CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of the General Government Budget Proposal for 2015-2017

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Summary

Since the breakout of the crisis, Slovakia has been able to gradually decrease its public finance deficit down to safer levels, which is necessary to steer the debt away from the sanction brackets stipulated in the Fiscal Responsibility Act. Such a development is also important from the viewpoint of population ageing, the additional fiscal cost of which cannot be met purely by increasing the statutory retirement age. Moreover, for a small and open economy, any relapse into yet another significant recession with high starting values of deficit and debt would be dangerous. Hence the government's plan for 2015 to improve the long-term sustainability of public finances in the aftermath of the substantial fiscal easing in 2014 should be viewed positively.

Against the backdrop of the current European debate on the plans by certain big member states to defer their consolidation efforts, the stance of Slovakia is commendable. It should be emphasised that the meeting of a nearly-balanced budget objective in 2017 and the stabilisation of public debt safely below 55 % of GDP in the medium term are objectives which are not only achievable under the current macroeconomic scenario, but which, if achieved, will bring Slovakia to the camp of those eurozone members which are responsible vis-à-vis future generations, and which do not adjust their fiscal parameters merely because EU rules require them to do so.

These objectives can be achieved in various ways. Rather than suggesting solutions, the role of the CBR is to assess whether or not the present government strategy is realistic. In spite of the government's ambition to attain a nearly balanced budget in 2017, the credibility of the consolidation plans requires that the upcoming parliamentary debate on the budget objectives and reserves also takes into account the worse-than-budgeted general government fiscal performance in 2014, as well as the risks for 2015 identified by the CBR.

The starting position for the next year's budget is unfavourable for two reasons. Firstly, the risks identified by the CBR at the end of the last year have materialised (lower dividends, worse fiscal performance of local governments and hospitals, financial corrections, ESO project, digital dividend, emission allowances); the 2014 deficit was pushed below the 3-percent threshold thanks to improved tax collection and the blockage of expenditures under the debt brake. For 2014, the CBR estimates the deficit still between 2.9 % and 3.4 % of GDP. The meeting of the declared objective (2.64 % of GDP) currently appears to be quite a challenge, requiring the adoption of additional measures; therefore, even with the debt level below 55 % of GDP, the lifting of the 3-percent blockage on expenditures is not advisable. At the same time, there is a risk of a significant deviation from the balanced budget rule, which may prompt the adoption of additional corrective measures.

The second reason lies in the less than satisfactory absorption of EU funds (probably the biggest economic problem for Slovakia these days, right after unemployment) which has numerous negative repercussions for public finances. On the one hand, the country loses this very effective way of leveraging growth at a time when the economy needs it the most, on the other hand, the financial corrections ensuing from irregularities increase deficits and undermine the credibility of Slovakia. Given the current setup and deadlines for the drawing of

EU funds, Slovakia runs the risk of not absorbing hundreds of millions euros from the second programming period.

Transition to ESA2010 has also made the budget preparation more difficult. The GDP increase due to this new methodology more than offsets the negative effects of the more transparent methodology for capturing fiscal transactions; consequently, the last year's public debt level has been revised downwards from 55.4 % of GDP to 54.6 % of GDP. The 55-percent debt level is critical from the perspective of the Fiscal Responsibility Act. Since these changes took place after the government had submitted its budget proposal to the parliament, it had no other choice but to respect the requirement of the Fiscal Responsibility Act and put a freeze on consolidated public expenditures. This is the main reason why the 2015 deficit is stated at 1.98 % of GDP, yet the publicly declared plan is to remain under the 2.5 % mark.

Hence, in its evaluation of the budget objectives the CBR bases itself on the levels presented in the Stability Programme. If we look at these values and adjust them for short-term impacts (economic cycle and one-off measures) we can see that the 2015 consolidation compensates for the fiscal easing in 2014. The "stop-and-go" type of policy, as opposed to smoothing, is inappropriate also with regard to meeting the 2017 objective, simply because the need for additional consolidation effort could have been lower.

From the viewpoint of long-term sustainability, the presented budget – even with the adjustments to be introduced through parliamentary procedure taken into account – represents an improvement via better actual structural deficit. However, due to the worse deficit in 2014, sustainability will not improve compared to 2013, despite the announced improvement in deficit.

Although the respective committees have assessed the underlying macroeconomic assumptions and the tax revenue forecasts as being realistic, the latest global economic indicators, particularly for major eurozone economies, coupled with the ongoing crisis in Ukraine, represent a negative risk which must not be neglected. Also due to this, it would be highly desirable if the parliament resisted the temptation of consuming the entire margin between 1.98 % and 2.49 % of GDP and, instead, as in the past, enabled the government to create a buffer to absorb adverse externalities (in the order of 0.1 % to 0.3 % of GDP).

On the whole, the 2015-2017 budget outline contains fewer one-off and temporary measures compared to 2014 and relies more on standard and permanent types of revenue. However, dividends represent an important exception. The planned revenue from the Slovak Gas (SPP) dividends at a level corresponding to 100-percent ownership in SPP subsidiaries (where the state actually controls only 51 %) appears to be a risk. Moreover, the crisis in Ukraine may shrink future receipts from the transit of gas. Apart from the dividend question mark, the revenue from the sale of CO_2 allowances also remains questionable.

On the expenditure side, the same risk items crop up for a number of years in a row. The reduction in healthcare expenditures and the maintenance of very low capital expenditures of municipalities appear to be unrealistic in the medium term. Likewise, the carryover of funds from one year to another, once exhausted, will increase the deficit.

In terms of the absorption potential, the budgeting of high volumes of EU funds available under the third programming period appears to be overly ambitious. Since the macroeconomic forecast in the budget is conservative and already assumes a lower absorption of EU funds, the co-financing is likely to represent a positive risk. However, as indicated above, this is negative news from the growth perspective.

