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TECHNICAL ASSISTANCE REPORT

SLOVAK REPUBLIC

Implementing Public Expenditure Limits

SEPTEMBER 2023

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Authoring Department

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Abbreviations and Acronyms

CBR	Slovak Council for Budget Responsibility
COM	Council Of Ministers
EU	European Union
FAD	Fiscal Affairs Department
FSR	Fiscal Strategy Report
IFP	Institute for Financial Policy
IFIs	Independent Fiscal Institutions
IMF	International Monetary Fund
MFSR	Ministry of Finance of the Slovak Republic
OECD	Organization for Economic Cooperation and Development
PEL	Public Expenditure Limit
PM	Prime Minister
RIA	Regulatory Impact Assessment
SAO	Supreme Audit Office of the Slovak Republic
SOSR	Statistics Office of the Slovak Republic
SP	Stability Programme
VFM	Value for Money

Preface

At the request of the Ministry of Finance of the Slovak Republic (MFSR), a team from the IMF's Fiscal Affairs Department visited Bratislava during the period from May 23 to June 6, 2023. The team was led by Mr. Fazeer Rahim (FAD) and comprised Messrs. Richard Allen, Geert Beekhuis and Tim Pyne (all FAD short-term experts).

At MFSR, the team met Mr. Michal Horváth, Minister of Finance, Mr. Branislav Reľovský, State Secretary I in MFSR, Mr Juraj Valachy, Director of the Institute for Fiscal Policy (IFP), Mr. Alexander Cirák, Director General of the Budget Policy Section (BPS), Mr. Martin Haluš, Director of the Value for Money Unit (VFM), and staff of the IFP, BPS, VFM, and State Reporting Section. Outside MFSR, the team met Mr. Ján Tóth, Chairman of the Council for Budget Responsibility (CBR), Mr. Martin Šuster, Member of the CBR and staff of the CBR; Mr. Viskupič, Head of the Finance and Budget Committee of the National Council, Mr. Ján Šebo, Economist for Recovery and Resilience Plan at the Government Office, Mr. Michal Lehuta, member of the Macroeconomic and Tax Forecasting Committees, Ms. Jana Juriová, Head of the Department of Strategy and Analysis at the Supreme Audit Office of the Slovak Republic and staff in the Department, and staff of the Ministries of Defense; Labor, Social Affairs and Family; Healthcare; and Transport.

The mission thanks all officials for their warm reception and constructive discussions. In particular, the mission thanks Mr. Juraj Šuchta, Head of the Fiscal Policy Department at IFP, for his guidance and logistical support.

Executive Summary

Adopted in 2022, multi-annual public expenditure limits (PEL) are the latest addition to Slovakia's rule-based fiscal framework. They are the culmination of a decade long effort, starting with the 2011 Constitutional Act on Fiscal Responsibility, which created an automatic debt brake rule, established the Council for Fiscal Responsibility (CBR), and set high standards for fiscal transparency. After the general elections in September 2023, the CBR will propose to the legislature numerical annual limits on general government primary spending (minus some exclusions) for 2024 through 2027, which the new government must adhere to over the full term of its office.

The main objective behind the introduction of the PEL is to create an operational instrument to strengthen fiscal discipline and fiscal sustainability. Set in nominal terms, the four-year path is calculated according to a structural balance target which is also linked to a long-term fiscal sustainability indicator. Given the projected rise in age-related spending in Slovakia, the PEL is an important complement to the debt brake which already includes harsh sanctions when debt exceeds a certain threshold. It also provides stronger operational guidance to fiscal policy than the debt brake under certain circumstances, including when some correction mechanisms under the latter do not apply (e.g., during the first two years of a new government).

The introduction of the PEL provides an opportunity to move beyond the annual budget and take strategic budgeting a step further into the medium term. To strengthen the budget process, the report proposes a strategic phase to the budget process, currently lacking, which could start with a Fiscal Strategy Report outlining fiscal challenges and policy options for consideration by the Council of Ministers. To set reliable sector ceilings under the PEL, and move progressively towards multi-year ceilings, the report proposes a sequence of reforms to ensure the use of no policy change (baseline) estimates across all line ministries, anchored in strong ownership by the Budget Policy Section (BPS) at the MFSR. This should eventually lead to the implementation of an effective medium-term budget framework with credible estimates of spending both for the budget year and the outer years.

Additionally, the report advises on how to manage spending under the PEL. An important challenge would be to address uncertain economic and fiscal developments given the constraints imposed by the PEL. This can be done through the judicious use of a contingency margin to account for macroeconomic uncertainties and shocks. This report includes considerations on how to set multi-annual contingency margins optimally. Another challenge is to contain policy decisions within the confines of the budget process. In this regard, stronger discipline on the part of the National Council is needed to avoid ad-hoc changes to policies without sufficient scrutiny of their fiscal implications, a practice that has increased significantly in recent years. The report strongly recommends the enhanced use of regulatory impact assessments for all new legislation, including estimates of fiscal costs.

Weaknesses in current budgeting practices may undermine the implementation of the PEL. This is partly the result of organizational fragmentation within the MFSR and insufficient cooperation between key units responsible for fiscal policy, value-for-money, and the budget. The excessive use of virements, the large share of spending allocated to the Treasury reserve, and the outsize role of parliament are

symptoms of weaknesses in the budget preparation process that may undermine the achievement of the PEL.

Compliance with the binding PEL will require stronger budget execution monitoring, including stricter control of in year virements. A particular challenge in Slovakia is the comprehensive nature of the PEL, which includes spending of many autonomous entities — around a third of the general government — which is harder to control and monitor than that of line ministries (budget chapters). The report recommends a stricter policy on in-year spending adjustments (virements), the number of which have risen to nearly 4,000 per year, including some solutions used in other countries, such as the creation of a few virement "windows" in the year or setting minimum thresholds for MFSR approval. Similarly, the current practice of keeping multiple Treasury reserves, with complex arrangements for giving line ministries access to them and a cumbersome reporting mechanism, can be reformed without reducing transparency. These reserves should be pooled to save time and effort, while ensuring that the overall amount is kept at a prudent level.

There is a strong a priori argument for external validation of the PEL methodology and calculations ideally through the Supreme Audit Office. The PEL will be critical in determining the course of fiscal policy in Slovakia in the medium term. The complexity of the methodology—combined with the use of discretionary adjustments—makes the calculation of the PEL vulnerable to errors and creates a reputational risk for the CBR, and ultimately the fiscal rule itself. An independent audit of the PEL could be carried out annually or after the election of a new government.

Organizational changes within the MFSR would improve the Government's ability to implement expenditure limits. Recommended changes include strengthening internal coordination between sections and units and undertaking a review of the organizational structure of the Budget Policy Section, which has not changed since 2003. A review would aim to align the organization with legal requirements as well as with best practices across the EU. Eventually, responsibilities for capital investment and spending reviews, currently carried out by the MFSR's Value-for-Money Unit, could be transferred to the Budget Policy Section. Finally, extending the timeline for preparing official macroeconomic and fiscal forecasts, which will be critical for setting and updating the PEL, would enable more substantive collaboration among members of the two relevant committees and strengthen the credibility of the forecasts.

Based on the recommendations in this report, the current caretaker government has a unique opportunity to propose an agenda of PFM reforms to the new government that will emerge from the elections in September. These recommendations rely heavily on the experience of countries that have to some extent successfully implemented PEL and progressively moved towards medium-term budgeting. Further detailed work will be needed in many of the above areas to flesh out the precise laws, decrees, regulations, or processes that will need to be changed to kick start the reforms.

The table below summarizes the mission's main recommendations.

Table 1. Summary of Recommendations

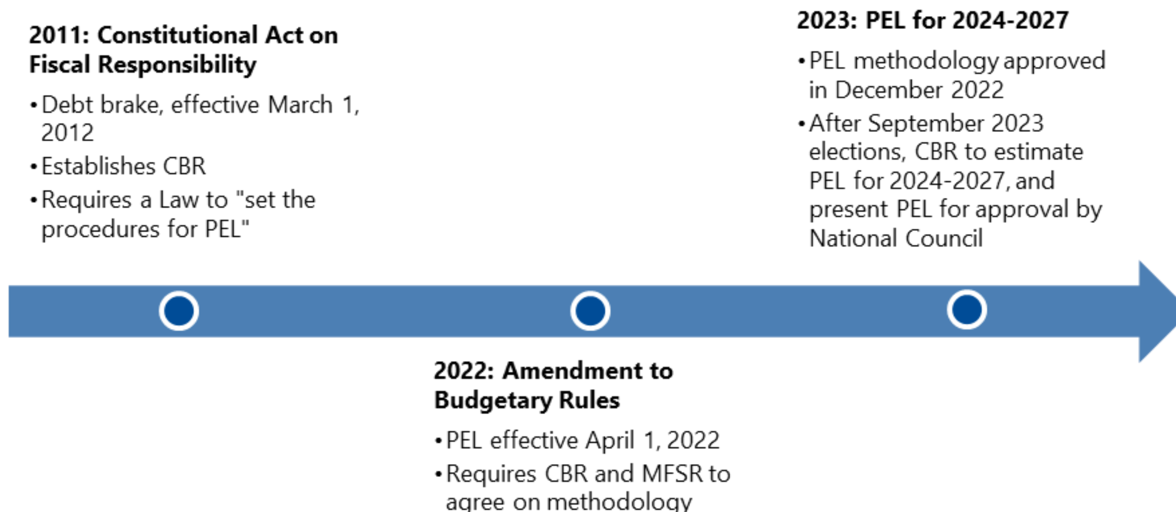
Recommendations	Action	Time horizon
Strategic Issues		
Prepare an annual FSR, starting in April 2024, for presentation to the Council of Ministers as a complement to the Stability Program (SP). Use the document as a vehicle for taking decisions on key fiscal issues required to prepare the budget for 2025.	Minister of Finance	2024
Require that the discussion of the FSR by the Council of Ministers conclude with an agreement on the various consolidation efforts required (on taxes and spending) under the following headings: (i) across the board policies (e.g., decisions on public employment); (ii) sector specific policies; and (iii) new measures arising from spending reviews.	Council of Ministers, led by MFSR	2024
Establish a procedure, independent of the CBR and MFSR, to review the CBR's methodology for calculating the PEL and consider adopting a simpler methodology with less room for judgment and discretion; and audit the PEL calculations themselves with a first audit taking place in early 2024 and every four years thereafter.	MFSR, CBR, SAO	2024
Carry out a review of the consistency of the EU's new Net Expenditure Rule with the PEL methodology and make changes to the national rule as appropriate. The review could also assess the experience with the national ceiling so far.	IFP and CBR	2024-2025
Strengthen existing arrangements, exercised through the Regulatory Impact Assessment Committee, for enforcing budget discipline in the National Council, as defined in existing law.	MFSR to propose to National Council	2023
Budget Preparation		
Undertake the analysis of forecasts errors, and develop a policy for the contingency margin.	IFP	September 2023
Rationalize the presentation of the Treasury Reserves in the budget as a single reserve with well defined access criteria and regular reporting to the National Council.	BPS	For the 2025 Budget
Prepare initial baseline estimates for all budget chapters	BPS	March 2024

Recommendations	Action	Time horizon
Provide guidance and training to line ministries to prepare baselines their chapters for the 2026 budget.	BPS (with support from IFP and VFM)	May 2025
Agree on updated expenditure baselines between line ministries and the MFSR	BPS	March 2026
Budget Execution		
Determine for each of the 'other entities' how to strengthen government control on their budgets and envisage strengthening the responsibility of line ministers in the budget law	BPS and VFM	September 2023
Decide upon and announce a stricter policy on virements	BPS	September 2023
Organizational Issues		
Establish a high-level committee of Director-Generals and their Directors to coordinate the work of the MFSR on key fiscal policy and budgetary issues and prepare policy advice for the Minister and State Secretaries.	BPS	2023-2024
Undertake an independent review of the Budget Policy Section's organization, functions, business processes; staff resources and training needs and prepare a phased action plan for implementing the new structure.	Minister of Finance	2024-2026

I. Why Expenditure Limits?

1. The 2011 Constitutional Act on Fiscal Responsibility requires the Council for Fiscal Responsibility (CBR), to establish public expenditure limits (PEL) for the purpose of ensuring long-term fiscal sustainability. In March 2022, the National Council amended the 2004 Budgetary Rules on Public Administration — Slovakia's Organic Budget law — to operationalize the PEL which consist of four-year limits on aggregate general government expenditure (excluding certain expenditures deemed outside of government control, representing around 25 percent of general government spending)[1] at the start of every new government's term of office. These limits are estimated in nominal terms, and the four-year path is calculated to ensure that fiscal consolidation measures are taken to improve the structural balance and achieve long-run fiscal sustainability.[2] The PEL limits should also not exceed constraints on expenditure imposed by the debt brake, the other fiscal rule that has been in place in Slovakia since 2012 (see **Error! Reference source not found.**). The law provides two escape clauses, namely when (i) there is a decline in annual GDP and /or (ii) the EU Stability and Growth Pact (SGP) is not being enforced. Withing the four-year period of a government's term, the PEL is only recalculated when the updated revenue forecast deviates by 3 percent of GDP or more from the forecast initially used in calculating the ceilings, or when exiting from the first mentioned escape clause.

