Addendum to the Evaluation of the General Government Budget for 2015-2017

(Based on the amendments to the 2015-2017 General Government Budget adopted by the Slovak parliament on 4 December 2014)

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Summary

In its evaluation of the 2015-2017 budget proposal submitted by the government, the Council for Budget Responsibility (CBR) indicated that it would update it in the light of the changes introduced in the budget by the parliament.

In addition to the government-approved budget, which assumed the deficit at 1.98 % of GDP in 2015, **two types of changes** were introduced **which increase the deficit to 2.49 % of GDP**. **The negative impact of the changes approved by the parliament represents 0.7 % of GDP,** including the reserve for worse-than-expected macroeconomic development at 0.2 % of GDP. In addition, the deficit has increased particularly due to the introduction of a health insurance allowance (0.2 % of GDP), a wage rise in public administration (0.1 % of GDP) and increases under certain expenditure headings (0.1 % of GDP). **The Ministry of Finance has updated certain assumptions for the development of revenues and expenditures with an overall positive impact of 0.2 % of GDP.** These mainly reflect the anticipated additional expenditure reductions in the local government sector, the positive impact of wage increases in the public sector on revenues from taxes and social contributions, and the carryover of an extraordinary loan instalment from railway freight company (Cargo) from 2014 to 2015.

The CBR views negatively the transparency of the budget-approval process in the parliament. In spite of the fact that the government's objectives are defined at the general government level in line with ESA2010 and the budget proposal is compiled for the period of next three years, the changes introduced by the parliament focus solely on the next year's cash budget. In other words, the absence of additional information makes the evaluation of impacts for 2015-2017 under ESA2010 impossible. Since the full list of incorporated measures was not available even after the parliament had passed the budget, the CBR requested it from the Ministry of Finance. The list has enabled the CBR to evaluate the 2015 development and at least assess the impacts of these measures on subsequent years. The increase in tax revenues above the forecast by the Tax Revenue Forecasting Committee represents another negative feature of the budget.

In the CBR's view, adjustments to the budgetary process might enhance its transparency. Firstly, it would be advisable to abandon the historically established approval of a cash-based budget and switch to the ESA2010-conform budget approval for all three fiscal years. Equally, an independent assessment of macroeconomic and tax revenue forecasts should be a precondition for their reflection into changes introduced by the parliament in order to avoid arbitrary increases of budgeted revenues. One of the consequences of increasing budgeted revenues and expenditures could be the avoidance of fiscal rules and of the sanctions applicable for the breach of these rules.

Some of the introduced changes automatically affect the budget also in 2016 and 2017. The CBR estimates their negative impact at about 0.4 % of GDP annually. The meeting of the 2017 **medium-term objective** (structural deficit not exceeding 0.5 % of GDP) requires the adoption of additional measures.

In its previous evaluation the CBR stated that the 2015 consolidation only compensated for the 2014 fiscal easing. **On adoption of the measures, the structural deficit estimate for 2015 reached 2.4 % of GDP, which is worse than in 2013.** While structural balance in 2015 should improve by 1.0 % of GDP year-on-year, it is expected to have deteriorated by as much as 1.4 % of GDP in 2014.

All the risks identified by the CBR in the budget proposal remain relevant also after its adoption by the parliament. Compared to the budget proposal, the approved budget contains a precise amount of the reserve created to offset worse-than-expected macroeconomic development (in line with CBR recommendations), which represents a source for risk coverage for 2015. **The risk associated with the local government sector increased by EUR 32 million in 2015**. In its evaluation of the budget proposal the CBR identified the local government risk at EUR 100-200 million and the Ministry of Finance expects that the wage increase in the public sector, which will also affect the budgets of local governments, will be covered by additional cuts in expenditures.

The debt estimate in the budget proposal of the government was based on the assumption of higher deficits compared to the budget, which created a positive buffer. **Nevertheless, the approved budget increases the debt above the original assumptions;** the debt will increase most significantly in 2017 due to the absence of measures. However, what is important from the perspective of the "debt brake" provision is that the debt remains below the 55-% threshold across the entire budget period and it will drop more markedly towards the end of 2017.

1. Changes in the general government budget

On 15 October 2014, the Slovak government approved the General Government Budget Proposal for 2015-2017 to which the Council for Budget Responsibility (CBR) published its evaluation[1] in November. Because the budget proposal envisaged additional changes to be made during the parliamentary debate, the CBR announced that it would update its evaluation following their approval. The general government budget was adopted by the parliament with amending proposals on 4 December 2014.