The good news in transparency terms is that the number of transactions subject to review by Eurostat is declining. On a more negative note, however, the recognition of hospital liabilities represents a step back. While in the past – due to prudency considerations and given the assumption of their bailout – the Ministry of Finance voluntarily chose to recognise the liabilities of hospitals on an annual basis as part of the public debt, under the current methodology the debts will be recognised in one go in the future (at the point of actual bailout). In order to make the application of sanctions under the Fiscal Responsibility Act more effective, the CBR believes that it is essential to better align budgeted items with those actually reported. Intensive discussions with the Ministry on this issue are currently underway.

The purpose of CBR's 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 identify those potential risks which need to be eliminated through the adoption of additional measures. The opinion is based on the General Government Budget Proposal for 2015-2017 and the Draft Budgetary Plan for 2015, approved by the government at its session on 15 October 2014. Since the budget proposal outlines a number of significant measures which are likely to pass through the parliamentary scrutiny, the CBR will subsequently update its opinion.

1. Budget development in 2014 and assessment of risks

The Ministry of Finance currently estimates[1] the 2014 deficit at 2.93 % of GDP. This is worse than the budgeted deficit of 2.64 % of GDP, yet the government intends to meet its target. However, no measures designed to meet it the have yet been specified.

In its evaluation of the 2015-2017 Medium-term Budget Outline the CBR estimated the deficit at 2.9 – 3.4 % of GDP assuming that no additional measures are taken. Most of the identified risks are materialising (see Annex 1 for detailed evaluation) and the deficit may in fact end up in the above brackets.

Tab 1: Major factors influencing the 2014 GG balance compared to the budget (MF SR estimates, % of GDP)

Positive impact		Negative impact	
Higher revenues from taxes and social contributions	0.66	Shortfall in dividend revenues	-0.76
Blockage of 3 % of state budget expenditures	0.41	Shortfall of revenue from the sale of assets (ESO project, telecom licences, emission allowances)	-0.29
Lower expenditures on co-financing	0.25	Higher expenditures of the public health insurance sector and deficits in the budgets of hospitals	-0.24
Revenue from fines imposed by the Antimonopoly Office for cartel agreements in the transport sector	0.06	Higher expenditures of other public sector entities (mainly local governments and universities)	-0.23
Lower transfers to the EU budget	0.06	Financial corrections payable to the EU budget	-0.11

Source: MF SR, CBR

The shortfall in revenues from dividends caused by the shift of their payment to 2013[2] and the lower profit of SPP have had the most significant negative impact on the budget. At the same time, revenues from the sale of assets within the ESO project fell short of achieving their budgeted level. The same is true for the revenues from the auction of telecom frequencies and the sale of emission allowances due to the lower-than-expected price. Likewise, financial corrections payable due to irregularities in the use of EU funds will increase the deficit. The Ministry of Finance expects higher than budgeted healthcare expenditures due to higher spending of health insurance companies and higher deficits of hospitals which, under ESA2010, are now classified in the general government sector. At the same time, the budgeted expenditures of local governments and public universities are likely to be overrun. The inclusion of other entities into the general government sector (National Motorway Company, Emergency Oil Stocks Agency, Eximbanka and selected municipal public transport companies) should have a nearly zero impact on this year's balance.

[1] Report on Macroeconomic Development and Development of Public Finances in 2014 and Prediction until Year-End, approved by the Slovak government on 29 September 2014

[2] The payout relates to dividends from the 2012 profit. Had the decision on their payment took place in 2014, as planned in the 2014 General Government Budget, under the rules of ESA the amount received would not have classified as an ordinary dividend, but as a superdividend without impact on the balance.

The major positive factors influencing the 2014 deficit are the higher-than-budgeted revenues from taxes and social contributions[3] and the blockage of government expenditures as a consequence of overshooting the third sanction limit laid down in the Fiscal Responsibility Act. The lower drawing of EU funds will reduce government expenditures on their co-financing. However, the overall impact on the balance may be different, since the non-use of this source of economic growth will affect public finances adversely through lower tax revenues (Annex 2).

Tab 2: Change in structural balance in 2014 (% of GDP)

	2013 GGB 2014	2014 GGB 2014	2013 GGB 2015	2014 GGB 2015	Change in 2013	Change in 2014
1. General government balance	**-3.0**	**-2.6**	**-2.6**	**-2.9**	**0.4**	**-0.3**
2. Cyclical component	-0.4	-0.3	-0.5	0.0	-0.1	0.3
3. One-offs[4]	1.0	1.7	-0.1	0.5	-1.1	-1.2
4. Structural balance (1-2-3)	**-3.6**	**-4.0**	**-2.0**	**-3.4**	**1.5**	**0.6**
5. Change in structural balance	-	**-0.5**	-	**-1.4**	-	**-0.9**

GGB 2014 – The 2014-16 general government budget
GGB 2015 – The 2015-17 general government budget proposal

Source: CBR methodology

At a deficit level estimated by the Ministry of Finance, the 2014 **structural balance will deteriorate quite considerably**. While the **fiscal policy easing** was estimated to reach 0.5 % GDP when the 2014 budget was approved, the **present estimate is 1.4 % of GDP**. The deficit development has had the most signifcant impact. In 2013, deficit was lower than the 2014 budget expected , but the 2014 deficit is expected to exceed the budget value. At the same time, the impact of the economic cycle on public finances is more favourable than originally expected, which has improved the forecast of tax revenues in 2014.

Beyond the present estimate by the Ministry of Finance (deficit at 2.93 % of GDP), the CBR **sees additional risks to the 2014 deficit development**[5], which exceed the potential sources for their coverage (Table 3). While certain risks may continue to have adverse effects in the years to come, for example the budgets of local governments and income from dividends, the potential sources for their coverage are of a one-off nature.