Figure 1. Slovakia. Milestones on Implementing the PEL



[1] The main exclusions are spending by local governments, EU Funds (including Recovery and Resilience Facility), state budget funds intended for co-financing programs funded by EU funds, Slovakia's dues to the European Union, interest expenditure, one-off expenses, and spending subject to the business cycle such as unemployment benefits.

[22] A consolidation of 0.5 percent of GDP in the structural balance (against a no policy change scenario prepared by the CBR) is required if the long-term sustainability risks are considered high ((long run sustainability indicator exceeds 5) or medium (indicator exceeds 1), and 0.25 percent of GDP if they are considered low (indicator below 1). If the indicator is below zero, no consolidation is required.

Box 1. Slovakia's Debt Brake

The Constitutional Amendment 2011 caps public debt of the Slovak Republic at 60 percent of GDP starting March 1st, 2012, until December 31, 2017, based on the Eurostat definition. Starting in 2018, this cap is reduced by one percentage point each year to reach 50 percent in 2027. The Amendment sets the following correction mechanisms based on the below thresholds. These thresholds are also reduced by one percentage point each start starting 2018 (in brackets the applicable threshold for 2023):

- **Level 1 sanction:** 50 – 53 percent (45-48 percent in 2023 for debt in 2022): the Minister of Finance is required to explain the reasons behind the increase to the National Council and propose measures to bring debt below this amount.
- **Level 2 sanction:** 53-55 percent (48-50 percent in 2023 for debt in 2022): the government is required to propose to the National Council a package of measures to bring debt down and to freeze wages of government members.
- **Level 3 sanction:** 55-57 percent (50-52 percent in 2023 for debt in 2022): in addition to the above, the Ministry of Finance will block 3 percent of the approved state budget expenditure, and general government entities cannot spend more than they spent the previous year.
- **Level 4 sanction:** 57-60 percent (52-55 percent in 2023 for debt in 2022): in addition to the above, the government should submit a balanced budget for the general government and local governments should also submit balanced budgets.
- **Level 5 sanction:** 60 percent (55 percent in 2023 for debt in 2022): in addition to the above, the government has to ask the National Council for a vote of confidence.

The Constitutional Amendment allows for numerically defined escape clauses for a major recession, banking system bailout, natural disaster, and the state of war. In addition, sanction levels 3, 4 and 5 are waived for 24 months for a new government which receives a vote of confidence from the National Council on its program document (Manifesto).

The formation of a new government in May 2021 allowed for the above-mentioned escape clause to apply until May 2023. The debt level reached 58.9 percent of GDP at that time, and level 1, 2 and 3 sanctions were applied. After the elections in September 2023, the new government will also benefit from the waiver for 24 months. In the interim, with debt at 57.8 percent of GDP (latest official notification by Eurostat in April 2023), the caretaker government in place is expected to prepare a balanced budget for 2024.

Source: Constitutional Act; Eurostat; RRZ (https://www.rrz.sk/dlhovabrzda_en/#sankcie)

2. Slovakia has made the unique choice to give the responsibility of estimating, updating, and assessing the fulfilment of the PEL to its fiscal council. The National Council can approve or reject the PEL proposed by the CBR. The government, in turn, takes these limits as given, and is required, through the MFSR, to break down the PEL into individual ceilings for public organizations which fall under the PEL definition, after setting a contingency margin for each year. Every June, the CBR revises the remaining years of the PEL, and adds an indicative limit for an additional year. The revision reflects new revenue measures and measures affecting long-run sustainability.[3] The CBR also adjusts the current year's PEL for any deviations (positive or negative) from the previous year's limit. Four other countries in the EU have a similar framework to set multi-year spending limits. **Error! Reference source not found.** highlights the main features and differences with Slovakia. In these countries, the PEL is proposed by the government, and typically reflects, at a more discretionary level, its policy choices. Slovakia's model reflects the principal objective for its adoption, which is to ensure long-run fiscal sustainability.

3. Successful implementation of the PEL will require significant refinements in the management of public finances in Slovakia. As discussed later in this report, the budget process currently lacks a strategic phase where policy debates take place at an early stage. As a result, decisions on fiscal consolidation are made late, and with the process focusing almost entirely on finalizing the next year's budget, policy discussions are also weighted towards immediate priorities rather than policies with a medium- to long-term impact on public finances. This is exacerbated by the increasing trend for policies to be adopted outside the budget process, a practice that became normalized during the COVID-19 pandemic and has become difficult to curtail ever since. Implementing the PEL will require a sea-change in these practices, and a much sharper focus on the medium term. It will also require better use of technical tools to prepare and implement the budget, stronger coordination among entities, and changes to inefficient practices that have crept up over time, such as the excessive number of virements. Some strengthening of the Ministry of Finance's internal coordination and organizational structure, notably its budgeting function, would also be needed.

4. This report focuses on issues of strategic planning, budget preparation and budget execution and reporting that will require strengthening to effectively implement the PEL. These issues were highlighted by MFSR as being of particular importance to the Ministry. The PEL also provides an opportunity to build on reforms that the MFSR has been working on in recent years (e.g., spending reviews, project evaluation and zero-based budgeting for capital, and baseline budgeting) and integrate them in the budget process.

[3] For policies that are deemed to worsen fiscal sustainability, the expenditure limits are adjusted downwards by the same amount. Similarly, for policies that are expected to enhance fiscal sustainability, the limits are allowed to increase, with a maximum set at 0.5 percent of GDP.

Box 2. EU Countries with MultiYear Expenditure Ceilings

Denmark. Expenditure ceilings were introduced in the Organic Budget Law in 2012. The ceilings, proposed by the Ministry of Finance, set legally binding nominal limits for expenditures of the central government, municipalities, and regions, respectively. Ceilings are approved by parliament and cover a rolling period of four years. Improved budget management and economic sanctions are used to support compliance with the expenditure ceilings.

Finland. Since 2003, successive governments have set annual limits to primary non-cyclical expenditure in real terms for the four-year term of their office. These limits are not set in law. They are proposed by the government, usually formed by a coalition of 4-5 parties which commit to the ceilings in the fiscal plans and fiscal policy objectives they publish at the beginning of their term of office. Currently, about 75 percent of total central government spending, and about 37 percent of total general government spending fall under the limits.

Netherlands. Since 1994, ceilings are fixed in real terms for aggregate expenditure of central government, health care and social security, all of which aggregate to about 90 percent of general government spending. Ceilings are also then set at a sectoral level for each year of the government's four-year term of office. The coverage of expenditure has changed over the years: from 2007-10 interest payments were excluded; since 2009, expenditure is defined in net terms, i.e., gross expenditure minus non-tax revenues, from 2009-10 expenditure excluded unemployment and social assistance benefits. If it is expected that the ceilings will be breached, the Minister of Finance is expected to propose corrective action.

Sweden. An expenditure rule has been implemented since 1997. The Organic Budget Law requires the Government to propose in its Budget Bill an expenditure ceiling for central government and old-age pension system expenditures for the third year ahead. Parliament (the Riksdag) then sets the ceiling. It is a rolling framework, with one additional year being added annually. The ceilings cannot be adjusted except for technical issues. A budgetary margin is used as a buffer. Interest expenditure is excluded from the ceiling. The audit office occasionally reviews compliance with the limits.

In all these countries, the limits are initially estimated by the Ministry of Finance, then proposed by the Government and ultimately approved by Parliament.

Source: Mission.

II. Strategic Issues

5. In this Section, we discuss the following strategic issues that are important implementing the PEL: (a) introducing a strategic phase to fiscal and budgetary planning; (b) validating the methodology and calculations used by the CBR to prepare the PEL; (c) ensuring consistency of the PEL methodology with the European Commission's proposed Net Expenditure Rule; and (d) limiting the National Council's powers to amend the budget and propose or amend legislation with a significant fiscal impact.

A. Introducing a Strategic Phase to Budget Planning

6. In the early stages of the budget process, there is no structured debate within the government on fiscal policy issues and the preparation of the annual budget. In April each year, Slovakia presents its Stability Programme (SP) to the European Commission. The government approves this document, which is prepared by a team in the MFSR led by the IFP. The SP outlines the no policy change fiscal scenario for coming years, and the fiscal consolidation effort needed under this scenario. The document is endorsed by the Government (and presented to the National Council for information) before being sent to the European Commission, without conducting a debate on the policies needed to address these fiscal challenges or the upcoming budget negotiations.

7. In some other EU countries such a debate takes place. For example, the Dutch government prepares a Strategy Report[4] for discussion by Ministers that sets out the implications of the updated macroeconomic and implementation forecasts for the required consolidation to meet multi-year expenditure ceilings (see Box 2). In France, the focus is on setting multi-year spending ceilings that are agreed in the Council of Ministers and formalized in letters to line ministries from the Prime Minister. Meetings of the Council of Ministers may also take place (see Box 3).

8. A similar approach could be followed in Slovakia. The government would submit a Fiscal Strategy Report (FSR) to the Council of Ministers along with the SP.[5] The FSR could focus on the preparation of the national budget for 2025 and, increasingly over time, the medium-term fiscal and budget framework (discussed further in Section III). The report would be consistent with but not overlap with the SP and identify concrete decisions to be made by the Council of Ministers. As discussed in Section V, arrangements for preparing the FSR would benefit from enhanced coordination procedures within the MFSR, especially between the Budget Policy Section, the IFP and the VFM Unit.

[4] Technically, in the Netherlands, this report comprises a letter ('Kaderbrief') to the Council of Ministers.

[5] The term "government" used in this report is a very broad one, while "Council of Ministers" is narrowly defined. "Government" may be defined broadly as "the exercise of authority, direction and restraint over the actions of citizens in a community, according to the established constitution, laws and regulations, or by other edicts" (Meriam-Webster). The Council of Ministers, by contrast, is the group of ministers in the Slovak Republic that takes key decisions on behalf of the government.

Box 3. France's Approach to Strategic Budgeting

The French Organic Budget Law (2001) provides for a strategic phase early in the budget process. The law was amended in 2021 to bring forward this phase and strengthen the nominal spending limit.

The Ministry of Finance kicks off the budget process early in the year, with a top-down proposal for a multi-annual spending limit. This limit will be included in a law ('Loi de programmation des finances publiques') and is discussed at the same time as the Stability Programme (Spring).

The Budget Department carries out analytical work in the Spring (called "exercises budgétaires") to identify savings and/or inefficiencies that help prepare the budget negotiations.

The Ministry of Finance provides some directions in a letter to line ministries, e.g., on non-replacement of retiring/departing staff, percentage reductions in current spending, transfers, etc.; a distinction between high-priority policies (few) where ministries may increase their expenditures and others that should see their expenditure decrease. But line ministries rarely comply with these directions. This letter is usually sent to line ministries in March / April.

Ministries come up with their own proposals, the sum of which greatly exceeds the aggregate ceiling. These proposals are discussed between the line ministries and the Budget Directorate in May.

Sometimes, a Ministerial Retreat takes place, either at the beginning of the process to encourage discipline, or at the end to put a formal end to the negotiating process. The impact of this meeting depends much on the Prime Minister's authority.

After the strategic phase there is a reconciliation and negotiation process which may lead to another Ministerial Retreat to put a formal end to the negotiations. Ceilings are set for three years and letters sent to line ministries, signed by the Prime Minister. The letters are usually sent in late June or early July, to be available to parliament before the Public Finance Orientation Debate.

These ceiling letters are the cornerstone of French public budget. They express political authority within the Government; are used to prepare the annual budget documents; set ceilings for three years; and lay down a roadmap for reform.

Parliamentary backing is sought through various means. These include debates on the annual budget law and the Stability Program but also through a Public Finance Orientation Debate which takes place in July, about two months before the budget is tabled.

Source. Mission.

9. The FSR prepared in April 2024 could include the following elements for discussion and approval by the Council of Ministers:

- The PEL ceilings for 2025 and subsequent years and the ceilings for the state budget and 'other entities' implied by those limits.
- The PEL contingency margin for 2025 and subsequent years.
- The total consolidation effort required in 2025 and the shares of consolidation for the expenditure and revenue sides of the budget.
- Any other fiscal targets such as the minimum spending target for the defense sector .
- The initial ceilings for line ministries for 2025, as determined by the MFSR.