In comparison with the government's budget proposal, the parliament made several changes which **increased the general government deficit to 2.49 % of GDP in 2015**. This represents the upper limit of the deficit declared in the budget proposal. Because the parliament's decisions covered the changes in the 2015 state budget only, the **CBR assumes that the objectives for 2016 and 2017 remain unchanged**[2].

Tab 1: General government balance targets (ESA2010, % GDP)

	2014E	2015B	2016B	2017B
1. Stability Programme of the Slovak Republic for 2014-2017*	-2.84	-2.49	-1.61	-0.54
2. General government budget proposal for 2015-2017	-2.93	-2.49 - -1.98	-1.43	-0.39
3. Approved general government budget for 2015-2017	-3.03**	-2.49	-1.43	-0.39
4. Change (3-1)	-0.2	0	0.2	0.2
5. Change (3-2)	**-0.1**	**0.0 - -0.5**	**0**	**0**

** Medium-term budget outline for 2015- 2017 assumed the same targets, these were however not approved by the government.*

Source: MF SR, CBR

*** Impact of the measure included in the 2015 budget (carryover of an extraordinary loan instalment from the Cargo from 2014 to 2015) incorporated in the official MF SR estimate of 2.93 % GDP.*

1.1 Impact of adopted measures in 2015

There were two types of changes made in the approved budget[3]. **The first entailed an update to the forecast of revenues from taxes and social security contributions by incorporating the impacts of legislative changes** (in particular, introduction of a health insurance tax allowance) and **those changes introduced by the parliament** which have increased state-budget expenditures. The budget envisages wage increases in **public administration**[4] which are to be funded from the state budget and local governments. The budget also contains a **reserve to offset potentially worse-than-expected macroeconomic development in the amount of 0.2 % of GDP**, which is in line with the recommendation made by CBR in its

[1] CBR, Evaluation of the General Government Budget Proposal for 2015-2017.

[2] In the Government's budget proposal, this interval was considered only for 2015, and no changes in objectives were envisaged for the years 2016 and 2017, not even in connection with the announced measures.

[3] A detailed overview of changes is provided in Annex 1.

[4] As of 1 January 2015, the wages of teachers in the regional education sector will rise by 5 %. The wages of other employees financed from the state budget (including educational staff in the public universities) will be increased in two steps: by 1 % as of 1 January 2015 and by a further 1.5 % as of 1 July 2015. The rise in wages will also apply to local government employees who are in charge of performing the original powers of local governments.

evaluation of the budget proposal. At the same time, the **expenditures of several ministries increased as well**, which includes, for instance, the expenditures for active labour market policies, rental apartments, flood prevention measures and higher wages for certain corps falling under the authority of the Ministry of the Interior. These changes have worsened the deficit (Table 2).

The **second type of changes,** which partially counteracted the impacts of these measures, includes an **update[5] to certain assumptions used in the budget approved by the government**. The Ministry of Finance expects additional savings in **local government expenditures, carryover of one-off revenues from 2014,** and **higher tax revenues**.

Due to higher expenditures of local governments necessitated by the rise in wages, keeping the general government deficit at the level of 2.49 % of GDP in 2015 will require finding additional sources of funding (by curbing other expenditures or by increasing revenues).

In 2014, no extraordinary loan instalment is expected from Cargo, the railway freight company. According to the approved budget, this instalment should be carried over to 2015. This means that, in comparison with the estimate presented by the Ministry of Finance in the budget proposal, the deficit **rises by 0.1 % of GDP to 3.0 % of GDP in 2014. The additional risks for the balance in 2014, as identified by the CBR[6], remain unchanged.**

Besides these changes, certain expenditure items have been transferred between individual budget chapters (science and research expenditures and coverage of losses generated by hospitals). At the same time, the total amount of cash revenues and expenditures increased by EUR 300 million through the creation of reserves. On the revenue side, a reserve has been created due to the anticipated higher collection of certain taxes (corporate income tax, value added tax and excise taxes). According to the Ministry of Finance, the revenues and expenditures under the ESA2010 methodology have increased commensurately with a neutral impact on the general government balance in 2015. **The CBR is of the view that an increase in cash revenues from taxes in a particular year does not automatically translate into an accrual effect of the same magnitude in that year**[7]. This is in particular the case of corporate income tax where an increase in cash revenues by EUR 150 million in 2015 will be recorded for the most part in 2014 under the ESA2010 methodology. Furthermore, a question remains as to whether the expected better collection of taxes will only have impact on 2015, or whether its effects will be permanent and affect also the subsequent years (Annex 2).

If one disregards the updates to certain budgetary assumptions by the Ministry of Finance (other changes beyond the modifications in the cash-based state budget and the tax

5 The amending proposals in the Parliament applied only to the state budget. Other changes that would reduce the deficit to the target value of 2.49 % of GDP in 2015 were not specified anywhere.

