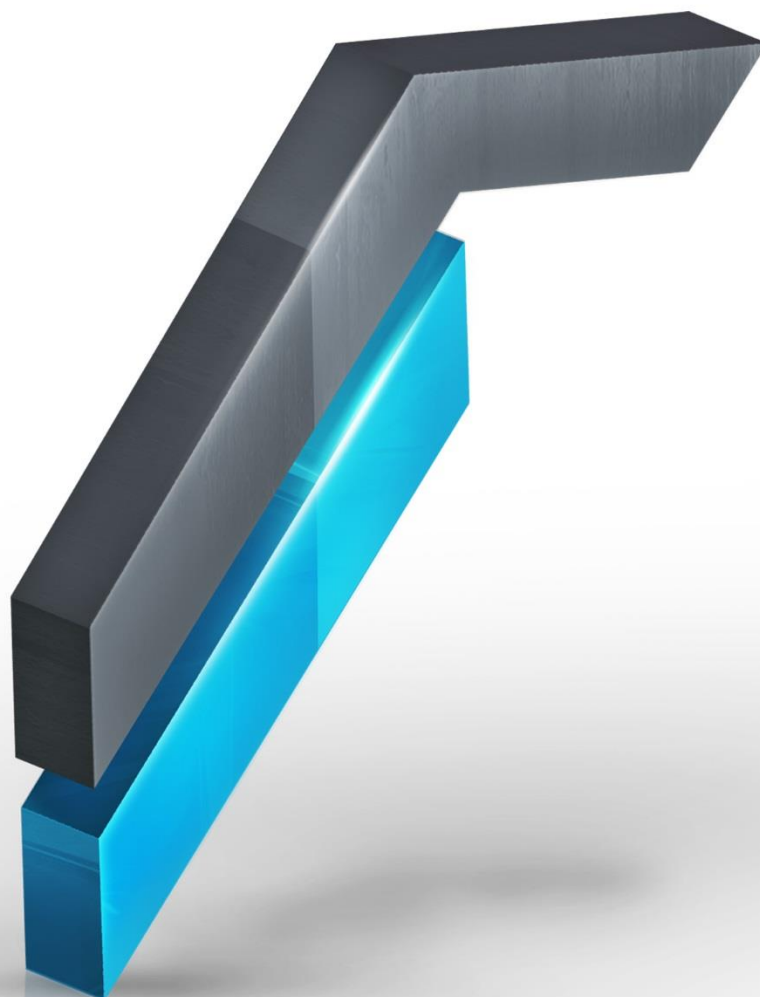
- **During the implementation of the budget, the so-called 13th pension payments were introduced in February 2020, resulting in a major change in the 2020 budget that has increased the expenditures above the limit approved by the government with no adequate compensations**²³.

The government's plans formulated in its Manifesto and subsequently also communicated in the Stability Programme can be regarded positively. They include, for example, enhancing the binding nature of the budgetary framework, expanding the scope of revenues and expenditures forecasted by the 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. 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.

²¹ For example, changes made to the general government balance. Amending proposals adopted in the parliament only amended the state budget for 2020. The CBR could only identify general government balances for 2021 and 2022 after it had requested additional information from the Ministry of Finance.

²² The Act on the General Government Budgetary Rules specifies just three particular reserves (the government's reserve, the prime minister's reserve, and the reserve for EU fund drawdowns and corrections), the use of which is notified to the parliament. However, they now account only for some 13 % of all budgetary reserves. The parliament has no information about how the remaining 87 % of reserves are used.

²³ Not even the existing binding expenditure ceiling for 2020 approved by the government in January 2020 due to the identified significant deviation from the balance budget rule did prevent increasing the expenditure by means of a change in legislation.



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