CBR
COUNCIL FOR BUDGET
RESPONSIBILITY

# Evaluation of the General Government Budget Proposal for 2014-2016

November 2013

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# List of abbreviations

ARDAL – Agentúra pre riadenie dlhu a likvidity (Debt and Liquidity Management Agency)
CBR – Council for Budget Responsibility
CDS – Credit default swap
CIT – Corporate income tax
DBP – Draft Budgetary Plan
EC – European Commission
EDP – Excessive Deficit Procedure
EFSF – European Financial Stability Facility
ESA – European system of national and regional accounts
ESM – European Stability Mechanism
ESO – Efektívna, spoľahlivá a otvorená verejná správa (Effective, reliable and open public administration)
EU – European Union
GDP – Gross domestic product
GG – General Government
GGB – General Government Budget
GGBP – General Government Budget Proposal
IFP – Institute for Financial Policy
ILO – International Labour Organization
IMF – International Monetary Fund
JAVYS – Jadrová a vyraďovacia spoločnosť (Nuclear and Decommissioning Company)
MBO – Medium-term Budget Outline
MF SR – Ministry of Finance of the Slovak Republic
MFC – Macroeconomic Forecasting Committee
MTO – Medium-term objective
NBS – National Bank of Slovakia
NDS – Národná diaľničná spoločnosť (National Motorway Company)
NPC – No-policy-change (scenario)
OECD – Organisation for Economic Co-operation and Development
PIT – Personal income tax
PPP – Public-private partnership
SEPS – Slovenská elektrizačná prenosová sústava (Slovak Electricity Transmission System)
SGP – Stability and Growth Pact
SGR – Self-governing regions
SIA – Social Insurance Agency
SOSR – Statistical Office of the Slovak Republic
SPP – Slovenský plynárenský priemysel (Slovak Gas)
SSC – Social security contributions
SZRB – Slovenská záručná a rozvojová banka (Slovak Guarantee and Development Bank)
TRFC – Tax Revenue Forecasting Committee
US – United States of America
VAT – Value added tax

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# Summary

The main objective of the government for 2013 and of the 2014-2016 General Government Budget Proposal is to keep the deficit below 3% of GDP and thus meet one of the most important conditions for the closure of the excessive deficit procedure. In the medium-term, the budgetary objectives should stabilise the debt level below 57% of GDP and ensure its gradual reduction from 2015 onwards. Due to the structural expansion in 2014, the budget proposal contemplates the use of the so-called “investment clause” which, subject to meeting certain conditions, may be taken into account in evaluating the pace of consolidation under the Stability and Growth Pact.

Compared to the original plans set out in the stability programme[1], the 2014 budget proposal is less ambitious. The deficit target has increased from 2.6% to 2.8 % of GDP. The change in the planned consolidation effort[2] is much more significant. While back in April, the Ministry of Finance assumed that the pace of public finance consolidation would continue at 0.8% of GDP, it now refers to a negative effort of 0.2% of GDP. According to the Commission’s calculations, the effort reaches -0.8 % of GDP. **The CBR has also quantified a negative consolidation effort of 0.5 % of GDP.** For the sake of objectiveness, it should be noted that the actual effort may deviate from planned values, for example due to higher or lower-than-expected uptake of the EU funds or the collection of taxes.

**The 2014 budget proposal impairs the long-term sustainability of public finances. It is based mainly on one-off and temporary measures whose impact will subside in the medium term and will thus have to be replaced by structural measures (in order to attain a near-balanced budget in 2017[3]). The plan to reduce the structural deficit from around 4% of GDP[4] in 2014 to 0.5% of GDP in the course of three years is very ambitious. On the other hand, the nature of the planned measures brings us to the conclusion that next year’s budget proposal contains fewer risks than the 2013 budget.**

The first important budgetary target is to have the excessive deficit procedure closed in the spring of 2014. For this to happen, the 2013 deficit should be close to 3% of GDP and the Commission’s forecasts for 2014 and 2015 should remain below 3% of GDP. According to the latest Commission forecast, the deficit will reach 3.2% of GDP in 2014 and 3.8% of GDP in 2015. The CBR stated[5] last autumn that the “the 2013 budget objective is achievable, however, ... the elimination of identified risks will require the adoption of additional operative or systemic measures”. Almost all identified risks have materialised. Some have already been reflected in the parliament (education sector and a part of the worse macroeconomic scenario), while other risks

1 Stability Programme of the Slovak Republic for 2013 to 2016
2 A year-on-year change in balance adjusted for the impact of economic cycle and one-off effects (change in structural balance). The calculation is in line with the Commission’s methodology, however, various institutions may use different calculations/estimates of the cyclical component of one-off effects. This causes differences in the value of the consolidation effort.
3 According to Council Conclusions of 19 June 2013.
4 According to CBR calculation. EC estimates the structural budget balance at 3.1% of GDP in 2014.
5 Evaluation of the General Government Budget for 2013-2015

have taken on clearer shapes in the course of the year (additional deterioration of macroeconomic development, local and regional governments, healthcare sector, dynamic effects in taxes and contributions, and revenues of the National Nuclear Fund). These negatives have been offset particularly by higher revenues from the sale of emergency oil reserves (by EUR 371 million), transfer of budgeted funds to 2014 (an impact of EUR 120 million[6]) and the significantly lower uptake of EU funds (anticipated saving in co-financing is EUR 403 million). Although the low uptake of EU funds is likely to facilitate the meeting of the 2013 budget objective, it cannot be evaluated positively because these funds could help the economy at the time of consolidation in generating higher output and creating more jobs[7]. The conclusion is that the year 2013 may end up as planned mainly as a consequence of one-off measures and lower uptake of EU funds. **In order for the excessive deficit procedure to be closed, the next stability programme will have to specify credible measures** based on which the Commission will be in a position to revise its deficit forecasts for 2014 and 2015 below 3% of GDP.

In designing the budget proposal, both macroeconomic and tax revenue forecasts have gone through a standard procedure of evaluation by independent experts. **Compared to the past year, the CBR views these forecasts as being more balanced** and carrying considerably lower negative risks. The budget proposal approved by the government contains a number of tax measures which have not been discussed within the Tax Revenue Forecasting Committee. **From transparency point of view, the CBR expects that new measures will be discussed, before the budget is approved by the parliament, at an extraordinary meeting of the Committee on 25 November 2013[8].**

During a one-year intermission in consolidation, the Ministry of Finance uses the investment clause which enables it, under the Preventive Arm of the Stability and Growth Pact, to adjust the profile of consolidation in a medium-term horizon to reflect the phase of the economic cycle. In the CBR's view, this procedure, otherwise legitimate, has its pitfalls. Firstly, the clause may only be invoked once the EDP has been closed, but whether this happens will not be known until next spring. Secondly, the lower consolidation effort will have to be progressively offset by higher consolidation in the years to come. Thirdly, the magnitude of the exemption[9] (even according to the ministry's calculations) falls short of covering the annual consolidation effort of 0.5% of GDP. **Even with the clause taken into account, the Commission's calculations show a negative effort of 0.2% of GDP.**

**The one-off and temporary measures, amounting to 1.6% of GDP, will dominate the 2014 effort to attain the planned deficit level**. The most significant ones include one-off dividends and the sale of telecommunication licences. The structural deficit (deficit net of the impact of the economic cycle and one-off measures) will, according to the CBR, thus remain in the vicinity of 4% of GDP in 2014.

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6 Under the budgetary rules, certain types of unspent expenditures may be carried over to the next year. The amount of expenditures carried over from 2013 and 2014 is EUR 120 million higher than that carried from 2012 to 2013.
7 Compared to the budget, the economy received EUR 1.3 billion less (including co-financing of EU funds).
8 On 6 November 2013 Ministry of Finance announced a new Tax Revenue Forecasting Committee meeting taking place on 25 November 2013.
9 It is not quite clear to the CBR why, when the investment clause is invoked, the Commission, takes into account the whole co-financing amount in the first year, as opposed to YoY change.

**Compared to 2013, the CBR sees fewer risks in the budget proposal, which is also due to the smaller extent of structural measures**. Nevertheless, the two most problematic areas from the past year are still present. Considering the fact that numerous studies point at a relatively low efficiency of the Slovak healthcare sector[10], it would be optimistic not to factor in any hospital debt increase given the fact that the level of available funds will remain more-or-less the same. In other words, it would take vigorous measures for the planned savings to materialise. Our estimate of risks for the entire sector stands at EUR 100 million. Municipalities, which have failed to attain the planned level of cuts in their current expenditures, represent the second source of potential risks. The CBR therefore sees uncertainty in generating additional savings in 2014, although to a lesser extent than in the previous year. Our quantification of risks for municipalities is in the order of EUR 120-180 million. Apart from these two sectors, we see additional smaller risks in a number of areas, for example the repayment of loans, equity capital increases, receipts from the sale of emission allowances, and the carryover of funds between years. Moreover, it is very difficult at this juncture to predict the impact of changes in methodology[11] on the 2014 budget. The budget proposal contains several reserves designed to cover the risks. It explicitly covers potential consequences of collective bargaining (EUR 98.9 million); the creation of a reserve for attaining the budgetary objective should be viewed as positive, although its amount is small (EUR 65 million).

The CBR views negatively the fact that, instead of moving towards a real three-year budget, the proposal does not contain, even in formalistic terms, a breakdown of the revenue and expenditure items in a manner that meets the 2015 and 2016 deficit target values.

**The same negative evaluation goes for the development of gross public debt which, on the budget horizon, should near the economically critical thresholds laid down in the constitutional Fiscal Responsibility Act**. Even a minor macroeconomic shock, a GDP data revision or a change in the ESA2010 methodology could easily swing public debt above the threshold of 57% of GDP, triggering the requirement to submit to parliament a balanced budget. On the other hand, a reduction of the government cash reserve may eliminate certain negative impacts at the expense of a slight increase in the liquidity risk.

**In terms of compliance with the transparency rules, the CBR's evaluation is positive,** although, in comparison with the year 2013, the CBR noted several transactions which were not captured consistently, were insufficiently explained or were not explained at all (non-tax revenues, e.g. dividends). Additional information was provided by Draft Budgetary Plan (DBP) which contains a detailed explanation of both one-off items and of overall expected effects of the ESO project. Nonetheless, the DBP cannot be viewed as a full-fledged substitute for the national budget which is approved by both the government and parliament (unlike the DBP). The positive aspects of the DBP should therefore in future be reflected directly in the budget, which could then serve as the main source of information without a need to cross-consult other documents.

[10] IMF: The Health Sector in the Slovak Republic: Efficiency and Reform

[11] Transition from ESA95 to ESA2010

When analysing compliance with the fiscal rules at both the national and EU levels, it is necessary in particular to underscore the magnitude by which the consolidation effort is below the benchmark of 0.5% of GDP, as well as another delay in putting in place the real expenditure ceilings. The CBR perceives positively the initiative of the Ministry of Finance to hold an intensive discussion soon on the introduction of expenditure ceilings.

**In the opinion of the CBR, the parameters of the 2014 budgetary objective contain risks that may impede the meeting of the MTO by 2017. The application of the investment clause for 2014 is subject to meeting a set of criteria, including the closure of the excessive deficit procedure in the spring of next year. The target for 2014 is achievable, however, only if the plans for revenues from one-off measures materialise.**

# Introduction

The Fiscal Responsibility Act[12] places on the Council for Budget Responsibility a duty to monitor and evaluate the development of public finances. Consequently, the CBR issues, twice a year, its independent opinion on the prepared general government budget for the forthcoming period, namely in the phase of preparing the Medium-term Budget Outline (April) and following the submission of the government-approved budget proposal to parliament (by 15 October). The purpose of the CBR opinions is to offer an independent view on the budget and assess whether the fiscal policy setup is sufficient in terms of achieving the targets set and, at the same time, to identify potential risks which need to be eliminated through the adoption of additional measures.

The present opinion relates to the 2014-2016 General Government Budget Proposal which the government discussed at a meeting held on 10 October 2013. In addition, this opinion largely draws from the information presented in the 2014 Draft Budgetary Plan of the Slovak Republic, submitted to the European Commission on 15 October 2013[13]. The draft budgetary plan is part of the new requirements under Regulation of the European Parliament and Council No 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (part of the “two-pack”) approved in May 2013. The purpose of these plans is to present the budget in a manner that enables the Commission to assess whether the budget complies with the rules of the Stability and Growth Pact.

The document is divided into six chapters. The **first part** describes the development of the budget in 2013 and evaluates the risks which the CBR identified in its November 2012 evaluation report concerning the 2013-2015 General Government Budget Proposal. The **second part** evaluates the budget proposal from the perspective of the targets proposed. The **third part** analyses the set objectives within the context of the external and internal macroeconomic environment and, through consolidation effort, assesses the fiscal policy setup. The **fourth and the fifth parts** of the document analyse the proposed budget from the viewpoint of the existing fiscal rules at both the national and EU levels, a breach of which may trigger certain corrective procedures. The final, **sixth part,** provides a qualitative evaluation of the proposed budget in terms of its impact on the long-term sustainability of public finances.

The ambition of the CBR is to communicate its opinions in a manner comprehensible to the general public. The technical assumptions and, where appropriate, supplementary calculations, are presented in annexes.

[12] Act No. 493/2011 on Fiscal Responsibility, Article 4, paragraph 1(d).
[13] http://ec.europa.eu/economy_finance/economic_governance/sgp/budgetary_plans/index_en.htm

# 1. Budget development in 2013 and assessment of risks

The current estimate of the general budget deficit for 2013 by the Ministry of Finance is at 2.98% of GDP. Compared to the deficit approved in the 2013 budget at the level of 2.94% of GDP, the deterioration is only slight.

Despite the current budgetary balance being approximately on par with the level specified in the budget, considerable changes have occurred in the structure of revenues and expenditure throughout the year. Changes on both sides of the balance reached 1.8% of GDP. The largest factors having positive impacts on the 2013 deficit compared to the budget include lower expenditures on the national co-financing to European Union funds (0.55% of GDP), higher revenues from the sale of emergency oil reserves (0.51% of GDP), dissolution of budgetary reserve related to the opening of the fully-funded pillar of pension scheme (0.31% of GDP), and the transfer of state budget expenditures to subsequent year (0.16% of GDP). The negative factors causing worse-than-budgeted development include lower tax and social contribution revenues (0.71% of GDP), lower dividend revenues and their transfer to 2014 (0.52% of GDP), a shortfall in revenues of the Telecommunications Regulatory Authority and their postponement to 2014 (0.18% of GDP), higher expenditures of local governments[14] (0.12% of GDP), and an increase in the debt of healthcare facilities (0.14% of GDP). The following table shows the key changes in deficit expectations for 2013[15]:

**Tab 1: Major factors affecting the 2013 GG balance (% of GDP)**

| Positive impact | | Negative impact | |
|---|---|---|---|
| Lower co-financing of EU funds | 0.55 | Lower tax revenues and SSC | -0.71 |
| Sales of emergency oil reserves | 0.51 | Lower dividends | -0.52 |
| Reserve on the opening of the fully-funded pension pillar | 0.31 | Revenues of Telecommunications Regulatory Authority | -0.18 |
| Net transfer of state budget expenditures to 2014 | 0.16 | Assumed debt in healthcare sector | -0.14 |
| Health insurance expenditure savings | 0.11 | Higher expenditures of municipalities | -0.12 |

*Source: MF SR, CBR*

At the time of preparing this report (November 2013) we note that **the risks which the CBR identified in its** Evaluation of the Government Budget Proposal for 2013-2015, published in November 2012, have largely materialised. The key risks identified by the CBR on the revenue side included worse economic development with negative impacts on the budget, and changes in the behaviour of taxpayers following the changes in the tax- and social insurance-related legislation (dynamic effects). Fiscal performance of local governments and the public health insurance system were identified as the main risks on the expenditure side. Other significant risks included the sale of state oil reserves and wage bargaining in the education sector. Of the aforementioned risks, the worse-than-expected macroeconomic development, in a smaller

[14] For the sake of correct comparison against the budget, the expenditures of local governments and of the state budget are adjusted for the effects of wage increase in the regional education system (EUR 69 million). These expenditures are included in the state budget, but are paid by local governments.

[15] More in Annex 1

extent changes in the behaviour of taxpayers induced by the tax- and social insurance-related legislative changes (dynamic effects), wage bargaining in the education sector, and fiscal under-performance of local governments and the public health insurance system, have all materialised.

**The largest deviation from the value set in the budget has been identified as revenues from taxes and social contributions** that have been revised across three forecast updates: in February, June and September. While the first and second updates revised the revenues expected for 2013 considerably downwards, the September forecast corrected this slump, estimating its total negative impact at EUR 526 million. The most important reason for these revisions was the deterioration in the macroeconomic scenario, as illustrated by the decline in the indicator of weighted tax bases (chart 17).

On top of the shortfall caused by macroeconomic development, the revenues have also decreased in the course of the year due to the **updated quantification of the impact of legislative measures** as a reaction to the increase in corporate income tax rates, as well as in taxes and social contributions paid by the self-employed and casual workers (so-called dynamic effects of changes in the tax burden[16]). The dynamic effects related to the corporate income tax[17] and contributions of self-employed seem to have had a considerably more negative impact than anticipated in the approved budget (total shortfall of some EUR 80 million), whereas the budget estimate was more conservative in the case of casual workers (a positive impact of some EUR 42 million). The most recent estimates prepared by the Ministry of Finance indicate that the dynamic effects of increasing the tax burden have been significant and, ultimately, increased the deficit by some EUR 38 million in 2013 compared to the budget target[18].

The shortfall in the collection of taxes and social contributions was offset, prior to the approval of the budget by the parliament, by the dissolution of reserve funds for the worse-than-expected macroeconomic development. Another decrease identified by a new macroeconomic forecast was offset by the dissolution of the reserve for the fully-funded pension pillar. **These reserves were fully sufficient to cover the tax and revenue shortfall in 2013.** As far as the use of these reserves is concerned, it is positive that they were used to reduce the deficit rather than to cover other current expenditures.

**The fiscal performance of local governments in 2013 fell short of reaching what they committed to** under the Memorandum on Cooperation in the Consolidation of Public Finances. The budget anticipated that current expenditures of local authorities would decline by nearly EUR 145 million and those of self-governing regions by EUR 45 million. At the same time, the budget anticipated an increase by EUR 42 million[19] in non-tax revenues at the municipal level. Given the largely decentralised nature of local governance and the absence of effective enforcement mechanisms, the CBR assessed these measures as posing a risk to the budget, with an estimated impact of EUR 150-200 million. Based on the results for 2012, the risk was revised

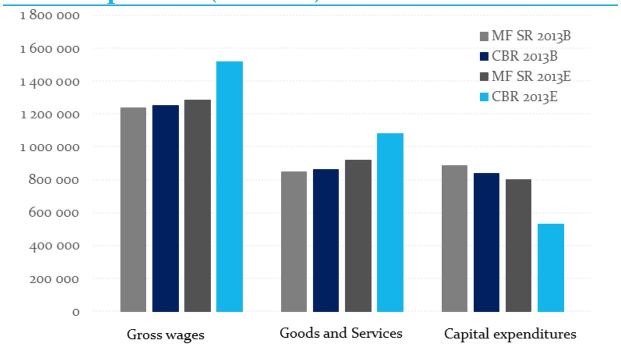
16 Evaluation of the General Government Budget for 2013-2015, page 16, box 1
17 It is a Ministry of Finance estimate only, as tax returns for 2013 will only be submitted in 2014.
18 A small part of that deterioration is caused by worse overall macroeconomic environment. On the other hand, larger than expected dynamic effects also negatively contributed to the deterioration of macroeconomic developments (accurate quantification of the impact of a deterioration of the macroeconomic environment net of the effect of measures is therefore impossible).
19 Compared to 2012 estimate of the Ministry of Finance, published in GGB 2013-2015.

downwards to EUR 100-150 million this April. **The most recent estimates, taking into account the fiscal results of municipalities and self-governing regions (SGRs) as at 30 June 2013, indicate that current expenditures have been growing even faster than expected by the CBR; however, a portion of this increase has been offset by a decline in capital expenditures.** Under CBR estimates, the overall balance may deteriorate by EU 70-120 million compared to the approved budget, which is less than the increase in current expenditures. Compared to the recent Ministry of Finance estimate, the CBR quantifies **the risk to the tune of EUR 40-60 million**.

- Unlike in the previous evaluation reports in which the CBR considered the fiscal performance of **self-governing regions** less risky, the current update quantifies the SGR-related risk at about EUR 40-60 million. The risk arises from the year-on-year increase in wages by 15% in the second half of 2013, which runs counter to the government's fiscal consolidation plans. The CBR still perceives these risks, despite being under potentially better control by the Ministry of Finance and despite the SGRs' commitment to run balanced budgets in line with the Memorandum. Higher current expenditures of SGR are partly offset by better than expected non-tax revenues, however reaching the target will be conditional upon a decrease in capital expenditures.

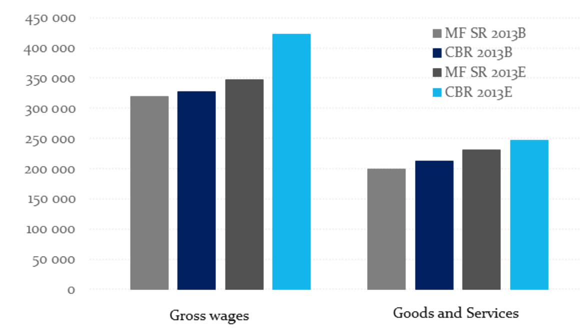
- Compared to the budget, the changes in the structure of **municipal** revenues and expenditures are quite significant. Taking into account the 2012 results, the savings in current expenditures should amount to EUR 251 million. On the other hand, the CBR expects an increase of EUR 300 million in current expenditures (on top of the increase in wages in the regional education system). The increase in current expenditures will be offset by higher non-tax revenues, by EUR 130 million, and a decrease in capital expenditures, by EUR 200 million, compared to the budget figures. The overall estimate of the municipal-level balance is approximately on par with the estimate by the Ministry of Finance (risk not exceeding EUR 30 million); the differences are mainly in the structure of revenues and expenditures. The different expenditure structure also poses a risk to meeting the budgetary objectives in the 2014-2016 period.

**Chart 1: Expenditure estimates in 2013 – municipalities (ths. eur)**




*Source: CBR*

**Chart 2: Expenditure estimates in 2013 – self-governing regions (ths. eur)**




*Source: CBR*

**The development in the healthcare sector was worse than expected in the budget,** although the debt of healthcare facilities grew at a slower pace than in the past. The recent estimate of the Ministry of Finance has already incorporated the assumption of the new healthcare sector's debts into the general government deficit and debt at EUR 100 million.

Additional expenditures on the wage bargaining **in the education sector** are also among the risks identified by the CBR. However, these expenditures have already been offset by additional measures prior to the approval of the budget by the parliament. This has translated into higher expenditures incurred by municipalities in the current period.

**The sale of emergency oil reserves**, with an expected contribution of EUR 471 million (EUR 371 million more than budgeted), **still remains an element of uncertainty with respect to the final general government balance in 2013.** Even though the relevant legislation has already been approved, the transaction itself has not yet taken place. Moreover, it is not yet certain how Eurostat will assess this change in the financing of oil reserves under the new ESA2010 methodology. In terms of net worth, the sale of oil reserves represents only a change in assets, but if the revenue is to be used to finance current expenditures it will ultimately reduce Slovakia's net worth[20].

The other risks that have materialised also include lower non-tax revenues of the National Nuclear Fund and the non-inclusion of VAT expenditures on PPP projects in the budget. The following table provides a summary of the 2013 budget risks identified by the CBR in November 2012, and their assessment.

[20] Due to the fact that these revenues will ensure compliance with the budgeted deficit, CBR assumes the same structure of expenditures as they were budgeted. This also applies to current expenditures.

**Tab 2: List of risks related to the 2013 GG Budget (mil. eur)**

| Risks related to meeting the fiscal targets | November 2012 | Risk coverage | Estimated impact (November 2013) |
|---|---|---|---|
| 1. Negative economic outlook due to worsening of the external environment | no estimate | 313 (reserve on worse macroeconomic development) | risk covered by the reserve |
| 2. Behavioural changes related to tax legislation amendments and their impact on tax revenues | no estimate | | 38 (estimate of the MF SR) |
| 3. Ambitious savings of local government without effective enforceability | 150-200 | | 70-120 (compensated with higher non-tax revenues and lower capital expenditures) |
| 4. Underestimation of costs in public healthcare (unbudgeted liabilities) | 100 | | 100 (MF SR has already taken into account) |
| 5. Absent legislative basis related to the sale of emergency oil reserves | 25 | | transaction has not been realized yet |
| 6. Likely wage increase of teachers and non-pedagogical employees in education sector | min. 60 | | 68 (included in the budget already in parliament) |
| 7. Unbudgeted or postponed expenditures on nuclear power plant decommissioning** | 20 | | 30 (financed with a grant from JAVYS, a.s.)** |
| 8. Risk of lower non-tax revenues of the National Nuclear Fund | 15 | | 20 (MF SR is budgeting from 2015) |
| 9. Unbudgeted expenditures on "green" projects related to the sales of emission quotas | 20 | | 46 (lower revenues from sales of emission quotas) |
| 10. Likely compensation of losses of the Cargo* | 20 | | 20 (a medium-term risk) |
| 11. Unbudgeted VAT payment related to the PPP project | 6 | | 6 (MF SR has already taken into account) |
| **Risks for the net worth of the SR** | **November 2012** | **Risk coverage** | **Estimated impact (November 2013)** |
| 1. Decreasing value of state´s property due to reduction of capital expenditures | no estimate | | no estimate |
| 2. Using the assets of contributors on current expenditures | 229 | 229 (reserve on the opening of the fully-funded pillar) | reserve covered the impact of the worse-than-expected macroeconomic development |
| 3. Using the assets from the levy of financial institutions on current expenditures and creation of contingent liabilities | 100 | | 100 |
| 4. Using the financial assets of JAVYS on decommissioning of nuclear power plants*** | 20 | | 30 |
| 5. Ambitious positive development of state-owned enterprises | no estimate | | Slovak Telekom -59 mil. eur, ŽSSK -11 mil. eur |
| 6. Change in assets related to the sale of emergency oil reserves | 75 | | 471 (estimate of the MF SR) |

** These risks do not have to materialize in the budget immediately, but in a horizon of few years.* Source: CBR
*** The budget accounted for this risk. It assumed to cover the expenditures with a grant from JAVYS, .a.s. However, given the grants are not budgeted, these revenues and expenditures were not included in the figures of the budget. They were only mentioned in the text.*
**** Financing of nuclear power plant decommissioning from accumulated funds of JAVYS does not affect net worth.*

Due to the external factors, dynamic effects of the government's consolidation package and the government's response to these developments, **the consolidation effort, originally at 1.2% of GDP, fell to 1.0% of GDP.** This is largely due to the government taking mostly one-off measures in reaction to the worsened fiscal performance, which does not improve the structural general government balance. Moreover, the 2013 balance benefited from the aforementioned low expenditures on the national co-financing of EU funds, a situation that is unlikely to recur in the years to come (this effect is not included in the CBR's calculation of the structural balance). The following table summarises the effects on the change in the structural general government balance.

**Tab 3: Change in structural budget balance in 2013 (% GDP)**

| | 2012 B2013 | 2013 B2013 | 2012 B2014 | 2013 B2014 | difference 2012* | difference 2013* |
|---|---|---|---|---|---|---|
| **1. General government budget balance** | **-4.6** | **-2.9** | **-4.5** | **-3.0** | **0.1** | **0.0** |
| 2. Cyclical component | -0.2 | -0.5 | -0.1 | -0.4 | 0.0 | 0.0 |
| 3. One-off effects | 0.3 | 0.8 | 0.5 | 1.0 | 0.2 | 0.2 |
| **4. Structural balance (methodology of EC) (1-2-3)** | **-4.7** | **-3.3** | **-4.9** | **-3.6** | **-0.2** | **-0.2** |
| **5. Change in structural balance** | | **1.4** | | **1.3** | | **-0.1** |
| 6. Change in fully-funded pension pillar | | 0.4 | | 0.4 | | 0.0 |
| **7. Change in structural balance net of fully-funded pension pillar (5-6)** | | **1.0** | | **0.9** | | **-0.1** |
| 8. Change in interest payments | | -0.1 | | 0.0 | | 0.1 |
| 9. Change in construction of motorways outside of the GG balance | | -0.1 | | -0.2 | | -0.1 |
| **10. Change in structural primary balance net of fully-funded pension pillar and construction outside GG – national methodology (7-8-9)** | | **1.2** | | **1.0** | | **-0.2** |

B2013 – General Budget 2013-2015 (CBR calculation)
B2014 – General Budget Proposal 2014-2016 (CBR calculation)
* Potential differences might be results of rounding

*Source: CBR*

# 2. Evaluation of budgetary objectives

The preparation of the budget proposal for 2014-2016 was affected by three factors. The first of them is the effort to bring the general government deficit below the level of 3% of GDP in 2013, a key precondition for closing the excessive deficit procedure under the EU rules (Stability and Growth Pact). In the medium term, fiscal targets should be aligned with the medium-term objective (MTO) of attaining the structural deficit of 0.5% of GDP in 2017. In addition to the requirement of reducing structural deficit by at least 0.5% of GDP each year until the MTO is met, the possibility of applying so-called 'investment clause' has been introduced, allowing governments to relax their consolidation effort. The second important factor are the national fiscal rules established by the constitutional Fiscal Responsibility Act. The general government debt reached 52.4% of GDP in 2012, overshooting the first debt threshold at 50% of GDP. This triggered correction mechanisms, which will tighten up as further thresholds are overrun. The last negative factor is the adverse effect of fiscal consolidation on economic growth.