6 CBR, Evaluation of the General Government Budget Proposal for 2015-2017, pg. 10.

7 In order to comply with the budgetary objective for 2015, a shortfall of EUR 150 million in revenues under the ESA2010 methodology would automatically require blocking the same amount on the expenditure side. In practice, the neutral effect in terms of the deficit would probably be preserved. This does not preclude the possibility of the entire expenditure reserve being spent even if there is an increase in revenues other than tax revenues or if the budget balance is improved by some other entity falling under the general government budget.

revenue forecast of the Tax Revenue Forecasting Committee), **the general government deficit might reach 2.64 % of GDP in 2015 as a result of changes introduced by the parliament**.

Tab 2: Changes in the budget proposal with impact on GG balance (ESA2010)

	2014 € million	2015 € million	2014 % of GDP	2015 % of GDP
1. GG balance - budget proposal approved by the government	**-2 199**	**-1 541**	**-2.93**	**-1.98**
2. Amendments by the parliament	**0**	**-519**	**0.00**	**-0.67**
Allowance on health insurance contributions*	-	-148	-	-0.19
Increased public wages - impact on state budget expenditures	-	-93	-	-0.12
Increased public wages - impact on local governments**	-	-32	-	-0.04
Increased expenditures on active labour market policies	-	-32	-	-0.04
Increased capital expenditures on rental housing	-	-20	-	-0.03
Reserve on worse-than-expected macroeconomic development	-	-156	-	-0.20
Better development of tax revenues and corresponding reserve:	-	0	-	0.00
- tax revenues (cash and accrual impact)	-	300	-	0.39
- expenditures (cash and accrual impact)	-	-300	-	-0.39
Other changes (taxes*, flood prevention, support of sports, reinforcement of certain corps of the Ministry of Interior, preschool facilities etc.)	-	-38	-	-0.05
3. Changes not communicated	**-78**	**120**	**-0.10**	**0.15**
Assumption on additional savings of local governments (covering increased wages)	-	32	-	0.04
Positive impact of public sector wage increase on taxes and SSC	-	9	-	0.01
Carryover of an extraordinary loan instalment (Cargo) from 2014 to 2015	-78	78	-0.10	0.10
Better development of tax revenues (MF SR assumption on accrual impact)***	-	0	-	0.00
4. GG balance - target (1+2+3)	**-2 277**	**-1 940**	**-3.03**	**-2.49**

** Including the impacts endorsed by the TRFC (accrualisation of taxes, impact on social contributions of economically active population).*

Source: MF SR, CBR

*** Reflects the impact of the decision to increase public sector wages on local governments´ budgets.*

**** MF SR has not explained sufficiently the assumption on equal cash and accrual impact of the reserve on better development of tax revenues.*

1.2 Outlook for 2016 and 2017

The effects of certain changes approved in the budget will also be felt in the years 2016 and 2017. The estimates of the effects of changes in taxes approved by the Tax Revenue Forecasting Committee are always published for the entire three-year period covered by the budget. As regards other changes, however, the estimates of their effects are not available at present[8]. The

[8] The amending proposals approved by the Parliament apply only to the Act on the state budget for 2015 which means that they contain only those changes for the upcoming year which have an impact on cash revenues and expenditures of the state budget. The Ministry of Finance plans to publish the approved general government

CBR has therefore made its own estimates based on the nature of the adopted measures[9] and based on the estimates provided by the Ministry of Finance.

In 2016, the general government deficit (Table 3) approaches the target value of 1.43 % of GDP, which significantly reduces the scope for additional expenditure-increasing or revenue-reducing measures. In 2017, the deficit is at 0.8 % of GDP, which exceeds the target by 0.4 % of GDP. **The approved budget does not yet contain all the measures necessary to meet the medium-term budgetary objective in 2017.**

Tab 3: Estimated impact of measures on the 2016 and 2017 GG balance (ESA2010)

	2016 € million	2017 € million	2016 % of GDP	2017 % of GDP
1. Allowance on health insurance contributions	-148	-136	-0.18	-0.16
2. Thin capitalisation - broadening of exemptions	-10	-10	-0.01	-0.01
3. Higher non-tax revenues	1	1	0.00	0.00
4. Increased public sector wages	-133	-133	-0.16	-0.15
- increased expenditures*	-148	-148	-0.18	-0.17
- increased revenues (taxes and SSC)**	15	15	0.02	0.02
5. Additional wage expenditures (Ministry of Interior, Supreme Court)	-15	-15	-0.02	-0.02
6. Total (1+2+3+4+5)	**-305**	**-294**	**-0.37**	**-0.34**
7. GG balance in the 2015-2017 budget proposal	-838	-383	-1.02	-0.44
8. GG balance after including the changes (6+7)	**-1 144**	**-677**	**-1.39**	**-0.78**
9. Targeted GG balance	-1 175	-338	-1.43	-0.39
10. Difference (8-9)* **	**31**	**-339**	**0.04**	**-0.39**