Tab 3: Overview of additional risks and reserves in 2014 (€ million)

Risks	Sum	Coverage	Sum
1. Outcomes of local governments´ budgets	0-80	1. One-off revenues from levy on business operations in regulated sectors	43
2. Additional financial corrections	70		
3. Lower dividends from SPP	131	2. One-off state budget expenditure cuts	50-150
4. Higher payout of retained profits of private health insurance companies	0-70		

Source: CBR

3 Despite the lower than budgeted drawing of EU funds (see Annex 2 for more).

4 Compared to the last year's CBR report, the one-off effects with a total impact of 0.4 % of GDP in 2014 have been revised. The revision relates to the exclusion of certain measures as a consequence of the new ESA2010 methodology (e.g., revenues from the fully-funded pillar) and alignment of the methodology for their identification with the MF SR (more in Annex 9). The difference in 2014 (0.8 % of GDP) is due the one-off effects not having materialised.

5 Nothwitstanding the existing risks for 2014, which will probably increase the deficit above the MF SR estimate, the CBR bases its calculations in the following parts of this document on the value of 2.93 % of GDP.

Despite the fact that the MF SR has reflected the anticipated worse **fiscal performance of the local governments** into the deficit, the ultimate negative impact may be even higher. Based on the information on the actual budget execution in the first half of the year, the risk is higher mainly in the budgets of municipalities due to higher wage and operating expenditures. The level presently estimated by the MF SR is achievable only through lower capital expenditures. Due to their low level in 2013 (deferred investments) and because of their increase this year in connection with municipal elections, the margin available to offset the increase in current expenditures will be narrower. **The additional negative impact may reach EUR 80 million**[6].

Likewise, the negative impact of the **financial corrections charged for irregularities** in the use of EU funds may be higher than expected. The drawing of funds from five operational programmes (out of the total number of 14) is currently suspended. The lifting of the suspension may require higher than expected financial corrections. Apart from their amount, what remains uncertain is the year in which they increase the deficit. This will depend on when the payments are unblocked and also to which periods the corrections relate. **The CBR estimates an additional negative impact for 2014 at EUR 70 million**[7].

The lower revenue from SPP dividends from the 2013 profits represent another risk. The present estimate of the 2014 budget balance foresees this revenue at EUR 268 million, which corresponds to the entire ordinary profits of SPP subsidiaries where the state, however, still[8] controls only 51 %. It is therefore questionable whether the whole revenue will affect the balance under the ESA2010 methodology. The resulting effect will be known only once the transaction has been reviewed by Eurostat. The negative risk for the balance represents the amount of dividends attributable to the minority shareholder in the **amount of EUR 131 million**.

Since 2012, **private insurance companies** have been paying out dividends from past profits, which adversely affects the general government deficit. The MF SR estimates the impact at EUR 26 million. With a view to the amounts disbursed in the past two years and the size of the still-retained profits (see Annex 3 for more), the CBR estimates the **additional risk to represent up to EUR 70 million**[9]. The risk may be partly eliminated through reduced healthcare expenditures. However, hitherto experience shows that this would probably negatively affect the size of hospital debts compared to the estimate of the MF SR.

6 The CBR, when evaluating the 2015-17 medium-term budgetary objectives, estimated the maximum negative impact of local governments compared to the budget at EUR 200 million. This estimate has not changed. Since the MF SR assumes a negative impact of EUR 117 million (excluding the impact of changes in tax revenues of local governments), the additional risk represents approximately EUR 80 million.

7 The CBR estimates the impact of corrections in 2014 at EUR 150 million. Since in its present estimate the MF SR uses EUR 81.1 million on account of financial corrections, the additional risk represents about EUR 70 million.

8 The gist of the changes in the SPP ownership structure, which took place in 2014, was to transfer the loss-making SPP into the hands of the state (100 % ownership) and retain a 51-percent interest in the SPP's profit-making subsidiaries.

9 The retained profit of the Union health insurance company represents almost EUR 20 million. In the case of the Dôvera health insurance, the CBR estimates the potential negative impact at EUR 50 million, which corresponds to the usual annual profit of the company; comparable amounts were paid to shareholders also in the past two years.

Revenue from the special levy on businesses in regulated industries may have a positive one-off effect. As a consequence of the transfer of assets relating to gas transmission from SPP (parent company) to *Eustream*, the latter posted an extraordinary profit which is subject to the levy. The Institute for Financial Policy (IFP)[10] has estimated the positive impact of the transaction at **EUR 43 million**, yet this amount is not reflected in the present deficit estimate. Its resulting impact will be known once Eurostat has reviewed the transaction.

The risks may also be covered by **additional cuts in government spending,** such as through higher transfers of capital expenditures to the following years or by carrying the implementation of certain operating expenditures over to the next year. However, these savings **would not be of a permanent nature**, which increases the risk of expenditure overrun in the following years.

[10] The IFP Commentary No. 2014/14 (available only in Slovak) includes the estimated cash impact in the amount of EUR 197 million in 2014, and the revenue under ESA2010 would reach EUR 43 million.

2. Evaluation of budgetary objectives

The General Government Budget Proposal for 2015-2017 (hereinafter the "budget proposal") was designed to meet both the EU and national fiscal rules. After the 2014 fiscal easing, the consolidation of public finances is planned to resume in order to meet the 2017 medium-term budgetary objective defined as structural deficit within 0.5 % of GDP.

The preparation of the budget proposal was also affected by sanctions applicable under the constitutional Fiscal Responsibility Act under which the government had to submit to the parliament for discussion a draft budget with expenditures frozen at the level of the 2014 budget. At the end, the new methodology for the reporting macroeconomic and fiscal data, known as ESA2010[11], led to such a revision of the government debt level which effectively rendered this stringent sanction inapplicable.

2.1 Fiscal framework

The budget proposal has been prepared so as to respect the requirement to freeze expenditures at the 2014 budget level; **based on the latest revenue forecast, this translates into a deficit at the level of 1.98 % of GDP in 2015,** gradually diminishing to 0.44 % of GDP in 2017. At the same time, the proposal indicates certain deficit-raising measures that are likely to be incorporated once approved by the parliament (introduction of a health insurance allowance, increase in wages in the public sector)[12]. Given the uncertainty of macroeconomic development, consideration is being given to creating a reserve in the budget, similarly as in the previous years.