10. The Council of Ministers could also discuss:

- Potential fiscal risks and policies to mitigate them.
- Possible consolidation measures for each line ministry on the expenditure side of the budget.
- Possible revenue measures.
- Possible structural reform measures for 2025-2027.

In subsequent years, the FSR could increasingly include a medium-term perspective.

11. **There are various options for the design and presentation of the FSR.** For example, Slovakia could follow the Netherlands' approach (see Box 4). Under such a model, an initial FSR would be presented for discussion by ministers in early April. Following this discussion, the MFSR would make amendments to the initial draft of the FSR and submit a final version for the approval of the Council of Ministers at the end of April. This approach is also used in the Netherlands in the case of difficult budgetary decision-making, for example with supplementary or draft budgets.

Box 4. The Netherlands' Fiscal Strategy Report ('Kaderbrief')

In March, the Minister of Finance will generally send a letter to the Council of Ministers, setting the stage for the upcoming budget negotiations. This letter summarizes the impact of the new economic forecasts (from the Central Planning Bureau) on the fiscal position of the government. Estimates of the budgetary consequences of the implementation of existing policies for the current and next years' budgets are also presented. Finally, the letter may indicate the (negative) fiscal space available, compliance with the Dutch expenditure limit, the relevant government priorities, and possible consolidation needs.

Following this discussion, the budgetary negotiations between the Ministry of Finance and line ministries are held, leading to an agreement on the supplementary budget for the current year and the line ministries' ceilings for next year's budget (including the medium-term budgets). This agreement is tabled in the Council of Ministers' meeting in parallel to the submission of the Netherlands' Stability Program.

Source. Kaderbrief(besluitvorming) en Totalenbrief - Parlement.com

Recommendation 1. Prepare an annual FSR, starting in April 2024, for presentation to the Council of Ministers as a complement to the SP. Use the document as a vehicle for taking decisions on key fiscal issues required to prepare the budget for 2025. *(Action: Minister, MFSR Departments; time horizon: 2023-2024).*

Recommendation 2. Require that the discussion of the FSR by the Council of Ministers conclude with an agreement on the various consolidation efforts needed (on taxes and spending) under the following headings: (i) across the board policies (e.g., decisions on public employment); (ii) sector specific policies; and (iii) new measures arising from spending reviews. (*Action: Council of Ministers, led by MFSR; time horizon: 2023-2024*

B. Validation of the PEL

12. The methodology used by the CBR to calculate the PEL is highly complex. In developing the methodology, a compromise was reached to satisfy the preferences of various stakeholders. Some stakeholders emphasized the need for precise rules governing the calculations, others preferred leaving more room for discretion. The result is a 63-page document comprising an in-depth explanation on the calculations, which requires the use of models and complex excel sheets with detailed analysis, supported by a range of assumptions (e.g., which estimates of the output gap to use in the models). The methodology also requires the use of judgement and discretion, for example on whether a particular item of spending should be considered as a one-off (and hence removed from the ceiling) or not.

13. The complexity of the methodology makes the calculation of the PEL vulnerable to errors that create a reputational risk for the CBR. The detailed calculations are carried out by a small, highly specialized, and skilled unit in the CBR. Given their complexity and capacity constraints, the MFSR finds it difficult to replicate the CBR estimates. There is a high potential for error which, if discovered, could have important implications for fiscal policy, potentially affecting the credibility of the government, and damaging the reputation of the CBR.

14. Given the complexity of the process, and the use made of judgment and discretion, there is a strong argument for introducing an independent procedure to validate both the methodology for calculating the PEL and the calculations themselves. To avoid conflict of interest, this work should not be done by the CBR itself. One option would be to give the task to the Supreme Audit Office. The SAO Law (Act No. 39/1993) already provides a mandate for the Office to audit the draft state budget as well as the annual financial statements, and the SAO presents an assessment of the budget to the National Council each autumn which differs from the standard compliance and performance auditing functions carried out by a national audit office.[6] Moreover, the assessment of risk is implicit in the SAO's mandate, and the Office takes account of risk factors in preparing its audit plan each year: risks associated with the validity and reliability of the PEL methodology and estimates would be consistent with this approach. The SAO law also refers to "the enforcement and exercise of the of the rights and obligations arising out of [Slovakia's] financial and economic relations and the financing of projects under international treaties." However, including a requirement to audit the PEL would represent a significant extension to the SAO's operational mandate and might require an amendment to its law.

15. First, the validation procedure should be considered as two related but separate exercises. First, there would be benefits in reviewing the methodology to make it simpler and reduce the room for judgment and discretion. Such a review could be one-off with any revisions to the methodology being applied after they have been approved according to existing legislation. Second, the PEL calculations themselves should be audited. Such an audit could be carried out by the SAO every year or, alternatively, after the CBR's first estimates of the PEL are made at the start of a new government (every four years). Based on the results of the audit, the CBR would be required to amend the calculations before the limits are presented to the National Council for adoption. This would require some adjustment

[6] *Opinion of the Supreme Audit Office of the Slovak Republic on the Draft State Budget of the Slovak Republic for 2023.* November 2022.

to the timeline for preparing the PEL estimates and possibly some changes to the 2004 Budgetary Rules on Public Administration. The first audit of the PEL calculations could be prepared in early 2024.

16. The SAO's Department of Strategy and Analysis, which prepares the Office's opinion on the draft state budget and conducts related analyses of the budget and fiscal policy issues, could be authorized to review the CBR's methodology and audit the PEL calculations. For this purpose, the SAO would probably need to recruit two or three economists on a temporary basis to conduct the required analysis and prepare a report for submission to the government and thence to the National Council.

17. A second option would be to make use of the EU Network of Independent Fiscal Institutions (IFIs)[7] to identify experts from the network to carry out both a review of the methodology and an audit of the PEL calculations. In addition, the MFSR's IFP needs to double check all the calculations in a parallel process to the CBR. This could be an informal process but the MFSR must be able to state that they fully understand and support the CBR's calculations, which they currently lack the capacity to do.

Recommendation 3. Establish a procedure independent of the CBR and MFSR to (i) review the CBR's methodology for calculating the PEL and adopt a simpler methodology with less room for judgment and discretion; (ii) audit the PEL calculations themselves with a first audit taking place in early 2024 and every four years thereafter. Audits should be carried out either by the SAO or the EU Network of IFIs The SAO option would complement the Office's existing functions but might require an amendment to Act No. 39/1993. *(Action: MFSR, SAO; time horizon: 2024).*

C. Consistency between the PEL and EU Rules

18. The European Commission recently proposed the introduction of a net expenditure ceiling within the European Stability and Growth Pact (see Box 5). The proposed approach appears to be comparable to the CBR's methodology for calculating the PEL, by linking multi-year expenditure ceilings (net of some exclusions) with an indicator of fiscal sustainability. However, the coverage of expenditure under the new rule would differ, as well as the indicator of fiscal sustainability. In addition, the Commission's proposal also considers spreading the need for consolidation (from four to seven years) when structural reforms are implemented. Currently, it is not clear whether the proposed ceiling will translate into greater demands for fiscal consolidation than Slovakia's national PEL, and to what extent the approaches can be made consistent.[8] Therefore, it would be useful to review the two methodologies once the European proposal has been agreed (expected later in 2023 or in 2024) and propose changes to the national ceiling as appropriate. This review could also assess the experience with the national ceiling so far.

[7] The Network was established in September 2015, at the 3rd informal meeting of EU IFIs held in Bratislava. The agreement has already been signed by 23 independent fiscal institutions from different European countries. The Secretariat is based in Brussels, See https://www.euifis.eu

[8] The CBR also noted that one of the key reasons why national PEL were introduced was the Slovak experience with EU rules, in particular the low compliance and non-enforcement of the preventive arm of the Stability Pact.

Box 5. Proposed Revision to the European Fiscal Rules

On April 26, 2023, the European Commission proposed a substantial reform of the preventive arm of the Stability and Growth Pact. The Council and European Parliament will have to agree on this reform of the supranational budgetary rules before member states are obliged to adhere to the new rules. The basic purpose of the proposal is to use expenditure ceilings to improve debt sustainability. The Commission's approach resembles the Slovak PEL. However, there are differences in definitions, criteria, and analysis between the two sets of rules. The processes governing the use of EU and national ceilings are also different.

The main components of the proposal are:

- Governments will submit a medium-term fiscal-structural plan covering fiscal policy, reforms and investments, and report annually on the implementation of this plan;
- the core element is a net expenditure path, excluding one-off measures, interest payments, EU-funded expenditure and cyclical unemployment expenditure, covering a period of four years;
- this path would need to ensure that public debt declines credibly, or remains at prudent levels, and that the deficit remains at or should be reduced below 3 percent of GDP;
- if the right reforms are implemented, the expenditure path, and the need for spending or revenue consolidation measures, can be extended from four to seven years, reducing annual consolidation needs; and
- the plan will be assessed by the Commission and approved by the Council, after which progress will be monitored by the Commission and may lead to more stringent consolidation if Member States underperform.

The proposal would replace the current preventive arm of the Stability and Growth Pact but leave the 3 per cent deficit and 60 percent debt rules in place. The corrective arm of the Stability and Growth Pact imposes greater demands on Members States and can lead to fines. The existing rules require debt-ratios to decline by 1/20th of the debt above 60 percent of GDP. This approach would be revised to incorporate the above-mentioned debt-reduction approach. Also, it would become more likely that countries with a substantial debt challenge would be sanctioned.

Source: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/economic-governance-review_en

19. The Slovak Republic submitted their Stability Program to the European Commission in April 2023, with a consolidation effort of almost 2.8 percent of GDP over the period 2024-2026. This would reduce the government deficit from 6.2 percent to 2 percent of GDP and keep debt under 60 percent of GDP over the reporting period. The consolidation measures would need to be determined by Slovakia's new government, which will take office after the elections on September 30. Beyond this period, consolidation would also be necessary due to Slovakia's high long-term fiscal sustainability risks.[9] These risks are assessed using the EU-wide S2 indicator which measures the fiscal adjustment required to stabilize government debt in the long term. Slovakia has one of the highest scores in the EU.[10] It is likely that pressures on fiscal space will continue over the medium term and that the PEL will significantly constrain government expenditure going forward.

20. If the European Commission recommends the Slovak Republic to be more ambitious in their consolidation efforts for 2024 and 2025 than is required by the national PEL, the government may be required to find additional consolidation measures.[11] Currently, it is not yet clear if the old or the new European rules will apply, whether the consolidation effort required in 2024 and 2025 will be greater or smaller than the national PEL, and how and to what extent the government will decide to follow the revised EU rules. In the meantime, until the new EU fiscal rules are approved and implemented, it might be advisable not to change the methodology of the national PEL, but to keep a certain margin within the limit, as appropriate.

Recommendation 4. Once the proposed EU Net Expenditure Rule has been approved, carry out a review of its consistency with the PEL methodology and make changes to the national rule as appropriate. The review could also assess the experience with the national ceiling so far. *(Action: MFSR, IFP, CBR; time horizon: 2024).*

D. Fiscal Powers of the National Council

21. In normal times, it appears that the National Council has generally exercised restraint in making amendments to the budget or proposing new legislation with significant fiscal impact. Whilst, according to the Constitution, the Council has unlimited powers to amend the budget, historically such changes have been relatively small, constrained by the political alignment of the legislature and the ruling coalition government. According to an OECD survey of 2019, most of the EU Member States have similarly unlimited authority to amend the budget, while in practice rarely exercising these powers (see **Box 6**).

[9] Slovak *National Stability Program*, 2023, available on: https://commission.europa.eu/content/2023-european-semester-national-reform-programmes-and-stabilityconvergence-programmes_en

[10] *Fiscal Sustainability Report*, 2021, available on: https://economy-finance.ec.europa.eu/system/files/2022-05/dp171_en_vol1.pdf

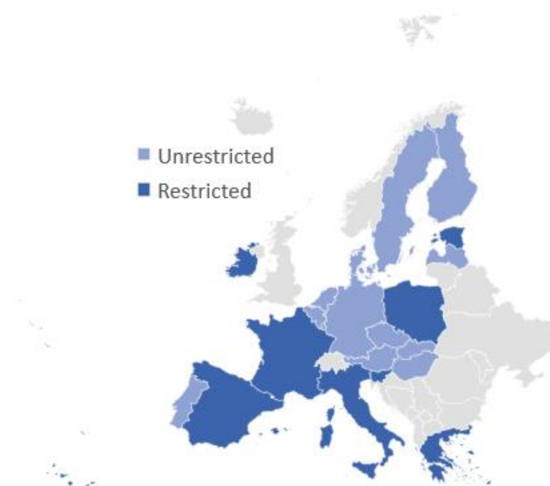
[11] The EC has already issued its recommendation for fiscal policy in 2024: to improve the structural balance in 2024 by 0.7 percent of GDP – see https://commission.europa.eu/system/files/2023-05/COM_2023_625_1_EN.pdf

Box 6. The Legislature's Powers to Amend the Budget in EU Member States

In a Survey published in 2019, the OECD has analyzed the parliament's powers to amend the budget in its member countries. Around two-thirds of EU Member States that are also members of the OECD report unrestricted amendment rights. In the other third, Parliaments have restricted powers (see Figure 2), most commonly to amend the budget within the country's fiscal aggregates (e.g., its expenditure ceiling or fiscal deficit limit).