** Estimate of the MF SR. While in 2015 the MF SR assumes that local governments will cover increased wage expenditures from additional resources, this assumption is not used in estimating the impacts both in 2016 and 2017.*

Source: MF SR, CBR

*** CBR´s assumption based on the estimated ratio of revenues and expenditures (linked to public sector wage increase) in 2015.*

**** (+) means potential space for increasing the deficit, (-) need for additional measures*

1.3 Change in the structural balance

In comparison to the evaluation of the budget proposal, there are also minor changes in the estimate of the structural balance which, in particular, relate to measures approved by the parliament. The general government deficit was increased to 2.5 % of GDP in 2015 also due to

budget for 2015–2017 with incorporated changes only after the ministries and other central government bodies submit a detailed breakdown of changes for their budget chapters; in accordance with Government Resolution No 508/2014, they are required to do so by 29 December 2014.

9 The CBR assumed that the approved changes in wages would also be reflected in subsequent years, but did not consider any additional increase beyond that which is planned for 2015. As regards other changes in expenditures in 2015 (capital expenditures and subsidies in particular), the effects in 2016 and 2017 are expected to be zero.

several one-off measures[10] (the carryover of one-off revenues from *Cargo* to 2015 and the creation of a reserve for macro-economic development in 2015). At the same time, the CBR has updated its estimate of the cyclical component since the calculation reflects the updated NBS forecast of the output gap which is already in line with the ESA2010 methodology. This update, however, has a negligible impact on the resulting indicators.

If the budgetary objectives are met, the structural balance will improve by 1 % of GDP[11] annually over the course of the next three years. The size of the measures approved for 2015 represents 1.5 % of GDP and, as a result of carrying the loan instalment from the *Cargo* company over to the year 2015, their effect in 2014 will be slightly negative. The government's consolidation effort in 2015 remains slightly higher than a year-on-year change in the structural balance, since the government has responded to the less favourable fiscal development[12].

Tab 4: Change in structural balance of GG in the years 2014 - 2017 (ESA2010, % GDP)

	2013	2014E	2015B	2016B	2017B
1. General government balance	**-2.6**	**-3.0**	**-2.5**	**-1.4**	**-0.4**
2. Cyclical component	-0.5	0.0	-0.2	-0.2	-0.1
3. One-off measures	-0.1	0.4	0.1	0.2	0.2
4. Structural balance (1-2-3)	**-2.0**	**-3.5**	**-2.4**	**-1.5**	**-0.4**
5. Change in structural balance (Δ4)/ Fiscal compact	**2.4**	**-1.4**	**1.0**	**1.0**	**1.0**
6. General government balance - NPC scenario	**-2.6**	**-2.9**	**-4.0**	**-3.5**	**-3.7**
7. Change in structural balance - NPC scenario	-	**-1.5**	**0.0**	**0.4**	**-0.2**
8. Size of measures (1-6)	-	**-0.1***	**1.5**	**2.1**	**3.3**
9. Change in size of measures (Δ8)	-	-0.1*	1.6	0.6	1.2
10. Consolidation effort of government (5-7)	-	**0.0***	**1.1**	**0.5**	**1.2**
p.m. 1 Measures with no impact on long-term sustainability	0.5	-0.1	-0.1	0.0	-0.1
p.m. 2 PPP projects	-0.1	0.0	0.0	0.0	0.0
Interest payments	-0.1	0.0	0.1	0.1	0.1

** Impact of the measure adopted in the approved budget for the year 2015 – carryover of the loan instalment from Cargo.*
(Measures adopted within the budget proposal for the year 2014 are not incorporated.)

Source: CBR methodology

1.4 The risks in terms of balance and debt for 2015-2017

All the risks identified by the CBR in the budget proposal remain relevant (the complete list is shown in Table 5). In comparison with the budget proposal, the announced deficit-increasing measures have been incorporated and the amount of the reserve for macroeconomic development, which represents a source for the coverage of risks in 2015, has been precisely quantified. **New measures increase the risk associated with the local government sector**

10 The list of all one-off effects is provided in Annex 3.

11 Because, in comparison with the budget proposal, the general government deficit in 2015 was increased to the upper limit of the interval (ranging from 2.0 to 2.5 % of GDP), analytical indicators measuring the consolidation and size of measures in 2015 shifted towards the lower limit of the interval presented in the CBR evaluation of the budget proposal.

