Speech by Dr Kračun, President of the Fiscal Council, at the 22nd emergency meeting of the Finance Committee (20 May 2023)

The Fiscal Council prepared its assessment of the draft revised state budget for 2023 after it had already, in mid April, assessed the draft Stability Programme for the period 2023–2026 and briefed the Committee on Finance regarding the assessment at the 20th emergency meeting.

The draft revised budget foresees a high general government deficit of -4.5% of GDP. Half of this deficit will be the result of intervention measures to cushion the effects of the cost-of-living crisis and the epidemic, and the remaining half will be the "core" deficit or the deficit excluding intervention measures. The latter is the reason for the projected significant increase in the headline deficit of the state budget of 2.2 percentage points of GDP compared to last year. This is largely based on the assumed decline in the revenue-to-GDP ratio and the further strengthening of the already high level of investment activity. Growth in "core" current spending of around 11% is expected to be higher than the current estimate of the medium-term economic potential growth also this year, which is contrary to the European Commission's recommendations. This nominal growth is mainly due to high inflation, but is also affected by discretionary measures. The share of core spending in GDP is not expected to increase markedly.

According to the government's assurances, the draft revised budget is in line with the Stability Programme. Hence, the assessment of compliance with the fiscal rules made by the Fiscal Council in April remains unchanged. This indicative assessment shows that most of the indicators for 2023 point to a deviation in fiscal policy from compliance with the fiscal rules. An expansionary fiscal policy stance, while exceptional circumstances still persist, is primarily due to the high inflation and the projected further strengthening of investment activity this year. The set high level of government expenditure in 2023 and the declining cyclical revenue-to-GDP ratio also contribute significantly to the limited room for manoeuvre for future fiscal policy measures. Any potential additional measures would not improve the structural position of public finances as currently envisaged, which would in turn negatively impact the medium-term sustainability of public debt.

Budget documents indicate insufficient awareness of the role of the fiscal policy in a monetary union that must contain the consequences of high inflation while it limits its own impact on price pressures by taking measures and creating expectations – including the drafting of realistic budgets. Otherwise, high inflation, which is to a large extent due to temporary supply-side factors, could persist for a prolonged period, resulting in higher direct and indirect costs for the economy, households and the state.

In this context, we note that the risks of the unsustainable financing of social protection systems are also increasing. Projections indicate that the abovementioned high growth in "core" current spending will to a large extent stem from the high growth in transfers from the state budget to the two social security funds. In 2023, the growth of transfers amounts to 25%, with particularly high transfers to the Health Insurance Institute. These trends are mainly linked to the adoption of a number of discretionary measures, including some that have gone from temporary to permanent, and with the announced reforms in the health sector, we estimate that social contributions will continue to be insufficient to cover the liabilities of the Health Insurance Institute. The introduction of new statutory and consequently structural transfers from the state budget to other funds is thus increasingly limiting the room for manoeuvre for the central government to perform its tasks and is affecting the sustainability of public debt in the medium term.

According to our assessment of the revised budget, budgeting remains deficient due to the inadequate classification of measures as intervention measures, the insufficient assessment of the impact of discretionary measures, systematic under- or overestimation of individual revenue and expenditure categories, and last but not least, the abovementioned uncoordinated processes for the preparation of budget documents. Maintaining such an approach to budgeting would not be in line with the revised EU economic governance system, which highlights the crucial importance of credible medium-term planning.