The government has set the upper limit for government deficit at 2.49 % of GDP for 2015 which, based on the Ministry of Finance calculations, would be in line with the EU fiscal rules. **The deficits in 2016 and 2017 are projected at 1.43 % and 0.39 % of GDP, respectively.** While a certain margin for deficit increase exists in 2016, the measures designed to meet the objective are missing for 2017. The adoption of the announced additional measures will narrow this margin in 2016 and increase the difference in 2017. In spite of the worsened 2014 outlook, the set objectives represent a moderate improvement compared to the last year's budget.

[11] The EU Member States report their data under ESA2010 since September 2014. Major change relates to the measurement of the economic performance and a more stringent definition of entities classified within the general government sector was introduced, as well. The impacts are described in more detail in Annex 4. The first data reported under the new methodology were published on 21 October 2014.

[12] The specific parameters of these measures are yet unknown, but based on the existing alternatives of health insurance allowance and past effects of wage increases, the deficit could raise to approximately 2.3% of GDP in case the legislative changes are being incorporated in the budget proposal.

Tab 4: General Government deficit targets (ESA2010, % GDP)

	2014E	2015B	2016B	2017B
1. Approved general government budget for years 2014-2016 (ESA95)	-2.64	-2.57	-1.5	-
2. General government budget proposal for years 2015-2017*	-2.93	-2.49 - -1.98	-1.43	-0.39
3. Change (2-1)	**0.3**	**0.1 - 0.6**	**0.1**	**-**
p.m. Balances drawn in GGBP for years 2015-2017		*-1.98*	*1.02*	*-0.44*

* impact of inclusion of new entities into the GG sector due ESA2010 amounts in average 0.03 % GDP yearly

Source: MF SR

The budgetary objectives, as currently set, would result in meeting the medium-term budgetary objective in 2017, which would be linked to the average annual improvement in structural balance by 1 % of GDP. These ambitious objectives are also supposed to offset the expected considerable deterioration in the structural balance in 2014. If the consolidation effort did not relax in 2014, the structural balance would have to annually improve by less than a half over the 2015-2017 period.[13]

Tab 5: Change in GG structural balance in 2014-2017 (ESA2010, % GDP)

	2013	2014E	2015B	2016B	2017B
1. General government balance	**-2.6**	**-2.9**	**-2.5 - -2.0**	**-1.4**	**-0.4**
2. Cyclical component	-0.5	-0.0	-0.1	-0.2	-0.1
3. One-off measures	-0.1	0.5	0.2	0.2	0.2
4. Structural balance (1-2-3)	**-2.0**	**-3.4**	**-2.6 - -2.1**	**-1.5**	**-0.4**
5. Change in structural balance/ Fiscal Compact	**2.4**	**-1.4**	**0.9 - 1.4**	**1.1 – 0.6**	**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	**-**	**-**	**-0.1**	**0.5**	**-0.2**
8. Size of measures (1-6)	**-**	**-**	**1.5 – 2.0**	**2.1**	**3.3**
9. Change in size of measures (Δ8)	-	-	1.5 – 2.0	0.6 – 0.1	1.2
10. Consolidation effort of government (5-7)	**-**	**-**	**1.0 – 1.5**	**0.6 – 0.1**	**1.2**
p.m. 1 Measures with no impact on long-term sustainability	0.6	-0.1	-0.1	0.0	-0.1
p.m. 2 PPP projects	-0.1	-0.0	0.0	0.0	0.0
p.m.3 Interest payments	-0.1	0.0	0.1	0.1	0.1

Source: CBR ´s methodology

The view of the budget proposal´s objectives remains unchanged even after other factors and measures are considered which, despite their medium-term effects, do not affect the long-term sustainability of public finances (fully-funded pillar of the pension system, the decommissioning scheme of nuclear facilities, special levy in banking sector) or which are not under government's direct control (interest payments).

On the upside, the budget proposal contains fewer one-off measures compared to the previous year. While the government one-off measures are expected to amount to 0.6 % of GDP[14] in

[13] Improving the structural deficit from 2.0% of GDP in 2013 to 0.4% of GDP in 2017 would require an average yearly improvement at a rate of 0.4% of GDP.

[14] Only government-adopted measures have been considered out of those included on the list of one-off measures (Annex 9). The one-off effects not resulting from the fiscal policy currently pursued by the government were not considered in quantification (VAT imputation from a PPP projects, financial corrections to EU funding, a fine imposed by the Anti-monopoly Office).

2014, they will fall to 0.2 % of GDP in subsequent years. Improving the deficit through one-off measures carries the risk of not achieving the planned revenues, or expenditure cuts (they are more difficult to quantify and may be subject to consideration of Eurostat), while their major drawback is that once they terminated, additional measures need to be adopted to keep the budget balance at the same level.

Assuming that no new measures are implemented and public finances develop within the limits of the existing legislation and practice (no-policy change scenario - NPC scenario), the deficit would surge from the estimated 2.9 % of GDP in 2014 to 4.0 % of GDP in 2015[15]. This considerable increase relates primarily to the expiry of one-off measures in 2014 in the total amount of 0.8 % of GDP[16].

The difference between the no-policy change scenario and the current deficit in 2015 is given by the size of measures incorporated in the budget proposal. The overall impact of these measures on the deficit represents 2.0 % of GDP in 2015 (the most significant measures are listed in sections 3.2 and 3.3). If the parliament increases the deficit towards the upper limit of the objective, the size of measures would drop to 1.5 % of GDP.

The quality of incorporated measures can be measured using the government consolidation effort indicator[17] which describes their contribution to a permanent improvement in deficit. Depending on the size of the deficit approved for 2015, the contribution should be within the range of 1.0-1.5 % of GDP. The government's contribution is only slightly greater than a year-on-year change in the structural balance, since the government has responded to the less favourable fiscal development[18].