12 Under the no-policy change scenario, the structural balance would worsen by less than 0.1 % of GDP year-on-year in 2015.

in 2015 by EUR 32 million. This has to do with the fact that the CBR identified the risks associated with the local government sector in the amount of EUR 100-200 million already in the budget proposal, whereas the Ministry of Finance expects that the rise in wages in public administration, which will also affect the budgets of local governments, would be offset by additional cuts in expenditures or revenue increases.

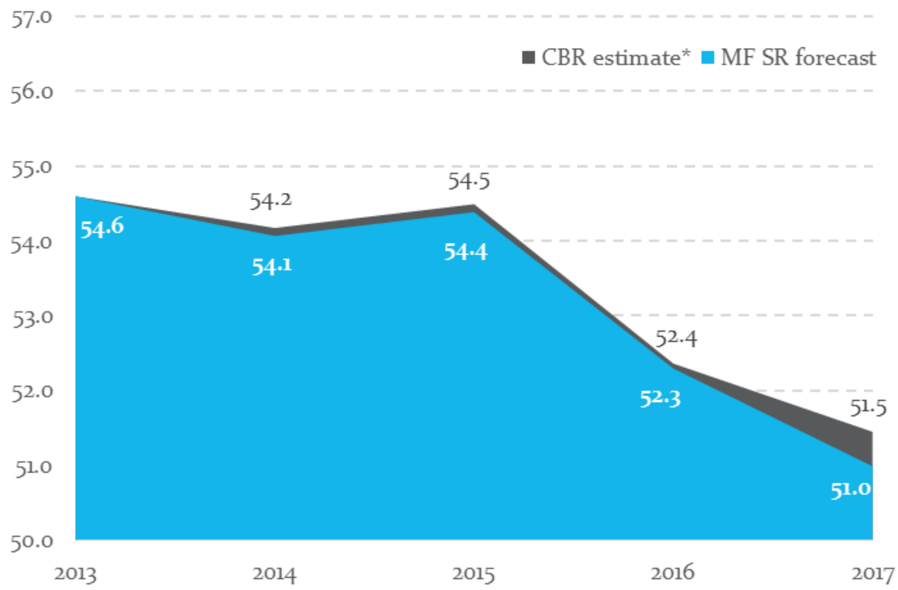
Tab 5: Overview of risks and risk coverage in the budget for 2015 - 2017 (€ million)

Risks affecting the GG balance	2015	2016	2017	Risk coverage in 2015	
1. Overestimated non-tax revenues:					
- revenues from dividends (SPP and VSE)	169	164	164		
- revenues from sales of emission allowances	52	52	52		
- revenues of the National Nuclear Fund from blocs 3 and 4 of the Mochovce NPP	0	29	35	potential savings on co-financing	190
2. Financial corrections to EU funding	not quantified				
3. Underestimated health care sector expenditures:					
- health care expenditures	50	not quantified	not quantified	reserve for macroeconomic development	156
- repayment of liabilities to shareholders of private health insurance companies	0	50	50		
4. Underestimated local government expenditures, investments in particular	132-232	not quantified	not quantified		
5. Impact of potential expenditure savings in 2014 (for example, carry-over of capital expenditures)	not quantified	-	-		
Risks from a net-worth perspective without impact on budget balance					
1. Reduced value of general government assets due to restriction on capital expenditures	not quantified				
2. Use of the revenue from the bank levy to finance current expenditures and occurrence of contingent liabilities	105	107	55		

Source: CBR

In its evaluation of the budget proposal, the CBR identified a positive risk for debt development if the 2015 deficit is lower. Because the deficit has increased nearing the upper limit, this risk is no longer applicable. **Quite the contrary, it seems that, in particular due to absenting measures in 2017, the debt at the end of 2017 could be slightly higher than the figure envisaged in the forecast.**

Figure 1: Debt forecast (% of GDP)



** In the debt estimate, the CBR reflected the differences from the official estimate of the GG balance (2014) and from the GG balance targets (2015-2017) while keeping the implicit interest rate assumed in the budget.*
Source: CBR, MF SR

2. Budget transparency

The approval process of the budget proposal by the parliament was characterised by a lesser degree of transparency. The CBR identified three major issues. Firstly, the tax revenue forecast was repeatedly changed beyond the forecast prepared by an independent committee enshrined in the constitutional Fiscal Responsibility Act. The second issue of concern is that changes made by the parliament only focused on the cash-based state budget for the next year, while the government's objectives have been defined at the level of the entire general government under the ESA2010 methodology, and the budget proposal is prepared for a period of the next three years. It means that the effects for the 2015-2017 period could not be assessed under ESA2010 without additional information. The entire list of the measures introduced into the budget compared with its original proposal was not available even after the budget had been approved, hence the CBR asked the Ministry of Finance to provide the list. Thirdly, using the available information, the CBR could comprehensively assess the development in 2015 only while the effects for subsequent years had to be estimated. Such steps render the process of compiling the budget less transparent, impairing public control over the process.