The alignment of such mutually contradictory requirements calls for the adoption of a budgetary strategy that will mitigate the negative impacts on economic growth and ensure compliance with the requirements of the EU and national fiscal rules.

## 2.1 Fiscal framework

**The key objective of the budget proposal is to continue reducing the general government deficit from 2.98% of GDP in 2013 to 2.83% of GDP in 2014, followed by a further decrease to 1.5% of GDP in 2016.**

Compared to the approved 2013-2015 General Government Budget, the targets are less ambitious. **The 2014 deficit is expected to be higher by 0.4% of GDP, and the 2015 deficit by as much as 0.6% of GDP.** The targets are also less ambitious compared to the Medium-term Budget Outline for 2014-2016 and the government-approved 2013-2016 Stability Programme of the Slovak Republic, which was submitted to the European Commission.

**Tab 4: Fiscal targets of general government (% GDP)**

| | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| 1. General Government Budget 2013–2015 | -2.9 | -2.4 | -1.9 | |
| 2. Medium–term Budget Outline 2014–2016 | -2.9 | -2.6 | -2.0 | -1.3 |
| 3. General Government Budget Proposal 2014–2016 | -3.0 | -2.8 | -2.6 | -1.5 |
| 4. Changes compared to GGB 2013–2015 (3-1) | 0.0 | -0.4 | -0.6 | |
| 5. Changes compared to MBO 2014–2016 (3-2) | 0.0 | -0.2 | -0.6 | -0.2 |

*Source: MF SR, CBR*

In addition, the general government budget proposal does not contain all the measures necessary to achieve the balance targets set for 2015 and 2016. The necessary additional measures amount to EUR 478.6 million for 2015 and EUR 926.2 million for 2016.

Assuming that no new permanent measures are taken in the 2014-2016 period in addition to those adopted in 2013 and that the budget development is influenced only by the existing legislation and macroeconomic development, the general government deficit would amount to 4.6% of GDP in 2014, according to a Ministry of Finance no policy change scenario. In subsequent years, the deficit will moderately decrease to 4.5% of GDP in 2015 and 3.9% of GDP in 2016[21].

In order to meet the targets set for 2014, the government had to adopt measures in the amount of 1.8% of GDP (EUR 1.4 billion)[22]. Assuming these measures are permanent, the additional measures to be taken in the next two years would only amount to 0.6% of GDP[23].

**Tab 5: Size of consolidation measures (ESA95, % GDP)**

| | 2013 | 2014B | 2015B | 2016B |
|---|---|---|---|---|
| 1. Balance of general government – NPC* | -3.0 | -4.6 | -4.5 | -3.9 |
| 2. Balance of general government – target | | -2.8 | -2.6 | -1.5 |
| **3. Size of consolidation measures (2-1)** | - | **1.8** | **2.0** | **2.4** |
| - € million | - | 1 351 | 1 561 | 2 028 |
| **4. Additional measures (annual change of line 3)** | - | **1.8** | **0.2** | **0.5** |
| - € million | - | 1 351 | 210 | 467 |

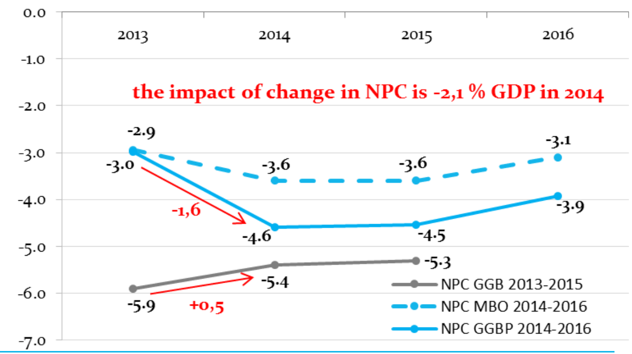
**NPC – No-policy-change scenario, i.e. government would not take any measures* *Source: MF SR*

Even though the 2013 deficit target close to 3% of GDP is likely to be met, considerable changes have occurred in the structure of revenues and expenditures, corresponding to as much as 1.8% of GDP on both sides, compared to the approved budget. Since a portion of the negative effects was of a permanent nature and they were offset by one-off cuts in expenditures and one-off revenues, it has inevitably been reflected in a deficit increase under the no-policy-change scenario.

The approved 2013 budget anticipated the need for consolidation measures at 3.0% of GDP. Assuming these measures are permanent, the original target deficit of 2.4% of GDP[24] could be achieved in 2014 without the need of adopting any additional measures. **The current budget proposal assumes a higher deficit, by 0.4% of GDP, but the need for consolidation measures has risen to as much as 2.1% of GDP.** The reason is that the recently updated no-policy-change scenario contains a year-on-year increase in the deficit at 1.6% of GDP, while a positive contribution of the no-policy-change scenario at 0.5% of GDP was assumed during the preparation of the 2013 budget.

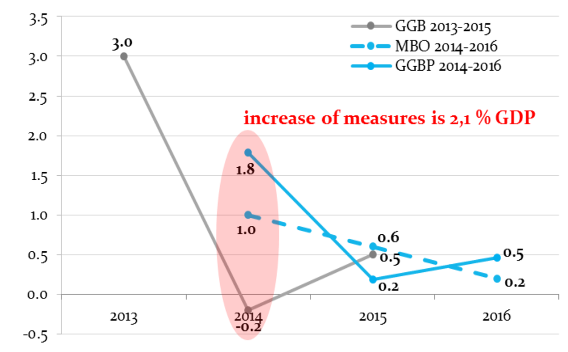
[21] NPC scenario development data for 2015 and 2016 were provided by the Ministry of Finance.
[22] The size of measures is calculated against the no-policy-change scenario. It does not mean that, for example, expenditures will automatically decrease year-on-year.
[23] 0.6% of GDP is the difference between 2.4% of GDP and 1.8% of GDP (line 3 in Table 5), and/or the sum of 0.2% of GDP and 0.5% of GDP (line 4).
[24] Effectively, a deficit at 2.2% of GDP could be achieved in 2014 without the measures because the deficit of 2.4% of GDP created room for the easing of the fiscal position by 0.2% of GDP.

**Chart 3: Balance development in NPC scenario (% GDP)**




*Source: MF SR, CBR*

**Chart 4: Size of measures to be implemented (% GDP)**




*Source: MF SR, CBR*

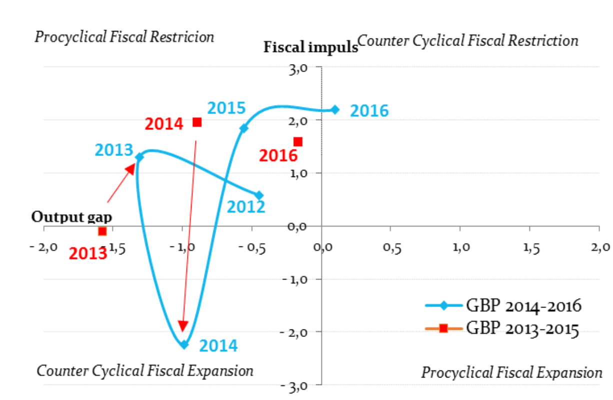
The fiscal consolidation in 2012 and 2013 had a negative impact on the economy in that it curbed economic growth at a time when the economy performed below its potential. **For 2014,** the budget proposal expects counter-cyclical expansion that should help economic recovery to return to the pre-crisis level and, simultaneously, mitigate the consequences of fiscal consolidation. However, its positive effects are conditional upon the ability to draw EU funds in full compliance with the budget. Similarly to 2012-2013, if the deficit targets are met, **the year 2015** will again be characterised by fiscal restriction accompanied by a moderate decline in revenues from the EU. The output gap is expected to close **in 2016** and the fiscal restriction will be based on a considerable reduction of the general government deficit and lower uptake of EU funds.

A significant change in the fiscal impulse[25] for 2013 and 2014 has occurred compared to the approved 2013-2015 budget. The budget assumed that a robust uptake of EU funds would have a positive impact on the economy, but the actual below-average EU funds' absorption caused consolidation to inhibit economic growth at a time when the economy is struggling to recover. On the contrary, in budget 2014 the uptake of EU funds is expected to step up and the fiscal policy to relax in 2014, which gives the economy quite a considerable impulse.

When the economic growth is low and fiscal consolidation must continue regardless, EU funds represent a unique driver of the economic growth. They can fully offset the government's negative contribution to the economic growth. The year 2013 is an example of a failure to capitalise on this potential; in fact, the uptake of EU funds was below the average even in comparison to previous years. **Given the experience with the uptake of EU funds in previous years, there is a risk that their actual uptake in 2014 in comparison to budget proposal for 2014 will again be lower and the expansion will only be driven by the structural balance deterioration.** At the same time, the risk of underspending the funds allocated within the 2$^{nd}$ programming period is growing.

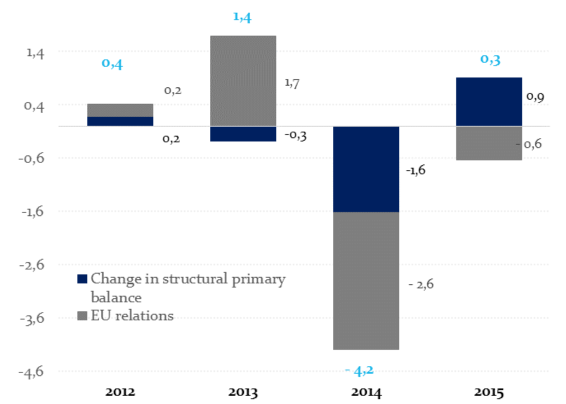
[25] Fiscal impulse measures the contribution of public budgets (defined as a change in structural balance under the national methodology) to the year-on-year change in aggregate demand. In combination with the output gap, it characterises the fiscal policy as to whether it has a stabilising effect or, on the contrary, a procyclical impact on the economy.

**Chart 5: Fiscal impulse in 2012-2016 (% GDP)**




Source: CBR

**Chart 6: Change in fiscal impulse in 2012-2015 - comparison to GBP 2013-2015 (% GDP)**




Source: CBR

## 2.2 General government debt

The budget proposal expects that even if the targets are met, the government debt will increase from 52.4% of GDP[26] in 2012 to 55.7% of GDP in 2016, up by 3.3% of GDP. According to the Ministry of Finance, the debt will peak at the end of 2014 and will gradually decline in subsequent years.

In terms of the entities contributing to the debt growth, it is particularly relevant to monitor the central government and local governments (municipalities and SGRs). The ministry estimates that the local government debt will decrease from 1.5% of GDP in 2012 to 1.1% of GDP in 2016. The share of the local government debt in the total government debt will follow a downward trend, shrinking from 2.9% to 1.9%.

[26] In its second deficit and debt notification for 2012, published on 21 October 2013, Eurostat revised the debt up from 52.1 to 52.4% of GDP, the main reason being the nominal GDP revision.

**Tab 6: Gross general government debt (% of GDP)**

| | 2012 | 2013E | 2014B | 2015B | 2016B |
|---|---|---|---|---|---|
| Gross general government debt (EUR mill.) | 37245 | 39600 | 43024 | 44805 | 46514 |
| **Gross general government debt (% of GDP)** | **52.4** | **54.3** | **56.8** | **56.4** | **55.7** |
| **Structure of debt** | | | | | |
| **1. Existing debt (end-2012)** | **45.4** | **45.8** | **45.7** | **45.0** | **44.3** |
| - debt level | 45.4 | 44.2 | 42.6 | 40.6 | 38.6 |
| - cumulated interest from existing debt | 0.0 | 1.6 | 3.1 | 4.4 | 5.7 |
| **2. New debt - fiscal policy in 2013-2016** | **0.0** | **0.9** | **2.8** | **4.4** | **4.6** |
| - primary balance (cumulated) + other impact | 0.0 | 0.9 | 2.8 | 4.3 | 4.3 |
| - cumulated interest from primary balances | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 |
| **3. Liabilities related to EFSF and ESM** | **2.5** | **3.4** | **3.6** | **3.4** | **3.3** |
| - EFSF liabilities | 2.1 | 2.6 | 2.7 | 2.5 | 2.4 |
| - paid capital into ESM | 0.4 | 0.7 | 0.9 | 0.8 | 0.8 |
| - cumulated interest payments (only ESM) | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| **4. Cash reserve for debt management** | **4.5** | **4.6** | **5.3** | **5.4** | **5.3** |
| - cash reserve | 4.5 | 4.5 | 5.0 | 4.9 | 4.7 |
| - cumulated interest related to cash reserve | 0.0 | 0.2 | 0.3 | 0.5 | 0.6 |
| **5. Extraordinary debt repayments*** | **0.0** | **-0.5** | **-0.6** | **-1.8** | **-1.8** |
| - extraordinary repayments | 0.0 | -0.5 | -0.6 | -1.8 | -1.7 |
| - cumulated int. related to extraord. repayment | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 |
| *p.m. implicit interest rate* | | 3.7% | 3.5% | 3.3% | 3.5% |

** superdividends, privatisation, repayment of loans less increased capital of state-owned enterprises* *Source: MF SR, CBR*

In terms of the factors which contributed to the change in debt against 2012, the following components should be considered:

- The debt growth is driven by **primary fiscal deficits** in 2013-2015, that is, by expenditures exceeding revenues. In 2016, this negative effect is partially offset by the primary fiscal surplus.

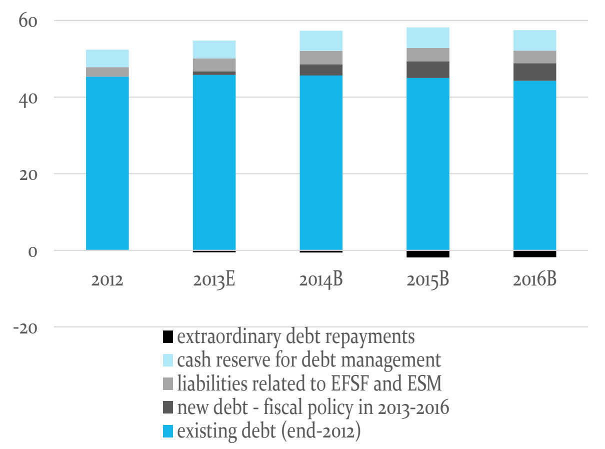
- **International commitments in the form of EFSF liabilities and ESM contributions** constitute the second major debt-growth contributor. The debt forecast incorporates the EFSF liabilities arising from the aid provided to Ireland, Portugal and Greece. The aid to Spanish banks was provided from the ESM and has no direct impact on the debt. The government debt was only affected by the cash contribution to the ESM's paid-in-capital. The overall liabilities increased from 0.3% of GDP in 2011 to as much as 3.6% of GDP in 2014.

- The third factor is the **increase in sovereign liquidity** through debt issuance above the actual needs for debt refinancing. The build-up of sufficient liquidity in times when the conditions on financial markets are favourable should be viewed positively, but retaining robust liquidity at the level of 4 to 5% of GDP carries considerable interest cost. The amount of liquidity is sufficient to cover the government's needs for 5-7 months on average[27].

[27] The amount of reserve funds may vary throughout the year, depending on the debt issue plan and debt repayments.

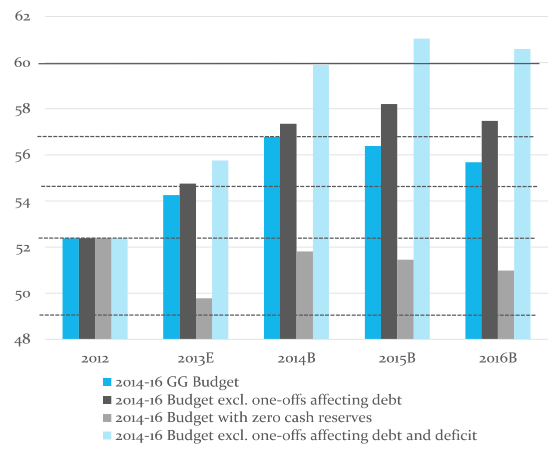
- The debt was positively influenced by the **additional cash available** to ARDAL (Debt and Liquidity Management Agency) for debt repayments or early debt redemption. These transactions have no effect on the general government balance under the ESA95 methodology, but represent a one-off contribution to debt reduction through the system of State Treasury. They include windfall revenues from super-dividends in 2013 (EUR 0.4 billion), repayment of a loan provided to the *Vodohospodárska výstavba* company (EUR 0.2 billion) net of contributions to the registered capital of *Eximbanka SR* and *Slovenská záručná a rozvojová banka* (EUR 0.1 billion) in 2014, and privatization revenues in 2015 (EUR 1.0 billion; Slovak Telekom in particular).

**Chart 7: Debt structure (% of GDP)**




*Source: MF SR, CBR*

**Chart 8: Alternative debt development (% of GDP)**



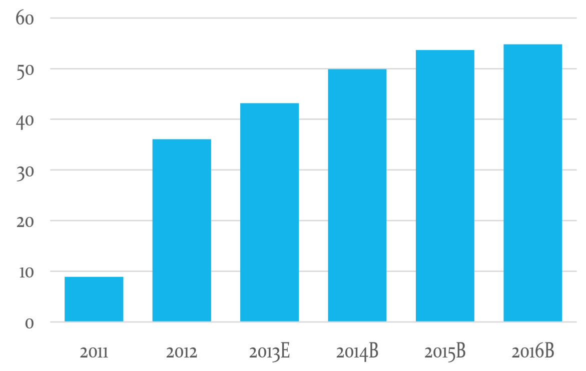

*Source: MF SR, CBR*

Chart 8 provides a different view on possible debt development. It reflects three possible development scenarios[28] illustrating the ways in which the size of the gross debt may be influenced. The considerable volume of additional cash obtained from one-off revenues allows the reduction of the 2015 debt by nearly 2 percentage points. The debt culminates in 2014 already, instead of 2015. On the other hand, the cash reserve, which ARDAL can reduce on a short-term basis down to zero in extreme situations, increases the debt. In such a case, it might theoretically be possible to reduce the debt below 52% of GDP in 2015. The last scenario shows how the debt would develop under the assumption that it is affected by the structural deficit only, i.e., disregarding the one-off effects on the deficit and debt. It is a hypothetical situation that illustrates the government's actual consolidation effort. Under this scenario, the government debt is higher by almost 5% of GDP.

The overall gross financing need to service the debt, cover the deficit and build-up the cash reserve represents EUR 7-8 billion annually (8-11% of GDP) throughout the budget horizon, with a moderately downward trend.

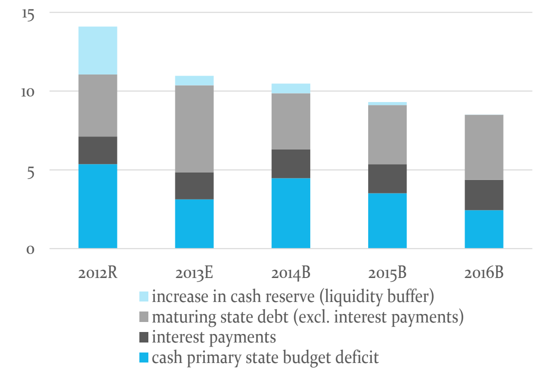
[28] They are separate, mutually independent scenarios, i.e., they are not cumulative.

**Chart 9: Cash reserve as a share of annual financing need (%)**




*Source: ARDAL, CBR*

**Chart 10: Gross financing need (% of GDP)[29]**




*Source: ARDAL, CBR*

The risk factors to the future development of Slovakia's general government debt include the new ESA2010 methodology, revisions of nominal GDP, and the assumption of debts from public hospitals. On the other hand, the size of the cash reserve is a positive factor:

- ESA2010 will be applied as of next October. On this account, the CBR estimated a maximum increase in the government debt by more than 3% of GDP[30]; however, an estimate of 1% of GDP is more realistic. Hence, under the worst-case-scenario, the next year's October notification may confirm that the second debt limit laid down in the Fiscal Responsibility Act was exceeded in 2013 (from the estimated level of 54.3% of GDP to more than 55% of GDP).
- Eurostat published updated figures on the 2012 deficit and debt in October 2013. The updated government debt amounted to 52.4% of GDP, up by 0.3% of GDP compared to the Ministry of Finance's expectations. The revision came as a consequence of the lower estimate of Slovakia's nominal GDP. It is realistic to assume that if these circumstances are taken into consideration and the recent GDP estimate is incorporated in the medium-term macroeconomic forecast, this fact may have repercussions on the size of the debt. The debt could thus reach 57% of GDP (without the ESA2010 impact), a limit that triggers further sanction mechanisms under the Fiscal Responsibility Act.
- The other risks to the debt also include regular debt assumptions of healthcare facilities, a factor not included in the budget proposal for subsequent years.
- On a positive note, the cash reserves of approximately 4.5% of GDP can, should a need arise, be used to reduce the debt.

The situation in the management of Slovakia's sovereign debt is described in the **Update to the Government Debt Management Strategy for 2011-2014** that forms Annex 6 to the budget proposal. The document describes past fulfilment of the strategy in detail, but confines itself to formulating future objectives in general terms only.

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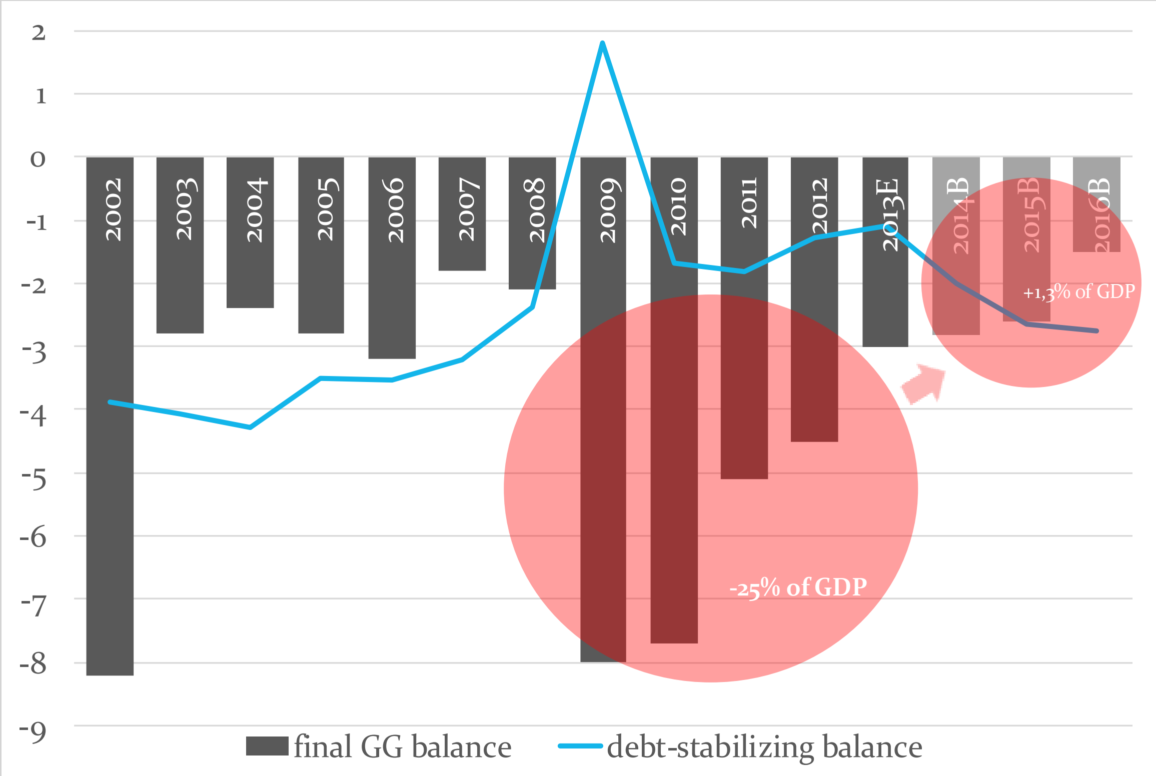
[29] Cash reserve consists of cash deposits in commercial banks and purchases of securities on behalf of MF SR.
[30] CBR **2013: Možný vplyv novej metodiky ESA2010 na verejné financie** (Potential impact of the new ESA2010 methodology on public finances)

## BOX 1: Debt, deficit and economic growth

One of the aggravating factors affecting the debt-to-GDP ratio at present, and most likely also in the future, is a feeble economic growth remaining below the pre-recession levels (pre-2009). While the economy grew in nominal terms at an average annual rate of more than ten percent between 2002 and 2008, the growth in 2010-2016 will be just above four percent. This weak economic performance reduces the size of the deficit necessary to stabilise the debt-to-GDP ratio. The debt-stabilising balance represents a deficit that will not increase the debt expressed as a percentage of GDP compared to the previous year's level.

This balance was at -2.9% of GDP between 2002 and 2008 (the so-called Maastricht deficit sufficed), compared to only -2.1% of GDP for the 2010-2016 period. The calculation is based on the assumption that the debt is only affected by the general government deficit (a zero component of the stock-flow adjustment).

**Chart 11: Difference between GG balance and debt-stabilizing balance (% of GDP, ESA95)**




*Source: CBR, MF SR*

From this point of view, the next year's budget containing a deficit target of 2.8% of GDP does not contribute towards debt stabilisation - the stabilisation will only occur after 2015 when the deficit is expected to be lower than what is necessary to inhibit debt increase. On the other hand, it will only be a small compensation for the debt 2009-2013 increase when the deficit was approximately 25% of GDP higher on a cumulative basis. By the end of the budget period, the debt will decrease by 1.3% of GDP only, due to deficit and economic growth.

The above concept provides a simplified view using the total budget balance; analyses usually employ a more detailed approach which explains the development using the initial debt level, primary balance and a difference between the debt interest rate and economic growth.

# 3. Evaluation of the likelihood of meeting the budgetary objectives

The expenditure framework of the general government budget is defined by the revenue forecast and the government's deficit target[31]. A realistic macroeconomic assumptions and the ensuing revenue forecast are thus essential prerequisites to designing a responsible budget.

The need of having realistic forecasts for budgetary purposes is governed by both the national and EU legislation. At the EU level, the legislation consist of the so-called two-pack[32] which requires Member States to procure independent macroeconomic forecasts. In addition, the six-pack directive[33] defines the minimum standards these forecasts must meet[34].

At the national level, the Macroeconomic Forecasting Committee (MFC) and the Tax Revenue Forecasting Committee[35] (TRFC) were established under constitutional Act No. 493/2011 Coll. on fiscal responsibility to serve as advisory bodies to the Minister of Finance. Their members also include, in addition to the Ministry of Finance, the National Bank of Slovakia, Infostat and commercial banks. The purpose of the committees is to ensure greater transparency, objectiveness and quality of macroeconomic and tax revenue forecasts. This in practice means that **all macroeconomic assumptions used for the preparation of budgets, as well as tax and social contribution revenue forecasts, must be discussed by the relevant committee.**

## 3.1 Macroeconomic assumptions

The macroeconomic development forecasts used in the preparation of the 2014-2016 budget proposal take into account the end of the recession in the second quarter of 2013, positive short-term signals for future development in domestic and foreign demand, but also uncertainty as to whether these signals can be considered a turning point towards long-term growth. Compared to what is included in the 2013-2015 budget, the most recent forecasts of economic growth in subsequent years are more prudent (Table 7). The growth, originally projected at 2.1%, has been revised downwards to 0.8%; the economy is expected to gradually accelerate towards 3.1% in 2016, driven mainly by a moderate recovery in aggregate demand. The Macroeconomic Forecasting Committee (the "Committee") assessed the macroeconomic forecasts for 2014-2016 as realistic in September 2013. However, the Committee did not have the final design of the budgetary measures at its disposal when assessing the forecast.

31 Simply put, the government expenditures consist of budgetary revenues and the amount the government decides to borrow.

32 Regulation (EU) No 473/2013 of the of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area; Article 2.

33 Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States; Article 4.

34 The forecasts should be realistic, compared with the Commission's forecasts and regularly assessed.

35 The committees were established in 2004, but their existence was not governed by law. Both committees have their own statutes, i.e., their own rules of operation.