The budget proposal assumes that, from the point of view of impacts on the economic development, the expansive fiscal policy of 2014 will be replaced by a neutral stance in 2015. The proposal envisages a year-on-year increase in the drawing of EU funds by 1.0 % of GDP; if this assumption is met, the increased drawing could contribute towards reviving economic growth and, at the same time, attenuate the adverse consequences of consolidation in the phase of a negative output gap. The macroeconomic forecast on which the budget proposal is built contemplates a lower rate of EU funds utilisation[19]. In that case, fiscal restriction would occur as soon as 2015.

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15 In its NPC scenario, the Ministry of Finance estimates the deficit to stand at 3.5% of GDP in 2014. The differences from the CBR's estimate ensue from differing assumptions on the development of certain items, such as, for example, revenues from dividends, expenditures in the health care sector and interest costs. The differences are described in more detail in Annex 5.

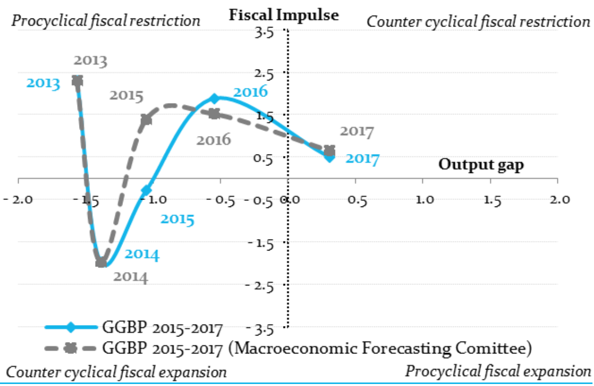
16 In addition to the one-off effects described in Annex 9, the increase in the basic VAT rate to 20%, which should be in force between 2011 and 2014 according to the applicable legislation, was also considered as having a one-off effect under the NPC scenario. The list of one-off effects incorporated in the NPC scenario is included in Annex 5.

17 The government consolidation effort indicator is linked exclusively to the contribution of government measures towards a permanent change of fiscal position. A detailed description of this indicator is given in the CBR Discussion Paper 02/2014: How to Measure Public Finance Consolidation.

18 The structural balance would worsen by 0.1% of GDP year-on-year in 2015 under the NPC scenario.

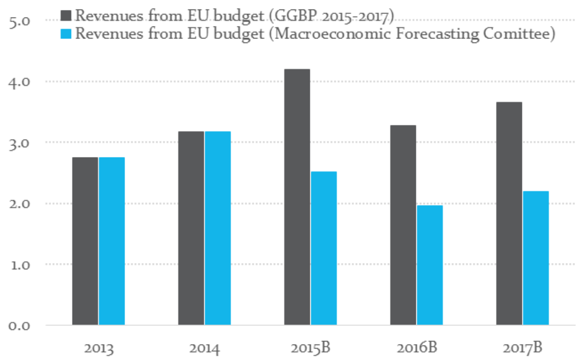
19 The absorption is expected at the level of 60% of budgeted revenues from EU funds.

Figure 1: Fiscal impulse in 2013-2017 (% GDP)



Source: CBR

Figure 2: Anticipated drawn of EU funds in GGBP (2015-2017) (% GDP)

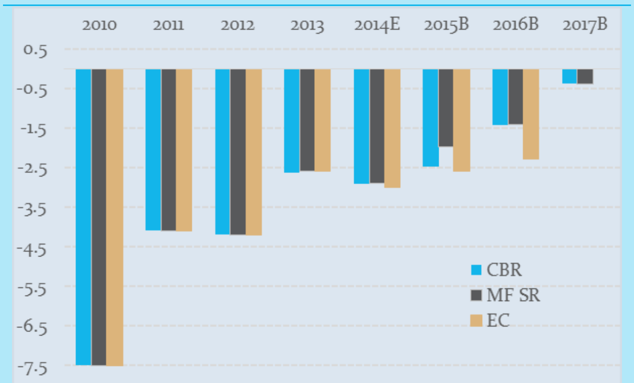


Source: CBR

Box 1: General government balance vs. structural balance from 2010 to 2017

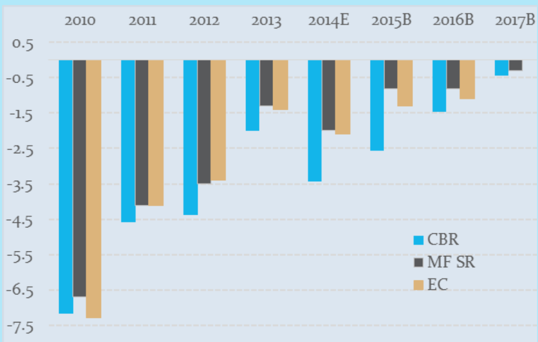
The following figures show the general government balance and estimates of the general government structural balance for 2010-2017 made by three institutions: the CBR, European Commission and Ministry of Finance. The differences in the structural balance are caused by different estimates of the 2015 and 2016 deficits, different estimates of the size of cyclical component (output gap) and the one-off effects taken into consideration. Except for 2014, when it grew considerably, computations by all three institutions show that the structural balance is improving.

Figure 3: GG balance in 2010-2017 (ESA2010, % GDP)



Source: CBR, MF SR, EC

Figure 4: GG structural balance in 2010-2017 (ESA2010, % GDP)