The OECD Survey notes that formal amendment powers do not tell the whole story. In practice most of the countries surveyed do not use their powers to make significant changes to the executive's draft budget, especially when the government has a large majority in the parliament, or where a coalition government has a strong mandate to exercise fiscal discipline. This has been the case historically in Slovakia. Consultation and bargaining during the budget formulation stage may reduce the size of the legislature's amendments. Fiscal rules and mandatory spending (e.g., on social benefits or pensions) may also constrain the parliament's ability to propose amendments. Further, legislatures in about half of the 21 EU countries included in the OECD survey regard a vote on the budget as a vote of confidence in the government which is likely to discourage them from using their formal powers.

Figure 2. EU member states' legislative powers to amend the budget



Note: The following countries which are members of the EU but not members of the OECD were not included in the Survey: Bulgaria, Croatia, Cyprus, Lithuania, Malta, and Romania.

Source: OECD, 2019, *Budgeting and Public Expenditures in OECD Countries*, pages 88-89.

22. Recently, the fiscal discipline exercised by the National Council appears to have eroded. The proportion of new laws proposed by the legislature (as compared to legislative proposals made by the executive branch) has increased from around 10 percent historically to 40 percent in the past two years. Some of these laws (e.g., a revision to the pensions law and a new provision to provide free meals to primary school students) have a substantial fiscal cost. The Budget law includes provisions that are intended to constrain parliamentarians from making legislative changes without their financial and budgetary implications being estimated and reviewed by the MFSR.[12] However, these requirements do

[12] Art. 67 of Law No. 350/1996 on Rules of Procedure of the National Council stipulates that (i) laws may be prepared by a committee [of parliament], any member, and by the government. Art. 68 states that new all new laws (but not amendments to existing laws) must be accompanied by an explanatory memorandum that (inter alia) includes "an evaluation …. of their economic and financial impact and their impact on the budget". Further, Art. 33 of the Act on Budgetary Rules 2004 stipulates that for any bill (1) "the presumed financial consequences for the public service have to be laid down and justified, not only for the current year but for the following three years" and (2) "the claimants are obliged to discuss the budgetary consequences of the [proposed law] with the Ministry of Finance in advance."

not seem to be strictly observed, do not provide reasonable time for the MFSR to review proposals, and do not apply to amendments to existing laws.

23. The MFSR is currently preparing proposals that would reinforce existing legal provisions for regulatory impact assessments (RIA) through a series of measures that would require legislative changes. It is intended that the proposals be put for public consultation before being submitted to the National Council later in 2024. These measures include: (i) reinforcing the role of the government's existing Committee on Regulatory Impact Assessment (RIA) by moving its location from the Ministry of Economy to the Government Office and increasing its analytical capacity; (ii) streamlining and strengthening the methodology for conducting RIAs; and (iii) requiring any proposals for new legislation to specify both the expected costs and benefits of the measures and review alternative methods of achieving the same policy objectives. RIAs could also consider how the proposed measures would be financed, e.g., through the budget or loans. Another proposal of the MFSR is to extend the period for voting on amendments to existing legislation by requiring them to be first submitted to one of the legislature's committees (e.g., the finance committee) for review. In addition, funding to the Parliamentary Institute, which provides technical support to members of the National Council, could be expanded, and include specific support for preparing RIAs.

24. An additional measure might be for the current caretaker government to recommend that the coalition parties forming the next government includes in its manifesto a commitment to maintain fiscal discipline and fiscal sustainability, an obligation that is already included in Art. 55a of the Constitution. The parties would commit to conducting policies that deliver the PEL ceilings and to only introducing new legislation which has undergone RIAs, and can be financed either through the budget, EU funding, or borrowing.

Recommendation 5. Strengthen existing arrangements, exercised through the RIA Committee, for enforcing budget discipline in the National Council, as defined in existing law. *(Action: MFSR, VFM Unit; time horizon: 2023).*

III. Budget Preparation

25. In this Section, we discuss the following issues related to the preparation of the budget that will be key to effectively implement the public expenditure limit: (a) how to move from the PEL to binding ceilings for line ministries, ideally covering the medium term; (b) the calculation of a contingency margin under the PEL; (c) the estimation of reserves to include in the General Treasury Account; and (d) setting sector ceilings.

A. From a Public Expenditure Limit to Binding Sector Ceilings

26. The four-year Public Expenditure Limit requires a strategic process early in the year when the top-down public expenditure limit meets the baseline estimates. The confrontation between these two approaches allows the government to make strategic fiscal choices on consolidation efforts, structural reforms, and priorities, setting the boundaries for the upcoming budget negotiation process. Ideally, this strategic process would extend beyond the budget for next year and include a medium-term budget.

27. During the first year in which the PEL was used, the MFSR has followed the traditional process of commencing with ministerial ceilings. At the end of April 2023, the process started with sending the initial ministerial ceilings for 2024 to line ministries and 'other entities', which, compared to the 2023 ceilings, included partial compensation for inflation . Reportedly, these ceilings were set at a higher level than spending announced in the Stability Program, requiring additional measures to be taken later. At the end of May, ministries entered their claims in the budget information system and the budget negotiations began in June. After the summer break, the outcome of the budget negotiations will be compared with the public expenditure limit and the mplications of these negotiations on the PEL discussed by the government. This process is facing some challenges. Not only will this comparison be undertaken for the first time, but the budget process is also hampered by the absence of a majority government, substantial spending amendments from the National Council and elections to be held on September 30.

28. For the preparation of the 2025 budget, and subsequent budgets, substantial improvements could be achieved by following the strategic process as outlined in Figure 3. First, the Government would set its strategic priorities at the beginning of the budget process (in April), a process that would be integrated with the Preparation of the FSR and the PEL. Second, consolidation needs would also be agreed in April, with a political choice made for tax increases or spending cuts. Third, the budget negotiations would take place within a frame set by the political leaders, avoiding cumbersome negotiations on issues without political support. Fourth, the medium-term focus would allow the Government to look beyond next year's budget and also decide on structural reform or consolidation measures that would be implemented in the subsequent years. Box 7 provides an example of the presentation of a governemnt's decisions taken with a medium-term focus.

Box 7. Multi-year Decisions in the Medium-term Budget in Australia

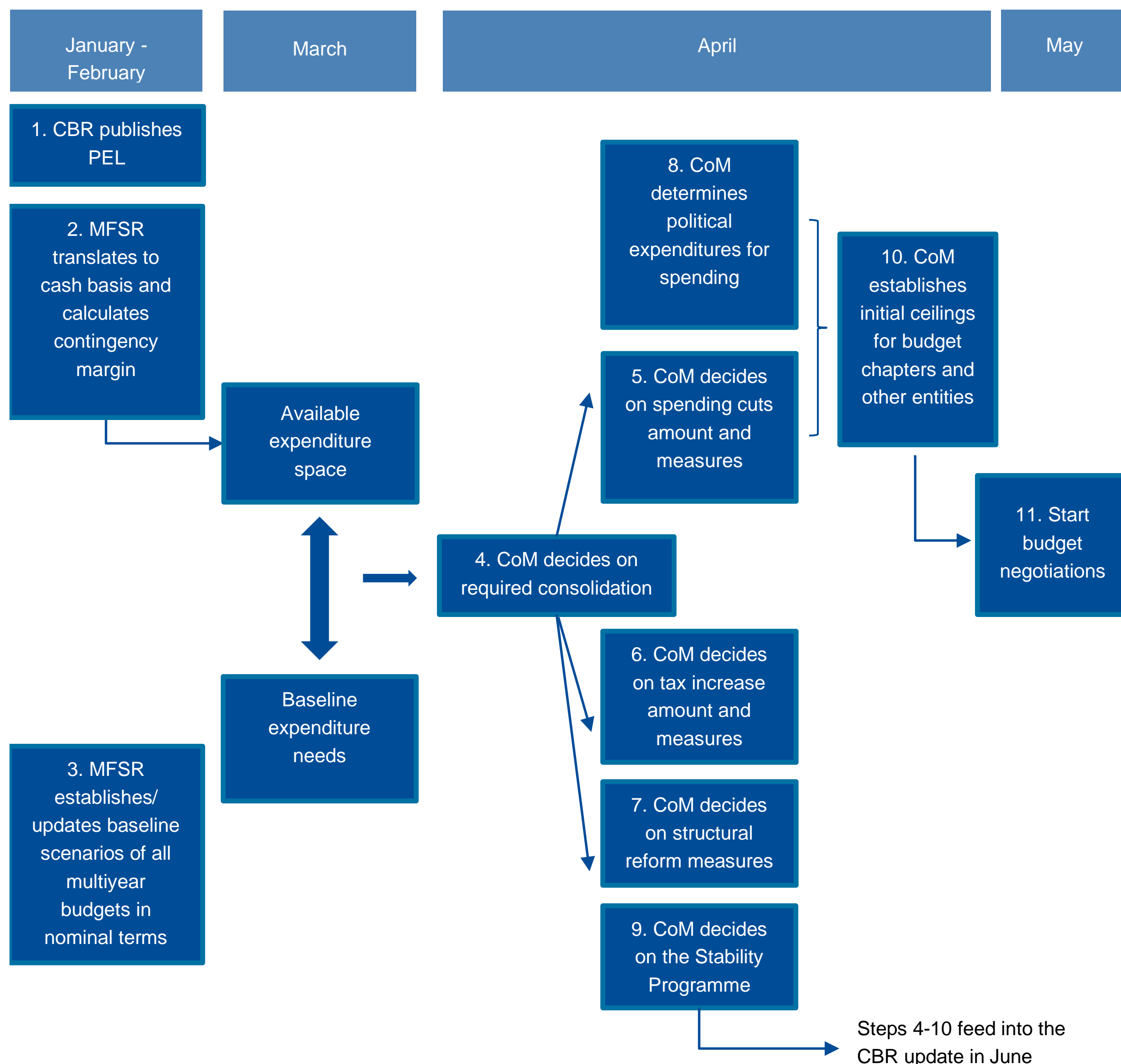
The following example from Australia shows the presentation of a set of multi-year decisions. It summarizes the major budget improvements in the 2022–23 October Budget and their impact on the budget balance. Decisions are taken based on their multi-year impact to achieve the medium-term fiscal objective.

Initiatives	2022–23	2023–24	2024–25	2025–26	Total
	$m	$m	$m	$m	$m
Building a Better Future Through Considered Infrastructure Investment	2,866.1	4,579.7	1,334.7	-4,049.8	4,730.6
Savings from External Labour and Savings from Advertising, Travel and	642.5	809.2	975.8	1,142.5	3,570.0
Extend ATO Compliance Programs – Tax Avoidance Taskforce	76.5	333.8	525.8	774.0	1,710.1
Government Spending Audit – National Water Grid Fund - responsible	370.0	279.5	430.0	593.5	1,673.0
Responsible Investment to Grow Our Regions	868.7	544.6	187.1	-173.3	1,427.0
Extend ATO Compliance Programs – Shadow Economy Program	-	236.8	479.8	657.1	1,373.7
Multinational Tax Integrity Package – amending Australia's interest limitation (thin capitalisation) rules	-1.3	-3.6	369.7	349.8	714.6
Government Spending Audit – Climate Change, Energy, the Environment and Water – efficiencies	368.4	183.8	94.2	53.4	699.8
Extend ATO Compliance Programs – Personal Income Taxation Compliance	-	111.3	246.8	236.0	594.1
Improving the integrity of off-market share buy-backs	..	150.0	200.0	200.0	550.0
Depreciation – reverse the measure allowing taxpayers to self-assess the effective life of intangible depreciating	-	20.0	150.0	380.0	550.0
Government Spending Audit – Industry and Science Portfolio – efficiencies	164.3	192.8	77.5	71.7	506.4

Source: Australian Government Budget October 2022-23 Budget Overview p61

29. The introduction of the strategic decision-making step through a fiscal strategy report would be an important step forward in the Spring of 2024, as discussed in Section II. Due to the substantial challenges to the MFSR, this may still have a focus on next year's budget. However, it would be beneficial to gradually extend to the outer years of the medium-term budget, in particular when the baseline scenarios are sufficiently available. **Figure 3** illustrates the most important steps in the strategic phase of the budget process.