**Tab 7: Forecasts of the Committee and international institutions**

| GDP real growth in % *Institution* | Reality 2012 | Forecast 2013 | 2014 | 2015 | 2016 | Y-o-Y change previous year 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|
| MFC (September 2013 vs. 2012) | 2.0 | 0.8 | 2.2 | 2.9 | 3.1 | -1.3 | -1.3 | -0.7 | *na* |
| IMF (October 2013 vs. 2012) | 2.0 | 0.8 | 2.3 | 2.8 | 3.3 | -2.0 | -1.3 | -0.8 | -0.3 |
| EC (November 2013 vs. 2012) | 2.0 | 0.9 | 2.1 | 2.9 | - | -1.1 | -0.9 | *na* | *na* |
| OECD (June 2013 vs. 2012) | 2.0 | 0.8 | 2.0 | 4.0 | 4.2 | -1.9 | -1.2 | 0.7 | 1.0 |

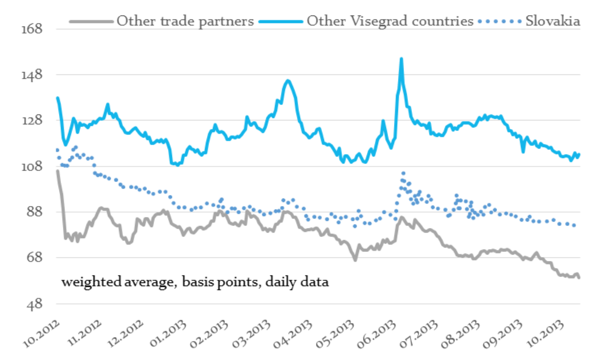
*Source: MF SR, IMF, OECD, EC, CBR*

## External factors

Global economy remains fragile and exposed to risks due to the incomplete implementation of the regulatory measures for the financial system, as well as uncertainties concerning the expectations of the Fed's monetary policy easing programme (within a one-year horizon). Uncertainties in the business sector stem from global shifts of capital and a more cautious lending in the domestic economy with a negative impact on economic growth. Compared to the situation at the end of last year, the volatility on European stock markets decreased and remained more or less flat in the US. Despite having a stable domestic banking sector, Slovakia remains sensitive to any downturns in global economy.

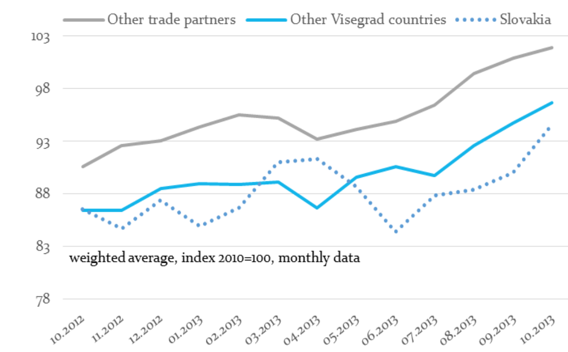
Due to consolidation in the financial and public sectors, the likelihood of Slovakia's sovereign default diminished over the past year (measured by CDS[36]) and has not increased in the case of Slovakia's major trade partners[37] either (Chart 12). CDS flag the need to ensure public debt sustainability through fiscal consolidation. The fiscal measures adopted by Slovakia's trade partners weakened demand for Slovak products and, according to the recent IMF forecast published after the Committee session, consolidation will continue across Europe, albeit at a slower pace than envisaged last year. Despite differing perceptions of the risks associated with the sustainability of sovereign debts, the sentiment across economies has been improving since the end of the last year (Chart 13), indicating recovery in demand towards the end of 2013.[38]

**Chart 12: Pressure for fiscal consolidation - investors risk perception - CDS (10-y bonds)**




*Source: Deutsche Bank, Bloomberg, SO SR, CBR*

**Chart 13: Economic Sentiment Indicator**




*Source: Eurostat, SO SR, CBR*

36 Credit default swap contracts – securities held by investors as an insurance against the risk of sovereigns' failure to repay their debts.

37 Other trade partners - Germany, France, Italy, Spain, UK, Austria, Belgium, the Netherlands, Romania (weighted averages based on their share in Slovak exports).

38 The economic sentiment indicator is a composite indicator made up of five sectoral indicators: industry, construction, retail, services and consumer (the chart contains weighted averages based on their share in Slovak exports).

### Domestic factors

The recovery in household consumption in the second quarter came sooner than expected, but seems to be driven by a combination of low inflation and one-off effects. The household sector expectations have been more favourable throughout the year compared to the previous one; after a decline in August and September, signs of improvement have begun to appear. Household consumption will be positively influenced by a growth in real wages due to low inflation. However, given only a moderate recovery on the labour market, an element of uncertainty exists as to whether the solid growth in household consumption will persevere. The potential for further economic growth (foreign investments excluded) depends on the situation in the sector of small and medium-sized enterprises; however, since no major surge in investments is projected (Table 8), this may have a negative impact on employment.

**Tab 8: Forecasts of the Macroeconomic Forecasting Committee**

| Indicator (in %) | Reality | Forecast (September 2013) | | | | Change (September 2012) | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2013 | 2014 | 2015 |
| GDP, real growth | 2.0 | 0.8 | 2.2 | 2.9 | 3.1 | -1.3 | -1.3 | -0.7 |
| Consumer prices, year average | 3.6 | 1.6 | 1.7 | 2.1 | 2.3 | -1.5 | -0.4 | -0.1 |
| Nominal wage, growth | 2.4 | 2.6 | 2.8 | 3.4 | 3.5 | -0.8 | -1.6 | -1.5 |
| Real wage, growth | -1.2 | 0.9 | 1.1 | 1.3 | 1.2 | 0.5 | -1.1 | -1.4 |
| Employment (ESA), growth | -0.1 | -1.0 | 0.2 | 0.6 | 0.7 | -1.1 | -0.5 | -0.2 |
| Unemployment rate (ILO) | 14.0 | 14.5 | 14.3 | 13.6 | 12.7 | 0.6 | 0.8 | 0.6 |
| Private consumption, real growth | -0.6 | 0.5 | 0.8 | 2.1 | 2.2 | -0.2 | -2.4 | -1.8 |
| Investment, real growth | -3.7 | -5.8 | 2.9 | -0.1 | -1.5 | -12.4 | 4.8 | -1.9 |
| Export, real growth | 8.6 | 4.8 | 4.3 | 4.5 | 5.1 | 0.2 | -0.2 | -0.1 |

*Source: MF SR, CBR*

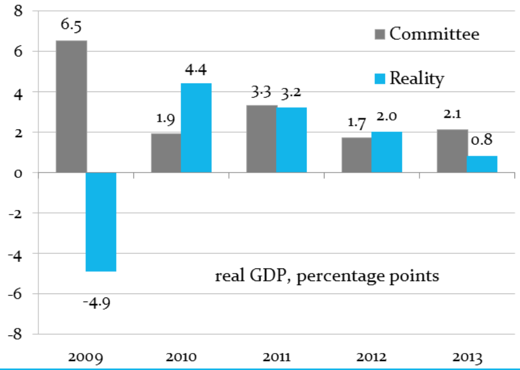
The country-specific economic risks lie in the business environment (legislation, taxes, social contributions) and in the rising cost of the government's debt service. Although the budget proposal quantifies the effects of the measures on economic growth, some of the additional measures were not presented before the Committee. The cost of the general government debt service depends on the development in foreign interests on sovereign bonds (Germany's, in particular) and the risk premium for Slovak economy; i.e., additional risk attached to Slovakia's sovereign bonds above those carrying the lowest risk. If the fiscal limits set for the debt-to-GDP ratio under the constitutional Fiscal Responsibility Act (as assumed in the budget proposal) are overrun, investors may change their perception of the degree of risk of investing in Slovak bonds and require higher interest rates.

### Risks of the forecast

The accuracy of the forecast depends primarily on the availability of the most up-to-date data and the timing of the forecast itself. The differences between the Committee's forecast and those of international institutions are negligible for 2014 (Table 7). Hence the main risk arises from unexpected changes in the external environment (Chart 14 and 15).[39]

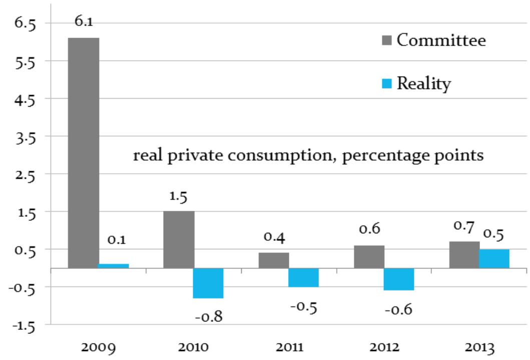
[39] The real figure for 2013 constitutes the current forecast of the Committee.

**Chart 14: Committee forecasts vs. reality - real GDP (p. p.)**




*Source: CBR, MF SR*

**Chart 15: Committee forecasts vs. reality - real private consumption (p. p.)**




*Source: CBR, MF SR*

Forecast errors can be rectified in two ways: through flexible updates of macroeconomic forecasts (and, subsequently, tax and social contribution revenue forecasts) depending on how the economy develops, and by creating sufficient reserves based on risk assessment. Reserve funds in the amount of EUR 65 million (0.09% of GDP) have been earmarked for 2014 to achieve the fiscal objective.

**In light of the aforementioned risks and the ambiguous conclusions following from the macroeconomic development signals, the risks of the 2014-2016 budget proposal associated with macroeconomic assumptions are equally balanced in both directions. In addition, the budget contains the EUR 65 million reserve which can offset, at least partially, any moderate downward revisions.**

## 3.2 Tax and social contribution revenue forecast

According to the tax and social contribution revenue forecast contained in the 2014-2016 budget proposal (BP 2014-2016), the share of tax and social contributions in GDP, **adjusted for the effects of one-off and new measures**, is expected to decrease from 26.3% of GDP to 25.3% of GDP (down by 1 percentage point) between 2013 and 2016 (baseline scenario). The main reason is the actual macroeconomic forecast of tax bases[40] which are expected to grow at a slower pace than nominal GDP (Chart 16). In terms of its structure, the economic growth is hence expected to be driven by less tax-intensive GDP components.

40 A weighted average of growth in selected macroeconomic aggregates (forecast by the MFC) that describes the dynamics in the development of individual tax bases. The shares of individual taxes in overall tax revenues of the general government give their weight. The following macroeconomic aggregates are used as tax bases:
- *Personal income tax and social contributions: wage bill*
- *Corporate income tax: GDP in current prices, net of wage bill*
- *VAT: final household consumption (current prices), gross fixed capital formation of the government (current prices) and intermediate consumption of the government (current prices)*
- *Excise tax on mineral oils: GDP in constant prices*
- *Other excise taxes: final household consumption in constant prices*

**Tab 9: Tax and social security contribution revenue in the Budget proposal 2014-2016**

| (% GDP, ESA95) | 2012 E | 2013BP | 2014BP | 2015BP | 2016BP |
|---|---|---|---|---|---|
| 1. Tax and SSC revenue in baseline scenario | **25.2** | **26.3** | **25.9** | **25.6** | **25.3** |
| 2. New legislation compared to Budget 2013-2015 | 0.0 | 0.1 | 0.6 | 0.0 | 0.0 |
| - *of which: permanent measures*[1)] | 0.0 | 0.0 | 0.1 | -0.2 | -0.2 |
| - *of which: temporary/one off measures*[2)] | 0.0 | 0.1 | 0.5 | 0.1 | 0.1 |
| 3. Other temporary/one-off measures[3)] | 0.2 | 0.5 | 0.0 | 0.0 | 0.0 |
| **TOTAL** | **25.5** | **26.8** | **26.5** | **25.5** | **25.3** |

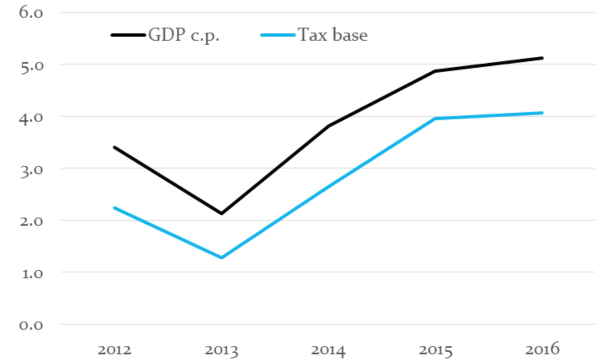
*Source: CBR, MF SR*

*1) lowering CIT rate from 23 % to 22 % in year 2014, introduction of licence fee for corporations in year 2014, lowering standard VAT rate from 20 % to 19 % in year 2015*

*2) one-off increase of VAT revenues in year 2014 by EUR 250 mil., one-off revenue increase from PIT and SSC due to collective bargaining in 2014, extension of the period of application of the special levy in regulated industries for years 2014-2016*

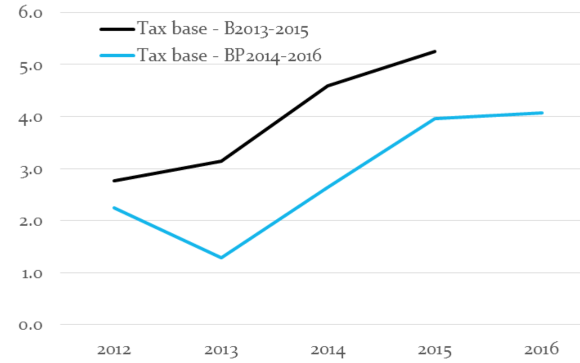
*3) special levy on selected financial institutions, special levy on enterprises in regulated industries, tax revenue from retained profits generated before year 2004, VAT revenue from PPP projects, social contribution revenue from healthcare facilities bailouts, revenue from opening the fully-funded pension pillar*

**Chart 16: Tax base and GDP growth (%, y-o-y)**




*Source: CBR, MF SR*

**Chart 17: Tax base growth (%, y-o-y)**




*Source: CBR, MF SR*

**The budget proposal expects the total tax and social contribution revenues to reach 26.5% of GDP in 2014,** EUR 745 million (1% of GDP) less compared to the approved 2013-2015 general government budget (the 2013-2015 budget). The main causes explaining this difference include the updated macroeconomic assumptions, updated quantification of the consolidation package effects, updated effective tax rates, as well as the adoption of new measures.

**Tab 10: Tax and SSC revenue forecast as compared to Budget 2013-2015**

| (ths. eur, ESA95) | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|
| PIT from dependent activity | 19 356 | -45 025 | -76 099[3] | -160 449 |
| PIT from business and other self-employment activity | -17 322 | -21 643 | -23 937 | -26 424 |
| Corporate income tax | -30 600 | -272 089 | -318 748 | -386 845 |
| Withholding income tax | 879 | -1 292 | -41 006 | -61 787 |
| Value added tax | -2 114 | -38 186 | 110 795[1] | -446 299[2] |
| Excise taxes | -6 713 | -86 810 | -144 105 | -203 518 |
| Special levy on selected financial institutions | 1 149 | 1 147 | -42 101 | 11 702 |
| Temporary levy on enterprises in regulated sector | -561 | 479 274 | 102 188 | 107 395 |
| Social Insurance Agency | 17 213 | -59 843 | -192 731 | -279 875 |
| Social insurance contributions | 13 035 | -87 326 | -192 731 | -279 875 |
| One-off income from opening the fully-funded pension pillar | 4 178 | 27 483 | 0 | 0 |
| Health insurance companies | 1 920 | -45 397 | -108 212 | -153 575 |
| **Tax and SSC revenue of general government** | **1 598** | **-525 778** | **-745 183** | **-1 616 234** |
| **Tax and SSC revenue of general government (% of GDP)** | **0.0** | **-0.7** | **-1.0** | **-2.0** |

*1) including positive effect of one-off increase in VAT collection efficiency* *Source: CBR, MF SR*
*2) including negative effect of lowering standard VAT rate from 20 % to 19 % in year 2015*
*3) including one-off increase of revenue from PIT and SSC due to collective bargaining*
*4) including one-off revenue increase of special levy in regulated industries*

Even though the **updated macroeconomic forecast** of September 2013 indicated a better outlook (after quite some time), the most recent macroeconomic assumptions are considerably worse than those contained in the 2013-2015 budget (Chart 17). While the 2013-2015 budget envisaged an average growth in macroeconomic tax bases at a rate of 4.3% between 2013 and 2015, the current 2014-2016 budget proposal expects a 2.6-percent growth only. The deterioration in macroeconomic assumptions is therefore a significant factor contributing to the lower forecast of the tax and social contribution revenues contained in the budget proposal.

In its 2013-2015 budget evaluation report of October 2012, the CBR warned of **potential risks on the revenue side of the budget** arising from possible dynamic changes resulting from the adoption of some of the **consolidation package measures[41].** The following table compares the most recent Ministry of Finance's estimates[42] for measures carrying the largest risk of dynamic effects against the estimates used in the 2013-2015 budget.

**Tab 11: Measures with dynamic effects: change in the financial impact estimate compared to Budget 2013-2015**

| (ths. eur, ESA95) | 2013 | 2014 | 2015 |
|---|---|---|---|
| Increase of the CIT rate to 23% | -73 636 | -90 036 | -101 772 |
| Increase of social contributions for self-employed | -6 253 | -9 176 | -11 646 |
| Increase of social contributions from casual workers | 41 514 | 47 134 | 49 451 |
| **TOTAL** | **-38 375** | **-52 077** | **-63 966** |
| **TOTAL (% GDP)** | **-0.05** | **-0.07** | **-0.08** |

*Source: MF SR*

41 Hodnotenie Návrhu rozpočtu verejnej správy na roky **2013** až **2015** (Evaluation of the Government Budget Proposal for 2013-2015), page 16, box 1

42 The measures can also have a negative impact on macroeconomic development, but this impact is negligible in the short term (in the year of the implementation, i.e., 2013).

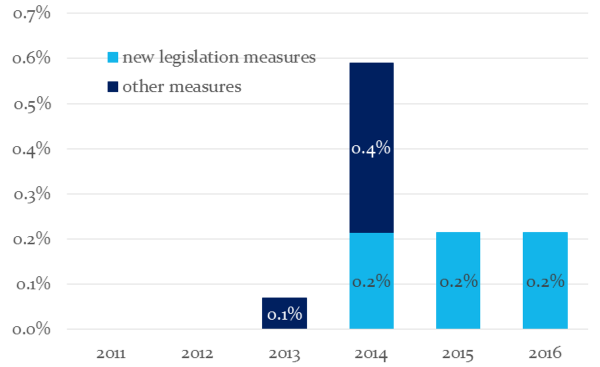
The number of casual workers fell considerably in 2013. **Despite the strong dynamic effects, we have to acknowledge on a positive note that the original estimates by the Ministry of Finance were sufficiently conservative and do not pose a risk to the budget in 2013.** The updates in subsequent years are attributable mainly to the less favourable macroeconomic assumptions.

As far as the corporate income tax is concerned, no assessment can yet be made of the degree of tax optimisation in 2013 because the tax returns for 2013 will only be submitted in 2014. The Ministry of Finance has reviewed its own assumptions and revised downwards the estimated effect of the higher corporate income tax rate against the 2013-2015 budget. According to the CBR, the **corporate income tax carries the highest degree of uncertainty** in terms of tax revenue forecasting, also due to the considerable delay[43] in obtaining the relevant data, as well as due to the new legislative measures adopted (described below).

With respect to the new legislative measures, the reduction in VAT rate from 20% to 19%, as of 2015, is already factored in. The rate is expected to be reduced in response to the expected achievement of the general government deficit target of 2.98% in 2013, which will automatically trigger a provision contained in the VAT legislation whereby the VAT rate returns to the 19% level as of 2015.

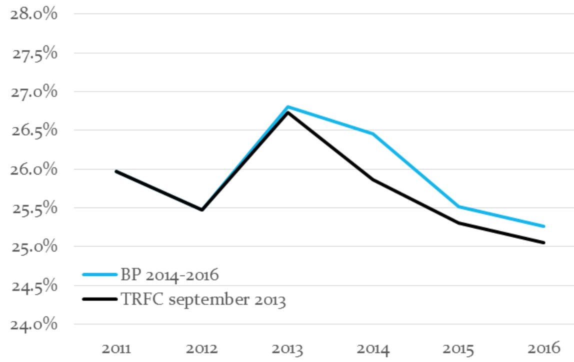
As regards the assessment of the budget risks and transparency, it should be noted that some of the measures having impacts on the tax and social contribution revenues contained in the budget proposal have not been approved by the Tax Revenue Forecasting Committee. At its meeting on 24 September 2013, the Tax Revenue Forecasting Committee assessed the forecasts as realistic. The effect of the measures included in the budget proposal on top of those discussed by the Committee corresponds to 0.6% of GDP in 2014 and 0.2% of GDP in the remaining years.

**Chart 18: Measures not discussed at TRFC (% GDP, ESA95)**




*Source: CBR, MF SR*

**Chart 19: Tax and SSC revenues (% GDP, ESA95)**




*Source: CBR, MF SR*

43 The actual revenues from the corporate income tax for 2013 calculated using the EAS95 (or ESA2010) methodology will only be known in January 2015.

**Measures included in the budget proposal not discussed by the TRFC**

**The reduction in the corporate income tax rate from 23% to 22%,** with effect from 1 January 2014, will reduce the corporate income tax revenue by EUR 37 million, according to the budget proposal. The CBR believes this figure is underestimated and the actual shortfall will be higher by EUR 20 million[44]. In addition, the decision to cut the corporate income tax rate from 2014 onwards motivates the taxpayers to optimise, already in the course of 2013, their tax liability in time, i.e., to transfer their profits to the period with lower tax burden. Such a behaviour could thwart the meeting of the 2013 fiscal targets.

The introduction of **licence fees for corporations** as of the same date is expected to generate EUR 120.8 million in additional revenues. The budget proposal itself does not contain sufficient information and assumptions enabling us to assess how realistic the figure is. In terms of content, it will basically be a minimum amount of corporate income tax, differentiated based on pre-defined criteria (the budget proposal states that the licence fee will be EUR 1,000 on average).

**The extension of the period of application of the special levy in regulated industries** is expected to yield additional EUR 78 million[45] in 2014, according to the budget proposal. The figure is slightly underestimated, according to the CBR, as the negative effect of the corporate income tax is calculated using the 23% rate instead of the proposed 22% rate.

Compared to the forecast approved by the Committee, t**he VAT revenue forecast contained in the budget proposal envisages a one-off increase of EUR 250 million in VAT revenues in 2014;** a reserve of the same size has been created on the expenditure side to be used if the increase does not occur. Tables included in Section 3.1 (Budgeting of tax and social contribution revenues of the general government) do not contain this increase at all. The increase is based on the change in assumptions concerning VAT collection efficiency in 2014.[46]. The measure is discussed in a greater detail in the chapter on fiscal transparency.

Compared to the forecast approved by the Committee, **the forecast included in the budget proposal contains an increase of EUR 50 million in revenues from the special levy in regulated industries** (in the section “Revenues of state financial assets”), but the budget proposal provides no explanation of this increase. Also, the figures used in Section 3.1 (Budgeting of tax and social contribution revenues of the general government) and Section 5.1 (SFA revenue

44 For the purposes of the Tax Revenue Forecasting Committee, the Ministry of Finance estimated in September 2013 that the increase in the tax rate from 19 to 23% would bring additional EUR 323.6 million in 2014. If, for the sake of simplification, we assume that the level of optimisation remains unchanged, than the decrease in the tax rate of 1 percentage point should entail a decrease in revenues by EUR58 million.

45 This is a net effect, after the adjustment for the negative effect of the corporate income tax, given that the special levy in regulated industries decreases the income tax base. According to the budget, the revenues of EUR 102,188,000 from the special levy are linked with a shortfall of 23,503,000 in the corporate income tax revenues in 2014. The calculation, however, does not incorporate the proposal for the reduction in the tax rate, which would moderate the negative impact on corporate income tax revenues.

46 The forecast is only revised for 2014, even though the additional revenues should be driven by a higher collection efficiency, where a permanent effect should be expected (i.e., the EUR 250 million increase should also occur in 2015 as well as in 2016).

operations) are inconsistent for 2013. The CBR notes that the increase in revenues from the special levy will entail a decrease in the income tax base; the corporate income tax revenue forecast should therefore be reduced by EUR 11 million, approximately.

The **effect of collective bargaining**, expected to amount to EUR 34 million in 2014, was not discussed by the Tax Revenue Forecasting Committee, either. The budget proposal does not contain any assumptions based on which this quantification is made. As is the case with the improved VAT collection efficiency, this measure has only a one-effect, namely in 2014; this would mean that wages (or the tax collection efficiency) will return to its original level in the later years.

**Tab 12: Tax forecast adjustments after TRFC endorsement**

| (ths. eur, ESA95) | | 2013 E | 2014 BP | 2015 BP | 2016 BP |
|---|---|---|---|---|---|
| **New legislation measures** | | 0 | 162 919 | 170 668 | 179 030 |
| Special levy in regulated industries - extension of the period | | 0 | 78 685 | 82 694 | 86 915 |
| *of which :* | *Levy revenue* | 0 | *102 188* | *107 395* | *112 877* |
| | *CIT impact* | 0 | *-23 503* | *-24 701* | *-25 962* |
| CIT rate from 23 % to 22 % | | 0 | -36 525 | -38 823 | -41 022 |
| Licence fee for corporations | | 0 | 120 759 | 126 797 | 133 137 |
| **Other measures** | | 50 000 | 284 473 | 0 | 0 |
| Special levy on enterprises in regulated sector | | 50 000 | 0 | 0 | 0 |
| VAT - one-off increase in collection efficiency | | 0 | 250 000 | 0 | 0 |
| PIT and SSC due to collective bargaining | | 0 | 34 473 | 0 | 0 |
| **TOTAL** | | 50 000 | 447 392 | 170 668 | 179 030 |
| **TOTAL (% GDP)** | | 0.1 | 0.6 | 0.2 | 0.2 |

*Source: MF SR*

The budget proposal also does not reflect the effects of a measure that **reduces social contributions for the long-term unemployed**[47] whose income does not exceed 67% of the average wage[48]. The grace period for the payment of social contribution[49] is one year. The measure aims to boost employment by increasing the net wage and, at the same time, enhance the employers' willingness to employ the long-term unemployed by reducing the costs of labour. Its purpose is give the low-skilled workers a better chance to get a job and acquire the necessary working habits According to the IFP calculations[50], the measure will have an overall negative impact on the general government balance in the amount of EUR 8 million in 2014; it enters into force as of 1 November 2013 (effect of EUR 1.1 million). Since the measure is not incorporated into the budget proposal, it represents a negative risk in the aforementioned amount.

The following table provides a summary of the main risks of the tax revenue forecasts from the CBR's perspective.

47 The National Council of the Slovak Republic approved the amendment to Act No. 461/2003 on social insurance on 16 October 2013; parliamentary room document 651
48 Over the period of two years prior to the current year.
49 Except for accident insurance and employer insolvency insurance payments.
50 IFP commentary No.10/2013

**Tab 13: Identified risks in the tax forecasts in the Budget proposal 2014-2016**

| (tis. eur, ESA95) | 2013 | 2014 |
|---|---|---|
| **Lowering CIT rate from 23 % to 22 %** | | |
| - *underestimated revenue shortfall*<br>- *may not be a risk for year 2014 (but conversely increases the risk for 2013) if taxpayers will optimize the tax base and move the profits into the year 2014* | ? | 20.0 |
| **One-off increase of revenue from PIT and SSC due to collective bargaining** | | |
| - *assumptions* about the source of financing these expenses are missing , and therefore the positive impact on the tax revenue is questionable | | 34.5 |
| **One-off revenue from special levy on enterprises in regulated sector** | | |
| - *special levy tax reduces the tax base for CIT, the budget proposal calculation does not include this effect* | 11.0 | |
| **Introduction of licence fee for corporations** | | |
| - *legislation is being prepared, calculation assumptions are only preliminary, potential dynamic effects* | | ? |
| **Social contributions exemption for the long-term unemployed** | | |
| - *Amendment to the Act. 461/2003 Coll. on social insurance was approved by the parliament and is effective from 1.11.2013; however financial impacts are not included in the budget proposal* | | 8.0 |

*Source: CBR, MF SR*

The risks identified by the CBR in the 2014-2016 budget proposal **range between EUR 30 and 60 million.** All identified risks are largely associated with the modifications that have been made outside the Tax Revenue Forecasting Committee meeting (Table 13), namely with the reduction in the corporate income tax rate, increase in wages resulting from collective bargaining, and the exemption of the long-term unemployed from social contribution payments. Furthermore, the positive effect of the introduction of licence fees for corporations, estimated at EUR 121 million in 2014, carries a degree of uncertainty as the legislative framework for this measure has not been specified in more detail and the figure is purely indicative.

On the other hand, if the last months of 2013 confirm that the collection of taxes has indeed improved, it will eliminate a sizable portion of these risks. **In order to enhance the transparency of the budgetary process, it is suitable to provide updates to the tax and social contribution revenue forecasts in the 2014-2016 budget proposal prior to its submission to the parliament for approval. For this purpose an extra Tax Revenue Forecasting Committee meeting[51] will take place on 25 November 2013.**

## 3.3 Consolidation measures

The fiscal consolidation strategy should be supported by specific measures. The 2014-2016 general government budget proposal describes the measures, corresponding to 1.8% of GDP, towards achieving the target set for 2014 only. To achieve the deficit targets for 2015 and 2016, additional measures amounting to 1.1% of GDP need to be specified. The underlying reason is that a great majority of the measures to be implemented in 2014 will only have a one-off effect.