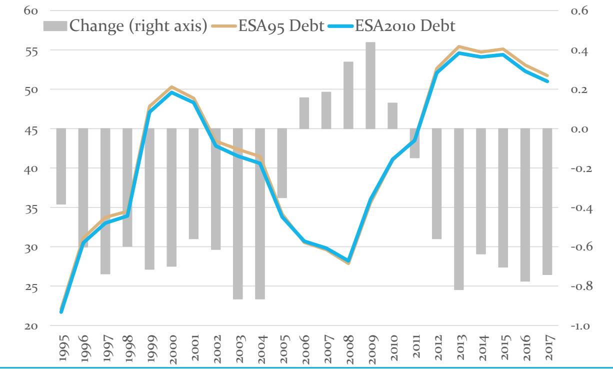


Source: CBR, MF SR, EC

2.2 General government debt

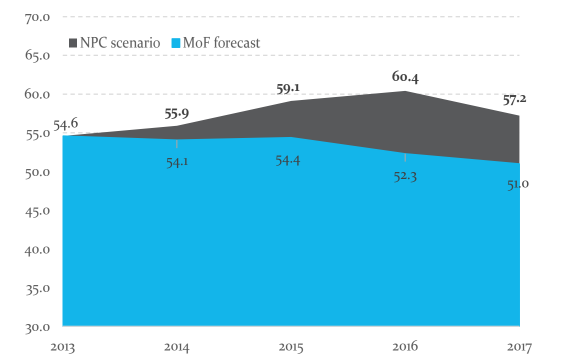
In October 2014, the end-2013 general government debt was revised downwards from the original 55.4 % of GDP to 54.6 % of GDP. The main reason for this revision was the changeover to ESA2010 which, on the one hand, increased the nominal debt (due to re-classification of certain entities to the general government sector), but, on the other hand, resulted in a more noticeable increase in nominal GDP. The positive impact of the change in methodology is also expected to be felt in the subsequent year, estimated at 1.0 % of GDP.

Figure 5: Impact of the transition to the ESA2010 methodology (% of GDP)



Source: SO SR

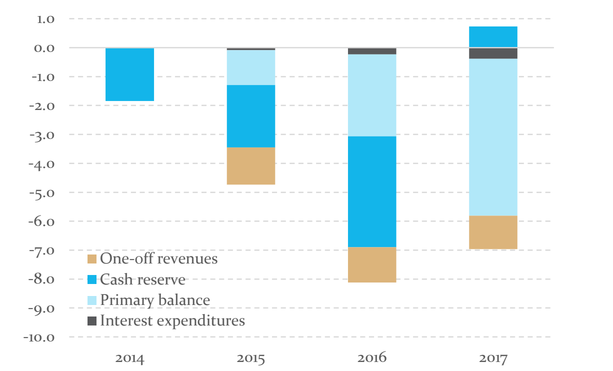
Figure 6: Debt development under NPC scenario (% of GDP)



Source: MF SR, CBR

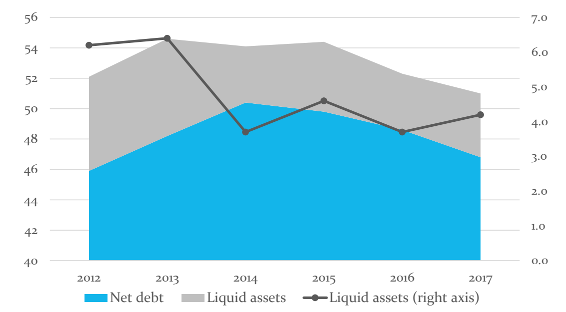
Compared to the no-policy change scenario under which the debt would gradually grow to as much as 57.2 % of GDP by 2017, the budget proposal foresees measures that are supposed to stabilise the debt below the 55 % of GDP level in the medium term, with a more considerable decrease towards the end of 2017. The largest impact on debt reduction in 2014-2016 comes mainly from a more massive use of the government's disposable liquidity[20] and additional one-off revenues (mainly from privatisation) to finance the government needs. The impact of the gradual deficit reduction should manifest itself more prominent in 2017. The debt forecast anticipates a deficit of 2.49 % of GDP in 2015, 1.43 % of GDP in 2016, and 0.39 % of GDP in 2017.

Figure 7: Contributions to change in debt (perc. points)



Source: CBR

Figure 8: Net debt (% of GDP)



Source: MF SR, CBR

[20] The no-policy-change scenario foresees a cash reserve in the volume sufficient to cover the government's needs for the first four months of the next year (Annex 5). The change in the impact of the reserve in 2017 is caused by a considerable reduction in the needs for financing in the first four months of 2018; this allows for a more sizeable debt reduction by the end of 2017 using the available liquidity.

The increased use of liquidity in the 2014-2016 period affects the volume of gross debt; therefore, in order to assess the development, it is also advisable to keep an eye on the development of the net debt from which government's liquid financial assets are deducted. Unlike the gross debt, the net debt has continued to grow in 2014; only afterwards, it will begin to copy the gross debt trajectory. This is caused by the use of the cash reserve to finance the debt, which decreases liquid assets by 2.2 % of GDP on average in the 2014-2017 period as compared to the previous period.

Meeting the assumptions on the use of privatisation revenues to cut the debt in the envisaged amount of 1.3 % of GDP is one of the major risks for debt development. The changes in methodology adopted in 2013 also included the exclusion of liabilities of healthcare facilities from the government debt, which are very likely to be assumed by the government, similarly as in the previous years. In that case, the general debt will increase in the year when the government decides to assume those liabilities[21]. The volume of risk liabilities amounted to EUR 212 million at the end of 2013, while the budget proposal expects them to grow to as much as EUR 322 million by the end of 2015 (0.4 % of GDP). Since the debt forecast takes into consideration the upper limit of deficit (at 2.49 % of GDP) for 2015, any reduction in the deficit target value would represent a positive risk to debt development.

[21] Moreover, in the case of higher-quality information about the nature of these liabilities, it is possible that a portion of them should be classified into debt, according to ESA. (Eurostat: The statistical recording of some operations related to trade credits incurred by government units of 31 July 2012).

3. Evaluation of the likelihood of meeting budgetary objectives

The expenditure framework of the general government budget is defined by the revenue forecast and the government's deficit target[22]. Realistic macroeconomic assumptions and the ensuing revenue forecast are thus essential prerequisites to designing a responsible budget.

At the national level, the Macroeconomic Forecasting Committee (MFC) and the Tax Revenue Forecasting Committee[23] (TRFC) were established under constitutional Act No. 493/2011 on Fiscal Responsibility to act 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, the Secretariat of the Council for Budget Responsibility (for taxes only) 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 the tax and social contribution revenue forecasts, must be discussed by the relevant committee.**

3.1 Macroeconomic assumptions

The budget proposal is based on the macroeconomic scenario discussed and in a consensual manner approved by the independent Macroeconomic Forecasting Committee in September 2014. Therefore, the CBR does not publish its own macroeconomic scenario for the purposes of budget assessment, but instead takes on board the assumptions approved by the MFC. The CBR evaluation concentrates on assessing the possible risks of the scenario from two points of view. Firstly, it assesses the feasibility of the forecast in light of the most recent information about the development of the external and internal environment. Secondly, it provides information about the volatility of forecasts, taking into account historical deviations of past forecasts from reality.