The CBR views negatively the adjustments to the tax and social security contribution revenues forecast that were not discussed and approved by the Tax Revenue Forecasting Committee (TRFC). This especially concerns an amendment[13] by which the parliament approved a one-off increase in the cash forecast of specific taxes, by a total of EUR 300 million in 2015, along with the creation of a reserve in the same amount on the expenditure side. The CBR considers this approach non-transparent for these reasons:

- **It circumvents the TRFC**. The CBR cannot consider any changes in a tax revenue forecast that have not been approved by the TRFC as trustworthy. At the last TRFC meeting, held just two weeks before the parliament approved the budget, the Ministry of Finance saw no reason to increase the tax revenue forecast due to improved tax collection and the effects of wage bargaining (by 1.4 % in total). In addition, no particular measures have been proposed to reduce tax evasion with respect to corporate income tax and excise taxes.

- It creates room for **circumventing fiscal rules** through relaxing more stringent sanctions under the debt brake mechanism (triggered when the debt exceeds 55 % of GDP) and the rule on increasing cash expenditures of the state budget by not more than 1 %. For example, if expenditures need to be blocked, this may lead to the blocking of the reserve for better tax collection without any considerable interventions in the government's expenditure policies[14], or with respect to the obligation to prepare a budget containing no increase in

[13] In addition to the aforementioned amending proposal, an additional increase in the tax and social security contribution revenues by EUR 9.4 million on top of the Committee forecast was approved for 2015 in order to reflect the effects of wage increases in the general government sector (Annex 2).

[14] This occurred after the publication of the 2013 year-end debt in April 2014, when a significant portion of the obligatory blockage of expenditures (2/3 approximately) involved the budgetary reserves for a better-than-expected VAT collection.

expenditures (where expenditures under the budget approved for the previous year are taken as a basis)[15];

- It is not a one-off measure, but **a recurring approach**, because the general government budget approved for the 2014-2016 period also contained a reserve for improved VAT collection (in the amount of EUR 250 million), as well as an increase in tax and social security contribution revenues due wage increases in the public sector;

- Without additional explanation[16], the CBR does not think the assumption of improved tax collection along with the created reserve automatically means a neutral impact on the general government balance under ESA2010 (Annex 2).

The CBR also negatively perceives that all changes in the budget introduced after its approval by the government have not been communicated to the general public. They were communicated only partially (cash state budget, tax revenue forecast by the TRFC), **with focus on 2015, but the overall effects for the next two years have not been published.** Even though the general government deficit targets have been set until 2017, it is currently not clear if the current budget will meet them. This questions the rationale behind preparing a three-year general government budget and impairs the availability of information to the public in a timely manner. In addition, the predictability of Slovakia's fiscal policy in the eyes of creditors on financial markets is impaired and the assessment of its international obligations (Stability and Growth Pact) is more difficult:

- The parliament approved changes in the 2015 state budget prepared on a cash basis. If these changes and the updated forecast by the Tax Revenue Forecasting Committee, prepared for the period of three years until 2017 using the ESA2010 methodology, were considered only, the general government deficit would amount to 2.64 % of GDP in 2015 (Table 2). The remaining changes in the budget, reducing the deficit to its target value at 2.49 % of GDP, involve other components of the general government (state financial assets, local governments), but these measures have yet not been published[17].

- At the same time, it is not presently clear how the measures adopted for 2015 will affect the subsequent two years of the three-year budget[18]. On that account, **it would be advisable in future to communicate all changes in the budget on a three-year timeframe under the ESA2010 methodology if the parliament approves considerable changes in the budget proposal**.

[15] If such expenditures contain a reserve for improved tax collection, the requirement to freeze expenditures in the following year is less painful, as the expenditures can increase, year-on-year, by the size of the reserve.
[16] The CBR asked the Ministry of Finance to provide an explanation for the assumption of a neutral impact on the balance. However, the incorporation of that assumption in the budget was not justified sufficiently.
[17] The CBR requested them from the Ministry of Finance in order to assess the approved budget. The Ministry of Finance plans to update documents related to the general government budget at the beginning of 2015 only.
[18] The exemption are changes in taxes approved by the Tax Revenue Forecasting Committee.

- A problem associated with the three-year budget is that even though the government sets its objectives until 2017, the measures taken are only designed to meet the objective in the first year. The remaining years play a less important role from this point of view. Even though this approach complies with the Slovak legislation[19], the OECD, the European Commission and the CBR have repeatedly[20] recommended Slovakia to **enhance the binding nature of a multiannual budget by introducing expenditure ceilings**.