[51] On 6 November 2013 Ministry of Finance announced a new Tax Revenue Forecasting Committee meeting taking place on 25 November 2013.

The present general government budget proposal was submitted to parliament based on revenues and expenditures that fall short of achieving the set budgetary objective. The three-year budgetary framework[52] was yet introduced with the purpose of helping to define a medium-term strategy so that the consolidation effort is more evenly spread over several years, taking also into account the measures whose effects are not necessarily immediately visible in the next fiscal year. In the context of budget management, focus on the next year budget needs to be perceived with concern, although the previous budgets also did not contain all real measures for the last two years of the budgetary period they covered.

**Tab 14: Consolidation measures to be implemented, GGBP 2014–2016 (ESA95)**

| | 2014 | 2015 | 2016 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| | € million | | | % GDP | | |
| 1. Measures necessary to reach target | 1 351 | 1 561 | 2 028 | 1.8 | 2.0 | 2.4 |
| 2. Measures incorporated in GGBP 2014-2016 | 1 351 | 1 082 | 1 102 | 1.8 | 1.4 | 1.3 |
| 3. Additional measures to be implemented (1-2) | 0 | 479 | 926 | 0.0 | 0.6 | 1.1 |
| annual change of line 3 | | 479 | 448 | | 0.6 | 0.5 |

*Source: CBR, MF SR*

The measures to be implemented in 2014 are relatively well and clearly described in the Draft Budgetary Plan. The revenue measures account for more than 80% of total measures, a majority of them involving non-tax revenues, while tax revenues are covered to a lesser degree. The major portion of non-tax revenues comes from one-off revenues from the sale of assets, dividend payments, loan repayments and windfall revenues of the Telecommunications Regulatory Authority. On the expenditure side, the savings are expected to come from the improved functioning of public administration (the ESO reform), i.e., lower operating and wage costs.

Similarly to the 2013-2015 budget, the present budget also envisages a surplus in the local government balance. However, the expectations are less optimistic since the year 2013 showed that even with the Memorandum signed, the meeting of the targets set therein cannot be taken for granted. Nevertheless, the CBR views the Ministry of Finance's estimate of current expenditures for 2014 as slightly underestimated (due to development of current expenditures in 2013).

### BOX 2: Consolidation measures in 2014

Against the no-policy-change scenario (NPC, prepared by the Ministry of Finance), **the measures on the revenue side** correspond to 1.5% of GDP. Most of them are one-off measures.

On the other hand, **the measures on the expenditure side** mainly involve structural changes, according to the Ministry of Finance, particularly savings in intermediate consumption and healthcare expenditures.

[52] The first three-year budget was the budget for 2005-2007.

According to the Ministry of Finance, the measures with permanent effects account for 0.8% of GDP, of which 0.3% of GDP on the revenue side (mainly changes in taxes) and 0.5% of GDP on the expenditure side (mainly the ESO reform[53]).

**Tab 15: Size of consolidation measures in 2014 (ESA95)**

| | € mill. | % of GDP |
|---|---|---|
| 1. GG balance – NPC scenario | -3 495 | -4.6 |
| 2. Targeted GG balance | -2 144 | -2.8 |
| 3. Size of consolidation measures (2-1) | 1 351 | 1.8 |
| **Revenue measures** | **1 101** | **1.5** |
| levy on enterprises in regulated sector | 79 | 0.1 |
| reduction in the corporate income tax rate to 22% | -37 | 0.0 |
| implementation of tax licences (corporate income tax) | 121 | 0.2 |
| property income | 20 | 0.0 |
| transfer of dividend payment from 2013 to 2014 | 437 | 0.6 |
| one-off increase in loan repayment by Cargo | 78 | 0.1 |
| SSC from wage increases due to collective bargaining | 36 | 0.0 |
| transfer of loan repayment of VHV to 2014 | 25 | 0.0 |
| capital revenues | 78 | 0.1 |
| other revenues, incl. rev. of Telecom. Regulatory Authority | 264 | 0.3 |
| **Expenditure measures** | **250** | **0.3** |
| personnel expenditures reduction | 5 | 0.0 |
| intermediate consumption savings | 137 | 0.2 |
| changes in healthcare expenditures | 175 | 0.2 |
| increase in government investment | -63 | -0.1 |
| other changes in expenditures | 11 | 0.0 |
| transfers to the EU budget | -15 | 0.0 |

*Source: MF SR*

The adjusted general government expenditures[54] will increase 5.3% year-on-year in 2014. The highest relative increase of 166.1% is expected in the net capital expenditure category. This is primarily caused by an extremely low 2013 benchmark level, when the sale of emergency oil reserves is expected to take place, reducing the stock of capital by EUR 471 million.[55] The expenditures earmarked for government operations (listed as mandatory; wages, goods and services, subsidies and other current transfers) will grow 50-percent faster in 2014 compared to the growth in expenditure set by the law and those driven by the current macroeconomic development (listed as facultative; social benefits, social security payments, etc.). The years 2015 and 2016 need to be considered illustrative only because the budgetary objective will not be attained at the given level of expenditures.

53 A portion of this amount comes from the freezing of expenditures, resulting in savings against the NPC scenario. It means that the entire effect cannot solely be attributed to the specific measures aimed at enhancing effectiveness.

54 The adjustment method is described in the following box.

55 After the adjustment for the change in inventories and valuables in 2013 and 2014, the capital expenditures would grow 6.6% year-on-year. The adjusted budgeted expenditures would increase by 3.1%.

## BOX 3: Structure and development of expenditures of the GG budget proposal

An overview of development in the structure of general government expenditures can only be obtained after their adjustment for those items that do not affect the general government balance or are not linked with the current economic policy. These item include:

- **Expenditures funded from EU funds** – they have a neutral effect on the balance, booked in the same amounts on both the revenue and expenditure sides
- **National co-financing** – the size of expenditures is directly proportional to the size of the EU funds drawn
- **Transfers to the EU budget** – made in line with the agreed mechanism
- **Interest expenditures** – reflect the previous policy and conditions on financial markets which the government cannot significantly influence in a given year
- **Social contributions on behalf of certain groups** – this item is also included on the revenue side in the same amount (net of premiums paid to the fully-funded pension pillar) and is not consolidated under the ESA95 methodology

The thus adjusted expenditures can be further disaggregated. The table below divides current expenditures into those that are mandated by the applicable legislation (social benefits, social security payments etc.) and those that can be affected by decisions taken by the government (wages, goods and services, subsidies, other current transfers). Capital expenditures constitute a separate category.

**Tab 16: Structure of general government expenditures (ESA95, € million)**

| | 2013 E | 2014 B | 2015 B | 2016 B |
|---|---|---|---|---|
| **Expenditures** | **26 187** | **27 875** | **27 623** | **28 247** |
| - EU expenditures | 1 003 | 1 198 | 1 245 | 1 319 |
| - co-financing | 234 | 640 | 496 | 357 |
| - interest paid | 1 363 | 1 375 | 1 426 | 1 559 |
| - social contr. on behalf of certain groups | 1 526 | 1 424 | 1 460 | 1 499 |
| - transfers to the EU budget | 650 | 683 | 667 | 686 |
| **Adjusted expenditures** | **21 412** | **22 555** | **22 329** | **22 827** |
| annual change (%) | | 5.3 | -1.0 | 2.2 |
| of which: mandatory | 9 494 | 9 847 | 9 432 | 9 602 |
| annual change (%) | | 3.7 | -4.2 | 1.8 |
| of which: facultative | 11 610 | 11 890 | 12 285 | 12 703 |
| annual change (%) | | 2.4 | 3.3 | 3.4 |
| of which: capital | 308 | 819 | 612 | 522 |
| annual change (%) | | 166.1 | -25.3 | -14.7 |

*Source: CBR, MF SR*

A detailed overview of adjusted general government expenditures, including their categorisation, is provided in Annex 8.

The consolidation measures for 2014 are largely of one-off nature. Even if the target set for 2014 is met, the need to adopt additional measures to meet the targets for 2015 and 2016 will not diminish any significantly. New, permanent measures will need to be adopted next year in order to reduce the deficit in a sustainable manner.

The government expects a 3.7-percent increase in the 2014 operating expenditures, driven mainly by the increase in wages (3.1%) and intermediate consumption (5.7%[56])[57]. It shows that the cuts even in this area may be problematic in the medium term. Postponing consolidation to later years thus gradually increases the need for new measures. At the same time, the budget proposal expects a further decline in investments in the medium term, which may have a negative impact on economic growth.

As far as the risks are concerned, the proposed measures carry fewer risks compared to the approved 2013-2015 budget. On the other hand, the meeting of the deficit target will depend on a number of one-off revenues, which may be problematic in reality. They primarily involve revenues from the sale of assets and windfall revenues of the Telecommunications Regulatory Authority. The assumptions concerning the current expenditures of local governments also carry a certain degree of risk.

## 3.4 Change in the general government's structural balance

The government defines its target deficits in the form of a general government balance under the ESA95 methodology. A mere comparison of the year-on-year change in these deficits is insufficient to assess whether the government saves or spends more compared to the year before. Some revenues may entail future liabilities and some revenues or expenditures may be of a one-off nature with no permanent effect on the budget. In the same vein, both the revenues and expenditures automatically respond to changes in economic activity, therefore they need to be cyclically-adjusted.

The preventive arm of the Stability and Growth Pact defines the rules which Member States must comply with in order to avoid excessive deficits. The fiscal position should aim towards creating conditions for the long-term sustainability of public finance, defining the **medium-term budgetary objective (MTO)** as its core element. The MTO is defined as a cyclically-adjusted general government balance net of one-off measures (structural balance). Meeting this objective should ensure that the deficit threshold set at 3% of GDP under the SGP is not exceeded, taking also into consideration the risks of cyclical development.

The Commission uses two indicators - **consolidation effort** (a year-on-year change in structural balance) and an **expenditure benchmark** - to assess whether a Member State is well on the adjustment path towards its MTO (i.e., towards its reference value). The recommended average annual pace of consolidation is set to 0.5% of GDP; the SGP permits a temporary deviation from the MTO, provided that certain criteria are met.

Under its Stability Programme for 2013-2016, Slovakia has defined its MTO in the amount of -0.5% of GDP. The EU Council approved this MTO in its recommendations with deadline for its fulfilment in 2017.

[56] There is budgeted reserve of 250 million EUR for better collection of VAT and 65 million EUR to achieve fiscal target included in the intermediate consumption.
[57] A detailed overview is provided in Annex 8.

For the purposes of quantifying compliance with the rules under the SGP's preventive arm, this section provides an estimate of the structural balance and the adjustment path towards the MTO. It should be emphasised that despite the methodology in place the estimates made by individual institutions may differ in the following aspects: in the economic cycle estimate; sensitivity of balance to changes in economic activity (elasticity); and in identifying one-off measures (which cannot always be interpreted unambiguously). The following table includes calculations made by the CBR using both the European and the national methodology. The economic cycle[58] used in the calculation of the cyclical component was estimated by the Ministry of Finance and presented before the Macroeconomic Forecasting Committee in September 2013. The applied elasticity, also used by the Commission, is taken from OECD estimates. The table shows one-off measures identified by the CBR.

[58] The output gap calculation presented at the Macroeconomic Forecasting Committee is consistent with the macroeconomic forecast used in the budget and, in addition, gives more attention to the specifics of the Slovak economy. Commission estimates are more volatile than those made by other institutions, resulting in a "seemingly" improving structural balance at the time of recession, and vice-versa. Therefore the CBR uses the output gap presented at the Committee meeting for its calculations. The CBR plans to use its own output gap calculation in the future.

### Tab 17: Change in structural budget balance in 2010 - 2016 (ESA95, % GDP)

| | 2010 | 2011 | 2012 | 2013E | 2014B | 2015B | 2016B |
|---|---|---|---|---|---|---|---|
| **1. Budget balance** (net lending/borrowing) | **-7.7** | **-5.1** | **-4.5** | **-3.0** | **-2.8** | **-2.6** | **-1.5** |
| 2. Cyclical component | -0.4 | -0.1 | -0.1 | -0.4 | -0.3 | -0.2 | 0.0 |
| 3. One-offs | -0.1 | -0.2 | 0.5 | 1.0 | 1.6 | 0.4 | 0.4 |
| *- exit from the fully-funded pension pillar* | | | 0.1 | 0.3 | | | |
| *- PIT (temporary increase of basic tax allowance)* | -0.3 | | | | | | |
| *- tax on excess emission allowances* | | 0.0 | | | | | |
| *- rev. of Social Insur.Agency from debt bailout in healthcare* | | 0.1 | | | | | |
| *- VAT revenue from a PPP project* | | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *- revenues from the sales of telecommunication licenses* | | 0.1 | | | | | |
| *- remission of receivables towards non-finan. corporations* | -0.1 | | | | | | |
| *- costs of natural disasters (drought/floods)* | -0.2 | | | | | | |
| *- accrualisation of high-risk state guarantees* | 0.4 | -0.9 | | | | | |
| *- extraordinary levy in banking sector (incl. CIT)* | | | 0.1 | | | | |
| *- temp. entrepreneurial levy in reg. industries (incl. CIT)* | | | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 |
| *- taxation of retained earnings before 2004* | | | | 0.0 | | | |
| *- extraordinary rev. from the Telecommunication Authority* | | | | | * | | |
| *- extended levy in banking sector* | | | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 |
| *- selling of emergency oil reserves outside the GG sector* | | | | 0.6 | 0.0 | 0.0 | 0.0 |
| *- cancelled "bearer deposits"* | | | | | 0.0 | | |
| *- dividends* | 0.0 | 0.2 | 0.3 | -0.4 | 0.8 | 0.2 | 0.2 |
| *- revenues from sales of state property* | | | | | 0.1 | | |
| *- JAVYS (voluntary grant)* | | | | 0.0 | 0.0 | | |
| *- reserve for achieving the fiscal target* | | | | | -0.1 | | |
| *- repayment of loans of Cargo a.s. (capital transfer in 2009)* | | | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| *- repayment of loans of Vodohospodárska výstavba, š.p. ( capital transfer before 2002)* | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | | |
| **4. Structural balance (methodology of EC) (1-2-3)** | **-7.2** | **-4.7** | **-4.9** | **-3.6** | **-4.1** | **-2.8** | **-1.9** |
| **5. Change in structural balance (Δ4)/ Fiscal effort according to EC methodology** | **-0.7** | **2.4** | **-0.2** | **1.3** | **-0.5** | **1.3** | **0.9** |
| 6. Change in fully-funded pension pillar | 0.0 | 0.0 | 0.2 | 0.4 | 0.0 | 0.0 | 0.0 |
| **7. Change in structural balance net of fully-funded pension pillar (5-6)** | **-0.7** | **2.4** | **-0.4** | **0.9** | **-0.5** | **1.3** | **0.9** |
| 8. Change in interest payments | 0.1 | -0.2 | -0.3 | 0.0 | 0.0 | -0.1 | -0.2 |
| 9. Change in construct. of motorways outside of GG | 0.3 | -0.4 | -0.4 | -0.2 | 0.1 | 0.0 | 0.0 |
| **10. Change in structural primary balance net of fully-funded pension pillar and construction outside GG – national methodology (7-8-9)** | **-1.1** | **3.0** | **0.3** | **1.0** | **-0.7** | **1.4** | **1.0** |
| 11. Change in EU relations | 0.9 | 0.1 | -0.3 | -0.3 | 1.6 | -0.4 | -1.2 |
| *- revenues from EU budget* | 0.7 | 0.2 | -0.2 | -0.2 | 1.5 | -0.5 | -1.2 |
| *- contributions to EU budget* | -0.2 | 0.1 | 0.1 | 0.1 | -0.1 | 0.0 | 0.0 |
| **12. Fiscal impulse (10-11)** | **-2.0** | **2.9** | **0.6** | **1.3** | **-2.2** | **1.8** | **2.2** |
| *p.m. output gap* | *-1.1* | *-0.4* | *-0.4* | *-1.3* | *-1.0* | *-0.6* | *0.1* |

* due signals in financial markets not released

*Source: CBR*

The structural deficit will improve by 1.3% of GDP **in 2013**, decreasing from the 2012-level of 4.9% of GDP to 3.6% of GDP. The improvement in the structural deficit will be 0.2% of GDP less than expected decrease in the general government deficit which falls by as much as 1.5% of GDP year-on-year. Even though the actual deficit is more-and-more influenced by negative economic development, corresponding to 0.3% of GDP, the deficit level will not exceed thanks to the increasing use of one-off measures, amounting to 0.5% of GDP in comparison to the previous year.

**In 2014, the structural deficit[59] will increase by 0.5% of GDP to 4.1% of GDP, despite a moderate decline in the actual general government deficit to 2.8% and more favourable macroeconomic expectations.** The deficit declines only thanks to the increased use of one-off measures (of 0.6% of GDP), a major part of which involves the carryover of dividend payments from corporations with the government's or NPF's stake and expected revenues of Telecommunication Regulatory Authority. **The year 2014 can therefore be considered a year of easing up on fiscal discipline.**

**In 2015 and 2016**, the average pace of consolidation should reach 1.1%, using the Commission's methodology, assuming that it is supported by permanent measures (balance is expected to reduce by 0.2% and 0.9% of GDP in 2015 and 2016, respectively) and that the output gap will continue to narrow.

With the structural deficit target set at 0.5% of GDP for 2017, **additional permanent measures in the amount of 1.2% of GDP[60] will have to be annually adopted over the 2015-2017 period in order to meet the MTO**.

In comparison with how the Commission perceives consolidation effort (through a change in structural balance), the CBR further adjusts the structural balance[61] for additional factors: costs of the implementation of the fully-funded pension system, costs of the government debt service and expenditures related to the funding of motorways and expressways under PPP projects. The CBR believes that these items should be incorporated in calculations because they better reflect the changes in policies. Debt interest payments are expenditures not directly related to the current development, but come as a consequence of the existing debt that has accumulated due to past deficits and reflects the current situation on financial markets. By the same token, changes in the fully-funded pillar of the pension system should not affect the size of consolidation effort. Immediate improvement in the budgetary balance due to higher revenues automatically entails higher expenditures in the future, and vice-versa. Therefore, a comprehensive assessment should also take the long-term effects into account; this, however, is not the purpose of this concept.[62] The road infrastructure is built through both through PPP projects and by the National Motorway Company (NDS). In the case of PPP projects, there is a time mismatch between the investment itself and the negative effects it has on the general government balance (in the form of payments by a government entity). However, in terms of how the government influences this item, it is the time when the decision is taken rather than the time when the payments fall due. For this reason, the general government balance is adjusted so that the impact on the balance occurs during the construction rather than during the repayment of a PPP project. The consolidation effort is also adjusted for the accrued debt of the NDS which formally falls outside the general government sector, but represents an alternative

59 Based on calculations made by the CBR using the Commission's methodology.
60 Based on calculations made by the CBR using the Commission's methodology.
61 Defined in accordance with **Act No. 493/2011 Coll.** on fiscal responsibility, the so-called structural primary balance also takes into account, in addition to the economic cycle, the costs of debt financing and one-off measures, fiscal performance of state corporations, local government corporations and the NBS. The latter ones are not included in current calculations.
62 The most comprehensive indicator is the so-called long-term sustainability indicator, which the CBR quantifies once a year in its reports on the long-term sustainability of public finance.

to the financing of motorway construction directly from the budget. On a year-on-year basis, no substantial changes occur in these items, except for the change in expenditures associated with the fully-funded pension system pillar in 2013, when the rate of contributions to the pillar decreased from 9% to 4%.

### BOX 4: Alternative approach to measuring consolidation

The documents prepared by the Ministry of Finance (stability programme) and by the CBR (evaluation of the budget and budgetary framework) currently use two standard indicators to illustrate the government's effort: the size of consolidation measures and the consolidation effort. Although both indicators are presented separately, the reader cannot always easily distinguish between them and chose the "right" one for the purpose of their interpretation.

Both approaches have their pros and cons, yet neither of them provides the sort of information it should – the actual need of measures and the government effort's contribution towards permanent structural balance improvement.

- **The size of consolidation measures** (SCM) expresses the need for consolidation as a difference between the desirable (target) balance and the general government balance under a no-policy-change scenario, i.e., with no legislative measures adopted by the government. This indicator does not take reflect influences beyond the government's control (e.g., economic cycle, interest payments).
- **The consolidation effort** (CE) compares the government's balances on a year-on-year basis, adjusted for one-off effects, cyclical effects, costs of the fully-funded pension pillar, interest payments and other effects. It is a net concept which does not take into account developments under the no-policy-change scenario.

The **new consolidation effort** (NCE) represents an alternative approach. It combines the advantages of both standard approaches and the result is a net concept that also takes into account the development under an NPC scenario.

Regardless of how it is measured, Table 18 shows that the 2014 consolidation will slacken considerably.

**Tab 18: Comparison of different approaches to measuring consolidation**

| | NPC scenario (% GDP) | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| 1. | NPC general government balance | -3.0 | -4.6 | -4.5 | -3.9 |
| 2. | *of which*: cycle, one-offs, interest, fully-funded pillar, other | -2.1 | -3.0 | -2.9 | -2.9 |
| 3. | Adjusted NPC general government balance (1-2) | -0.9 | -1.6 | -1.6 | -1.1 |
| | **Different approaches to measuring consolidation (% GDP)** | **2013** | **2014** | **2015** | **2016** |
| 4. | General government balance - target | -3.0 | -2.8 | -2.6 | -1.5 |
| 5. | *of which*: cycle, one-offs, interest, fully-funded pillar, other | -2.1 | -1.3 | -2.4 | -2.4 |
| 6. | Adjusted general government balance (4-5) | -0.9 | -1.5 | -0.1 | 0.9 |
| 7. | Consolidation effort - annual change of line 6 | **0.8** | **-0.7** | **1.4** | **1.0** |
| 8. | Size of consolidation measures - cumulative (4-1) | 0.0 | 1.8 | 2.0 | 2.4 |
| 9. | Size of consolidation measures - annual change of line 8 | **2.3*** | **1.8** | **0.2** | **0.5** |
| 10. | Consolidation effort – **new concept** - cumulative (6-3) | 0.0 | 0.1 | 1.5 | 1.9 |
| 11. | Consolidation effort – **new concept** - annual change of line 10 | **1.3*** | **0.1** | **1.4** | **0.5** |

** Values used in calculation are based on NPC scenario and other data of CBR* *Source: CBR, MF SR*

A look at the NPC scenario reveals the difference between the currently applied and alternative definition of the consolidation effort. Under the current approach, the 2014 consolidation is quantified as a decline in the adjusted balance by 0.7% of GDP. The alternative concept indicates government's positive effort at 0.1% of GDP. A closer look at the structure of the difference between these two figures shows that 0.5% of GDP comes from the year-on-year change in the amount of national co-financing, 0.1% of GDP is the difference between adjusted balances (lines 6 and 3 in the table), and 0.1% of GDP is primarily attributable to the cyclical development and costs associated with road infrastructure development. When evaluating the government's effort in 2014, the new approach seems more favourable. In the case of 2016, the new approach seems less favourable than the standard approach, by 0.5% of GDP. The reason is that even if the government did not take any measures at all (NPC scenario), the adjusted balance would improve exactly by the same amount.

The following table compares the estimates of the structural balance and its changes as calculated by different institutions. In the case of the Commission's estimates, comparisons can only be made for 2014, because the 2015 estimate has been prepared on a no-policy-change basis and with only some measures taken into consideration. The Ministry of Finance and CBR's estimates for subsequent years are based on the targets set in the budget proposal. The Ministry of Finance calculated the easing of fiscal discipline at 0.2% of GDP in 2014, while the figure provided by the European Commission is 0.8% of GDP. The difference stems from different approaches to identifying the one-off measures and estimating the size of the cyclical component. Quite considerable differences can also be seen in the actual amount of the structural balance, which should contract to a deficit of 0.5% of GDP in 2017.

**Tab 19: Change in structural budget balance in 2012-2015 (ESA95, % GDP)**

| | 2012 | 2013E | 2014B | 2015B |
|---|---|---|---|---|
| **CBR (methodology of EC)** | | | | |
| Structural balance | -4.9 | -3.6 | -4.1 | -2.8 |
| Change in structural balance | | 1.3 | -0.5 | 1.3 |
| **CBR (national methodology)** | | | | |
| Change in structural balance | | 1.0 | -0.7 | 1.4 |
| **European Commission** | | | | |
| Structural balance | -4.0 | -2.3 | -3.1 | -2.9 |
| Change in structural balance | | 1.7 | -0.8 | 0.2 |
| **MF SR (methodology of EC)** | | | | |
| Structural balance | -4.2 | -2.9 | -3.1 | |
| Change in structural balance | 0.1 | 1.3 | -0.2 | |

*Source: CBR, MF SR, EC*

## BOX 5: Application of the investment clause

In connection with the consolidation requirements under the Preventive Arm of the Stability and Growth Pact, the Commission has recently introduced so-called "investment clause" that allows temporary deviations for Member States from the adjustment path towards their medium-term objectives (MTOs) amidst the ongoing economic crisis. The clause should apply to expenditures that foster sustainable economic growth. The investment clause can be invoked if the following criteria are met:

- GDP growth remains negative or far below the potential growth level.
- The country meets the numerical fiscal rules – deficit below 3% of GDP, debt below 60% of GDP (or in case of countries with debt above 60% of GDP, where debt is decreasing at a sufficient speed)
- The permitted deviation from the adjustment paths towards MTO applies to the national expenditure on projects co-funded by the EU (under the Structural and Cohesion policy, excluding expenditures under the agricultural and fisheries policies) with positive, direct and verifiable long-term effects on public finance and potential growth. The size of the deviation will be directly proportional to the actual amount of expenditures spent on co-financing provided to EU projects.
- Once the economic growth returns to black figures, the deviation permitted under the investment clause **will have to be compensated for to avoid delays in achieving the MTO.**

Slovakia has applied for the investment clause for 2014; the European Commission will assess whether Slovakia meets the criteria in its autumn forecast and will make its decision conditional upon Slovakia exiting the excessive deficit procedure under which it is currently placed. If the investment clause is granted, Slovakia's consolidation effort will be adjusted for the amount corresponding to the amount of funds allocated under the budget for national co-financing (0.6% of GDP after adjustment for programmes that are not eligible).

**The submitted general government budget proposal for 2014-2016 indicates the easing up of fiscal policy in 2014. Moreover, according to the Commission's calculations, the consolidation effort remains negative even after incorporating the investment clause. If the European Council insisted that the medium-term objective is met in 2017, the annual consolidation effort would have to be at 1.2% of GDP on average between 2015 and 2017, according to the CBR's calculations made using the Commission methodology, which is a very ambitious task.**

## 3.5 Risks to meeting the medium-term objectives

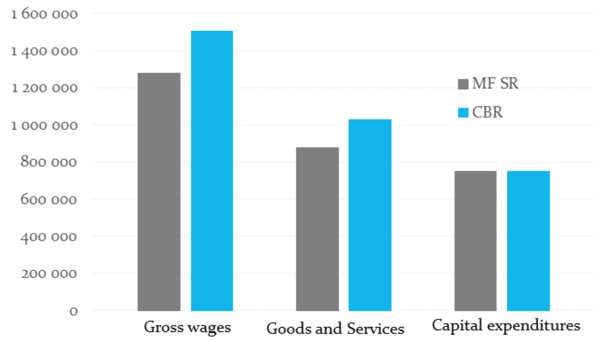
This section describes the risks which the CBR sees in the budgeting of individual revenue and expenditure items and which go beyond the possible risks identified in connection with the forecast of economic development and the tax and social contributions revenues (described in Section 3.1 and 3.2).

**Risks in the budget proposal for 2014**

Compared with the budget proposal for 2013, the approach adopted in the 2014 budget proposal with respect to **municipalities** is more cautious, indicating only a slight surplus. Against the ministry's estimate for 2013, the total expenditures of municipalities should continue to decline by 4.4% in 2014, with current expenditures down by EUR 69 million and capital expenditures down by roughly the same amount, EUR 52 million. According to the CBR, the current developments in the fiscal performance of municipalities indicate that the revenue and expenditure structure in 2013 will significantly depart from the expectations of the Ministry of Finance. The increase in current expenditures above the 2013 level presented by the ministry will probably also be reflected in the years ahead. Municipalities are likely to counteract the negative impact by further cutting down on their capital expenditures. However, during the election year of 2014, their motivation to reduce expenditures will be weaker than usual. The CBR estimates the risk at EUR 100-150 million.

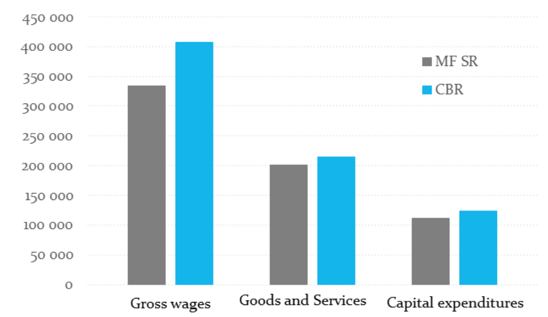
In the case of **self-governing regions**, their fiscal performance in 2013, which deviates from the expectations of the Ministry of Finance, represents a particular risk. The 15-% increase in wage expenditures in the first half of 2013 will probably continue also in subsequent years and the self-governing regions will have to address this issue. The CBR estimates the risk at EUR 20-50 million.