The present macroeconomic forecast reflects the bleak outlook for global economic growth and the continued stagnation of the euro area. On that account, after the economic growth accelerated to 2.4 % this year, only a slightly higher growth is expected for 2015 (below the last year's expectations - Table 6). International institutions share the assumption of gradual economic acceleration throughout 2015 towards the 2017 horizon.

Tab 6: Forecast of the MFC and international institutions

GDP real growth in %	Reality	Forecast				Change from previous year			
Institution	2013	2014	2015	2016	2017	2014	2015	2016	2017
MFC (September 2014 vs. 2013)	1.4	2.4	2.6	3.5	3.5	+0.2	-0.3	+0.4	-
IMF (October 2014 vs. 2013)	1.4	2.4	2.7	2.9	3.1	+0.1	-0.1	-0.4	-0.4
EC (November 2014 vs. 2013)	1.4	2.4	2.5	3.3	-	+0.2	-0.5	-	-
OECD (November 2014 vs. 2013)	1.4	2.6	2.8	3.4	-	+0.7	-0.1	-	-

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

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

23 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.

Actual risks of external and internal environment

Stagnation in the euro area and sluggish growth in Germany have also been confirmed by the most recent leading indicators of sentiment (IFO and ZEW). The ZEW indicator has been declining since the beginning of 2014, the IFO indicator since May 2014. The composite PMI indicator for October shows lower activity compared to the beginning of the year, but it does not indicate further decrease[24]. Declining sentiment reflect corrections of the optimistic outlook from the beginning of the year with respect to the recovery of economic growth in the euro area, as well as the impacts of political tensions with tangible effects on the economy ensuing from the Russia-Ukraine conflict and the developments in Iraq. On the other hand, Brent crude oil prices have been falling since July year-on-year, recently moving just below USD 90 per barrel[25], which represents a positive risk for economic growth in 2015 (oil importing European and Asian countries). The recent development in the US may also have a positive impact on the euro area cycle, as the recent published data were above expectations. However, negative risks prevail when compared against the MFC forecast assumptions, which may become prominent in the last months of 2014 and in the first quarter of 2015.

According to the most recent MFC forecast, Slovakia's economy will achieve 2.4 % growth this year, followed by a moderate acceleration to 2.6 % in 2015 with optimistic outlook for a more dynamic growth in 2016 and 2017. The Ministry of Finance estimates that the consolidation of public finances will lead to negative or neutral contributions of government expenditures and investments to GDP growth. Domestic growth will thus be driven by a combination of private consumption and contributions of net foreign trade in line with the moderate growth in foreign demand and lower negative contributions from imports (low crude oil prices are, however, toned down by euro's depreciation against US dollar). Monthly data indicate that the growth in household consumption, which has been driven by an increase in real wages and employment this year, is slowing down over the last two quarters of 2014, while the negative sentiment may result also in an increase household savings. The growth in employment and consumption can thus be expected to slow down over the next few quarters in the underperforming economic environment, translating into a slower growth in the tax revenue base next year (the MFC forecast on basic macroeconomic indicators in Annex 6).

Forecast risks based on historical deviations

The MFC assessed the macroeconomic forecasts for 2015-2017 as 'realistic' in September 2014. There are only moderate differences between the MFC forecast and those prepared by international institutions with respect to 2014 and 2015; however, the differences are more noticeable in the longer term due to differing assumptions concerning the closing of output gap.

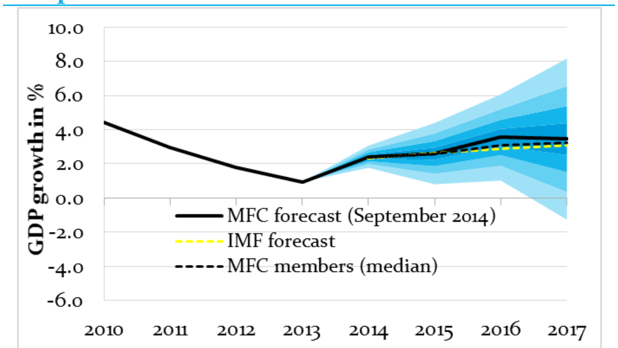
Even if forecasts are considered realistic at the time of their assessment, a change in development (in the external environment in particular) often leads to a different actual development. The level of uncertainty of a forecast can be estimated over the medium term by analysing the past forecasts errors (methodology described in Annex 8, box 4). Assuming the

[24] IFO, ZEW, PMI – sentiment indicators in Germany (IFO – CESifo Group Munich, ZEW – Zentrum für Europäische Wirtschaftsforschung, PMI – Markit Economics).

[25] The MFC forecast foresees the crude oil prices to keep above the USD105 per barrel for the entire period covered.

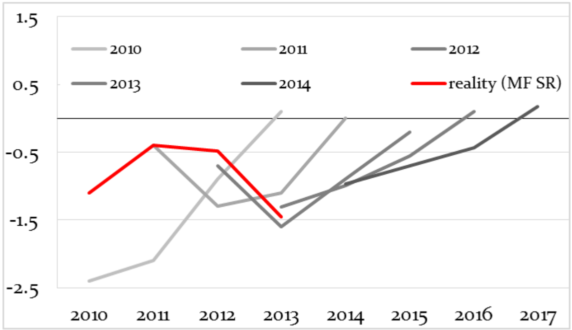
present forecast will be as accurate as the average for 2009-2013, the GDP growth is more likely to move within the 1.7 % to 3.5 % interval[26]. Due to increasing uncertainty, the forecast interval expands in the subsequent years. In the past five years, the closure of the output gap was postponed every year; consequently, growth estimates were revised downwards.