BOX 1: Recommendations to enhance transparency of the budgetary process

- The approval of a cash-based state budget by the parliament is based on a historical tradition, but it is no longer sufficient to capture all changes in public finances. Under ESA2010, the budgetary objectives are defined for the entire general government sector. Therefore, any amendments tabled in the parliament should cover all changes affecting the general government budget, expressed using the currently applicable data reporting methodology. A possible alternative is to publish a complete list of changes in the budget proposal under the ESA2010 methodology for all fiscal years during its approval in the parliament.

- The general government budget should be based on a forecast prepared by the Tax Revenue Forecasting Committee (TRFC). Any proposals to make changes in the amount of tax revenues that are subject to discussion by the TRFC would automatically (before the proposal is definitely approved by the parliament) trigger a TRFC meeting convened to assess the proposed changes. The purpose of this approach is to prevent arbitrary increases in tax revenues by the parliament.

- Budgetary reserves should only be created for possible adverse developments (for example, impact of a negative macroeconomic development on public finances).

[19] Act No. 523/2004 on the general government budgetary rules (§4(2)) stipulates that revenues and expenditures budgeted for the second and third year covered by the budget are not binding indicators.

[20] The Council's most recent recommendation to introduce expenditure ceilings is from July 2014, as included in the assessment of the Stability Programme of the Slovak Republic for 2014 – 2017.

Annex 1 – Changes in the 2015 budget

The 2015-2017 general government budget proposal approved by the government was amended by the parliament through proposals concerning the state budget for 2015 and additional measures applicable to other general government entities as incorporated by the Ministry of Finance.

The exact impact of all measures until 2017 is unknown, hence only their impact until 2015 is presented. Table 6 contains all the measures that have contributed to a change in the general government balance. Table 7 contains other changes that have affected the amount of revenues and expenditures with respect to which the Ministry of Finance declares they have a neutral impact on the general government balance under the ESA2010 methodology.

Tab 6: Changes in the budget proposal affecting the GG balance (ESA2010, € thousands)

	2014	2015
Allowance on health insurance contributions	**0**	**-148 349**
- impact on personal income tax	-	6 905
- impact on corporate income tax	-	10 541
- impact on health insurance contributions (EAP)	-	-165 795
- increased state budget expenditures on health insurance contributions on behalf of people defined by law	-	-151 979
- higher health insurance contributions paid by the state	-	151 979
Thin capitalisation - broadening of exemptions	**0**	**-9 306**
Amendment of the act on taxation of motor vehicles	**0**	**11 591**
Reserve on worse-than-expected macroeconomic development	**0**	**-155 832**
Higher non-tax revenues	**0**	**736**
- revenues from gambling	-	436
- revenues of the Ministry of Economy from refunds	-	300
Carryover of an extraordinary loan instalment (Cargo) from 2014 to 2015	**-78 220**	**78 220**
Positive impact of public wage increases on tax revenues	**0**	**9 447**
Increased expenditures	**0**	**-185 784**
- public wage increases (wage bargaining)	-	-92 854
- 5% indexation of wages of teachers in regional education sector	-	-49 808
- 1% indexation of wages in public universities	-	-2 403
- 1% indexation of wages of other employees as of 1 January 2015	-	-22 195
- 1,5% indexation of wages of other employees as of 1 July 2015	-	-18 448
- impact of indexation on local governments	-	-32 000
- additional saving in local governments	-	32 000
- expenditures on active labour market policies	-	-32 000
- capital expenditures on rental housing	-	-20 000
- flood prevention expenditures	-	-15 000
- reinforcement of certain corps of the Ministry of Interior (regions with higher criminality, natural disasters)	-	-15 000
- support of education, training, sports and youth	-	-10 000
- other expenditures	-	-930
Impact on the GG balance	**-78 220**	**-399 277**

Note: (+) improves, (-) worsens the general government balance *Source: MF SR*

Tab 7: Changes in the budget proposal with no impact on the GG balance (ESA2010, € ths.)

	2015
Reserve on better development of tax revenues - increased revenues and expenditures	**0**
- increased revenues from corporate income tax	150 000
- increased revenues from value added tax	100 000
- increased revenues from excise taxes	50 000
- increased state budget expenditures	-300 000
Financing new and contracted projects of the SAS - reallocation of expenditures	**0**
- decreased expenditures of the Ministry of Education	8 000
- increased expenditures of the Slovak Academy of Sciences	-8 000
Financing health care facilities - reallocation of expenditures	**0**
- cancellation of a modifying factor (accrualisation) on the balance of health care facilities	50 000
- increased expenditures of the Ministry of Health to cover losses of health care facilities	-50 000

Note: (+) improves, (-) worsens the general government balance *Source: MF SR*

Annex 2 - Updated forecast of revenues from taxes and social security contributions

Compared to the government's budget proposal for 2015-2017 of October 2014, the general government tax revenue forecasts **were updated twice**. The macroeconomic forecasts were not updated and the same assumptions were applied as in the government's proposal.