**Chart 20: Expenditure estimates in 2014 – municipalities (ths. eur)**




*Source: CBR*

**Chart 21: Expenditure estimates in 2014 – self-governing regions (ths. eur)**




*Source: CBR*

In 2014, the budget proposal counts on higher effectiveness in the **healthcare sector** which would reduce the overall insurance expenditure by 1.4% (taking into account the growth in liabilities in 2013[63]). Without adopting resolute and clearly identifiable measures, this scenario will represent a risk for the budget. Moreover, the budget proposal yet again does not envisage any growth in the debts of healthcare providers. The CBR expects the expenditure to grow by 1.5%, which translates into a risk of EUR 100 million compared to budget proposal.

The state financial assets have budgeted a revenue of EUR 98 million as loan repayment by **Cargo Slovakia a.s**. Because Cargo Slovakia was not expected to be in a position to repay this loan in the past, the amount was classified as a capital transfer with a negative impact on the deficit. The budgeted revenue thus improves the budget balance. Cargo Slovakia expects to make a loss of EUR 18 million and there are some doubts to what extent can be funds obtained from sale of assets[64]. The sale of Cargo's assets and the use of the proceeds from sale to cover current expenditures will have a negative impact on net worth.

63 Liabilities represent output of healthcare insurance companies not covered by financial resources which has been transformed into an increase in liabilities (debt) of healthcare facilities.

64 Government approved the document "Návrh opatrení na konsolidáciu železničnej nákladnej dopravy SR" (Proposal of measures to consolidate rail freight transport in Slovak Republic) on 10 July 2013.

Another potential risk comes in the form of **equity injection** of entities controlled by the state, such as the Slovak Guarantee and Development Bank (SZRB) and EXIMBANKA SR. The budget proposal estimates a total of EUR 100 million to be injected into these entities in 2014. The transaction is marked as financial operation with no effect on the deficit and debt. Even though these entities are treated as units classified outside the general government sector, their profits vis-à-vis the funds invested by the state are not adequate and, for this reason, there is a risk that Eurostat will not consider these contributions as financial transactions, but rather as subsidies (capital transfer) with an impact on the deficit and debt. Slovakia already faced this situation in 2012 when a total amount EUR 60 million was reflected in the deficit.

The budget proposal envisages revenues from the sale of **emission allowances** at some EUR 100 million. Considering the current market conditions (low price, low demand), there is a risk that these revenues will not materialise in 2014. On the other hand, the net negative effect may be lower because several projects financed from the sale of allowances are likely to be put on hold.

The **sale of assets** and **more efficient performance of general government** as part of the ESO programme represent also the consolidation measures. The supporting documents for the budget proposal do not specify the structure of assets up for sale, nor do they estimate the selling price, however, a certain degree of conservatism is justified in this case. The actual yield depends on the demand by potential buyers which, among other things, depends on how attractive the real estate put up for sale is. There was no detailed specification on expenditure savings available.

In some cases, the General Government Budgetary Rules Act makes it possible to **carry over unspent expenditure to the subsequent year.** In 2013, the positive effect of such carryovers on the deficit is expected to reach EUR 120 million, provided that these expenditures are spent in 2014. The effect on the 2014 balance will depend on the amount of funds to be carried over from 2014 to 2015 which is, however, difficult to predict at this point. The effect can therefore be either positive or negative.

In the current year, the lower uptake of EU funds and the lower **co-financing** expenditure generate budget savings. Unspent funds will be carried over to subsequent years; however, considering the intention to utilise them by the end of 2016[65], this will constitute a potential risk for the deficit between 2014 and 2016. The estimated amount of co-financing which could thus worsen the deficit in the upcoming years represents 0.6% of GDP. The alternative is not to spend all of the allocated resources in the second programming period

The prepared changes in the **Eurostat** methodology (transition to ESA2010) may have a negative impact on the deficit. The most significant impacts are likely to be due to the changed sectoral classification of non-financial corporations[66], which will give more weight to qualitative characteristics, albeit this is very hard to predict at this point. The figures for 2013 will be published in the autumn of 2014 for the first time.

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65 The year 2016 could come into consideration if the Government successfully negotiates a transition from the '*n+2*' rule to the '*n+3*' rule, otherwise the year 2015 would be the last year for the drawing of EU funds in the 2007-2013 period.

66 Including, in particular, such companies as the NDS national motorway company, the ZSSK railway company (freight transport), the ŽSR railway company (passenger transport), hospitals or corporations with equity participation of local governments.

**Certain risks viewed through the prism of net worth**

Section 3.4 specifies those one-off measures with impact on the deficit of general government in 2013 which cannot be included into the consolidation effort. In addition to these items, the budget proposal also includes other items which cannot be clearly and fully identified as consolidation effort when viewed through the prism of net worth. Net worth represents an important corner stone of the constitutional Fiscal Responsibility Act.

The consolidated balance of general government revenue and expenditure indicates that **investments** in 2014 should reach roughly the 2013 level (up by 2.2%). Additional cuts in capital expenditures (e.g., lower absorption of EU funds) or the sale of assets might not necessarily make up for a sustainable strategy in the long term. Effective public investments increase the capital stock and underpin long-term economic growth. Their reduction has the opposite effect.

The net worth approach offers a different story also when it comes to **special levies payable by selected financial institutions**. If these funds are assumed to be used in future to cover the risks in the financial sector, their effect on the net worth is zero, even though they improve the current balance of public finances[67].

**Coverage of risks in the budget proposal for 2014**

All of the above risks, including the risks in the forecast of tax and contributions revenues, translate into several hundreds of millions of euros. The upside is that the budget includes a reserve, albeit amounting to only EUR 65 million. Since it only takes a few risks to materialise for the reserve to be depleted, new measures will have to be adopted during the year.

The other options to counteract the risks include the reduction in capital expenditures (as expected from local governments) and cuts in the co-financing of EU funds. The budgeted uptake of EU funds exceeds by far the average absorption capacity within a single year, which may cut expenditures by as much as 0.3-0.4% of GDP.[68] On the other hand, Slovakia should spend these funds within the specified time limit. Both types of cuts cannot be considered a good solution, be it from the perspective of net worth, impact on economic growth or in terms of carrying the deficits over to future periods.

67 There are assets and potential future liabilities. There is no clear quantification of potential risks in the financial sector, neither if liabilities are contingent or implicit.
68 Assuming an uptake of EU funds corresponding to the average for the previous years.

**Tab 20: Overview of risks and reserves in the budget proposal in 2014 (€ million)**

| Risks to meet budgetary targets | | Risk coverage | |
|---|---|---|---|
| 1. Additional measures in taxes and social contributions not discussed in the Tax Revenue Forecasting Committee | 30-60 | no estimate | Better tax collection in 2013 |
| 2. Underestimation of current expenditures of local government | 120-180 | | |
| 3. Underestimation of costs in healthcare sector (increase in liabilities which were not budgeted) | 100 | 65 | Reserve to reach the fiscal target |
| 4. Contributions to registered capital (Eximbanka, SZRB) | max. 100 | | |
| 5. Shortfall in revenues from sale of emission allowances<br>6. Lower impact from ESO (lower income from sale of state owned assets and lower savings in expenditures)<br>7. Negative impact from carry-over of unspent expenditure in 2013 to the subsequent year | 50-100 | 200-300 | Potential savings in co-financing in 2014 |
| 8. Carry-over of unspent EU funds and co-financing to the subsequent years* | 400 | | |
| 9. Change in methodology ESA2010 | no estimate | | |
| **Risks viewed through the prism of net worth without budget impact** | | **Risk coverage** | |
| 1. Decrease in net worth due sale of assets (ESO) | 54 | | |
| 2. Decrease in net worth due capital expenditures constraints | no estimate | | |
| 3. Sale of assets (Cargo) and use of these revenues on current expenditures | 98 | | |
| 4. Use of revenues from special levies payable by selected financial institutions on current expenditures and creation of contingent liabilities | 160 | | |

** Risk is calculated for the entire period 2014-2016 and might not be detected right in 2014.* *Source: CBR*

## Risks in the budget proposal for 2015 and 2016

The budget proposal does not include all the measures designed to reach the general government deficit targets. Some of the measures, which have already been incorporated, are common with the 2014 measures and, as such, carry the same risks. These measures include, in particular, new tax legislation, revenues from dividends, revenues from the sale of assets, revenues from the sale of emission allowances, or cuts in the spending of local governments (predominantly in 2015).

The one-off nature of the 2014 measures can be considered a risk as well, and this approach will require new measures to be adopted in 2015 and 2016. With a real improvement in the fiscal performance of the general government deferred to a later point, the need to adopt permanent measures is growing. However, there is also an increasing risk in that the budgetary objectives, including the MTO, will be either postponed under the pressure of the consolidation effort or that selective, non-systemic *ad hoc* measures will be adopted.

# 4. Evaluation of the budget in terms of fiscal rules

The general government budget must respect the national rules, as well as the rules applicable to Slovakia as member of the euro area. The constitutional Fiscal Responsibility Act represents the most important piece of national legislation. At the EU level, Slovakia is required to comply with the requirements of the Stability and Growth Pact (and related regulations) and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the so-called "fiscal compact").

## 4.1 Rules of Constitutional Act No. 493/2011

In 2012, the public debt of Slovakia surpassed the first debt-level threshold and is bound to exceed the next two thresholds, 53% of GDP in 2013 and 55% of GDP in 2014, during the budget period. After surpassing the 53% mark, the applicable sanctions (submission of debt-reducing measures to the parliament and wage reduction for members of the government down to the previous year's levels) will probably be imposed in April next year when the 2013 debt is to be published. However, as already assumed in the budget proposal, the wages of the constitutional officials will remain at the 2013 level.

**According to the budget proposal, the debt level of 55% of GDP is envisaged to be exceeded in 2014,** which will translate into the blockage of 3 % of expenditures of the state budget as of May 2015. At the same time, the budget for 2016 must be devoid of any nominal increase in expenditures (adjusted for exemptions). According to present observations, the year 2016 should see an increase in net expenditures; on the other hand, these expenditures fall short of reflecting all the measures aimed at reducing the deficit between 2015 and 2016. The budget execution will depend, to a large extent, on the structure of the measures adopted in 2015 (Box 6). If the 2015 net budget expenditure reaches the presently proposed level, 58% of the measures would have to be taken on the expenditure side in 2016.

**However, there is a risk that the 55% threshold will be exceeded at the time of the October notification in 2014 detailing the debt level for 2013**. This will be the first year of the application of the new ESA2010 methodology which may translate into a one-off debt increase by 1.0% of GDP.[69] Unless the Ministry of Finance takes action in advance, the blockage of expenditures in November and December may even cause operational problems. Considering that the net expenditure is expected to decline in 2015, Slovakia should not encounter any serious problems in meeting this criterion.

**The freezing of expenditures prescribed by the constitutional act must also be respected by local governments.** Their budgets should include expenditures only up to the levels indicated in the budgets for the previous year. Because the budget proposal does not contain any information on EU funds and co-financing with respect to municipalities, such expenditures cannot be evaluated in the absence of additional data. However, the expenditures of self-governing regions may pose a risk as they will increase by 2.5% in 2015 and 0.7% in 2016,

[69] If the debt for 2013 to be presented in the April notification reaches the expected level of 54.3% of GDP, it will be only 0.7 percentage points below the threshold of 55% of GDP.

according to the budget proposal. The total expenditures of municipalities are projected to decline slightly between 2015 and 2016.

### BOX 6: Freezing the general government expenditure

In order to assess whether the planned expenditures stated in the 2014-2016 general government budget comply with Article 5 (6)(c) of the Fiscal Responsibility Act, it is necessary to know the time when the debt is to exceed the 55% threshold of GDP[70]. The above section of the Act imposes an obligation[71] to submit a budget wherein the nominal consolidated general government expenditures, net of items prescribed by the Act, are not higher than those in the general government budget for the previous budgetary year. One of these expenditure items constitutes the costs of remedying damages caused by natural disasters. For the purposes of the table below, this figure will be set to zero because such expenditures are not budgeted.

**Tab 21: Expenditures of general government (ESA95, € million)**

| | 2014 RVS | 2015 RVS | 2016 RVS |
|---|---|---|---|
| Expenditures | 27 875 | 27 623 | 28 247 |
| - interest paid | 1 375 | 1 426 | 1 559 |
| - EU expenditures | 1 198 | 1 245 | 1 319 |
| - co-financing | 640 | 496 | 357 |
| - transfers to the EU budget | 683 | 667 | 686 |
| - remedying damages (e.g. natural disaster) | 0 | 0 | 0 |
| Adjusted expenditures | 23 980 | 23 789 | 24 326 |
| annual change | | -190 | 536 |
| Additional measures to be implemented | | 479 | 926 |
| if measures are permanent | | 479 | 448 |

*Source : CBR, MF SR*

The table indicates that this target is achievable provided that it is not necessary to increase the adjusted expenditure in 2015. The budget proposal meets this requirement even without incorporating additional measures totalling EUR 479 million (also thanks to the VAT reserve budgeted in 2014). The assumption is that expenditures in the given year should not rise significantly during the budgetary process. If the requirement of zero-increase in expenditures is applied to 2016, the ability to meet this objective is questionable. It actually depends on how additional measures will be incorporated in 2015. First of all, the measures should be split between items on the revenue and expenditure sides. Secondly, it is also important to know whether such measures are of one-off or structural nature. For the time being, the expenditure base for 2015 therefore remains uncertain.

70 Assuming that this situation actually occurs.

71 The obligation does not apply to:
- a period of 24 months following the approval of the Government Manifesto and the vote of confidence in the Government;
- a period of 36 months after identifying a year-on-year slowdown in GDP growth by 12 percentage points at the least;
- a period of 36 months, if aggregate expenditure identified for the recovery of the banking sector, remedy of damages caused by natural disasters, or expenditures on account of commitments arising under international treaties exceed 3% of GDP;
- the period spanning between the declaration of war or the state of war until they are ended.

**The rules for local governments** are effective from 2015 and must be assessed on a case-by-case basis after taking stock of the actual situation. For the purposes of the general government budget proposal, the monitoring of compliance with these rules is not necessary.

The constitutional act requires the introduction of **expenditure ceilings.** The Ministry of Finance presented its legislative amendment transposing the *fiscal compact* requirements into Slovak legislation, hand in hand with expenditure ceilings. Given that the expenditure ceilings are intended as the primary tool for managing the budget on a day-to-day basis, the definition of expenditure ceilings must be specified in more detail compared to the definitions in the existing legislation. Moreover, these measures should be of permanent nature, and are not intended merely as a correction mechanism.[72] The absence of such ceilings needs to be viewed negatively. On a positive note, the Ministry of Finance is keen to launch a broader discussion on the form of these ceilings shortly.

## 4.2 European budgetary rules

The Slovak Republic committed itself to correct the so-called excessive deficit in its public finances (excessive deficit procedure/EDP) by 2013. In April next year, Eurostat will publish the first official estimate of the actual general government deficit for 2013. Following this date, the Commission will decide whether to close the excessive deficit procedure imposed on Slovakia in 2009. In addition to the actual reduction of the deficit below three percent of GDP this year, the Commission will also judge **whether maintaining this deficit below the 3% threshold would be sustainable in the years to come**.

The Commission will evaluate the fulfilment of the criteria based on its own forecast of deficits for 2014 and 2015 which are required to stay below three percent (the definition of the so-called *durable correction*) – in addition to the no-policy-change scenario, the prognosis will take into account some of the measures announced for these years. The current Commission's forecast for 2014 and 2015 is above 3% of GDP (3.8% of GDP in 2015). **In order for the excessive deficit procedure to be lifted, Slovakia will have to specify credible measures in its next stability programme, which will allow the Commission to adjust its forecast of deficits in 2014 and 2015 below 3% of GDP.**

Effective as of next October, the new ESA2010 methodology represents another risk for the deficit. It is very likely that one-off revenues from the transfer of pension assets (i.e., savers exiting the second, fully-funded pillar in Slovakia) will have to be excluded from the general government balance, which will push the deficit up by 0.3% to 3.3 % GDP. It is questionable whether the Commission, after having analysed the figures available in April, would close the excessive deficit procedure for Slovakia only to reopen it later in the fall. Another option is that the Commission will view the change in methodology as a one-off impact without placing Slovakia under the excessive procedure again.

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[72] The new legislation defining expenditure ceilings triggers this rule only after a Government decision. The rule for local governments cannot be assessed, because it applies to individual municipalities and self-governing regions (the budget does not elaborate on this issue to such a level of detail).

Should the 2013 deficit exceed the threshold of 3% of GDP, the Commission may also consider the costs associated with the adoption of the so-called systemic pension reform. The general government costs related to the existence of the fully-funded pension pillar[73] stand at some 0.6% of GDP today, which would represent a sufficient reserve for the abrogation of the **excessive deficit procedure for Slovakia even if the 3% threshold for the general government deficit is exceeded.** However, given the voluntary nature of Slovakia's fully-funded and a very low share of young people joining the fully funded scheme, treating this scheme as a systemic reform may turn out to be difficult (see more details in Box 7). **From this perspective, there is a risk that the costs of the fully-funded pension pillar might not necessarily be taken into account for the purposes of lifting the excessive deficit procedure.**

### BOX 7: Assessment of the pension reform for the purposes of the EDP

If a country fails to correct an excessive deficit within the prescribed deadline and if its deficit continues to exceed 3% of GDP, the European Commission and the Council **may, for the purposes of assessing the possible abrogation of the excessive deficit procedure, give due consideration[74] to the implementation of the so-called systemic pension reform[75] in the country concerned**. To put it simply, in Slovakia's case the Commission may assess whether the introduction of the fully-funded pension pillar **in its current form** can be considered a systemic pension reform which would then make it possible to exclude the related general government costs from the general government deficit.

The basic conditions for acknowledging the net cost of the pension reform **comprise the mandatory system** and the **fully funded nature** of the pension pillar. For Slovakia, the mandatory system requirement is disputable due to continual changes regarding the participation of new labour market entrants in the fully-funded pension pillar. Currently, the participation in the pillar is voluntary, i.e., new labour market entrants must actively express interest in joining the fully-funded pension pillar. They have to make this choice before reaching 35 years of age. Frequent changes in the system, in particular the fact that the government allowed the savers to exit the scheme already on three occasions, thereby reducing the participation rate in the fully-funded pension pillar, can be judged very negatively and, given its voluntary nature for new pension savers, there is a considerable risk that the participation rate will continue to decline.

In addition to pushing the deficit below three percent of GDP, Slovakia's balance must be approaching the medium-term budgetary objective (MTO), i.e., "balanced budget". This objective currently stands at the structural deficit level of 0.5% of GDP in 2017. In order to reach such a low deficit, the Slovak Republic must follow a trajectory defined by European institutions. However, this "roadmap" has not been published yet.[76] Nonetheless, the Commission did

73 In the form of a shortfall in revenues of the Social Insurance Agency
74 If the general government deficit declines significantly and permanently while approaching the reference value (3%), the net costs of the mandatory fully-funded pension pillar may also be taken into account in considering the abrogation of the excessive deficit procedure.
75 Specifications on the implementation of the Stability and Growth Pact, September 2012
76 In the Stability Programme for 2013-2016, it was the Government itself which outlined this trajectory. However, the budget proposal increased the general government deficit in 2014 by 0.23 p.p. (from 2.60 to 2.83% GDP), with consolidation effort falling 0.6 percentage points (from 0.4 to -0.2% of GDP based on the data provided by the Ministry of Finance).

publish its recommendations for Slovakia to consolidate its finances at the speed of 1.0% of GDP per year between 2010 and 2013, and by at least 0.5% of GDP per year in the subsequent period (the preventive arm of the Stability and Growth Pact). **According to Autumn forecast of European Commission, the average consolidation effort between 2010 and 2013 reaches 1.3% of GDP.**[77]

**The budget proposal envisages the easing of the budgetary discipline in 2014,** albeit this runs contrary to the commitment of consolidation at the speed of at least 0.5 percentage points of GDP per year until the medium-term objective is achieved. In this case the government applies the so-called investment clause of the European Commission. The clause allows the country to relax its consolidation effort, provided that the debt and deficit are at sufficiently low levels, and that the output gap is wide. By the same token, the expenditures for the co-financing of EU projects with a lasting positive impact on public finances may serve as the only excuse for Slovakia's lagging behind in the consolidation plan, however, the country is still required to achieve the medium-term objective by the deadline. Slovakia is applying for the exemption because it expects higher EU funds' co-financing which, in 2013, fell to the lowest level in several years. After "taking a break" in 2014, Slovakia will have to **consolidate its finances at an average speed of 1.2% of GDP per year between 2015 and 2017** in order to meet the MTO in 2017, which is a very ambitious plan considering the fact that 2016 is the year of parliamentary election.

As part of the preventive arm of the Stability and Growth Pact, Slovakia will also have to comply with the so-called expenditure benchmark. This means that expenditure growth must not exceed the medium-term rate of potential GDP growth. Expenditures may grow faster only if the excess is matched by measures on the revenue side. This criterion is complied with in the 2014 budget proposal, in which the Ministry of Finance indicated EUR 763 million as revenue measures**.** The CBR is not able to provide an assessment for the years 2015 and 2016 because the expenditures and revenues necessary for reaching the target deficits are not known, and neither is their structure.

77 According to the CBR's calculations, the average consolidation effort between 2010 and 2013 reaches only 0.7% of GDP. The Ministry of Finance presents an average figure of 1.1% of GDP, as it applied only one-off measures accounting for more than 0.1% of GDP in the calculation of the structural balance.

# 5 Fiscal transparency rules

In order to foster transparency in the process of compiling the budget, Articles 8 and 9 of the Fiscal Responsibility Act define the rules of fiscal transparency governing the establishment and functioning of the committees, as well as the mandatory publication of data.

The Macroeconomic Forecasting Committee and the Tax Revenue Forecasting Committee[78] have been established as advisory bodies to the finance minister for the purpose of enhancing the objectiveness of macroeconomic, and tax revenue forecasts by the ministry and fostering transparency in the process of compiling the general government budget. Under the Fiscal Responsibility Act, the Committees are obliged to prepare and publish their forecasts no later than by 15 February and 30 June of the respective fiscal year. The Committees may convene also more frequently than prescribed by the Act.

In 2013, the Macroeconomic Forecasting Committee met three times: on 29 February, 10 June and then on 16 September. The updated medium-term macroeconomic forecasts of the Ministry of Finance were officially presented on 30 February, 11 June and 19 September. The economic forecasts of the Ministry of Finance were published in accordance with the law.

The **Tax Revenue Forecasting Committee** held regular meetings on 6 February, 24 June and 24 September. Updated forecasts of the tax and social contributions revenues were published on 8 February, 27 June and 26 September, in full compliance with the time limits prescribed by the Fiscal Responsibility Act. However, in terms of the tax revenue forecasts, the General Government Budget Proposal for 2014-2016 **contains measures not included in the forecast which the Tax Revenue Forecasting Committee[79] discussed at its session in September.** Moreover, **the VAT forecast for 2014** (see Box 8 for more details) has been revised upwards quite significantly **due to adjusted assumptions concerning the collection efficiency.** At the same time, the section of the budget proposal concerning the forecast of the tax and social contributions revenue[80] does not contain such forecast adjustments.

**The forecast used in the budget proposal was therefore not discussed with members of the Committee and, for this reason, the CBR[81] expects that the Committee members will be informed of updates and especially the causes of changes in the assumptions presented at the extraordinary Committee meeting, as otherwise the transparency of the budgetary process is reduced.**

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78 The reasons for the formation of the Tax Revenue Forecasting Committee are defined in its Statutes in Article 2 as follows: „Tax revenues and social insurance revenues represent a major portion of general government revenues. Similarly, as with economic environment, their estimate carries a significant level of uncertainty. Uncertainty is a breeding ground for suspicions of purposefully overestimating or underestimating the revenues on the part of institutions responsible for compiling general government budgets. The Committee's activities therefore contribute towards better public control over the process of compiling the general government budget by involving experts in the discussion".

79 30th session of the Tax Revenue Forecasting Committee (September 2013)

80 General Government Budget Proposal for 2014-2016, Section 3.1, pg. 19 and 22

81 On 6 November 2013 Ministry of Finance announced a new Tax Revenue Forecasting Committee meeting taking place on 25 November 2013.

**BOX 8: Reserve for improving the VAT collection efficiency in terms of transparency**

The CBR holds the view that changing the assumptions for the VAT forecast and increasing the related budget revenues without the Committee having discussed this issue is not positive in terms of transparency, despite the fact that a reserve of identical amount has been budget on the expenditure side. The above transaction can be seen in two ways:

1) **Discussion about measures at the Tax Revenue Forecasting Committee**
The forecast of the tax and social contributions revenues for the purposes of compiling the general government budget must be discussed with and approved by the Tax Revenue Forecasting Committee. If any adjustments to the forecast are made, the Committee should be informed accordingly, familiarised with the assumptions for their quantification, and approve the update of the forecast.

2) **Circumventing the 1-% rule pursuant to the State Budget Act**
§2(2) of the State Budget Act defines a fiscal rule whereby the total state budget expenditure cannot be exceeded by more than 1%. In other words, if the actual state budget revenue exceeds the budgeted level, the expenditure may not be exceeded by more than 1%. Considering that the revenue forecast has been increased arbitrarily and that an identical reserve is created on the expenditure side, the CBR holds the view that the potential limit for expenditure has been artificially increased.

Articles 9 (1) through (3) of Act No. 493/2011 (the Fiscal Responsibility Act) defines the requirements which must be formally complied with by general government entities. The budget proposals should contain data on the actual execution of the budget for previous fiscal years, including the budget itself, as well as data on projected budget execution for the current year, and data on budgeted items for the coming three years.

In its most recent review the CBR noted that, in formal terms, the budget proposal provided all the necessary data required in accordance with the definition in the Fiscal Responsibility Act, paragraph (4). In terms of content, however, not all the information is adequately explained and justified[82].

The **consolidated balance of general government revenues and expenditures**, however, contains a more detailed breakdown of revenues and expenditures compared to the general government budget proposal for 2013-15.

The **update to the 2011-2014 Sovereign Debt Management Strategy** analyses in a greater detail the trends seen in the previous period and, for this reason, offers only limited information as to the future development.

The budget proposal presents the basic approaches towards the possible quantification of **tax expenditures**, including the quantification of their main items[83]. In the future, the definition of

[82] CBR additionally asked Ministry of Finance for data and more detailed explanation of several issues. Some of them were further discussed.

[83] As part of quantification, the CBR identified the missing calculation of the VAT rate reduction from 20% to 19% (in this case, the effect of the reduced rate against the basic rate is treated as tax expenditure).

tax expenditures should be made more precise and consideration should also be given to presenting smaller expenditure items (even without impact quantification) which could be included in the manual.

**Implicit liabilities** represent a hidden future indebtedness of general government beyond the official debt statistics. The publication of their estimates in the budget is thus an important part of enhancing its transparency. Implicit debts arise, in particular, on account of population ageing and occur in those expenditure categories that are sensitive to demographic changes: pensions, healthcare, long-term care and education. The document contains a detailed quantification which, compared with the previous year, also contains an impact assessment of PPP projects. In the future, the analysis should be expanded to cover also other types of liabilities (for example, the cost of nuclear decommissioning).

**Contingent liabilities** of the general government are published in Annex 4 of the budget proposal. As quantified by the Ministry of Finance, these liabilities total EUR 2.06 billion (2.9% of GDP). Year-on-year, the liabilities increased by EUR 0.38 billion (0.5 p.p. of GDP), which is also attributable to changes in the data collection methodology. For 2012, **information from the notes to individual financial statements of general government entities was automatically processed for the first time ever**.[84]

When compared with the General Government Budget Proposal for 2013-2015, the current budget proposal contains tables broken down into one-off tax and social contributions revenue and one-off non-tax and expenditure measures. As regards the one-off impacts, it would be appropriate (for the sake of clarity) to present one summary table containing all revenues and expenditure items consistent with the one-off effects for the calculation of the structural balance.

The General Government Budget Proposal also includes information **on the fiscal performance of state corporations**; however, the list does not contain information on corporations with equity participation of the National Property Fund and, therefore, we recommend that the list of corporations be expanded to cover these as well. At the request of the CBR, the Ministry of Finance provided an outlook of the fiscal performance of companies with equity participation of the National Property Fund for the budgeted period. The absence of a detailed specification and justification of the reasons for such assumptions with respect to the future direction of these entities makes it difficult to evaluate an important part of the net worth: aggregate equity of state corporations.

In formal terms, the **General Government Budget Proposal for 2104-2016** contained all required data categories, which largely enhances the budget transparency**.** However, compared with the previous budget, there are several transactions that are either inconsistently captured in the budget (taxes), explained insufficiently, or not explained at all (non-tax revenues, such as dividends).