Figure 3. Slovakia. A Proposed Approach to Combine Top-down and Bottom-up Budgeting at the Strategic Phase of the Budget Process



Source: Mission

B. The Public Expenditure Limit Contingency Margin

30. The inclusion of a contingency margin for uncertainties in the macroeconomic and fiscal forecast seems appropriate. The public expenditure limit will be based on a forecast of economic growth, inflation, wage developments and revenues (i.e., the 'original forecast'). It is probable that forecasts will evolve during the four-year period of the PEL and increasingly deviate from this 'original forecast', while the ceiling will normally not be revised for any macroeconomic updates. As mentioned in Section 1, the escape clause that requires a recalculation of the ceilings by the CBR only kicks in if tax revenues deviate by more than 3 percent of GDP or if GDP growth is negative. Smaller shocks will have to be absorbed within the unchanged ceilings.

31. Higher than expected inflation and wage growth leads to pressure under the limit. If inflation turns out to be lower than expected, more fiscal space would be available, and conversely, if inflation is higher than expected, fiscal space will be constrained, in particular for parts of the budget that are partially or wholly linked to inflation, such as pensions. For this purpose, it is suggested to establish an increasing contingency margin under the public expenditure limit, in line with the amended organic budget law of 2022[13]. The case of Sweden provides an example (see Box 8).

32. The size of this contingency margin is a trade-off between prudence and available fiscal space. With a binding ceiling and substantial consolidation needs, a larger reserve translates into less available fiscal space for the Government. On the other hand, higher inflation than expected would create substantial fiscal pressure and calls for a contingency margin.

33. Unexpected inflation and wage growth are the key drivers behind potential deviations in actual spending against budgeted plans. For example, pension payments are indexed to inflation: in 2022 pension indexation reached 11.8 percent and was mainly responsible for an increase in pension expenditure of Euro 1.1 billion in 2023. Also, wage developments will influence the bargaining power of public service employees. Indirectly, there are more (indirect) linkages between inflation and wage developments, such as the rising cost of medicines and healthcare services.

34. A logical starting point for determining the size of the contingency margins would therefore be the past forecast errors in inflation and wage growth. Preliminary analysis shows that the average errors are positive, i.e., that forecast inflation exceeded realized inflation on average[14], which implies that, on average, there were no additional spending pressures due to unexpected inflation. However, these averages mask years when inflation was higher than expected (almost half of the observations in the 2004-2022 period). There may also be an upside risk during periods (as is the case at present) when inflation persists for longer than expected. An analysis of wage growth leads to a similar picture: the forecast errors were on average positive, but the average masks negative errors in more than half of the years.

35. A second step is to determine the minimum contingency margin based on these estimates and on the authorities' sensitivity to risk. An extreme approach would be to set this minimum margin

[13] Amending Act No. 523/2004 Coll. On Budgetary Rules of Public Administration, etc., Art 30a, (5) : "Within the limit of public expenditure, increasing reserves are obligatory budgeted over time so as to ensure that unforeseen budgetary effects are covered".

[14] Over the 2004-2021 period; if 2022 is included, the picture changes due to the impact on inflation of the energy crisis.

based on the maximum strain on fiscal space caused by previous episodes of higher-than-expected inflation and wage growth. A more realistic approach is to tolerate some risk that realized inflation and wage growth will exceed the forecasts. In this approach, the regular underspending compared to the budget may be factored in. For example, if, on average spending, is one percent below budget, the margin might be set at a somewhat lower level than the macroeconomic forecast errors.

Box 8. Sweden's Approach to a Contingency Margin

As part of its fiscal policy, Sweden has been using a nominal expenditure ceiling for central government and the pension system (excluding interest expenditure) since 1997. A budgeting margin is held as the difference between the expenditure ceiling and the 'ceiling-limited expenditure' and is primarily intended to act as a buffer if macroeconomic developments lead to expenditure growth not expected when the expenditure ceiling was fixed. Table 2 shows the budgeting margin for the 2023-2027 period, increasing from 4.3 percent to 9.1 percent of the expenditure ceiling.

Table 2. Sweden. Ceilings and Margins

SEK billion	2023	2024	2025	2026
Expenditure ceiling	1665	1745	1825	1860
Budgeting margin	71	82	136	169
% of expenditure ceiling	4,3%	4,7%	7,5%	9,1%
Ceiling-limited expenditure	1594	1663	1689	1691

Guidelines recommend gradually increasing the minimum size of the budgeting margin compared to the expenditure ceiling. It should be noted that the 1 percent reserve for an inflation error translates into a fixed amount for year t and all the following years; also, the 1.5 percent for year t + 1 translates into a reserve of a fixed additional amount for year t+1 and all the years thereafter. Hence, the yearly policy rates should be compounded. In Sweden, the budgeting margins are larger than the required minimum especially in the early years of their medium-term budget (see Table 3).

Table 3. Sweden. Budgeting margins. Policy vs. Practice

(Percent of expenditure ceiling)

	year t	year t + 1	year t + 2	year t + 3
Required minimum	1,0%	1,5%	2,0%	3,0%
Compounded required minimum\ a	1,0%	2,5%	4,3%	7,1%
Actual margin (average 2014-2023)	3,0%	3,6%	5,0%	7,3%

\a: Assuming no inflation correction for the contingency margin

As the need for a safety margin decreases over time, the budgeting margin can gradually be used for reforms and other expenditure needs. The yearly budget process is bound by these guidelines so that the minimum margin is respected. Note that while these guidelines are not based on legislation and the government does not incur any formal sanctions if the guidelines were not respected, breaches have resulted in ex-post criticisms from the Fiscal Policy Council and the Parliamentary Audit Office.

Sources: Convergence Programs Sweden, 2014-2023; Swedish National Audit Office: The expenditure ceiling: different roles in different times, 2020.

36. The fiscal context and political commitments to consolidation provide additional considerations for setting the contingency margin. In a context where consolidation is needed, setting high reserves may lead to unrealistically tight ceilings to line ministries, which may lead to considerable debate and revisions to the reserves. On the other hand, when fiscal space is expected to be available in outer years, an increasing reserve margin may be an appropriate balance between managing fiscal risks and constraining budget allocations for these years.

37. If Budget chapters are compensated for the budgetary consequences of unexpectedly higher inflation (in areas such as pensions), this results in a level change in budget spending. For example, higher than expected inflation in the first year would not only lead to higher pensions in that year, but also in the subsequent years. The cumulative nature of unexpectedly high inflation on spending therefore calls for cumulating the contingency margin over time. This is illustrated in Table 4, which shows how a multi-annual reserve might be calculated on a range of assumptions.

Table 4. Hypothetical Example of a Contingency Margin (CM)

	Unit	2024	2025	2026	2027
Public expenditure limit	billion Euro	44.3	46.5	48.8	51.3
Contingency margin (CM)	%	1.00%	1.12%	1.20%	1.30%
CM for 2024 @ 1%	billion Euro	0.443	0.465	0.488	0.513
CM for 2025 @ 1.12%	billion Euro		0.521	0.547	0.575
CM for 2026 @ 1.2%	billion Euro			0.586	0.616
CM for 2027 @ 1.3%	billion Euro				0.667
Total contingency margin	billion Euro	0.443	0.986	1.620	2.370
Total contingency margin	% of PEL	1.0%	2.12%	3.3%	4.6%
PEL net of margin	billion Euro	43.9	45.5	47.2	48.9

Source: Mission.

38. The following stylizes the process of setting and updating contingency margins, and its relationship with the Treasury reserves in the annual budget:

- At the beginning of the budget process (March/April in year T), the size of the contingency margins for T+1 and outer years are set (or revised from previous year's) based on the considerations mentioned earlier (prudence, available fiscal space, uncertainty on inflation and wage growth).
- When macroeconomic forecasts are later updated, say in September/October, revisions to the contingency margin can be made. If the updated forecasts on inflation and/or wage growth exceed the previous earlier estimates, relevant budget chapters are to be compensated accordingly for the years, T+1 to T+3. If, on the other hand, inflation and/or wage growth do not exceed baseline forecasts, the earlier estimated contingency margins can now be revised downwards. In the latter case, a decision has to be made on the use of the resources that are now deemed to have been freed up. Nevertheless, macroeconomic uncertainty will still not be completely resolved for T+1 – a

decision has to be made on how much will be kept aside in the actual budget reserve for T+1, which is the Treasury Account reserve.

39. In addition, each year, an assessment can be made on how much of the contingency margin in the forward years can be freed up. For example, in April 2024 the contingency reserve for 2025 can be reduced from 2.1 percent to 1% if the updated inflation forecast is close to the forecast of inflation when the reserve was first set. In the hypothetical example above, this would free up an amount of approximately 580 million for the 2025 budget or for debt reduction. From a fiscal sustainability point of view, the default use would be to reduce public debt; in particular when debt exceeds the thresholds set by the debt brakes, this perspective should prevail. Freeing up these reserves and the process of adding the amounts to the budget would be part of the policy on the contingency margin. When budgeting takes a multi-year perspective, this discussion about reserves for 2025 can start even earlier, say in August/September 2023, when the 2024 budget is being finalized.

40. Increasing this contingency margin even further for other unexpected budgetary shock would not be appropriate. For example, if social security or local government expenditure is higher than allowed under the ceiling, this may lead to spending above the ceiling and a reduction in ceilings in a later year. Rather than reserving precious fiscal space for this purpose, it is better to enhance control and or come to arrangements with these 'other entities'. Also, it is difficult to estimate the probability and size of such cost overruns.

41. Reducing the contingency margin, because of the existence of reserves in the General Treasury Account (see next section) does not seem appropriate. These reserves are part of the budget and underspending could be factored in (see above). However, the simple fact of the existence of these reserves should not lead to a lower margin, as there are specific purposes for these reserves. Also, it is recommended to rationalize the substantial reserves (see next section).

Recommendation 6. Analyze forecasts errors, and develop a policy for the contingency margin *(Action: IFP in conjunction with the Budget Policy Section, time horizon: September 2023).*

C. Reserves in the General Treasury Account

42. The General Treasury Account includes expenditure of the state budget that has not been allocated to line ministries. The Account is included in the budget law and provides for 6.9 billion of funds in 2023 for: a reserve of Euro 2.4 billion, relations with the EU (Euro1.5 billion), debt expenditure (Euro 1.3 billion) and other expenditure (Euro 1.6 billion)[15]. The purposes of the various items are detailed in the budget document, to ensure that there is transparency in presenting the information to the National Council. The 2004 Budgetary rules on Public Administration Budget (Art. 10.1) allows for reserves in the state budget to "cover the time or amount of uncertain necessary or unforeseeable expenditures", but no specific governance rules such as access criteria are included. Detailed reporting on the use of the reserves is included in the annual accounts.

[15] Draft budget (Hlavna Knika) 2023-2025.

43. The 2.4 billion euros of reserves in 2023 (7.6 percent of the state budget, 4.2 percent of the general government budget) is substantial (Table 5). The increase compared to 2022 was driven by the additional reserves for Ukraine, energy policy and new legislation, which more than offset the drawdown related to the COVID-19 crisis. Reserves are lower in 2024-2025 than in 2023, largely because of the absence of reserves for the Ukraine war and the surge in energy prices.

44. The Treasury Account consists of eight separate reserves in the 2023 budget. The practice of having several reserves contrasts with the single reserve found in many countries and was designed by the previous government's coalition partners to limit the amount of discretion exercised by the MFSR in allocating these resources. In practice, however, the MFSR can reallocate funds from one reserve to another either before the budget is approved by the National Council or during the budget year. For example, in 2022, the budgeted reserve for wages and insurance premiums was increased by EUR 100 million, transferred from the reserve for 'European Union funds and contributions to the European Union', with the aim of funding the collective labor agreement for civil servants[16]. This revision was included in the revised proposed budget voted on by Parliament.

Table 5. Slovakia. Reserves in the Treasury Account

(Euro million)	2022	2022	2023	2024	2025
	Budget	Realized	Budget	Budget	Budget
Reserve of EU Funds/levies	558	537	405	239	216
Reserve for new legislation	131	131	858	985	1053
Reserve for emergencies	11	7	21	21	21
Reserve of the judiciary	10	0	10	10	10
Reserve for public salaries	276	265	188	168	213
Reserve for healthcare	220	220	0	0	0
Reserve for Covid	717	525	0	0	0
Reserve for Ukraine	0	0	100	0	0
Reserve for energy policy	0	0	860	0	0
Reserve of the government	5	1	5	5	5
Reserve of the prime minister \ a	2	2			
Total reserves	**1930**	**1688**	**2447**	**1428**	**1518**

\a: This reserve has been included in the budget of the Government Office from 2023 onwards.

