

Speech by the President of the Fiscal Council at the meeting of the Committee on Finance on 22 April 2024

On 10 April 2024, the Government submitted to the Fiscal Council, for its assessment of compliance with the fiscal rules, the proposal for the Ordinance on the framework for the preparation of the general government budgets for the 2025–2027 period and the draft Stability Programme 2024 covering the same period. The Government also requested an assessment regarding the end of the period of exceptional circumstances. Regarding exceptional circumstances, I would like to reiterate what the Fiscal Council had already concluded last spring and at the Government's request confirms that, according to the information currently available, as of 2024 there are no conditions that would justify the existence of exceptional circumstances.

The Government's documents and our assessments come at a time when, according to the Fiscal Council, the Fiscal Rule Act cannot be implemented according to the formula for setting the domestic fiscal rule, because the parameters have not yet been defined by the European Commission and the new economic governance system has not yet been approved. The Fiscal Council notes that once this system has been adopted at the EU level, and in view of the identified non-compliance with the existing Fiscal Rule Act, the EU legislation will take precedence over the non-harmonised part of the national legislation. This consideration will be taken into account in the further assessment of budget documents until the non-compliance is rectified. We also expect domestic legislation to be harmonised properly as soon as possible to avoid prolonged uncertainty.

Although the macroeconomic environment remains relatively stable, with real economic growth in line with the long-term average and currently estimated potential growth and continued relatively high nominal growth of the tax base, the general government deficit is expected to increase again this year, following a fall last year. This situation suggests an expansionary fiscal policy, which is inconsistent with current cyclical conditions and last year's EU Council recommendations.

The country's projected record level of investment, above 6% of GDP, is a major contributor to the increase in the deficit. According to the Fiscal Council, this level of investment is again overestimated and exceeds the long-term average by almost 1.5% of GDP over the next few years. While the Fiscal Council is not opposed to productive public investment that enhances long-term economic potential, it recognises that such ambitious investment plans may be difficult to implement in view of administrative constraints and the absorption capacity of the economy. These constraints are currently most visible in the labour market and the resulting cost pressures, while at the same time increasing the possibility of inappropriate asset allocation.

With the scale of intervention measures reduced, the "core" deficit is projected to remain at around 2.0% of GDP over the next three years. This is mainly due to high current expenditure as a result of various discretionary measures introduced in recent years.

While the general government gross debt is not expected to reach the 60% of GDP threshold by the end of 2027, it is projected to fall below its pre-pandemic level. This debt reduction will be driven by relatively high inflation and nominal economic growth, which is expected to exceed the government financing rate.

Despite the temporary nature of the documents cited, the Government should seize the opportunity to establish a credible medium-term fiscal planning framework. According to the

Fiscal Council's assessment, the documents submitted fell short of this, even though they were submitted just before the transition to the new system, when the requirements for credible planning should have been strengthened. The pre-entry test was not successful.

In the autumn, Member States are required to submit to the European Commission for assessment a medium-term fiscal and structural plan outlining the trajectory of public finances over the next four to seven years. In its assessment, the Fiscal Council has already taken into account the currently known parameters of the new economic governance system. The Fiscal Council is also willing to provide further clarification to deputies or deputy groups through a special presentation on the reformed fiscal rules.

The autumn plan will need to include a credible presentation and assessment of measures that will allow the adjustment of public finances towards medium-term fiscal sustainability. We estimate these measures to be at least between 1% and 1.5% of GDP and they will require a corresponding reduction in the growth of net primary expenditure. The current orientations of the documents submitted do not ensure the sustainability of public finances, even taking into account the lower increase in ageing costs projected in the updated 2024 Ageing Report. This conclusion is reached despite the fact that the interest rate is falling behind the projected economic growth, mainly due to a persistent or widening primary balance deficit, aggravated by the increasing demands of the healthcare and pension funds. Given the potential materialisation of all currently identified risks, the scale of the required action could be significantly larger. This underlines the fact that the expected fiscal adjustment will be much more challenging than the fiscal efforts of the past 20 years. To this end, net primary expenditure growth will have to be at least one percentage point lower than in the years preceding the epidemic crisis.

Against this background, and in view of all the additional shortcomings identified in the submitted budget documents, as detailed in the assessment, we therefore consider that the drafting of the first medium-term fiscal and structural plan under the new system of fiscal rules will be a major challenge.

Let me conclude by linking this issue to the Government's response to our assessment. The Fiscal Council does not limit itself to a mere mathematical verification of compliance with the fiscal rules. The Fiscal Council is an independent institution that provides expert opinions based also on mathematics, and mathematics is a politically neutral science. Nevertheless, it is not simply a question of whether our warnings are meaningful when current spending is financed by borrowing, when investment projections suggest the possibility of their inefficient implementation, and when analyses suggest that, without intervention, public debt could begin to rise systematically in five years' time. All this points to a very difficult task ahead in setting a sustainable medium-term fiscal trajectory this autumn.