84 An amendment to Act No. 431/2002 Coll. on Accounting requires that notes to the financial statements be also submitted in the form of tables. In 2011, contingent liabilities were reported only if such data was requested by the Ministry of Finance.

Against the 2013-15 budget, several issues are less transparent. The shortcomings of the budget proposal were compensated for by the **Draft Budgetary Plan of the Slovak Republic for 2014** which was submitted to the Commission. It provided an analytical summary of the objectives and measures, including the quantification of the structural balance of the budget. The CBR also appreciates the effort to offer a detailed insight into the structure of expenditures broken down into categories.

Taking the Draft Budgetary Plan into consideration, the CBR notes that the **degree of transparency has increased compared to the previous budget.** On the other hand, the Draft Budgetary Plan (DBP) cannot be seen as a substitute for the state budget which must be approved by the government and parliament (unlike the DBP). In the future, the positive aspects of the DBP should be directly reflected in the budget which could then be used as the main source of information without having to consult other documents.

# 6 Impact on the long-term sustainability of public finances

The long-term sustainability of public finances is influenced by the current budgetary position and future liabilities associated, in particular, with population ageing. Even though the CBR will focus more on the evaluation of sustainability in its April 2014 report, the budget proposal can be briefly and qualitatively evaluated from this perspective by making a simple comparison between the basic parameters and the approved budget for 2013-15.

**Impact of the current budgetary position of public finances**

In terms of long-term sustainability, it is necessary to compare budgetary objectives on a structural basis. Apart from the cyclical effect of the economy, the reason lies in how the budgetary objectives are to be achieved. Since one-off measures do not have a permanent impact on the fiscal performance of general government, the comparison must be adjusted for such measures.

The primary structural balance for 2014 worsened by 1.96% of GDP compared to the general government budget for 2013-15. Such a slowdown in fiscal consolidation has had a negative effect on the long-term sustainability (measured by GAP indicator), which can be quantified at roughly the same amount as that seen in the deterioration of the primary structural balance objective. The evaluation does not take account of the objective for 2015 and 2016 because the budget proposal fails to provide a credible consolidation strategy.

Tab 22: Budgetary targets affecting the long-term sustainability – comparison

| (% GDP) | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Cyclically adjusted primary balance* | | | | | | |
| 1. GGB 2013-2015 | -1.89 | -1.76 | -0.55 | 0.44 | 0.94 | - |
| 2. GGBP 2014-2016 | -2.21 | -1.88 | -0.86 | -1.53 | -0.13 | 0.89 |
| **difference (2-1)** | **-0.31** | **-0.12** | **-0.31** | **-1.96** | **-1.07** | |
| General government debt | | | | | | |
| 1. GGB 2013-2015 | 43.3 | 52.2 | 54.9 | 55.8 | 56.0 | - |
| 2. GGBP 2014-2016 | 43.3 | 52.1 | 54.3 | 56.8 | 56.4 | 55.7 |
| **difference (2-1)** | **0.00** | **-0.10** | **-0.60** | **1.00** | **0.40** | |

* EC structural balance (tab. 17) net of fully-funded pension pillar and construction outside GG - national

*Source: CBR*

**Future liabilities**

The budget proposal includes an increase in Christmas bonuses paid to pensioners in 2013 (EUR 8.61 per eligible pensioner). In terms of the impact on the long-term sustainability, this measure represents an additional burden. Even though the Christmas bonus eligibility is not automatic and its amount must be approved every year, it is unlikely to see this amount declining in the years ahead. The CBR therefore holds the view that the Christmas bonus, hand in hand with pension expenditures, does have an impact on the quantification of the long-term sustainability.

On the other hand, the parliament approved an important parametrical reform of the social security scheme for members of the police and military forces (effective from May 2013), whereby the requirement of minimum years in service increased from 15 to 25 years, coupled with a rise in social contributions rates and changes in pension indexation. This measure will have a positive impact on the long-term sustainability of public finances in the form of less intensive subsidies injected to the scheme through transfers from the state budget. If the reform ensures balanced budget of the social security scheme for members of the police and military forces in every year in the future (which can be considered an optimistic assumption)[85], the long-term sustainability indicator GAP will improve by up to 0.5% of GDP[86].

**Having considered the changes in the expected development of public finances in 2014 and the legislative changes in the long-term expenditures sensitive to demographic changes, the CBR must conclude that the long-term sustainability of public finances will worsen year-on-year.** The effect of higher debt and worse structural deficit will outweigh the long-term benefits brought in by the reform of the social security scheme for armed forces.

85 Which is unrealistic due to gradual launch of reform.

86 According to the economic analysis of IFP no. 26 "Analýza dlhodobej udržateľnosti a návrhy na zmenu dôchodkového systému SR", the balance of the retirement scheme of soldiers and policemen without any reform will worsen by 630 million (in 2010 prices) by 2060, which is about 1% of GDP (pages 57 and 58). Given the deterioration of the balance will happen gradually, the impact on sustainability indicator taking into account discounting should not exceed 0.5% of GDP.

# Annex 1 – Budget balance estimate for 2013

| Tab 23: Differences compared to the 2013 budget | € mill. | % of GDP |
|---|---|---|
| **GG balance - budget** | **-2 187** | **-2.94** |
| **Tax revenues and social security contributions** | **-521** | **-0.71** |
| tax revenues | -426 | -0.58 |
| social security contributions | -95 | -0.13 |
| **Other GG revenues** | **-97** | **-0.13** |
| revenues from property ownership (other than dividends) | 7 | 0.01 |
| dividends | -377 | -0.52 |
| administrative and other fees | 36 | 0.05 |
| revenues of Telecommunications Regulatory Authority | -130 | -0.18 |
| capital revenues | 10 | 0.01 |
| revenues from sales of emission quotas | -46 | -0.06 |
| sales of emergency oil reserves | 371 | 0.51 |
| interest revenues | 3 | 0.00 |
| other non-tax GG revenues | -5 | -0.01 |
| fee for administration of emergency oil reserves | -28 | -0.04 |
| grants received (state budget, public universities, nuclear fund) | 62 | 0.08 |
| **Co-financing related to EU projects** | **403** | **0.55** |
| **EU budget levy** | **4** | **0.01** |
| **GG interest expenditure** | **54** | **0.07** |
| **Other state budget expenditure items*** | **408** | **0.56** |
| reserve on opening of the fully-funded pension pillar | 229 | 0.31 |
| transfer of expenditures into 2014 | 120 | 0.16 |
| expenditures on social inclusion | 16 | 0.02 |
| other | 43 | 0.06 |
| **Debt of healthcare providers** | **-100** | **-0.14** |
| **Expenditure of other GG entities** | **-139** | **-0.19** |
| local governments* | -84 | -0.12 |
| Social Insurance Agency | -1 | 0.00 |
| public health insurance | 83 | 0.11 |
| National Property Fund | -15 | -0.02 |
| public universities | -42 | -0.06 |
| RTVS | -12 | -0.02 |
| Environmental Fund | -8 | -0.01 |
| other GG entities | -60 | -0.08 |
| **GG balance - estimate** | **-2 175** | **-2.98** |

*(+) positive impact on GG balance (higher revenues, expenditure savings)* *Source: MF SR*

** expenditures of particular GG entities were adjusted for the impact of wage increase in regional education (wage increase amounting to EUR 68 mill. was budgeted in the state budget, while in reality it affects expenditures of local governments)*

# Annex 2 – Budget balance developments in 2013

## Tab 24: Risks and reserves for budget 2013 (€ million)

| Risks for fiscal target fulfilment | *Budget Proposal CBR evaluat.* | *Approved Budget* | *15.2.* | *12.3.* | *14.8.* | *11.10.* |
|---|---|---|---|---|---|---|
| **Approved GG budget** | -2 187 | -2 187 | -2 187 | -2 187 | -2 187 | -2 187 |
| *Approved GG budget (% GDP)* | -2.94 | -2.94 | -2.96 | -2.96 | -3.01 | -3.00 |
| **Official measures of MF SR** | | 0 | 16 | 16 | 44 | 11 |
| *Update of tax forecasts* | | -266 | -628 | -628 | -974 | -842 |
| *Disbanding of reserve for macroeconomic development* | | 313 | 313 | 313 | 313 | 313 |
| *Reduction in capital expenditures of State Budget* | | 21 | 21 | 21 | 21 | 21 |
| *Wage increase in education sector* | | -68 | -68 | -68 | -68 | -68 |
| *Disbanding of reserve for fully-funded pension pillar* | | | 229 | 229 | 229 | 229 |
| *Updated impact from opening the fully-funded pension pillar* | | | | 4 | 4 | 4 |
| *Lower expenditures from managing emergency oil reserves* | | | | 2 | 2 | 2 |
| *Expenditures cuts* | | | 99 | | | |
| *Dividends* | | | 49 | 69 | 52 | -377 |
| *Compensation of healthcare contributions shortfall* | | | | 39 | | 39 |
| *Savings in expenditures in OP Transport* | | | | 26 | 42 | |
| *Cuts in wages of constitutional authorities* | | | | 1 | 1 | |
| *OÚ MV SR* | | | | 2 | 2 | |
| *Reconstruction of building in Veľký Meder* | | | | 2 | 2 | |
| *Cuts in wages (MZVaEZSR)* | | | | 1 | 1 | |
| *Savings in defence related expenditures* | | | | 1 | 1 | |
| *Savings in payment for PPP accessibility* | | | | 1 | 1 | |
| *Shortfall of the Telecom. Reg. Authority revenues* | | | | | -130 | -130 |
| *Interest payments* | | | | | 49 | 54 |
| *Contributions to EU budget* | | | | | -2 | 5 |
| *Savings in co-financing* | | | | | 195 | 402 |
| *New concept of managing the emergency oil reserves* | | | | | 380 | 371 |
| *Fee for managing the emergency oil reserves* | | | | | | -28 |
| *VAT from repayment of PPP* | | | | | -6 | -6 |
| *Capital transfer in guarantee insurance* | | | | | -19 | 14 |
| *Savings in healthcare expenditures* | | | | | 102 | 125 |
| *Increase in healthcare facilities liabilities* | | | | | -100 | -100 |
| *Levies from nuclear power plant operator* | | | | | -21 | |
| *Public universities* | | | | | 22 | |
| *RTVS* | | | | | -15 | |
| *Environmental fund* | | | | | -42 | |
| *Balance of municipalities and SGRs (excl. tax revenues)* | | | | | | -127 |
| *Balance of other GG entities* | | | | | | -115 |
| *Non-tax revenues, grants and transfers* | | | | | | -84 |
| *Savings in expenditures of State Budget* | | | | | | 310 |
| **GG budget after measures (A+B)** | -2 187 | -2 187 | -2 170 | -2 170 | -2 143 | -2 175 |
| *Budget after measures (% GDP)* | -2.94 | -2.94 | -2.94 | -2.94 | -2.95 | -2.98 |
| GDP, current prices | 74 372 | 74 372 | 73 826 | 73 826 | 72 632 | 72 987 |

*Source: CBR*

# Annex 3 – Fiscal performance of municipalities in 2013

The approved general government budget (GGB) envisaged a surplus of EUR 146.2 million in the fiscal performance of municipalities. **For the purposes of the GGB, their budget is compiled by the Ministry of Finance. The year 2013 was specific in that municipalities signed a memorandum containing a commitment to contribute their share to consolidation, and this agreement was reflected in the budget proposal presented by the ministry** (see Box 9 for more details). However, municipalities themselves approved a surplus of only EUR 3 million. Municipalities may adjust their budgets on a continuous basis and, by 30 June 2013, they expected a deficit of nearly EUR 23 million. A purely mechanical calculation would shoot this deficit risk up to EUR 169 million.

Even though revised budgets should herald the expected year-end figures, the reality may be considerably different, as witnessed on many occasions in the past. As at 30 June 2013, municipalities posted a surplus of EUR 229 million in their fiscal performance, which implies that the actual figures could be slightly better than what the municipalities had budgeted.

**Tab 25: Budget fulfilment in the first six months of 2013 - municipalities**

| (ths. eur) | Approved Budget by NR SR | Approved Budget by municipalities | Budget adjusted by municipalities 30.3.2013 | Budget adjusted by municipalities 30.6.2013 | till June 30 2013 | Difference |
|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 4.1 |
| Revenues | 3 512 428 | 3 368 096 | 3 394 588 | 3 474 544 | 1 758 175 | -37 884 |
| Expenditures | 3 366 253 | 3 365 068 | 3 401 771 | 3 497 420 | 1 529 309 | 131 167 |
| **Balance** | **146 175** | **3 028** | **-7 183** | **-22 876** | **228 867** | **-169 051** |
| *modifications* | -10 000 | | | | | |
| Balance (ESA95) | 136 175 | | | | | |

* receivables/liabilities are not included

*Source: State Treasury, CBR*

**BOX 9: Memorandum of Cooperation between the Slovak Government and the Slovak Association of Towns and Communities (ZMOS) in the consolidation of public finances**

Under the Memorandum on Cooperation, the ZMOS made a commitment that towns and municipalities would approve their budgets in line with the objective of the Memorandum. This means that, in 2013, the municipalities should:

- reduce personnel expenditures by 5% against the budget approved for 2012;
- reduce the expenditures on the purchase of goods and services by 10% against the budget approved for 2012;
- These cuts apply to municipalities with a population of 2,000 or more, whereas smaller municipalities with population of up to 2,000 should limit their personnel expenditures and expenditures on the purchase of goods and services to amounts approved in the 2012 budget.

These municipal were reflected in the approved GGB. Yet, when adopting and, subsequently, revising their budgets, municipalities did not respect the cuts declared in the Memorandum.

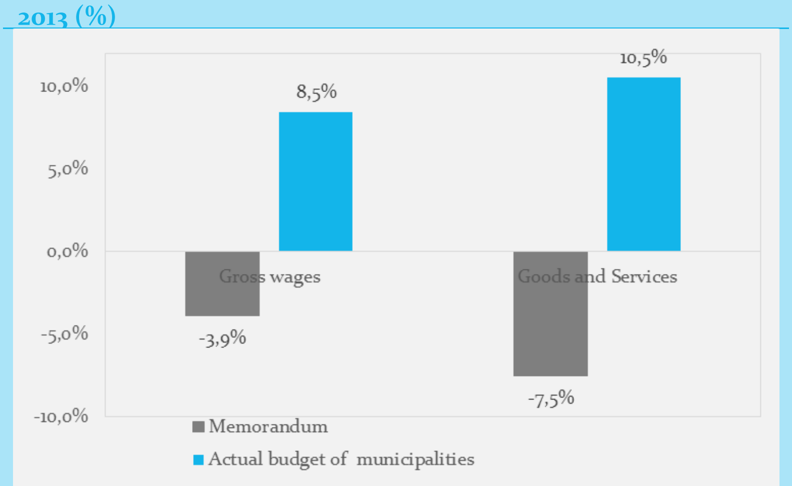
**Municipalities are not meeting their commitments, as the expected cuts in personnel expenditures of 5% (effectively 3.9% [87]) and the projected cuts in expenditures on goods and services of 10% (effectively 7.5 %) were not complied with. On the contrary, municipalities expect an 8.4-% rise in personnel expenditures and a 10.5-% rise in expenditures on goods and services.**

**Tab 26: Memorandum and budget of municipalities in 2013**

| (ths.eur) | B2012 municipalities | B2013 NR SR | B2013 municipalities | Adjusted Budget by muni. 30.6.2013 | Difference | Effective savings | Increase in expenditures |
|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5=2-1 | 6=5/1 | 7= (4/2 -100)*100 |
| **Current Expenditures** | **2 589 895** | **2 481 356** | **2 612 260** | **2 684 831** | **-108 539** | **-4,2%** | **8,2%** |
| Gross Wages | 1 286 773 | 1 236 924 | 1 316 565 | 1 340 984 | -49 849 | -3,9% | 8,4% |
| Goods and Services | 916 908 | 848 009 | 900 244 | 937 195 | -68 899 | -7,5% | 10,5% |
| Subsidies and Transfers | 354 300 | 368 423 | 365 807 | 376 996 | 14 123 | 4,0% | 2,3% |
| Interest | 31 914 | 28 000 | 29 643 | 29 656 | -3 914 | -12,3% | 5,9% |

*Source: CBR, State Treasury, MoF*

**Chart 22: Current expenditures growth of municipalities in 2013 (%)**




*Source: CBR*

In order to identify the potential risk posed by the fiscal performance of local governments to the 2013 general government budget, the CBR analysed the trends in the selected revenue[88] and expenditure items in individual calendar quarters of 2006-2012 as shown in the table below. As a result, three scenarios are outlined:

- The first scenario takes into account the average trends in budgetary items throughout the entire period (2006-2012) by calendar quarters.
- The second scenario zooms in on the 2010-2012 period during which the trends in revenues and expenditures were slightly different compared to other years (stronger first half-year results).

[87] Considering that the Memorandum did not apply to all municipalities, the “actual” budgeted savings for all municipalities are lower.

[88] Tax revenues were taken from the calculations of the Institute for Financial Policy (be it in the case of municipalities or self-governing regions).

- As regards the upcoming municipal elections, slated for the fall of 2014, the last scenario focused on the pre-election years in order to identify different patterns in the behaviour of municipalities. However, this assumption has not been confirmed.

**Tab 27: Development of selected budgetary items of municipalities in the 2nd quarter**

| (% fulfilment) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | Ø (2006-2012) | Ø (2010-2012) |
|---|---|---|---|---|---|---|---|---|---|
| 200 Non-tax Revenues | 45.2 | 44.4 | 44.3 | 44.4 | 46.2 | 45.9 | 46.9 | 45.3 | 46.3 |
| 300 Grants and Transfers | 44.4 | 45.7 | 42.2 | 35.5 | 42.2 | 43.2 | 48.1 | 43.0 | 44.5 |
| 610+620 Gross Wages | 40.4 | 40.5 | 41.1 | 41.9 | 41.9 | 42.2 | 42.6 | 41.5 | 42.3 |
| 630 Goods and Services | 45.3 | 45.3 | 42.6 | 46.1 | 45.7 | 45.2 | 47.2 | 45.3 | 46.0 |
| 640 Subsidies and Transfers | 49.1 | 48.2 | 47.1 | 48.9 | 48.6 | 48.2 | 49.9 | 48.6 | 48.9 |
| 650 Interest Payments | 41.0 | 48.1 | 48.2 | 57.6 | 42.9 | 48.0 | 52.3 | 48.3 | 47.7 |
| 700 Capital Expenditures | 27.2 | 35.6 | 28.6 | 27.2 | 32.6 | 34.7 | 39.0 | 32.1 | 35.5 |

*Source: State Treasury, CBR*

The year-end estimate was calculated for the first two scenarios shown in the table below. The year-end estimate calculation was based on the actual figures reported by municipalities at the end of June and, by applying the above scenarios, the expectations for the end of 2013 were calculated. In both cases it seems that municipalities should end with a surplus of EUR 70-110 million in 2013.

**Tab 28: Scenario comparison - municipalities**

| (ths. eur) | 2013E MF SR | 2013E CBR sc1 | 2013E CBR sc2 | sc 1 vs MF SR | sc 2 vs MF SR |
|---|---|---|---|---|---|
| **Revenues** | **3 527 814** | **3 701 008** | **3 643 273** | **173 194** | **115 459** |
| 100 Tax revenues | 1 720 904 | 1 718 331 | 1 718 331 | -2 573 | -2 573 |
| 200 Non-tax revenues | 471 276 | 611 243 | 598 304 | 139 967 | 127 028 |
| 300 Grants and Transfers | 1 335 634 | 1 371 433 | 1 326 638 | 35 799 | -8 996 |
| **Expenditures** | **3 426 386** | **3 631 880** | **3 534 000** | **205 494** | **107 614** |
| 600 Current expenditures | 2 624 295 | 3 076 000 | 3 030 160 | 451 705 | 405 865 |
| Gross wages | 1 285 532 | 1 529 681 | 1 502 743 | 244 149 | 217 211 |
| Goods and Services | 920 946 | 1 090 382 | 1 074 089 | 169 436 | 153 143 |
| Subsidies and transfers | 389 817 | 430 388 | 427 473 | 40 571 | 37 656 |
| Interest Payments | 28 000 | 25 550 | 25 855 | -2 450 | -2 145 |
| 700 Capital expenditures | 802 091 | 555 879 | 503 841 | -246 212 | -298 250 |
| **Balance** | **101 428** | **69 128** | **109 273** | **-32 300** | **7 845** |

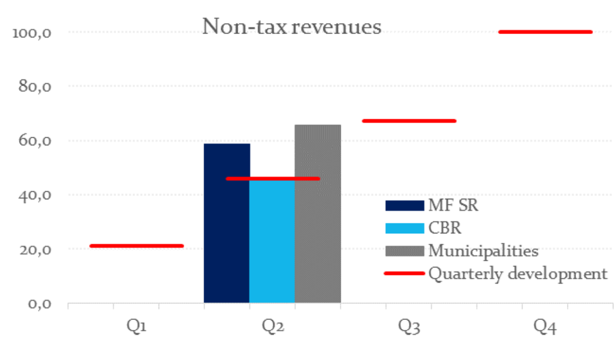
*Source: CBR*

The following series of charts present the trends in non-tax revenues and selected expenditure categories in 2013. The line charts represent the calculated average figures of trends in the relevant calendar quarters (cumulatively), taking account of the annual revenue, whereas the bar charts show the ratio between the actual (cash) execution of the budget by municipalities as at 30 June 2013 against the year-end estimate based on the assumptions of the Ministry of Finance, the municipalities themselves (revised municipalities' budget as at 30 June 2013) and the CBR. With the exception of capital expenditures, the CBR's estimate of budgetary items remains below the estimates presented by municipalities and the Ministry of Finance.

The estimate by the Ministry of Finance for 2013 is based on the actual execution of the budget for 2012 and also includes, for the first time, financial transactions recorded on extra-budgetary accounts, which renders the year-on-year data less comparable. Moreover, these financial transactions are not budgeted.

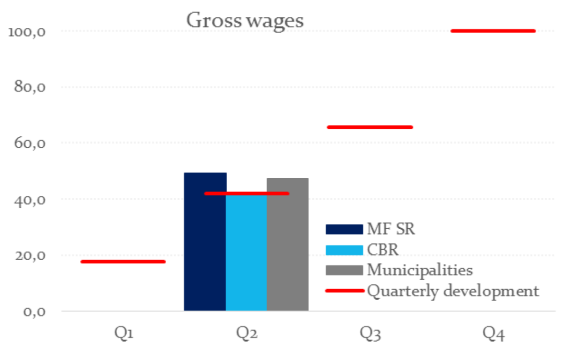
The year-end estimates by individual institutions diverge in three budget items. While municipalities and the Ministry of Finance assume that non-tax revenues for the first six months will represent about 62% of the annual revenue, the CBR's analysis indicates that this figure was around 45% in previous years and that this share would remain relatively stable over the entire period between 2006 and 2012. The estimates by the Ministry of Finance[89] and municipalities concerning the compensation of employees probably do not reflect the announced wage increase across the education sector (with some EUR 68 million earmarked in the budget for this purpose), because these estimates are even below the level reported in 2012. The Ministry of Finance and local governments also expect to spend 80% of the estimated revenue on capital expenditures, which seems unrealistic considering the actual spending as at the end of the first half of the year. However, in terms of the overall balance, it should be noted that these items could offset each other and that municipalities could end up in black figures, but only at the cost of lower capital expenditures.

**Chart 23: Municipalities in 2013 – non-tax revenues**




*Source: CBR*

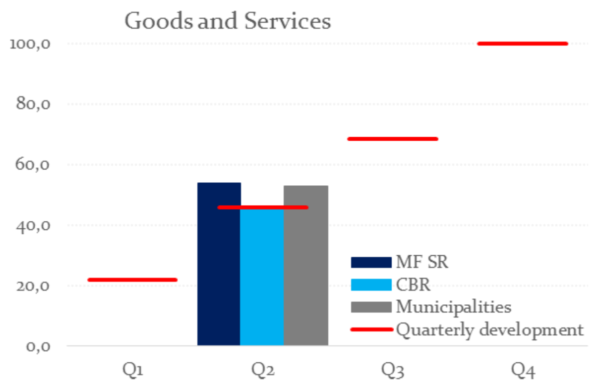
**Chart 24: Municipalities in 2013 – gross wages**




*Source: CBR*

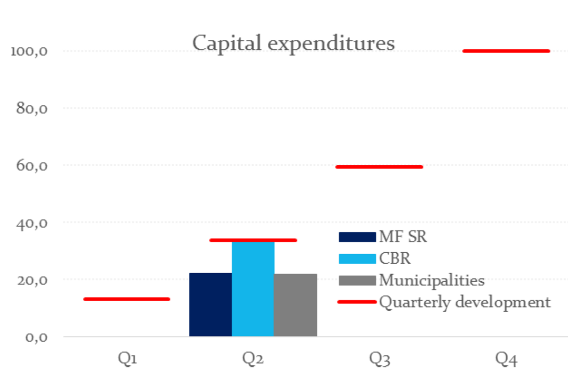
89 Most resent estimate by MF SR is based upon GGB 2013-2015 where the increase in wages in regional education system was already incorporated in the amount of EUR 39 million, as a consequence MF SR expects much higher savings in other wages, while not takes into account actual higher spending in expenditures recorded until June 30 2013 in comparison to previous year.

**Chart 25: Municipalities in 2013 – goods and services**




*Source: CBR*

**Chart 26: Municipalities in 2013 – capital expenditures**




*Source: CBR*

The table below sums up the current trends in the selected budgetary items, with the last two columns representing an estimate by the Ministry of Finance and that of the CBR (average for the scenarios).

**Tab 29: Budget fulfilment in the six months of 2013; estimated results of 2013–municipalities**

| (ths. eur) | Reality 2012 | Approved budget 2013 by NR SR | Budget approved 2013 by muni. | Adjusted budget by muni. 30.6.2013 | June 30 | 2013E MFSR | 2013E CBR |
|---|---|---|---|---|---|---|---|
| **REVENUES** | 3 486 009 | 3 512 428 | 3 368 096 | 3 474 544 | 1 758 175 | 3 527 814 | 3 672 140 |
| 100 Tax Revenues | 1 674 254 | 1 733 873 | 1 687 032 | 1 701 137 | 890 667 | 1 720 904 | 1 718 331 |
| 200 Non-tax Revenues | 501 053 | 471 276 | 399 696 | 421 270 | 277 139 | 471 276 | 604 774 |
| Revenues from business | 155 671 | | 146 297 | 150 702 | 72 667 | | |
| Administrative payments | 230 451 | | 140 969 | 143 408 | 135 741 | | |
| Capital income | 68 480 | | 77 695 | 86 789 | 29 279 | | |
| Interest | 1 748 | | 1 197 | 1 235 | 736 | | |
| Others | 44 703 | | 33 539 | 39 135 | 38 717 | | |
| 300 Grants and Transfers | 1 310 702 | 1 307 279 | 1 281 367 | 1 352 137 | 590 369 | 1 335 634 | 1 349 036 |
| Domestic current G+T | | | 783 946 | 835 131 | 473 745 | | |
| Domestic capital G+T | | | 483 056 | 502 109 | 111 174 | | |
| Foreign Grants | | | 14 365 | 14 897 | 5 450 | | |
| **EXPENDITURES** | 3 404 743 | 3 366 253 | 3 365 068 | 3 497 420 | 1 529 309 | 3 426 386 | 3 582 940 |
| 600 Current | 2 737 290 | 2 481 356 | 2 612 260 | 2 684 831 | 1 350 647 | 2 624 295 | 3 053 080 |
| Gross Wages | 1 309 136 | 1 236 924 | 1 316 565 | 1 340 984 | 634 924 | 1 285 532 | 1 516 212 |
| Goods and Services | 1 026 594 | 848 009 | 900 244 | 937 195 | 494 263 | 920 946 | 1 082 235 |
| Subsidies and Transfers | 371 983 | 368 423 | 365 807 | 376 996 | 209 116 | 389 817 | 428 930 |
| Interest | 29 577 | 28 000 | 29 643 | 29 656 | 12 344 | 28 000 | 25 702 |
| 700 Capital | 667 453 | 884 897 | 752 808 | 812 589 | 178 661 | 802 091 | 529 860 |
| Capital assets | 645 595 | | 730 968 | 788 924 | 170 604 | | |
| Capital transfers | 21 858 | | 21 840 | 23 665 | 8 057 | | |
| **BALANCE** | 81 266 | 146 175 | 3 028 | -22 876 | 228 867 | 101 428 | 89 201 |
| *modifications* | | -10 000 | | | | -10 000 | -10 000 |
| **BALANCE (ESA95)** | | 136 175 | | | | 91 428 | 79 201 |

*Source: MF SR, State Treasury, CBR*

**In light of the above, the CBR expects the fiscal performance of municipalities to end with a surplus of EUR 70-110 million in 2013. This figure is worse by EUR 37-77 million compared with the approved budget. The ministry's most recent estimate falls within the boundaries of CBR's estimate, and the risk should not exceed EUR 30 million.**

The ministry envisages that the budgets of local governments will remain in surplus throughout the 2014-2016 period. Given the fact that municipalities compile and approve their budgets themselves, the ministry's proposal is indicative. There is a potential risk in the funds for joint projects with the EU, and in particular the funds to be used as co-financing, as they have not been budgeted so far. Furthermore, municipal elections are slated for the fall of 2014 which may have an impact on future (in particular long-term) activities of the municipalities. The permanent slowdown in capital expenditures begs a number of questions because this trend is not sustainable in the long run. **For this reason, the CBR sees a potential negative risk of EUR 100-150 million in the fiscal performance of municipalities in 2014.**

# Annex 4 – Fiscal performance of self-governing regions in 2013

In the 2013 general government budget, the Ministry of Finance envisaged a surplus of EUR 17.6 million for self-governing regions**. As was the case with municipalities, the self-governing regions** (through the **Association of Self-governing Regions**, the so called **"SK8") signed a memorandum which should help reduce the overall general government deficit** (see Box 10 for more details). The surplus budgeted by the self-governing regions themselves was EUR +5.6 million. As at 30 June 2013, the revised budgets of self-governing regions projected a deficit of EUR 2.5 million. Compared with the general government budget, the risk in terms of the overall general government deficit might reach some EUR 20 million.