Source Draft Budget 2023-2025 (Hlavna Kniha); State Closing Account Reserves 2022, provisional

45. The MFSR could reconsider these reserves and reduce the large number of virements. As forecasting unforeseen events is difficult, and amounts can be reallocated by the MFSR, transparency might be better served by a single reserve, with agreed ex-ante access criteria and timely reporting on use and scoring on the access criteria. The current allocation in the budget provides only limited leverage to the National Council as the MFSR might reallocate the budgets as it deems important; there are no access criteria in place. If these access criteria are published, discussed by the National Council and supported by them, their role may be strengthened compared to the current situation. Also, pooling the reserves into one, instead of keeping multiple isolated reserves, might encourage the rationalization of

[16] Source: Draft State Closing Account 2022.

the size of this reserve. While the alternative of keeping a large reserve may be considered prudent, it comes at a cost in terms of the resources that could be allocated and scrutinized within the budget process.

46. The MFSR might consider a rationalization of the Treasury Reserves on the following lines:

- Pool the eight reserves into one;
- Define access criteria based on the principles of urgency, non-foreseeability, unavoidability, and inability to absorb within existing budget appropriations;
- Evaluate the use of the reserves over the past few years on the basis of these criteria and decide whether reserves can be reduced based on this evaluation;
- Include a reasonable estimate of reserves for outer years (vs. the current practice of focusing largely on budget year); and
- Continue the practice of regular ex-post reporting on the use of reserves, and report against the access criteria defined above.

Recommendation 7. Rationalize the presentation of the Treasury Reserves in the budget as a single reserve with well-defined access criteria and regular reporting to the National Council (*Action: Budget Policy Section, April 2024 with 2025 budget).*

D. Setting Sector Ceilings

47. With the aggregate public expenditure limit set and the size of the reserves established, the key task would be to allocate the remaining available limit over the budget and outyears to individual budget chapter ceilings. The focus on the medium term is important because achieving medium-term fiscal objectives (particularly multiyear expenditure limits) involves prioritizing policies and taking into account their medium-term impact.

48. Prioritizing expenditure within an aggregate limit is more effective when informed by a clear understanding of the cost of maintaining existing policies for each budget chapter. From this starting point, the consolidation required over the PEL years can be applied to each budget chapter to calculate their budget ceilings. While expenditure ceilings can be prepared on a bottom-up basis for each budget chapter, it is not clear until late in the process whether the total of these ceilings will achieve the required aggregate limit. Calculating the cost of existing policies consistently using a widely accepted methodology, and using these estimates to prepare the expenditure ceilings, would allow the MFSR to calculate the contribution of each budget chapter to the Government's overall fiscal consolidation effort.

No-policy Change Baselines

49. The widely used tool to estimate medium-term cost of existing policies is commonly referred to as the no-policy change scenario or baseline. The baseline estimates should be the best estimate of the cost of continuing all existing policies at current levels of service delivery over the medium-term. While it is common internationally for this to be a three-year period, in the case of the Slovak Republic, a four-year period would be appropriate as it is consistent with the period of the

expenditure limits. These baseline estimates exclude the cost of one-off activities that will not continue under existing policy but include adjustments for the future price impacts of the cost of services, together with volume changes in cases where there the programs are demand driven. Baselines also include the fiscal impact of existing spending decisions that have not yet been fully implemented.

50. The preparation of baseline estimates enhances the budgetary process in several ways.

- At an aggregate level, they provide a robust estimate of the cost of existing policies to assess any available fiscal space or future fiscal consolidation needs. This is done by comparing the baselines with the fiscal strategy. The expenditure baselines can validate expenditure projections prepared on a more top-down basis.
- Baselines provide a starting point for the preparation of ministries' expenditure limits, and clarify the consolidation effort required of each ministry.
- They identify early on any spending pressures at a program level, such as rapidly growing programs, and pinpoint spending areas where policy changes may be necessary.
- Baselines also provide a starting point for budget negotiations based upon agreed models and spending projections adjusted for exogenous inputs like inflation. This has the potential to simplify negotiations considerably because it can reduce the amount of time spent each year discussing the cost of existing programs, releasing staff to instead focus on assessing new policy proposals and evaluating the quality of existing policy.

Progress on Expenditure Baselines in the Slovak Republic

51. In the Slovak Republic, work has been undertaken on developing a baseline projections methodology. IFP has developed this methodology in partnership with VFM and the Budget Policy Section and set out an approach to construct baseline estimates for different types of expenditure. It provides guidance on appropriate price adjustments and where volume projections may be required. It could be used to prepare baseline projections within the MFSR and, in the longer run, by other budget chapters.

52. The VFM Department used this methodology to prepare baseline projections for selected budget chapters. The most notable of these is the health sector, where projections involve forecasting the cost of the full range of medical services and medicines. They are used by the Budget Policy Section and the line ministry in preparing the budget allocations for this sector. The zero-based budgeting approach to major capital works implemented by the VFM Department also provides an appropriate no-policy change baseline for existing approved projects.

53. Budget chapters prepare their own estimates of the future expenditure needs of their agencies as part of the preparation for budget negotiations. These estimates include both the projected cost of existing activities and new policy proposals. The estimated cost of existing activities will commonly reflect expected price increases and constitute a form of baseline projection. They are used by budget chapters to compare with the budget ceiling to inform their budget negotiations.

54. Both the Budget Policy Section and the budget chapters would benefit from calculating expenditure baseline consistently. It would provide a common basis for budget negotiations and, when compared to budget chapter expenditure ceilings, make transparent fiscal consolidation needs for each

budget chapter. The discussion of the cost of maintaining existing activities would be minimized and negotiations would focus on the changes to policy required to achieve expenditure ceilings.

55. Currently, the Budget Policy Section has concerns about providing expenditure baselines to line ministries. There is a concern that expenditure baselines could be seen as budget allocations. Alternatively, the baselines could be interpreted by line ministries as an admission that the ceilings advised by the Ministry of Finance are inadequate to provide for existing programs and services.

56. Communication with and training of line ministries are crucial elements to rollout baselines in the budget process. Communication needs to emphasize that baselines are a starting point for the budget process and that they precede spending prioritization to meet expenditure limits. In a fully developed framework, they provide a commonly agreed basis for important policy decisions in the settling of the budget. The agreement between the Ministry of Finance and budget chapters requires the use of a commonly understood methodology and a dialogue on (and resolution of) areas where there are different views.

Further development and use of expenditure baselines

57. The task of developing agreed quality expenditure baselines for all budget chapters is a significant one and is best suited to a staged approach. Such an approach allows to prepare baselines progressively within the Budget Policy Section to develop the methodology and check the baselines for consistency and quality before engaging with line ministries.

Preparing a complete set of baselines within the Ministry of Finance would provide a more robust estimate of aggregate medium-term expenditure under current policies and consequently improve the assessment of consolidation effort required to meet the medium-term expenditure limits.

58. Baselines prepared within the Ministry of Finance could be used to setting medium-term ceilings for budget chapters and provide a clearer understanding of consolidation beeds for each chapter. Using baselines would improve information available for setting the chapters' ceilings and reduces the likelihood of setting unrealistic ceilings.

59. In the first phase, expenditure baselines would be developed in the Budget Policy Section to frame the 2025 Budget. The methodology already developed by the Institute for Financial Policy, VFM and the Budget Policy Section would be used, taking the 2024 Budget as a starting point, updated where necessary for the outcome of the 2023 year. The baselines should be constructed using economic parameters provided by the Institute for Financial Policy and should aim to be completed by the end of March 2024. This will mean preparing them based on the parameters that become available in January 2024. Under this proposed timing, baselines can be used to assess the fiscal space at the strategic phase of the budget process, and in the setting of budget chapter expenditure limits at the end of April.

60. In the second phase, the methodology for preparing expenditure baselines would be shared with budget chapters which would be asked to prepare a set of baselines in early 2025. The preparation of baselines would involve the budget areas of each chapter and the analytical institutes that have been created in several line ministries. Budget chapters would be provided with a manual setting out the expenditure baselines' methodology together with some training. The manual would make it clear that

baselines are not budget allocations and that consolidation efforts are expected from budget chapters that will be reflected in their expenditure limits. The preparation of the baselines by budget chapters reduces the concerns about how budget chapters may interpret baselines prepared by the MFSR. The Budget Policy Section would have the opportunity to refine expenditure baselines for each chapter based on the information provided by the chapters and these baselines would be used again in assessing the fiscal space and calculating budget chapter expenditure limits.

61. In preparing their budget submissions, chapters would be requested to frame their submissions in reference to their baselines. Budget chapters should be required to present in their submissions policy changes that are necessary to achieve the expenditure limits set for them. Hence, the focus of budget submissions moves towards prioritizing expenditure within the budget chapter and identifying consolidation options .

62. The third phase of the baselines' rollout would involve budget chapters to update them in early 2026 in consultation with MFSR. This would involve further discussions with budget chapters on the application of the methodology to each chapter with a view to agreeing expenditure baselines. Areas of disagreement on the application of the methodology would be escalated with any outstanding issues to be resolved by ministers prior to the commencement of the budget process. The baselines would then provide the basis for setting budget chapter expenditure limits in May 2026.

Frequency of baseline updates

63. The frequency of baselines is a balance between the benefits of more up to date information and the cost of preparing them. In the early years this balance is best reflected in an annual update of baselines prior to starting the budget process. This provides quality information for assessing the fiscal position and setting budget chapter expenditure ceilings**.**

64. In the longer term and with a broad agreement on the baseline methodology, consideration could be given to increasing the frequency of updates. This allows baselines to reflect the latest government decisions and changes in economic parameters. A move to a twice a year update of baselines would provide for one update early in the budget process (prior to the strategic phase) and a second update of the forward years in the finalization of the budget.

Allocating Consolidation in Budget Chapter Ceilings

65. Expenditure baselines at the budget chapter level provide a starting point for allocating consolidation efforts at the budget chapter level. This can be done by taking decisions on consolidation measures at the strategic phase of the budget process as discussed in Section II. This could include across-the-board consolidation measures such as decisions on public sector wages, or more targeted savings such as those arising from the recommendations of spending reviews where these are available at the relevant timing (April each year).

66. The alternative to basing budget chapter ceilings on specific consolidation measures is to allocate consolidation on a bottom-up basis by requiring line ministries and other budget chapters to develop savings measures to achieve the ceilings. Once again, this can be informed by spending reviews. If a spending review has identified proposed measures of 200 million euro per annum

in a budget chapter, a proportion of these savings could be applied to the ceilings for that chapter. If the relevant chapter can achieve larger savings than those included in the ceilings, it could be allowed to spend those funds on other initiatives. This encourages savings measures to be actively pursued.

67. In the absence of specific consolidation options from spending reviews, the MFSR can allocate savings based on government's priorities. In some countries this can be ascertained from strategic planning documents, public commitments, or government manifestos. In other cases, there may be clear commitments to a level of spending in areas such as defense, or areas that would be quarantined from consolidation such as certain benefit payments.

68. The Budget Policy Section's should allocate the remaining consolidation efforts based on the capacity within each budget chapter or on a proportional basis. This approach places the responsibility prioritize their expenditure on budget chapters given that they are, in most cases, best placed to identify savings.

69. Irrespective of the method used to allocate savings across budget chapters, the process should be transparent to decision makers. Ideally this would be agreed by the Council of Ministers as part of the Fiscal Strategy Report in April each year. This provides political authority to expenditure ceilings and increase the probability of compliance with ceilings.

Budget finalization

70. The presence of binding expenditure limits has implications for finalizing the budget in August/September. It will require strong coordination to achieves the limits. Crucial to this will be the outcomes of the negotiations on budget chapters and whether the ceilings set for chapters in April have been achieved. Changes to economic forecasts may also impact on the realism of the limits. For example, an increase in projected inflation in the September macroeconomic update would impact expenditure forecasts for pensions and other entitlements. Changes in both budget negotiations and economic forecasts may require additional consolidation measures.

71. This reinforces the need for strong internal coordination within the MFSR as discussed in section VI. A more structured forum could ensure process and advice are coordinated across the ministry.