1. Updates by the Tax Revenue Forecasting Committee

As announced in advance, the Ministry of Finance convened an extraordinary meeting of the Tax Revenue Forecasting Committee on 19 November 2014 (held "*per rollam*") to discuss new forecasts due to **changes in the tax and social security legislation.** The tax revenues forecast was updated to include, in particular, the effects of the introduction of a health insurance allowance and the broadening of exemptions by the parliament in the government's proposal for the thin capitalisation rules. **The overall tax and social security contributions revenue forecast for 2015-2017 was therefore revised down by some EUR 150 million**, and the Tax Revenue Forecasting Committee evaluated the updated forecast as realistic.

2. Updates by the parliament

The parliament approved two additional changes to the tax revenue forecast through amendments adopted on 4 December 2014. They **were not discussed and approved by the Tax Revenue Forecasting Committee.**

Taking into consideration the outcomes of wage bargaining (a rise in public sector wages), the parliament increased the forecast for revenues from income tax and social and health contributions by EUR 9.45 million in 2015 on a one-off basis. The government's original budget proposal contained a zero growth in wages of general government employees.

By the same amendment, the parliament also increased the forecast of **both cash and accrual** revenues from corporate income tax by EUR 150 million (6.5 % increase), from VAT by EUR 100 million (2 % increase) and from excise taxes by EUR 50 million (2.4 % increase) in 2015. The forecast **increased by EUR 300 million in total,** a one-off rise of 1.4 % in 2015. The reason for this increase is **the anticipated better tax collection driven by combating tax evasions**[21]. At the same time, a **reserve in the identical amount was created** on the expenditure side of the budget. The purpose was to make sure that if the higher revenues are not achieved, the expenditures tied in the reserve will not be spent and the deficit will not increase. **But the CBR is of the view that this measure does not have in fact a neutral impact under the ESA2010 methodology**. An increase in cash revenues in a particular year does not automatically translate into an accrual effect of the same magnitude in that year. Under ESA2010, a part of higher cash revenues should also be recorded in 2014. It especially applies to the corporate income tax, where a large portion of the increased cash revenues in 2015 should be recorded in 2014[22]. Another question is whether the anticipated better tax collection will be felt in 2015 only, or whether it will have permanent effects over subsequent years.

[21] Speech delivered by the finance minister in the parliament

[22] A higher tax collection envisaged for 2015 with respect to combating tax evasions will especially reflect when tax returns are filed, i.e., in the payment of outstanding tax for the 2014 tax period (and, consequently, in higher tax advance payments). Under the applicable ESA2010 methodology, this portion of revenues should, on an accrual basis, be recorded to 2014, not to 2015.

Annex 3 – Change in one-off measures

The 2015-2017 general government budget adopted by the parliament on 4 December 2014 contains two modifications which the CBR incorporated in its update of one-off effects. An extraordinary loan repayment of EUR 78.2 million by *Cargo, a.s.*, originally planned for 2014, was carried over to 2015. At the same time, a reserve was created for 2015 to achieve a fiscal target in the amount of EUR 155.8 million. Assuming that a risk scenario covering the worse-than-expected macroeconomic development does not materialise and the economy will develop in line with the forecast of the Ministry of Finance, the funds are likely to be spent on other one-off measures.

Tab 8: One-off measures in the years 2013-2017 (ESA2010, % GDP)

	2013	2014	2015B	2016B	2017B
- VAT revenue/payment from a PPP project (Granvia)	-0.01	-0.01	-0.01	-0.01	-0.01
- digital dividend	-	0.22	-	-	-
- dividends	-	0.19	0.19	0.18	0.17
- EU corrections	-0.17	-0.11	-	-	-
- Penalty of the Antimonopoly Office of the Slovak Republic	-	0.06	-	-	-
- repayment of loans of Cargo	0.03	**0.03**	**0.13**	0.02	-
- repayments of loans Vodohospodárska výstavba	0.04	0.06	-	-	-
- fiscal reserve	-	-	**-0.20**	-	-
TOTAL	**-0.11**	**0.44**	**0.11**	**0.20**	**0.16**
Difference to GGB proposal	*-*	***-0,10***	***-0,10***	*-*	*-*

Source: CBR

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