Tab 30: Budget fulfilment in the first six months of 2013 - SGR

| (ths. eur) | Approved Budget by NR SR | Approved Budget by SGR* | Budget adjusted by SGR 30.3.2013 | Budget adjusted by SGR 30.6.2013 | till June 30 2013 | Difference |
|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 4.1 |
| Revenues | 1 049 796 | 1 103 633 | 1 131 230 | 1 173 185 | 603 208 | 123 389 |
| Expenditures | 1 032 198 | 1 098 071 | 1 133 036 | 1 175 716 | 528 078 | 143 518 |
| **Balance** | **17 598** | **5 563** | **-1 806** | **-2 531** | **75 129** | **-20 129** |
| *modifications* | -4 688 | | | | | |
| Balance (ESA95) | 12 910 | | | | | |

* receivables/liabilities are not included

*Source: State Treasury, CBR*

## BOX 10: Memorandum of Cooperation between the Slovak Government and the SK8 Association in the consolidation of public finances

The government and the SK8 association signed a memorandum whereby the self-governing regions declared their interest to participate in the consolidation of public finances in order to reduce the general government deficit to 2.9% of GDP in 2013.

Specifically, compliance with the Memorandum means that:

- the level of total capital expenditures will be adhered to
- the self-governing regions will not change the amount of borrowings, capital expenditures, expenditures related to the repayment of the principal and changes in the stock of liabilities and receivables as per documentation which they submitted to the Ministry of Finance upon signing the Memorandum.
- any changes to the Memorandum may only be made by amendments signed by its signatories.

The table below monitors the trends in the capital expenditures of self-governing regions. While the general government budget counted on capital expenditures declared in the Memorandum, the self-governing regions adjusted them on several occasions (the CBR is not aware of the Ministry of Finance having granted any consent to that effect). The budget revised as at 30 June expected capital expenditures to surge by 77% compared with the Memorandum.

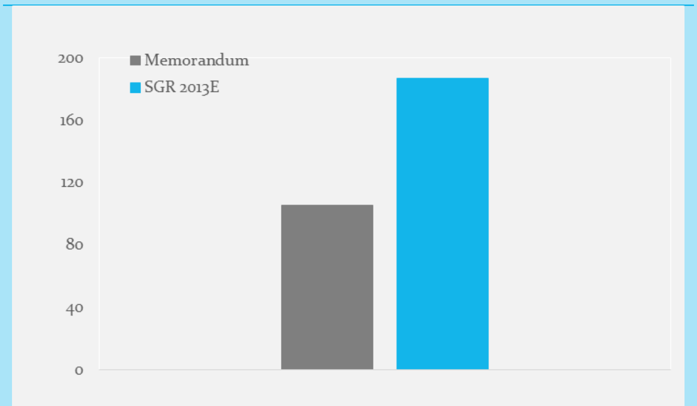
**Tab 31: Memorandum and Budget of SGR in 2013**

| (ths. eur) | Memorandum | B2013 NR SR | B2013 SGR | Adjustment 30.3.2013 | Adjustment 30.6.2013 | Memorandum excess | Memorandum excess |
|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 3/1 | 5/1 |
| Capital expenditures | 105 343 | 105 343 | 146 264 | 158 205 | 186 966 | 139% | 177% |

*Source: State Treasury, CBR*

The chart below shows the amount of capital expenditures approved in the general government budget for 2013 in accordance with the signed Memorandum, as well as the revised budget of the self-governing regions as at the first half of 2013:

**Chart 27: Capital exp. of SGR in 2013 (in mill. eur)**




*Source: CBR*

For the most accurate quantification of the possible risk posed by the performance of self-governing regions to the general government deficit in 2013, the expected 2013 figures were estimated on the basis of the same procedure as that applied in the case of municipalities. A comparison was made in terms of the execution of the relevant revenue and expenditure categories of the budget during a given year over the 2006-2012 period.

**Tab 32: Development of selected budgetary items of SGR in the 2nd quarter**

| (% fulfilment) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | Ø (2006-2012) | Ø (2010-2012) |
|---|---|---|---|---|---|---|---|---|---|
| 200 Non-tax Revenues | 48.2 | 47.4 | 50.7 | 51.1 | 47.8 | 52.3 | 63.5 | 51.6 | 54.5 |
| 300 Grants and Transfers | 46.7 | 49.7 | 47.9 | 48.3 | 48.2 | 47.3 | 47.8 | 48.0 | 47.8 |
| 610+620 Gross Wages | 38.8 | 38.3 | 39.8 | 39.9 | 41.0 | 40.5 | 40.8 | 39.9 | 40.8 |
| 630 Goods and Services | 39.3 | 39.5 | 41.0 | 44.9 | 42.9 | 44.2 | 49.8 | 43.1 | 45.6 |
| 640 Subsidies and Transfers | 45.3 | 47.7 | 46.8 | 48.5 | 49.2 | 47.9 | 48.4 | 47.7 | 48.5 |
| 650 Interest Payments | 35.3 | 37.4 | 43.9 | 60.6 | 46.2 | 36.9 | 53.5 | 44.8 | 45.5 |
| 700 Capital Expenditures | 21.4 | 23.0 | 15.5 | 27.0 | 40.0 | 23.0 | 29.8 | 25.7 | 30.9 |

*Source: State Treasury, CBR*

Furthermore, alternative scenarios for trends in the selected budgetary items in the individual quarter periods were applied and, taking into account their actual execution by self-governing regions for the first half of 2013, the year-end estimate was calculated. Based on the calculations, the self-governing regions are expected to run a deficit of EUR 48-100 million.

**Tab 33: Scenario comparison - SGR**

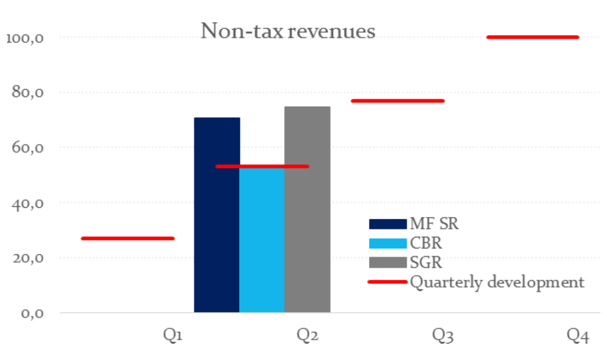
| (ths. eur) | 2013E MF SR | 2013E CBR sc1 | 2013E CBR sc2 | sc1 vs MF SR | sc 2 vs MF SR |
|---|---|---|---|---|---|
| **Revenues** | **1 124 320** | **1 169 960** | **1 165 609** | **45 640** | **41 289** |
| 100 Tax revenues | 550 795 | 549 331 | 549 331 | -1 464 | -1 464 |
| 200 Non-tax revenues | 89 000 | 122 141 | 115 488 | 33 141 | 26 488 |
| 300 Grants and Transfers | 484 525 | 498 488 | 500 790 | 13 963 | 16 265 |
| **Expenditures** | **1 107 075** | **1 269 315** | **1 213 707** | **162 240** | **106 632** |
| 600 Current expenditures | 986 649 | 1 123 921 | 1 093 095 | 137 272 | 106 446 |
| Gross wages | 347 222 | 427 719 | 418 575 | 80 497 | 71 353 |
| Goods and Services | 231 019 | 253 447 | 239 186 | 22 428 | 8 167 |
| Subsidies and transfers | 400 408 | 436 440 | 429 118 | 36 032 | 28 710 |
| Interest Payments | 8 000 | 6 315 | 6 216 | -1 685 | -1 784 |
| 700 Capital expenditures | 120 426 | 145 394 | 120 613 | 24 968 | 187 |
| **Balance** | **17 245** | **-99 355** | **-48 098** | **-116 600** | **-65 343** |

*Source: CBR*

The charts shown below present the trends in non-tax revenues and expenditure categories in 2013. They follow the same philosophy as that applied in the case of municipalities. The line bars represent the calculated average figures of trends in the relevant quarters (cumulatively) related to the actual figures in a given year, whereas the bar charts show the ratio between the actual (cumulative cash) execution of the budget by self-governing regions as at 30 June 2013 against the year-end estimate based on the assumptions of the Ministry of Finance, the self-governing regions (the revised budget of self-governing regions as at the first half of 2013) and the CBR.

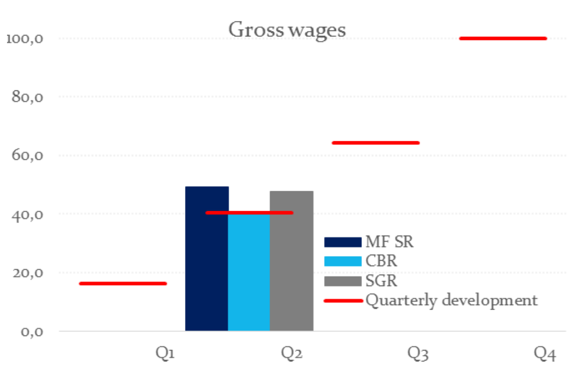
The expected non-tax revenues based on the figures of the Ministry of Finance and the self-governing regions was above 70% of the annual revenue as at the first half of 2013, a pattern not seen in any year during the period analysed by the CBR. As was the case with municipalities, it seems that the structure of estimated expenditures falls short of reflecting the actual execution of the budget by the self-governing regions. The Ministry of Finance and the self-governing regions are assuming that compensations are disbursed at 50%, which is questionable in terms of elections to the bodies of self-governing regions slated for 9 November 2013 as they will probably translate into an increase in compensations towards the end of the year. The estimate of capital expenditures is uncertain, because self-governing regions themselves have already revised their budgets twice despite the signed Memorandum.

**Chart 28: Self-governing regions in 2013 – non-tax revenues**



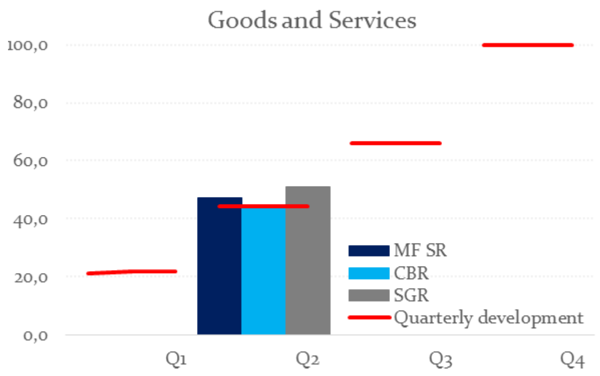

*Source: CBR*

**Chart 29: Self-governing regions in 2013 – gross wages**



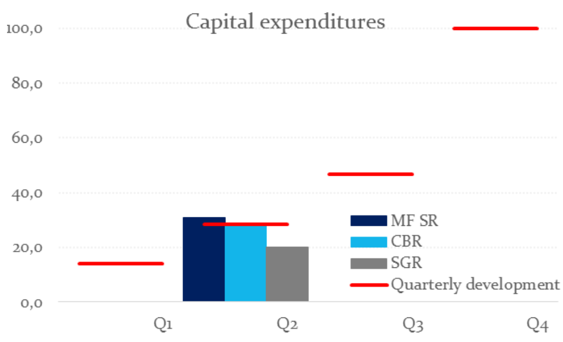

*Source: CBR*

**Chart 30: Self-governing regions in 2013 – goods and services**




*Source: CBR*

**Chart 31: Self-governing regions in 2013 – capital expenditures**




*Source: CBR*

The table shows the current execution of the self-governing regions' revenues and expenditures, with the last two columns representing an estimate by the Ministry of Finance and that of the CBR (average for the scenarios).

**Tab 34: Budget fulfilment in the six months of 2013; estimated results of 2013–SGR**

| (ths. eur) | Reality 2012 | Approved budget 2013 by NR SR | Budget approved 2013 by SGR | Adjusted budget by SGR 30.6.2013 | June 30 | 2013E MF SR | 2013E CBR |
|---|---|---|---|---|---|---|---|
| REVENUES | 1 118 239 | 1 049 796 | 1 103 633 | 1 173 185 | 603 208 | 1 124 320 | 1 167 784 |
| 100 Tax Revenues | 535 727 | 554 287 | 550 719 | 550 330 | 300 886 | 550 795 | 549 331 |
| 200 Non-tax Revenues | 101 363 | 89 000 | 78 675 | 84 218 | 62 991 | 89 000 | 118 814 |
| Revenues from business | 9 612 | | 5 947 | 7 038 | 4 715 | | |
| Administrative payments | 75 727 | | 59 546 | 59 785 | 42 502 | | |
| Capital income | 11 038 | | 10 554 | 14 260 | 5 326 | | |
| Interest | 470 | | 337 | 337 | 133 | | |
| Others | 4 516 | | 2 291 | 2 798 | 10 315 | | |
| 300 Grants and Transfers | 481 149 | 406 509 | 474 239 | 538 638 | 239 330 | 484 525 | 499 639 |
| Domestic current G+T | | | 394 249 | 421 678 | 215 347 | | |
| Domestic capital G+T | | | 77 363 | 112 771 | 19 669 | | |
| Foreign Grants | | | 2 623 | 3 798 | 3 926 | | |
| Foreign Transfers | | | 3 | 390 | 388 | | |
| EXPENDITURES | 1 133 526 | 1 032 198 | 1 098 071 | 1 175 716 | 528 078 | 1 107 075 | 1 241 511 |
| 600 Current expenditures | 999 190 | 926 855 | 951 807 | 988 749 | 490 749 | 986 649 | 1 108 508 |
| Gross Wages | 345 882 | 319 124 | 347 743 | 357 144 | 170 630 | 347 222 | 423 147 |
| Goods and Services | 223 821 | 199 323 | 204 809 | 214 396 | 109 151 | 231 019 | 246 317 |
| Subsidies and Transfers | 421 095 | 400 408 | 387 348 | 406 136 | 208 137 | 400 408 | 432 779 |
| Interest | 8 392 | 8 000 | 11 908 | 11 073 | 2 831 | 8 000 | 6 266 |
| 700 Capital expenditures | 134 336 | 105 343 | 146 264 | 186 966 | 37 329 | 120 426 | 133 003 |
| Capital assets | 119 612 | | 135 374 | 172 339 | 34 442 | | |
| Capital transfers | 14 724 | | 10 889 | 14 627 | 2 887 | | |
| BALANCE | -15 287 | 17 598 | 5 563 | -2 531 | 75 129 | 17 245 | -73 727 |
| *modifications* | | -4 688 | | | | -3 226 | -3 226 |
| Balance (ESA95) | | 12 910 | | | | 14 019 | -76 953 |

*Source: CBR*

**In light of the above mentioned calculation while taking into account the development in the first six month of 2013, the performance of self-governing region should run a deficit in the amount of EUR 48 - 100 million. Due the uncertainty of the method used and speed up of expenditure spending due the election, the CBR expects the self-governing regions to run a deficit of EUR 20-40 million in 2013. Compared with the approved budget, this figure is worse by EUR 40-60 million. The current estimate by the Ministry of Finance is in line with the assumptions of the approved budget of the self-governing regions.**

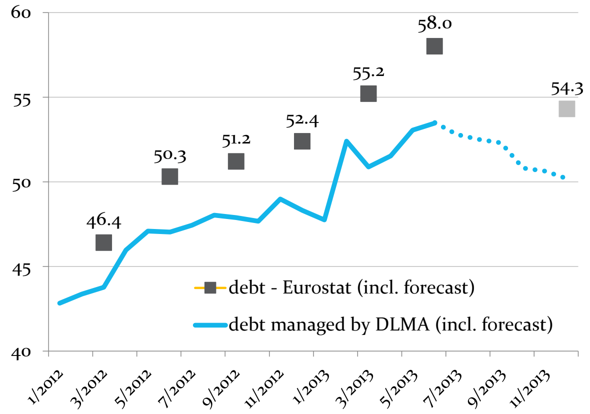
The budget of self-governing regions, as compiled by the Ministry of Finance for 2014-2016, envisages a surplus over the entire period. Despite the above risk identified by the CBR in 2013 and the different dynamism in the individual revenue and expenditure items, the CBR is of the view that a portion of the current expenditure increase could be offset, for instance, by a decline in capital expenditures. The CBR expects a lower deviation from the budget drawn up by the Ministry of Finance because the coordination between the Ministry and self-governing regions is more effective**. The estimated risk for 2014 is quantified at EUR 20-50 million.**

**Beyond the actual estimate of the Ministry of Finance for 2013, the CBR has quantified the risks posed by the fiscal performance of municipalities and self-governing regions at EUR 40-60 million. In comparison with the budget, current expenditures rose sharply, but this trend is almost fully compensated for by a decline in capital expenditures. For 2014, the CBR has quantified the risks at EUR 120-180 million, which can primarily be attributed to differences in the 2013 revenue and expenditure estimates against the ministry's expectations.**

# Annex 5 – Debt development in 2013

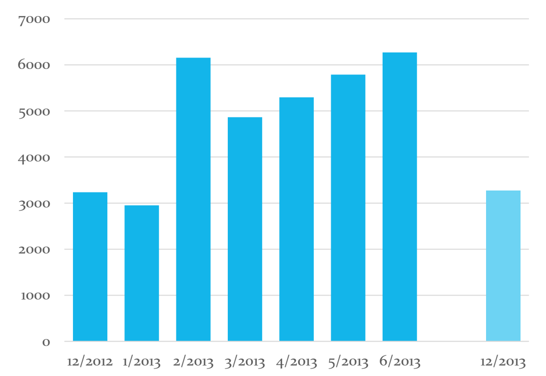
**In 2013, the debt firstly grew to hit its all-time high (58% of GDP) in the second quarter based on Eurostat figures.** This was primarily due to the cash reserves of Slovakia increasing from almost EUR 3.2 billion in December 2012 to roughly EUR 6.3 billion at the end of June 2013. As of June this year, the cash reserve should be gradually declining as governments bond fall due (for redemption) back to the level of EUR 3-4 billion, which will also reduce the overall public debt. The state cash reserves should also be propped up by the super dividend amounting to EUR 0.4 billion. The Ministry of Finance expects that the year-end debt according to Eurostat notification in April next year will end up somewhere around 54.3% of GDP.

**Chart 32: Debt development in 2013 (% GDP)**




*Source: ARDAL, CBR*

**Chart 33: Cash reserve[90] (mil. eur)**




*Source: ARDAL, CBR*

[90] Includes cash deposits in commercial banks and the purchase of securities on behalf of the Ministry of Finance of the Slovak Republic

# Annex 6 – One-off and temporary measures between 2013 and 2014

1. **Temporary levy on business operations in regulated sectors** – Effective from 1 October 2012, a levy on business operations in regulated sectors was put in place. It applies to companies with revenues from regulated activities accounting for least 50% of their overall revenues and with profits in excess of EUR 3 million. As presented in the original draft of this piece of legislation, the measure was supposed to be in place only for the period between 2012 and 2013, but the general government budget proposal for 2014-2016 envisages an extension of this period. The impact of the levy is EUR 114 million in 2013 and should oscillate around EUR 80 million in the period between 2015 and 2016.

2. **Extraordinary revenues from the Telecommunications Regulatory Authority** – In 2014, the announced sale of frequency bands through auction, the so-called digital dividend, will have a one-off positive effect on the non-tax revenues.

3. **Taxation of retained profits from before 2004** – The effect of the one-off tax on retained profits from before 2004 (withholding tax) in the amount of 15% only applies to the 2013 tax period. This measure will yield EUR 8 million in additional general government revenue in 2013.

4. **Extended bank levy** – As of 1 January 2012, the government imposed a bank levy of 0.4% from the adjusted value of liabilities on selected financial institutions. As of 1 September 2012, the levy calculation base was extended to also include the value of the protected or retail deposits which were initially exempt from the levy. Depending on the aggregate amount of the levy and the total assets of the banking sector, the bank levy rate could even drop to zero. In 2013, the levy is expected to increase revenues by EUR 87 million. In 2014, the positive effect on the general government deficit should represent EUR 70 million, with some EUR 50 million expected in 2015 and 2016.

5. **Possible opt-out from the fully-funded pillar of the pension system** – In response to the changes made in the fully-funded pillar at the turn of 2012 and 2013 (effective from 1 September 2012 until 31 November 2013), the government temporarily 'opened' the fully-funded pillar of the pension system allowing citizens to either exit or enter the scheme. The overall positive effect on the budget balance in 2013 is EUR 240 million.

6. **Sale of emergency oil reserves** – As regards the management of emergency oil reserves, new EU directive requires the transfer of ownership of the emergency oil reserves – up until now administered by the State Material Reserves of the Slovak Republic – to a newly established legal entity, the Emergency Oil Reserves Agency. The new system of emergency oil reserves financing, as well as the sale of the entire volume of oil reserves in 2013, is expected to have a positive effect on the general government balance in the amount of EUR 471 million.

7. **Transfer of funds resulting from the cancellation of bearer deposits** – In 2006, bearer deposits were cancelled and subsequently transferred under the management of state

financial assets. The deposit **claims** will expire at the end of 2013, which is expected to translate into EUR 26 million in revenues in 2014.

8. **VAT revenue from a PPP project** – In 2011, the imputation of a claim towards the Granvia company as a consequence of VAT payment in connection with a PPP project for the R1 motorway in the amount of EUR 174 million had a positive effect on the budget deficit. For the next 30 years, the amount of the advance payment will be reduced every year by an aliquot portion amounting to EUR 5.79 million. This amount will have a negative effect on the general government budget during the 30-year period.

9. **Revenues from the sale of state property (assets)** – As part of the second stage of the ESO reform focusing, in particular, on streamlining the system of public administration, one-off revenues totalling EUR 54 million should be cashed in from the sale of redundant state assets in 2014.

10. **Repayment of a loan provided to Vodohospodárska výstavba, š.p.** – In 2014, the payment of the last two instalments on a loan provided to the Vodohospodárska výstavba (state corporation) before 2002 is expected to increase the revenues of state financial assets by EUR 48 million. Because, in the past, the loan was treated as a capital transfer with negative effect on the deficit under the ESA95 methodology, the transaction will have a positive effect on the general government balance in 2014.

11. **Repayment of a loan provided to Cargo, a.s.** – On 4 March 2009, the government approved the use of state financial assets for the provision of a loan to Cargo Slovakia a.s. in the amount of EUR 166 million. Under contract with the Ministry of Finance and the Ministry of Transport, Post and Telecommunications, Cargo used the loan to finance its payroll and personnel expenditures, charges for the use of the railway infrastructure, and its own financial expenses. The payment of interest was set to begin in 2009, the payment of the principal in 2011, and the entire loan matures in 2020. In 2013, the instalment will have a positive effect of EUR 20 million on the general government balance, in 2014 an amount of EUR 98 million should be repaid, and in 2015 and 2016 the general government deficit should drop by EUR 20 million in each year.

12. **Dividends** – The General Government Budget Proposal for 2013 does not expect any payment of regular dividends from the SPP Company (Slovak Gas). In 2012, the company actually posted a net profit of EUR 365 million. Should the net profit be paid out to shareholders in full, the state budget could receive EUR 186 million (51%). After subtracting one-off dividends for 2013 which, as identified by the CBR methodology[91], account for EUR 3 million from subsidiaries, the assumption is that EUR 183 million in regular dividends could be received from SPP. The CBR recorded this amount as one having a negative effect on the balance in 2013 on grounds that the payment is carried over to 2014. Because a one-off effect equivalent to the 51% stake in SPP is envisaged in 2013, it is for this very reason that the CBR considers

[91] More details can be found in a separate CBR document: Identification of one-off dividends in general government revenue.

the remaining portion of dividends (49%) as one-off effect, as envisaged in the state budget for 2014 (even though the state will formally become a 100% shareholder already) [92].

For 2014, the budget proposal expects to receive only regular dividends in the amount of EUR 735 million. The amount of dividends for 2013 which are attributable to the 100% stake of the state can be calculated by subtracting the amount of dividends attributable to the 49% stake for the 2012 tax period (EUR 183 million, as explained in the previous paragraph). Because the purpose of the transaction, which changes the SPP ownership structure, is to unbundle the loss-making SPP and bring it under the control of the state, as well as to retain the 51% stake in other profitable subsidiaries, a question remains as to how it will be possible to pay out EUR 386 million in 2014, that is the amount corresponding to the total current profits of its subsidiaries. Because the state will continue to control only 51% stake in these companies, the amount of dividends should be equivalent to that stake. Anything that goes beyond it is therefore considered a one-off effect which can be attributed to a special agreement between the state and the original minority owner.

**Tab 35: One-off effects from dividends of SPP**

| | (€ million) | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| (1) | Budget Proposal | 0 | 735 | 300 | 300 |
| (2) | Expected common dividends CBR | 183 | 186 | 153 | 153 |
| | **One-off effect (1-2)** | **-183** | **549** | **147** | **147** |
| | *from shift* | *-366* | *366* | - | - |
| | *51% share from ownership of SPP in 2013* | *183* | - | - | - |
| | *49% share from filials* | - | *183* | *147* | *147* |

*Source: CBR*

A similar principle has been applied in the case of the SEPS transmission grid operator in 2013. The budget proposal does not count on the payment of dividends even though the company posted a net profit of EUR 78 million in 2012. Again, the non-payment of these dividends was treated by the CBR as one having a negative one-off effect on the 2013 balance, assuming that the dividends will be paid out in 2014. However, it needs to be said that the SEPS company does not usually distribute 100% of its profits to shareholders. In 2014, the budget proposal expects SEPS to pay out regular dividends in the amount of EUR 131 million to the state. Relying on the assumption of the budget proposal in that the company would pay regular dividends in the amount of EUR 53 million in 2014, the one-off effects related to the SEPS dividends were identified at EUR 78 million. The one-off effects are due to the carryover of dividend payment from 2013.

**Tab 36: One-off effects from dividends of SEPS**

| | (€ million) | 2013 | 2014 |
|---|---|---|---|
| (1) | Budget Proposal | 0 | 131 |
| (2) | Expected common dividends CBR | 78 | 53 |
| | **One-off effect (1-2)** | **-78** | **78** |
| | *from shift* | *-78* | *78* |

*Source: CBR*

92 Another argument as to why it is not possible to use the full amount of dividends in terms of structural balance is that the dividends corresponding to the 49% stake will be part of the purchase price of the 49% stake from EPH, which means that it represents a non-recurring revenue.