Recommendation 8. Prepare initial baseline estimates for all budget chapters. *(Action: Budget Policy Section; time horizon: March 2024)*

Recommendation 9. Provide guidance and training to line ministries to prepare baselines their expenditure baseline by budget chapters for the 2026 budget *(Action: Budget Policy Section,IFP,VFM; time horizon: May 2025)*

Recommendation 10. Agree on updated expenditure baselines between line ministries and the MFSR *(Action: Budget Policy Section; time horizon: March 2026)*

IV. Budget Execution and Reporting

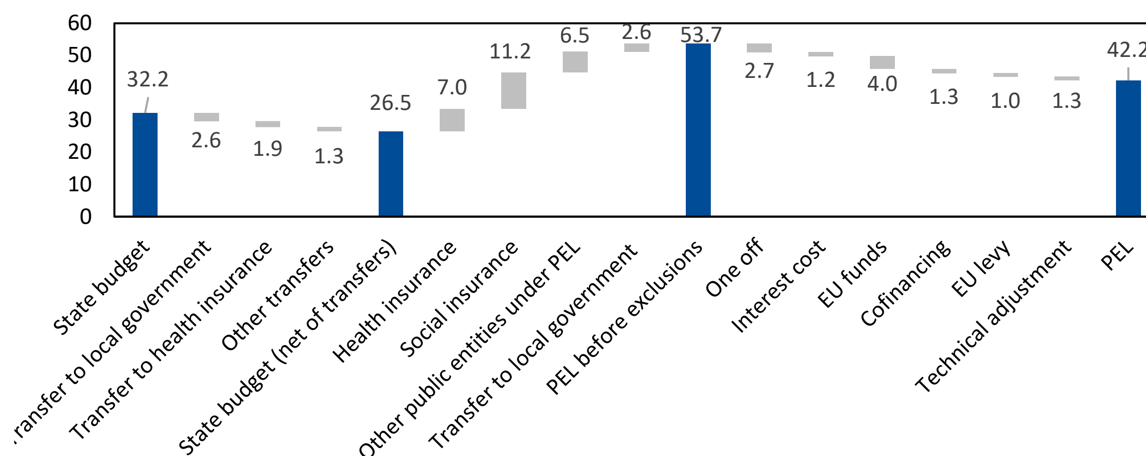
72. In this section, we discuss two issues related to budget execution and reporting can affect PEL implementation: (a) controlling spending of entities that are included in the general government budget but are outside the state budget; and (b) managing in-year expenditure virements.

A. Control of Spending by 'Other Entities'

73. The general government budget consists of the state budget of and the budget of the so-called 'other entities'. [17] These 'other entities' refer to a diverse group of organisations, ranging from municipalities to health and social insurance companies. The state budget is organised in different chapters, such as the chapters for the line ministries. Whereas the Government and National Council determines the size and composition of the state budget, they have less control over the expenditure and revenues of these entities.

Table 6. Slovakia. From the state budget to the PEL

(In billions of euros)



74. The budget of 'other entities' is a substantial part of the government budget and falls to a large extent under the public expenditure limit. These 'other entities' (health insurance, social insurance, medical facilities, public universities, railway and highway companies) have a budget of approximately Euro 24.7 billion in 2023, corresponding to around half of general government expenditure. The state budget contributes to these entities' revenues through transfers (Euro 2.2 billion), while other revenues include insurance premiums, user fees and railway tickets. Also, these 'other entities' have assets and cash reserves or access to borrowing, which they may use to finance expenditure. The total

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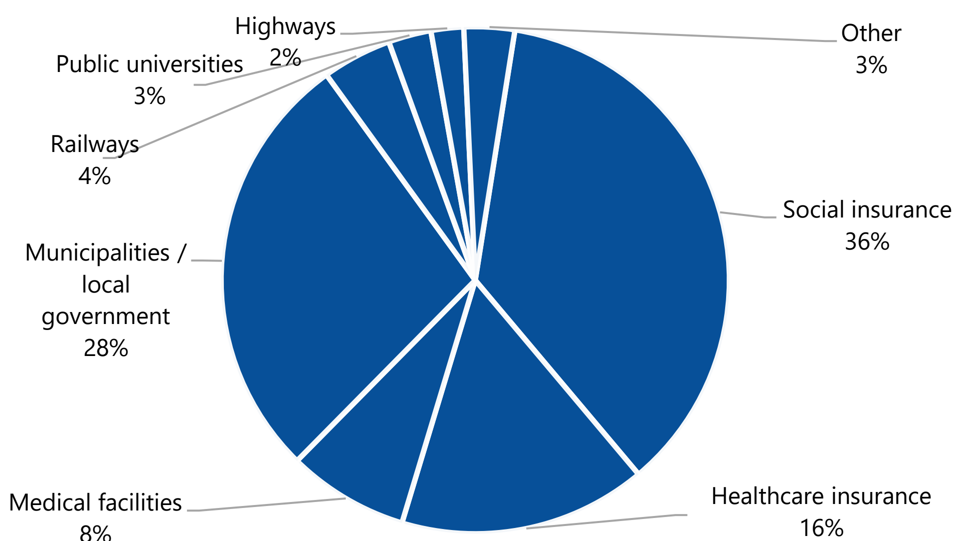
[17] The difference between the sum of the state budget and the budget of the 'other entities' and the government budget consists of transfers from the state budget which are netted out to the 'other entities' and rounding differences.

expenditure of these entities is part of the public expenditure limit. It is worth noting that while the spending of local governments is not included in the PEL, transfers to them from the state budget are.

75. The ability to influence and supervise the budget of the 'other entities' will be crucial in meeting the public expenditure limit. Even after correcting for the state budget transfers to these 'other entities', their budget makes up 38 percent of the public expenditure ceiling. Although the preference for more control is convincing from a public finance perspective, there may be limits on how far controls can be extended given that these 'other entities' are independent and approve their own annual budgets.

76. The 'other entities' sector is diverse and receives varying degrees of support from the state budget. For budgeting purposes, the entities are grouped into 36 categories, with some categories representing many separate entities, such as municipalities or hospitals and other medical facilities. Figure 4 summarizes the budget shares in 2023 of the largest entities. Their budgets vary from 6 million euro for the Press Agency to 11 billion euro for the Social Insurance Agency. Similarly, the contribution from the state budget varies from very small amounts up to 80 percent of their expenditure.

Figure 4. Slovakia. Budget Shares of 'Other Entities'



Source: MFSR. Figures exclude EU-resources and own contributions.

77. Reportedly, the MFSR has limited control over spending of most 'other entities', potentially leading to higher spending than the PEL. The other entities have their governance arrangements, such as a management board, that decide their total budget. The government's decision-making power is limited to the transfers from the state budget. In some cases, the government and/or the National Council would have some leverage to agree with these entities on next year's budget and on the regular provision of sufficient expenditure data. For example, for the railways, the government would have some influence due to the contribution from the state budget, being the regulator and having the right to approve the Board.

78. In addition, the expenditure of some of the largest entities (e.g., in the social welfare and health areas) is often demand-driven. This further limits the influence that the Government may be able to exercise on expenditure outcomes. Good expenditure projections and good monitoring are crucial, but further efforts to strengthen control are needed under the public expenditure limit.

79. Given their different nature and the other public policy considerations, there is no one-size fits all solution to strengthen control, and a combination of various instruments would be needed. In addition to an effort to improving spending forecasts and monitoring, for example through monthly reporting instead of quarterly reporting, a combination of the following measures could be considered for each 'other entity':[18]

- Bring the entities' cash balances within the Treasury Single Account—to monitor expenditure in real time.
- Integrate all revenues and expenditure in the state budget—the case for this approach is strongest where the entities are entirely within the public sector, predominantly funded by the budget, and not subject to private competition (such as the construction and maintenance of railways).
- Integrate revenues and expenditure that are outside the state budget under the line ministries' sectoral ceilings to align their incentives and make the line ministers responsible.
- MFSR or the respective line ministry to agree with the 'other entities' on their budget—formal agreements would be made at ministerial or board level on the permitted expenditure level of entities with any variations on these levels to be approved by the Minister of Finance.
- Consider penalties for entities that have unapproved expenditure (e.g., reduction in transfers from the budget, sanctioning the Board of Directors).

80. As they are government-owned entities, the government is able to exert influence on these "other entities" to ensure expenditure limits are met. This responsibility lies largely with line ministries rather than the MFSR. Line ministries are responsible for appointing board members of these entities and, in many cases, for setting the strategic direction of the entities. In some cases, the role of line ministries has been strengthened to facilitate compliance with the PEL. For instance, Article 10 of the 2022 Amendment to the Budgetary Rules states that "the Ministry of Health of the Slovak Republic shall ensure compliance with the limit of public expenditure on public health insurance and the general budget for medical facilities included in the central administration". It has a similar provision for the Ministry of Education regarding entities of higher education.

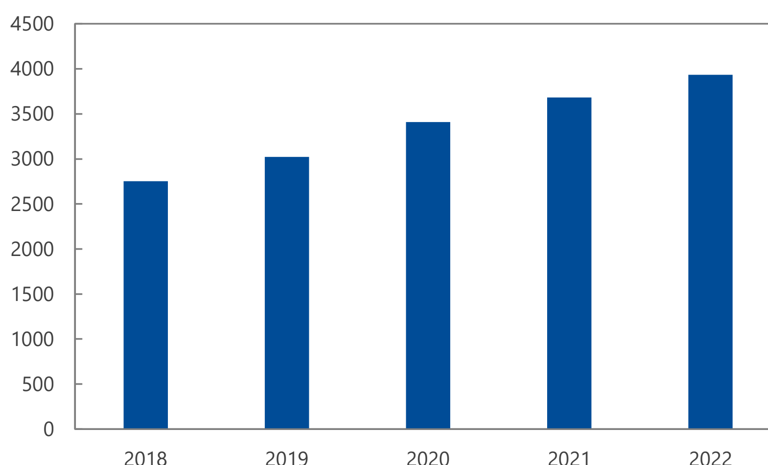
Recommendation 11. Determine for each of the 'other entities' how to strengthen government control on their budgets, which to integrate within the state budget, and explore the strengthening of the responsibility of the line ministers in the budget law (Action: BPS and VFM; time horizon: September 2023).

[18] Given the specific nature of locally elected municipalities and other territorial units, the MFSR could focus on better coordination and data exchange with these units.

B. Managing Virements

81. A large and fast-growing number of reallocations in the budget are approved by the MFSR. The volume of these so-called virements have been growing annually by about 10 percent, from approximately 2,750 in 2018 to more than 3,900 in 2022 (see Figure 5). These virements include (i) virements between programs of the same chapter (budget neutral), (ii) transfers from one type of expenditure to another in the same budget chapter (budget neutral), (iii) transfers of the European Union and national co-financing from paying unit to final recipient and also (iv) virements that add budget from the treasury chapter to the line ministry chapters (budget neutral at the state budget level).

Figure 5. Slovakia. Number of in year Virements



Source: MFSR, information available on: https://rozpocet.sk/web/#/rozpocet/rozpoctove-opatrenia

82. Both the Acts on Budget Rules and on the State Budget set limits on in-year amendments to the state budget but provides considerable room for the MFSR to adjust the allocations. This provides a tool to respond quickly to unforeseen, urgent budgetary needs. In combination with drawing on the unallocated contingency reserves included in the budget (see Section III), the MFSR may use the virements to quickly react to new events without requiring approval from the legislature.

83. However, the absence of strict rules governing these virements creates several problems:

- There is little incentive for line ministries and 'other entities' to propose a budget with the correct breakdown, as the figures can be amended later.
- The budget approved by the National Council may be revised significantly during implementation without its consent, since virements only need to be notified to the Council ex post (twice a year), undermining the oversight role of the National Council.
- Managing these virements creates considerable work for the Budget Policy Section of the MFSR, as well as the budget sections at budget chapters' level, diverting resources away from more strategic work.
- The current procedures reduce the strategic approach to budgetary resources, as virements are approved on a case-by-case basis, and not grouped together for integrated decision-making.

84. To contain virements in 2024, the MFSR could tighten its policy in the coming months, so that the quality of the budget proposals for 2024 will be improved before they are submitted to the National Council in October 2023. Drawing on the experience of other countries such a policy change could include: i) strict criteria for accepting or rejecting requests for transfers by line ministries and 'other entities'; ii) a threshold for a minimum size of virements that can be submitted by line ministries (thus requiring them to approve smaller in-year adjustments themselves); iii) grouping virements into 4-5 windows a year, each window lasting one week; and iv) excluding some types of virement during some windows (e.g. additional funding virements only during budget-decision making by the Council of Ministers).

85. Whereas the proposed policy and revised procedures should be clear, their implementation will be gradual. Adopting too harsh restrictions on virement may potentially have substantial negative consequences on budget execution or impact negatively on the government's ability to react to unforeseen and urgent events. Further, the MFSR will need to build the capacity of the budget sections of the line ministries and 'other entities' to work with the revised procedures and processes.

Recommendation 12. Decide upon and announce a stricter policy on virements (*Action: Budget Policy Section; time horizon: August 2023*).

V. Organizational Issues

86. In this section, we discuss three organizational issues that would improve the Government's ability to implement expenditure limits: (a) internal coordination of fiscal and budgetary policy issues within the MFSR; (b) the procedures for preparing the government's macroeconomic and tax forecasts; and (c) strengthening the organization of the MFSR's Budget Policy Section.