### Tab 37: One-offs in 2011-2016 (ESA95, € million)

| | 2011 | 2012 | 2013E | 2014BP | 2015BP | 2016BP |
|---|---|---|---|---|---|---|
| - exit from the fully-funded pension pillar | | 44 | 240 | | | |
| - tax on excess emission allowances | 30 | | | | | |
| - revenues of SIA from debt bailout in healthcare | 59 | | | | | |
| - VAT revenue from a PPP project | 174 | -6 | -6 | -6 | -6 | -6 |
| - capital income incl dividends | 198 | 186 | 211 | 943 | 148 | 148 |
| - accrualisation of high-risk state guarantees | -633 | | | | | |
| - extraordinary levy in banking sector (incl. CIT) | | 40 | | | | |
| - temp. entrepreneurial levy in regul. industries (incl. CIT) | | 25 | 114 | 80 | 84 | 88 |
| - taxation of retained earnings before 2004 | | | 8 | | | |
| - extended levy in banking sector | | 23 | 87 | 70 | 49 | 52 |
| - cancelled "bearer deposits" | | | | 26 | | |
| - JAVYS (voluntary grant) | | | 30 | | | |
| - reserve for achieving the fiscal target | | | | -65 | | |
| - repayment of loans of Cargo a.s. (capital transfer) | | 10 | 20 | 98 | 20 | 20 |
| -repayment of loans of Vodohospodárska výstavba,.p. (capital transfer) | 22 | 27 | 30 | 48 | | |
| **Total** | **-150** | **349** | **734** | **1 193** | **295** | **302** |
| *% GDP* | *-0.2* | *0.5* | *1.0* | *1.6* | *0.4* | *0.4* |

*Source: CBR*

# Annex 7 – Balance of GG revenue and expenditure

## Tab 38: Balance of GG revenue and expenditure (ESA95, € million)

| | 2012 | 2013 E | 2014 B | 2015 B | 2016 B |
|---|---|---|---|---|---|
| Total revenues | 23 606.3 | 24 012.5 | 25 731.0 | 25 102.5 | 26 067.7 |
| **Tax revenues** | **10 983.4** | **11 393.7** | **11 841.0** | **11 758.4** | **12 233.4** |
| Indirect taxes, of which | 7 056.4 | 7 284.5 | 7 451.8 | 7 140.8 | 7 341.6 |
| - VAT (without EU institutions) | 4 243.8 | 4 306.8 | 4 634.6 | 4 349.7 | 4 519.3 |
| - Excises | 1 973.3 | 1 941.0 | 1 944.1 | 1 955.9 | 1 966.5 |
| - Property tax and other | 196.4 | 225.5 | 233.2 | 241.4 | 249.9 |
| Direct taxes, of which | 3 927.0 | 4 109.2 | 4 389.1 | 4 617.6 | 4 891.8 |
| - Personal income tax | 1 865.1 | 1 910.6 | 1 975.9 | 2 079.8 | 2 189.0 |
| - Corporate income tax | 1 672.6 | 1 766.9 | 1 904.5 | 2 001.0 | 2 102.8 |
| - Withholding tax | 167.1 | 183.3 | 152.8 | 172.0 | 226.3 |
| - Property tax and other | 101.5 | 104.2 | 107.7 | 111.6 | 115.5 |
| **Social contributions** | **9 068.0** | **9 913.6** | **9 845.4** | **10 174.7** | **10 567.0** |
| Actual social contributions | 8 972.4 | 9 823.3 | 9 736.8 | 10 075.9 | 10 464.9 |
| Imputed social contributions | 95.6 | 90.3 | 108.6 | 98.8 | 102.0 |
| **Non-tax revenues** | **1 841.7** | **1 109.8** | **1 943.4** | **1 457.5** | **1 461.0** |
| Sales | 1 007.2 | 845.4 | 842.2 | 859.3 | 867.3 |
| Other current revenue | 834.6 | 264.4 | 1 101.2 | 598.2 | 593.7 |
| - Dividends | 623.7 | 154.2 | 997.4 | 484.3 | 435.0 |
| - Interests | 163.4 | 60.1 | 50.5 | 59.4 | 103.3 |
| **Grants and transfers** | **1 713.2** | **1 595.4** | **2 101.3** | **1 711.9** | **1 806.4** |
| of which: EU | 806.7 | 1 012.7 | 1 197.9 | 1 245.4 | 1 319.0 |
| Total expenditures | 26 836.4 | 26 187.5 | 27 875.4 | 27 623.3 | 28 247.0 |
| **Current expenditure** | **24 866.3** | **25 159.2** | **26 384.2** | **26 610.8** | **27 716.6** |
| Compensation of employees | 5 013.5 | 4 893.7 | 4 985.3 | 4 860.8 | 4 893.1 |
| Intermediate consumption | 3 099.7 | 3 064.5 | 3 530.8 | 3 661.4 | 4 251.8 |
| Taxes | 69.0 | 21.6 | 22.8 | 23.3 | 23.5 |
| Subsidies | 999.5 | 894.0 | 989.1 | 928.5 | 954.1 |
| - Agricultural subsidies | 120.2 | 94.0 | 149.3 | 91.8 | 105.1 |
| - Transport subsidies | 757.6 | 690.6 | 703.1 | 709.4 | 725.5 |
| - rail transport | 504.4 | 465.0 | 477.5 | 478.0 | 477.9 |
| - bus transport | 246.0 | 219.6 | 224.6 | 230.4 | 246.6 |
| - Other | 121.8 | 109.4 | 136.7 | 127.3 | 123.5 |
| Property income | 1 322.9 | 1 362.7 | 1 375.0 | 1 425.6 | 1 559.2 |
| - Interest | 1 322.1 | 1 362.7 | 1 375.0 | 1 425.6 | 1 559.2 |
| Social benefits | 13 291.1 | 13 454.2 | 13 652.5 | 14 084.4 | 14 540.3 |
| - Social benefits other than transfers in kind | 9 789.6 | 9 792.1 | 9 943.7 | 10 213.4 | 10 526.0 |
| - Active labour market policy | 57.1 | 47.2 | 20.9 | 13.2 | 2.3 |
| - Sickness benefits | 428.5 | 435.5 | 432.0 | 446.5 | 462.2 |
| - Old-age and disability pensions | 5 639.5 | 5 889.7 | 6 106.0 | 6 323.6 | 6 570.2 |
| - Unemployment benefits | 175.8 | 186.5 | 179.2 | 177.0 | 170.0 |
| - State benefits and social assistance | 1 375.4 | 1 364.8 | 1 402.2 | 1 420.2 | 1 437.0 |
| - Child allowance | 316.0 | 317.2 | 319.2 | 322.2 | 328.5 |
| - Allowance for newborns | 8.9 | 8.6 | 9.3 | 9.2 | 9.2 |
| - Parental allowance | 343.5 | 348.8 | 361.0 | 363.0 | 371.8 |
| - Material needs benefits | 305.8 | 275.2 | 282.8 | 278.5 | 275.8 |
| - Cash subsidies on compensation | 225.5 | 240.2 | 246.7 | 258.6 | 263.0 |
| - Other | 175.7 | 174.8 | 183.3 | 188.7 | 188.7 |
| - Social contr. on behalf of certain groups | 1 598.5 | 1 526.3 | 1 424.2 | 1 460.1 | 1 498.9 |
| - Social transfers in kind (Healthcare) | 3 501.5 | 3 662.1 | 3 708.8 | 3 871.0 | 4 014.4 |
| Other current transfers | 1 070.5 | 1 468.5 | 1 828.9 | 1 626.9 | 1 494.6 |
| of which: to the EU budget | 556.4 | 649.9 | 683.1 | 667.1 | 685.9 |
| of which: 2% of income tax to the 3rd sector | 44.7 | 46.4 | 49.5 | 44.2 | 46.9 |
| **Capital expenditures** | **1 970.1** | **1 028.2** | **1 491.2** | **1 012.5** | **530.4** |
| Capital investment | 1 326.1 | 677.8 | 926.8 | 561.1 | 420.8 |
| Capital transfers | 644.0 | 350.4 | 564.4 | 451.5 | 109.6 |
| General government balance | -3 230.1 | -2 175.0 | -2 144.4 | -2 520.8 | -2 179.3 |
| Measures necessary to achieve budgetary goal | | | | 478.6 | 926.2 |
| General government balance - target | | | | -2 042.2 | -1 253.1 |

*Source: CBR, MF SR*

## Tab 39: Balance of GG revenue and expenditure (ESA95, v % GDP)

| | 2012 | 2013 E | 2014 B | 2015 B | 2016 B |
|---|---|---|---|---|---|
| **Total revenues** | 33.2 | 32.9 | 34.0 | 31.6 | 31.2 |
| **Tax revenues** | **15.4** | **15.6** | **15.6** | **14.8** | **14.6** |
| Indirect taxes, of which | 9.9 | 10.0 | 9.8 | 9.0 | 8.8 |
| - VAT (without EU institutions) | 6.0 | 5.9 | 6.1 | 5.5 | 5.4 |
| - Excises | 2.8 | 2.7 | 2.6 | 2.5 | 2.4 |
| - Property tax and other | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Direct taxes, of which | 5.5 | 5.6 | 5.8 | 5.8 | 5.9 |
| - Personal income tax | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 |
| - Corporate income tax | 2.4 | 2.4 | 2.5 | 2.5 | 2.5 |
| - Withholding tax | 0.2 | 0.3 | 0.2 | 0.2 | 0.3 |
| - Property tax and other | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Social contributions** | **12.8** | **13.6** | **13.0** | **12.8** | **12.6** |
| Actual social contributions | 12.6 | 13.5 | 12.9 | 12.7 | 12.5 |
| Imputed social contributions | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Non-tax revenues** | **2.6** | **1.5** | **2.6** | **1.8** | **1.7** |
| Sales | 1.4 | 1.2 | 1.1 | 1.1 | 1.0 |
| Other current revenue | 1.2 | 0.4 | 1.5 | 0.8 | 0.7 |
| - Dividends | 0.9 | 0.2 | 1.3 | 0.6 | 0.5 |
| - Interests | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Grants and transfers** | **2.4** | **2.2** | **2.8** | **2.2** | **2.2** |
| of which: EU | 1.1 | 1.4 | 1.6 | 1.6 | 1.6 |
| **Total expenditures** | 37.7 | 35.9 | 36.8 | 34.8 | 33.8 |
| **Current expenditure** | **35.0** | **34.5** | **34.8** | **33.5** | **33.2** |
| Compensation of employees | 7.1 | 6.7 | 6.6 | 6.1 | 5.9 |
| Intermediate consumption | 4.4 | 4.2 | 4.7 | 4.6 | 5.1 |
| Taxes | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Subsidies | 1.4 | 1.2 | 1.3 | 1.2 | 1.1 |
| - Agricultural subsidies | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 |
| - Transport subsidies | 1.1 | 0.9 | 0.9 | 0.9 | 0.9 |
| - rail transport | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 |
| - bus transport | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| - Other | 0.2 | 0.1 | 0.2 | 0.2 | 0.1 |
| Property income | 1.9 | 1.9 | 1.8 | 1.8 | 1.9 |
| - Interest | 1.9 | 1.9 | 1.8 | 1.8 | 1.9 |
| Social benefits | 18.7 | 18.4 | 18.0 | 17.7 | 17.4 |
| - Social benefits other than transfers in kind | 13.8 | 13.4 | 13.1 | 12.9 | 12.6 |
| - Active labour market policy | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| - Sickness benefits | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| - Old-age and disability pensions | 7.9 | 8.1 | 8.1 | 8.0 | 7.9 |
| - Unemployment benefits | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 |
| - State benefits and social assistance | 1.9 | 1.9 | 1.9 | 1.8 | 1.7 |
| - Child allowance | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| - Allowance for newborns | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| - Parental allowance | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 |
| - Material needs benefits | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 |
| - Cash subsidies on compensation | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| - Other | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| - Social contr. on behalf of certain groups | 2.2 | 2.1 | 1.9 | 1.8 | 1.8 |
| - Social transfers in kind (Healthcare) | 4.9 | 5.0 | 4.9 | 4.9 | 4.8 |
| Other current transfers | 1.5 | 2.0 | 2.4 | 2.0 | 1.8 |
| of which: to the EU budget | 0.8 | 0.9 | 0.9 | 0.8 | 0.8 |
| of which: 2% of income tax to the 3rd sector | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Capital expenditures** | **2.8** | **1.4** | **2.0** | **1.3** | **0.6** |
| Capital investment | 1.9 | 0.9 | 1.2 | 0.7 | 0.5 |
| Capital transfers | 0.9 | 0.5 | 0.7 | 0.6 | 0.1 |
| **General government balance** | -4.5 | -3.0 | -2.8 | -3.2 | -2.6 |
| Measures necessary to achieve budgetary goal | | | | 0.6 | 1.1 |
| **General government balance - target** | | | | -2.6 | -1.5 |

*Source: CBR, MF SR*

# Annex 8 – Structure and development of general government expenditures

### Tab 40: Adjusted general government expenditures and their growth (ESA95)

| | € million | | | | growth in % | | |
|---|---|---|---|---|---|---|---|
| | 2013E | 2014B | 2015B | 2016B | 2014 | 2015 | 2016 |
| **Total expenditures** | 26 187.5 | 27 875.4 | 27 623.3 | 28 247.0 | 6.4 | -0.9 | 2.3 |
| **Adjusted expenditures** | 21 411.7 | 22 555.4 | 22 329.4 | 22 826.9 | 5.3 | -1.0 | 2.2 |
| **Mandatory** | **9 493.9** | **9 846.6** | **9 432.2** | **9 602.2** | **3.7** | **-4.2** | **1.8** |
| Compensation of employees | 4 794.4 | 4 943.9 | 4 829.7 | 4 889.8 | 3.1 | -2.3 | 1.2 |
| - Wages | 3 529.5 | 3 624.2 | 3 549.2 | 3 595.4 | 2.7 | -2.1 | 1.3 |
| - Employer social security contributions | 1 264.9 | 1 319.7 | 1 280.5 | 1 294.4 | 4.3 | -3.0 | 1.1 |
| Intermediate consumption | 2 844.4 | 3 005.8 | 2 700.8 | 2 742.0 | 5.7 | -10.1 | 1.5 |
| Taxes | 21.6 | 22.8 | 23.3 | 23.5 | 5.4 | 2.1 | 1.1 |
| Subsidies | 817.5 | 840.4 | 840.5 | 855.9 | 2.8 | 0.0 | 1.8 |
| - Agricultural subsidies | 17.5 | 7.4 | 7.4 | 7.4 | -57.9 | 0.0 | 0.0 |
| - Transport subsidies | 690.6 | 703.1 | 709.4 | 725.5 | 1.8 | 0.9 | 2.3 |
| - rail transport | 465.0 | 477.5 | 478.0 | 477.9 | 2.7 | 0.1 | 0.0 |
| - bus transport | 219.6 | 224.6 | 230.4 | 246.6 | 2.3 | 2.6 | 7.0 |
| - Other | 109.4 | 130.0 | 123.8 | 123.0 | 18.8 | -4.8 | -0.6 |
| Social transfers | 342.1 | 379.0 | 372.8 | 385.4 | 10.8 | -1.6 | 3.4 |
| Other current transfers | 673.9 | 654.7 | 665.2 | 705.6 | -2.8 | 1.6 | 6.1 |
| **Facultative** | **11 610.1** | **11 890.2** | **12 285.3** | **12 702.9** | **2.4** | **3.3** | **3.4** |
| Social benefits | 11 563.7 | 11 840.7 | 12 241.2 | 12 656.0 | 2.4 | 3.4 | 3.4 |
| - Social benefits other than transfers in kind | 8 243.7 | 8 510.9 | 8 743.0 | 9 027.0 | 3.2 | 2.7 | 3.2 |
| - Active labour market policy | 25.2 | 12.4 | 2.9 | 2.3 | -50.8 | -76.5 | -22.1 |
| - Sickness benefits | 435.5 | 432.0 | 446.5 | 462.2 | -0.8 | 3.4 | 3.5 |
| - Old-age and disability pensions | 5 889.7 | 6 106.0 | 6 323.6 | 6 570.2 | 3.7 | 3.6 | 3.9 |
| - Unemployment benefits | 186.5 | 179.2 | 177.0 | 170.0 | -3.9 | -1.3 | -4.0 |
| - State benefits and social assistance | 1 364.8 | 1 402.2 | 1 420.2 | 1 437.0 | 2.7 | 1.3 | 1.2 |
| - Child allowance | 317.2 | 319.2 | 322.2 | 328.5 | 0.6 | 1.0 | 1.9 |
| - Allowance for newborns | 8.6 | 9.3 | 9.2 | 9.2 | 9.1 | -1.7 | 0.0 |
| - Parental allowance | 348.8 | 361.0 | 363.0 | 371.8 | 3.5 | 0.5 | 2.4 |
| - Material needs benefits | 275.2 | 282.8 | 278.5 | 275.8 | 2.7 | -1.5 | -1.0 |
| - Cash subsidies on compensation | 240.2 | 246.7 | 258.6 | 263.0 | 2.7 | 4.8 | 1.7 |
| - Other | 174.8 | 183.3 | 188.7 | 188.7 | 4.8 | 3.0 | 0.0 |
| - Social transfers in kind (Healthcare) | 3 662.1 | 3 708.8 | 3 871.0 | 4 014.4 | 1.3 | 4.4 | 3.7 |
| Other current transfers | 46.4 | 49.5 | 44.2 | 46.9 | 6.7 | -10.8 | 6.2 |
| of which: 2% of income tax to 3rd sector | 46.4 | 49.5 | 44.2 | 46.9 | 6.7 | -10.8 | 6.2 |
| **Capital expenditures** | **307.7** | **818.5** | **611.8** | **521.8** | **166.1** | **-25.3** | **-14.7** |
| Capital investment | -12.1 | 448.6 | 297.1 | 416.4 | -3 811.1 | -33.8 | 40.1 |
| Capital transfers | 319.7 | 370.0 | 314.7 | 105.4 | 15.7 | -14.9 | -66.5 |

*Source: CBR, MF SR*

# Annex 9 – Fiscal performance of general government entities

**Tab 41: General government performance (ESA95, ths. eur)**

| | 2011* | 2012* | 2013B | 2013E | 2014B | 2015B | 2016B |
|---|---|---|---|---|---|---|---|
| **A. State Budget** | -3 608 365 | -3 808 962 | -2 748 495 | -2 109 922 | -2 495 664 | -3 083 199 | -2 653 742 |
| **B. Other entities of GG** | 108 959 | 578 859 | 561 964 | -65 079 | 351 302 | 562 426 | 474 443 |
| Municipalities | -69 093 | 82 282 | 136 175 | 91 428 | 22 357 | 241 416 | 124 803 |
| Self-governing regions | 4 135 | -5 181 | 12 910 | 14 019 | 16 506 | 18 001 | 23 386 |
| Social Insurance Agency | 173 473 | 94 317 | 40 033 | -12 270 | 44 340 | 23 167 | 25 435 |
| Health insurance companies | 107 028 | 153 591 | 16 249 | 46 943 | 24 702 | 7 222 | 9 064 |
| Nuclear decommissioning fund | 99 860 | 144 191 | 155 701 | 139 745 | 128 192 | 150 021 | 170 238 |
| National Property Fund | -287 681 | -23 163 | -17 083 | -477 666 | -15 795 | -6 647 | -4 712 |
| Environmental fund | 6 251 | 12 622 | 120 505 | 27 304 | 39 126 | 39 146 | 39 146 |
| State fund for housing development | 84 376 | 78 527 | 93 346 | 91 811 | 81 553 | 81 998 | 82 423 |
| Healthcare Surveill. Authority | 2 040 | 1 084 | 112 | 148 | 185 | 650 | 835 |
| Slovak Land Fund | 10 210 | 13 752 | 5 625 | 5 988 | 7 824 | 5 259 | 5 259 |
| Slovak consolidation agency | -5 853 | -20 246 | 582 | -6 782 | 2 680 | 1 817 | 157 |
| Public universities | -1 210 | 24 190 | 211 | 30 921 | 1 | 0 | 1 |
| Broadcasting and television | 24 143 | -325 | 1 211 | -13 189 | 1 072 | 1 047 | 887 |
| RTVS | 223 | 185 | -109 | -140 | - | - | - |
| TASR | -161 | 186 | 0 | -307 | 434 | 384 | 384 |
| Audit Surveillance Authority | 35 | -130 | -84 | -42 | -12 | -5 | 4 |
| Audio-visual Fund | 859 | -314 | 0 | 430 | 50 | 0 | 0 |
| Council for Budget Responsib. | - | - | - | - | 60 | 5 | -4 |
| Nation's Memory Institute | -16 | 32 | - | - | - | - | - |
| Sl.Nat. Centr for Human Rights | -8 | -2 | - | - | - | - | - |
| Contributory organisations | -39 651 | 23 261 | -3 420 | -3 420 | -1 973 | -1 055 | -2 863 |
| **C. General government** | -3 499 406 | -3 230 103 | -2 186 531 | -2 175 001 | -2 144 362 | -2 520 773 | -2 179 299 |
| ( % GDP ) | -5.1 | -4.5 | -2.9 | -3.0 | -2.8 | -3.2** | -2.6** |
| *GDP cur.p. mill. eur* | *68 974* | *71 096* | *74 372* | *72 987* | *75 773* | *79 462* | *83 539* |

* From Annual Report of Slovak Republic 2012 *Source: CBR, MF SR*

** without measures

# Annex 10 – Dynamic effects on the labour market

The changes applicable to the tax and social contributions system have been effective since January 2013 and their purpose was to increase budget revenues through unifying and increasing the maximum assessment bases, extending the social contributions base and increasing the tax rates. In quantifying the effects on the budget, the Ministry of Finance took into account the changes in the behaviour of economic agents in response to the growing payroll tax burden. Because multiple changes were made simultaneously, the CBR warned, in its Opinion on the Social Insurance Act Amendment, of potential negative risks arising from uncertainties concerning the magnitude of dynamic effects, while also pointing to the fact that the legislative changes would affect most essentially the category of casual workers (see the change in tax wedge in Chart 34 and Chart 35).

The current estimate of the impact of the consolidation package by the Ministry and analysis of individual data indicate that the dynamic effects were indeed essential. However, the negative risk has not materialised, in particular thanks to conservative budgeting. Despite positive developments in the interim budget execution, it is necessary to know which changes in the labour market are attributable to legislative amendments. Based on individual data provided by the Social Insurance Agency, the CBR has identified sizeable dynamic effects in the period between January and April 2013:

- The number of casual workers plummeted (by 42.3%), whereas the total average number of employees has not changed year-on-year over the reported period (-0.2 %).
- Of the original number of casual workers, 68% remained in the labour market in 2012 (either keeping their casual work contracts or switching to other form of economic activity, in particular, employment contracts) and 32% exited the labour market.
- The net outflow of casual workers who exited the labour market was 73,600 on average, with pensioners and students aged around 25 years entering the category of the economically inactive. The inflow of casual workers can be observed, in particular, in the category of younger students (see Chart No. 36).

Table No. 43 provides a list of changes in the average amount of disposable income and labour costs for:

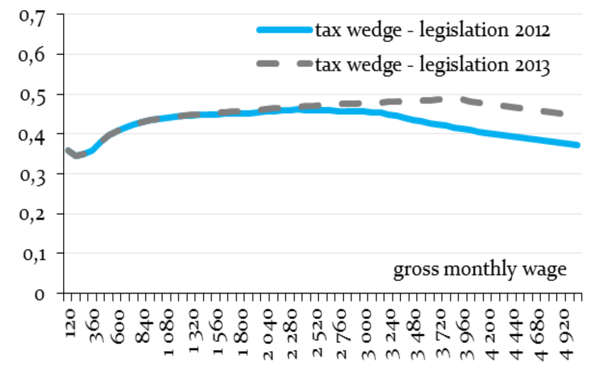
1. casual work contracts which remained casual work contracts in year-on-year comparison
2. casual work contracts which were merged or transformed into employment contracts.

For the first group, the additional payroll tax burden was split between employers and casual workers (the ratio depends on the type of casual work contract, income, etc.). For those casual work contracts that were transformed into employment contracts, the average amount of gross and net income increased considerably (by more than 140%), with labour costs following suit (up by more 220 %). The labour market responded to the new legislation by a slump in the number of casual workers by more than 70,000; however, their workload was probably shifted to those casual workers who remained in the labour market and switched to employment contracts or whose casual work contracts were merged with employment contracts.

In aggregate terms (Table No. 44), employers managed to keep the costs of labour in the production of goods and provision of services almost unchanged (up by 0.4 %). In 2013, their output required a smaller number of contracts, however, the average remuneration is higher. The average monthly savings of EUR 25 million attributable to the decline in the number of casual workers are offset by an increase in employment costs (EUR 33 million).

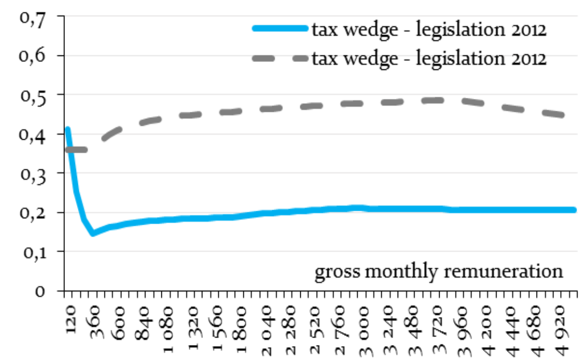
Higher contributions paid by the remaining casual workers contributed (by 1.5 percentage points) towards the average year-on-year increase in social contributions (by 6.4%). The net effect of casual workers exiting the labour market is zero – what the state lost in contributions from the "drop-outs" gained in contributions paid in by the new casual workers. Interestingly enough, the flows of casual workers within the labour market even contributed towards an increase in contributions by 2.1 p.p. The remaining 2.8 p.p. are attributed to the growing payroll taxes of natural persons – "other than casual workers".

### Chart 34: Tax wedge for employees




*Source: CBR*

### Chart 35: Tax wedge for casual workers with regular income



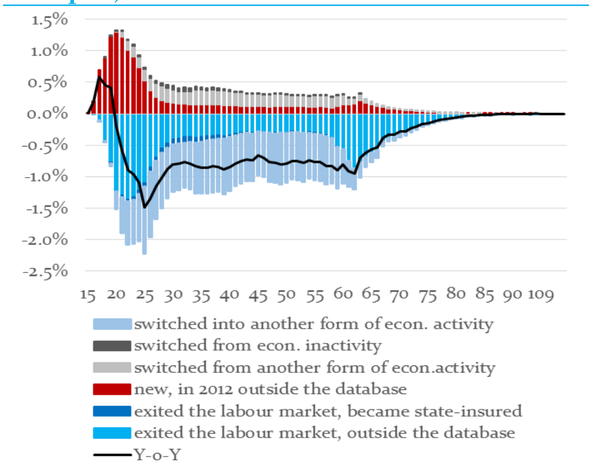

*Source: CBR*

### Tab 42: Changes in the labour market structure (January-April)

| | Number | %, p.b. |
|---|---|---|
| Casual workers in 2012 | 450 391 | 100% |
| Remained economically active | 306 614 | 68% |
| of which: keeping casual work contract | 153 681 | 34.1 |
| of which: swithched to empl. contract/self-empl. | 152 933 | 34.0 |
| Exited the labour market | 143 778 | 32% |
| of which: out of the database | 136 592 | 30.4 |
| of which: became state-insured | 7 186 | 1.6 |
| Casual workers in 2013 | 259 793 | 100% |
| Casual workers from 2012 | 153 681 | 59.1 |
| of which: in 2012 were employed/self-empl. | 35 979 | 13.8 |
| of which: in 2012 were state-insured | 4 158 | 1.6 |
| New casual workers (in 2012 outside the database) | 65 976 | 25.4 |
| Year-to-year change in the number of casual workers | -190 598 | -42.3% |
| Net outflow of casual workers into another form of economic activity | -116 954 | 61.4 |
| Net outflow of casual workers outside the labour market | -73 644 | 38.6 |

*Source: Social Insurance Agency, CBR*

### Chart 36: Contributions to the change in the number of casual workers (age distribution in April)




*Source: Social Insurance Agency, CBR*

## Tab 43: The split of the additional payroll tax burden between employers and casual workers

| | Y-o-Y changes for causal work contracts that remained causal work contracts | | | | | | Y-o-Y changes for causal work contracts that switched to employment contracts (1 contract only) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | January | February | March | April | Average | Median | January | February | March | April | Average | Median |
| Gross Income | -6.7% | -6.7% | -9.9% | -4.3% | -7.3% | -8.8% | 141.5% | 133.6% | 136.1% | 150.8% | 140.5% | 236.1% |
| Disponible Income | -7.7% | -7.7% | -10.8% | -5.3% | -8.2% | -3.8% | 140.3% | 134.4% | 137.4% | 152.9% | 141.3% | 299.5% |
| Labour Costs | 11.2% | 11.2% | 7.1% | 13.9% | 10.4% | 8.0% | 222.1% | 211.6% | 214.7% | 234.5% | 220.7% | 348.6% |
| Social Insurance Contributions | 2297.4% | 2297.4% | 2180.4% | 2320.8% | 2257.7% | 1834.2% | 7736.7% | 7498.2% | 7553.7% | 8029.5% | 7704.5% | 10769.1% |

*Source: Social Insurance Agency, CBR*

## Tab 44: Year-to-year aggregate changes

| | Number of contracts | Changes in the average amount | | | | Changes in the sum | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Gross Income | Disp. Income | Labour Costs | Soc. Ins. Contr. | Gross Income | Disp. Income | Labour Costs | Soc. Ins. Contr. |
| Casual work contracts | -38.4% | -15.6% | -21.8% | 0.3% | 2386.1% | -48.0% | -47.0% | -38.3% | 1227.6% |
| Employment contracts | -0.2% | 1.3% | -2.5% | 2.1% | 4.4% | 1.1% | 0.2% | 1.9% | 4.4% |
| ***Total*** | ***-7.7%*** | ***7.0%*** | ***1.8%*** | ***8.8%*** | ***19.6%*** | ***-1.2%*** | ***-2.3%*** | ***0.4%*** | ***6.4%*** |
| Casual work contracts (EUR million) | | | | | | -30.8 | -25.9 | -24.8 | 8.1 |
| Employment contracts (EUR million) | | | | | | 14.2 | 1.6 | 32.9 | 18.2 |
| ***Total (EUR million)*** | | | | | | ***-16.6*** | ***-24.3*** | ***8.1*** | ***26.3*** |

Note: Year-to-year changes are calculated for contracts with non-zero income

*Source: Social Insurance Agency, CBR*

**Council for Budget Responsibility**

Imricha Karvaša 1
Bratislava 1
813 25
Slovakia

www.rozpoctovarada.sk