A. Internal Coordination within the MFSR

87. The MFSR does not currently have any structured process for discussing and coordinating issues related to fiscal policy, fiscal rules, and budget preparation at a high level. During the budget planning process for example, the Budget Policy Section discusses specific issues with IFP and the VFM Unit on an ad-hoc basis. A more structured process would bring together on a regular basis official from the Budget Policy Section, the IFP and the Value for Money Unit in a high-level Committee consisting of Director-Generals and their Directors.

88. A high-level committee with the MFSR could facilitate communication, information sharing and coordinated advice to the Minister. The Committee would discuss issues that include the preparation of Slovakia's Stability Program, the Fiscal Strategy Report (see Section II), the macroeconomic and tax forecasts, and the setting of the PEL ceilings and reserve. It would be responsible for coordinating advice submitted to the Minister and State Secretaries on key fiscal and budgetary issues at key points in the budget process. The Committee would not be involved in the negotiations on the annual budget which would continue to be managed by the Budget Policy Section. The Committee could meet regularly from March to May each year and intermittently at other times of the year. It might be chaired by one of the Director-Generals on a rotating basis.

Recommendation 13. Establish a high-level committee of Director-Generals and their Directors to coordinate the work of the MFSR on key fiscal policy and budgetary issues and prepare policy advice for the Minister and State Secretaries. *(Action: IFP / Budget Policy Section / VFM Unit; time horizon 2023-2024).*

B. Procedures for Preparing Official Macroeconomic and Tax Forecasts

89. Two independent committees[19], chaired by the IFP, prepare macroeconomic and tax forecasts that the MFSR use to prepare the budget and related documents. The IFP prepares preliminary forecasts which are discussed by the respective committees. The Macroeconomic Forecasting Committee provides real GDP and inflation forecasts. The Tax Forecasting Committee projects all tax revenues (according to the national classification), some non-tax revenues, and some

[19] According to the 2011 Constitutional Act on Fiscal Responsibility, these committees are defined as advisory bodies to the Minister of Finance. The committees comprise representatives from the IFP, the CBR, the National Bank of Slovakia (NBS) the SOSR, and several other institutions and private banks. The committees meet at least twice a year.

expenditure items.[20] Members with voting rights vote on whether the forecasts are conservative, realistic, or optimistic, and the committees must agree on the forecasts with an absolute majority required. The statutes governing the operations of the two committees require their discussions to be collaborative, and the minutes of their meetings are published. These minutes have, in practice, disclosed any disagreements between the IFP and the other committee members on the forecasts, and how they were resolved. The statutes also state that the IFP "is independent of the Minister of Finance and the political level of government in its forecasting activities".

90. In practice, however, the committees have extremely limited time to finalize the forecasts, and insufficient time is allocated for a fully collaborative discussion. For example, forecasts that must be submitted to the National Council by the end of June are based on flash releases of national accounts data submitted to the MFSR by the Statistics Office of the Slovak Republic (SOSR) at the end of May or early June. This leaves only four weeks for the initial forecasts to be prepared by the IFP, submitted to the Macroeconomic Committee for review, any comments by the Committee to be considered, and the final forecasts to be submitted to the National Council.[21] The meeting of the Tax Committee takes place soon after the Macroeconomic Committee has met. As a result of this extreme time pressure, the initial forecasts prepared by the IFP are rarely changed.

91. A more collaborative process would be beneficial by allowing a more substantive discussion to take place within the two committees. Two of the members of the committees (the CBR and the NBS) operate macroeconomic forecasting models and have substantial forecasting capabilities, so their inputs to the committee meetings are crucial. Comments received from the committee members (especially the CBR and NBS) could be incorporated by the IFP in a revised forecast that would then be resubmitted to the Committees for approval a few days after the initial discussion. Such a process would require more time, either by encouraging the SoSR to produce its national accounts data earlier (by say two weeks, as is the case in some EU Member States) and/or by moving back the date on which the forecasts are delivered to the National Council.

C. Organization of the Budget Policy Section

92. The Budget Policy Section is faced with substantial challenges. The crisis measures related to the Covid-19 pandemic, the war in Ukraine and the escalation of energy prices, as well as increased election year spending has put the Budget Policy Section under strain. Ad-hoc spending decisions taken by the National Council generating large fiscal costs (see section II), and a steep increase in virements and supplementary budgets has intensified pressure on the Budget Policy Section. At the same time, the PEL introduction, large consolidation needs in the coming years and stronger focus on medium-term resource allocation have further increased the need for an efficient, effective, and sufficiently resourced Budget Policy Section.

[20] In past years, there were several occasions when the tax revenue forecasts used in the budget differed (budgeted revenues were higher) compared to the forecast adopted by the committee.

[21] The timeline is as follows: May 22: start of the macro forecasting process; June 5 or 6: release of national accounts and labor market data by the SOSR; June 12: IFP sends macro forecasts to the Macroeconomic Committee; June 14-16 Macroeconomic Committee meets and evaluates the IFP's forecasts; June 20: IFP sends the tax forecasts to the Tax Committee; June 22-24: Tax Committee meets and evaluates the forecasts; June 30: legal deadline for publishing forecasts.

93. Initial discussions with the Budget Policy Section suggest an overstretched and fragmented organization. The current structure and capacity (78 staff) were established in 2003 and supplies good basic budgeting services that are aligned with current legislation. Current practices appear to focus on preparing the annual budget, monitoring its execution, and making a large number (currently around 3,900 per year) of in-year reallocations to the approved budget (see section IV).[22]

94. The staff of the Budget Policy Section appear to have little time to strengthen their strategic focus and improve budgetary processes. Functionally, responsibilities for preparing and executing the budget are split between two separate sections. The VFM Unit (outside of the Budget Policy Section) deals with spending reviews and evaluates most investment projects of line ministries, functions that in many EU and OECD countries are carried out by the Budget Policy Section. The current structure of the department appears to be mirrored by a similar structure in line ministries. For example, technical issues related to planning and executing the budget (including virements) in the two largest spending ministries (responsible for health and social affairs) appear to be dealt with by their budget departments whereas analytical "institutes" within these ministries are responsible for forecasting, setting priorities for programs and projects, and providing policy analysis and advice.

95. Several other countries in the EU and OECD have different and more streamlined organizational arrangements for budget planning and execution. These integrated structures typically include: more staff resources with a much stronger focus on challenging budget sections in line ministries on their forecasts, and on policy priorities and proposed new projects and programs; responsibility for evaluating capital projects to assess line ministries' spending priorities and the efficient delivery of programs; an integrated structure with separate teams responsible for both budget preparation and execution functions; and close involvement in the planning and implementation of spending reviews. As noted above, improving the capability of the Budget Policy Section to analyze and challenge the budget proposals put forward by the line ministries would also require making comparable changes in the organization of the budget sections of line ministries, with an associated requirement for capacity development in these ministries as well as the MFSR.[23]

96. A comparison with the functions of the budget department in the Netherlands is instructive (see Box 9). The Dutch budget department has enhanced its efficiency and effectiveness by establishing a unit responsible for consolidating the preparation of the budget, and by pooling resources into a single team that works on each line ministry. This team supervises the budgetary operations of a line ministry including both its recurrent spending and capital investment projects, as well as its 'related non-state budget entities'. The team acts as the representative of the minister of finance through the monitoring of budget execution, approving changes to the budget, preparing budget decisions, establishing / supervising baseline estimates, supervising budget preparation, and evaluating the

[22] The Budget Policy Section is presently divided into four sections. The **first unit** is responsible for preparing the annual budget law and related documents, setting ceilings for line ministries in the state budget, engaging in collective bargaining with the public service unions on annual wage increases, and producing statistical data for the European Commission and the IMF. The **second unit** is responsible for budgetary analysis and negotiating the annual budget with budget organizations with whom it has a regular dialog; it also monitors the execution of the budget. The **third unit** is primarily responsible for approving in-year adjustments to the annual budget. The **fourth unit** deals with the nearly 3,000 subnational governments and also making amendments to budgetary law and regulations.

[23] For an analysis of the importance of the challenge function, and how it can be developed, see Sierd Hadley and Bryn Welham, *The Ministry of Finance "Challenge Function"*. Overseas Development Institute, London, November 2016.

effectiveness and efficiency of spending. The budget department also participates actively in the Netherlands' extensive program of spending reviews.

97. Moving towards a more modern organizational structure of the Slovak Budget Policy Section could bring benefits in terms of improved efficiency but would require new staff resources and retraining. It would need to be phased in slowly so as not to disrupt ongoing business operations. Over time, some of the functions of the VFM Unit (on capital projects and spending reviews) could also be transferred to the Budget Policy Section. Reducing the burden of work from virements, as recommended earlier in this report, could free up resources for higher priority work. Including all staff working on a particular line ministry in the same unit would provide greater flexibility to cope with workload surges. However, more detailed analysis of the Budget Policy Sections' business processes and staffing, through a comprehensive audit, would be required before a new structure for the department, aligned to international best practices, can be designed. Moreover, given the current heavy pressures on the staff and management of the department any changes in the organizational structure should be phased in slowly.

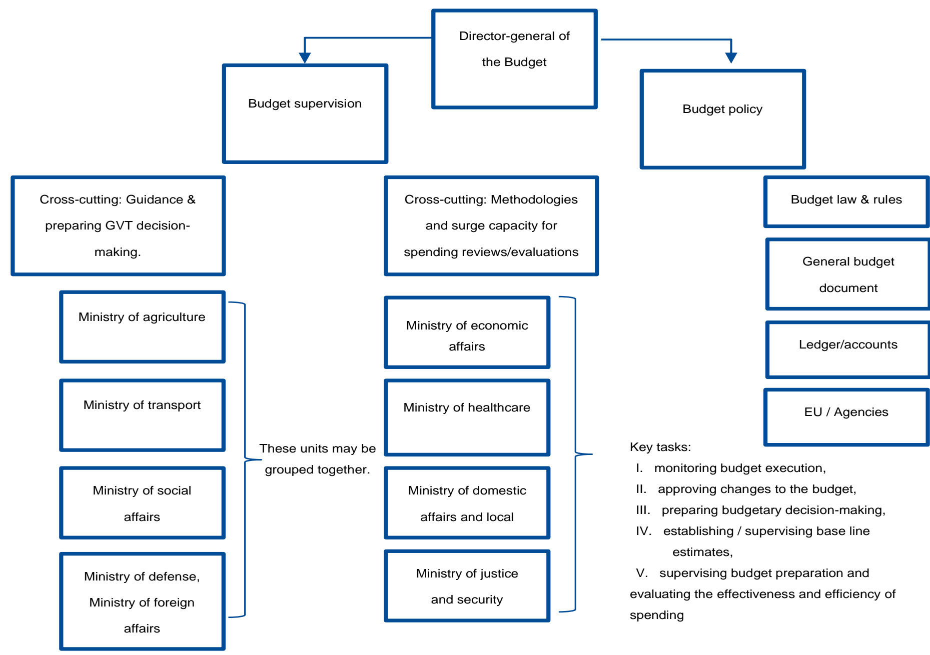
Recommendation 14. (i) Undertake an independent review of the Budget Policy Section's functions, business processes, staff resources and training needs; (ii) prepare a phased action plan for implementing the new structure. *(Action: Minister with the Budget Policy Section; time horizon 2024-2025).*

Box 9. Organization of the Budget Department in the Ministry of Finance in the Netherlands

A key function of the Dutch Budget Department is to supervise the policies and budgets of the line ministries including the related 'other entities'. Two-thirds of the resources of the Department are devoted to supervision work, grouped in teams by line ministry. There is also a unit responsible for consolidating the overall preparation of the budget. Figure 6 below shows the organizational structure. The more integrated approach to budget management in the Dutch ministry of finance contributes to (i) more resources devoted to each line ministry; (ii) Close integration of the work on planning and executing the budget; (iii) Sufficient resources for supervising spending outturns and raising red flags if needed; (iv) Sufficient capacity to challenge new projects, programs and policies; (v) Close involvement in the planning and implementation of spending reviews; (vi) Team leaders with a mandate to oversee the budgets of their line ministries and challenge their counterparts in budget negotiations.

In the Netherlands, each line ministry has a finance/budget directorate of approximately 50-60 staff. These figures are approximate for two reasons: (i) as line ministries adapt their resources to their workload; (ii) there is, at any point in time, staff moving across ministries. These directorates have a functional relation to the Budget Department in the finance ministry; and the Minister of Finance approves the nomination of the directors. In Slovakia, the finance units in the line ministries seem more limited in their role and capacity, Typically, in the Netherlands, budget staff will start their career with responsibility for the budget management system (approving virements for example) and develop their knowledge to become responsible for a set of program budgets. Dutch budget staff typically rotate from supervising one ministry to another after a few years to avoid 'turning native'.

Figure 6. The Netherlands. Structure of the Budget Department of the Ministry of Finance



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