Figure 9: The MFC's GDP forecast risks based on past forecast errors



Source: CBR, MF SR

Figure 10: The MFC's output gap autumn forecasts in p.p.



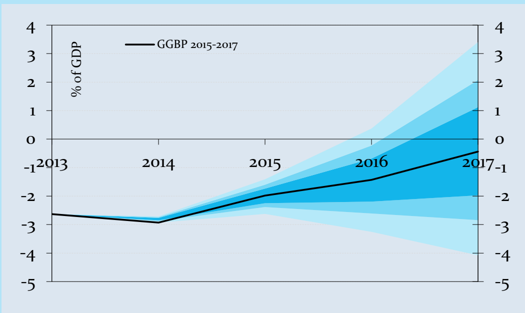
Source: CBR, MF SR

Box 2: Macroeconomic risks in budget

Any reduction or increase in economic growth is reflected in general government deficit and debt in two ways. The first one is the direct impact it has on the amount of tax and social contribution revenues[27] which is automatically reflected in the absolute change in the budgetary balance. The second one is the change in nominal GDP which then affects the amount of objectives defined relatively to GDP. The cumulation of these two effects causes the impact of the change in macroeconomic development to be reflected more markedly in both the deficit and debt.

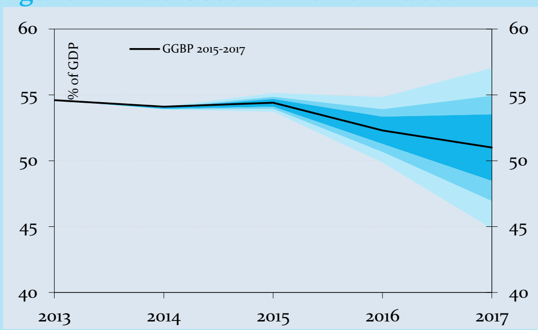
Budget sensitivity scenarios show that there is an 80 % probability that the budget balance will remain within an interval of up to 0.6 % of GDP around the budgeted level in 2015. Considering the cumulative effect of the increase in deficit and change in nominal GDP, the impact on debt is higher and the deviation may grow to as much as 1.6 % of GDP. It means that the deficit may near the 3 % of GDP level in case of negative development, and the debt may again exceed the level of 55 % of GDP.

Figure 11: Macroeconomic risk - balance



Source: CBR

Figure 12: Macroeconomic risk - debt



Source: CBR

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26 Chart 9 shows a 20-percent probability intervals for the forecast. The darkest area around the MFC forecast represents a 20-percent probability (low certainty) that the real GDP growth will move within the given interval.

27 The scenario disregards changes in expenditures with negligible impacts compared to revenues.

3.2 Forecast of revenues from taxes and social contributions

The forecasts of revenues from taxes and social contributions (hereinafter only referred to as tax revenue forecasts) were examined[28] and approved by the independent Tax Revenue Forecasting Committee in September 2014. Similarly to the macroeconomic assumptions, the CBR's evaluation concentrates on the assessment of risks taking into consideration the most recent information and, as far as possible, illustrates the impact of measures on firms and households.

The new **legislative measures** expected to yield more than EUR500 million (0.7 % of GDP) annually between 2015 and 2017 have a significant impact on the tax revenue forecast. The most significant of them include the keeping of the basic VAT rate at 20 %, and the new income tax rules that restrict tax-deductible expenditures (e.g., changes in tax depreciation of assets and introduction of the ceiling on interest costs for related taxpayers, so-called low capitalisation rules). The absence of absolutely reliable data to quantify the effect of measures, as well as the attempts by the affected taxpayers to avoid additional taxation introduces a certain level of uncertainty into the tax revenue forecast that must be taken into consideration, even though the forecasts were subject to independent assessment. In addition, the parliament has extended the exemption from the low capitalisation rules to also apply to leasing companies; this would reduce (according to computations based on individual data[29]) the amount of revenues by some EUR 3-4 million compared to that envisaged in the budget proposal. The Committee did not review the measure which introduces health insurance allowance. The CBR expects the Committee to discuss, at an extraordinary meeting, all additional changes in the tax legislation that will be included in the budget approved by the parliament.

The taxpayers' response to the increase in income tax[30] depends on the possibilities they have to shift the burden onto employees (a slower growth in wages, lower employment) or customers (higher prices). A drop in profits can only be expected if a particular taxable entity faces fierce competition on the market and cannot raise its final prices, or if its possibilities to streamline wage expenditures are limited. Despite a multitude of studies, no clear consensus[31] exists in academic literature[32] on who actually bears the increased tax burden. The resulting effect is assumed to be a combination of all three channels mentioned above and will only be felt in full over the medium term.

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28 The Secretariat of the Council for Budget Responsibility became a full Committee member in September 2014. The evaluation of the tax revenues forecast is also available at the Finance Ministry web site.

29 Individual corporate income tax returns and profit and loss accounts for 2010-2012.

30 For example, a company will increase other tax expenditures or export profits abroad through a related company.

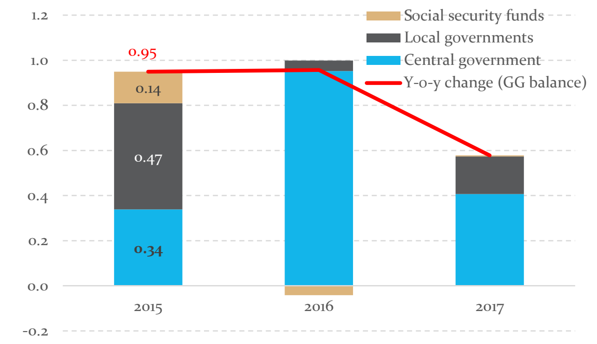
31 Interestingly, several studies argue that a major portion of the additional burden will be borne by employees. However, these conclusions cannot be accepted unequivocally, due to methodological constrains of the approaches used.

32 Corporate Tax Incidence: A Review of Empirical Estimates and Analysis (CBO, 2011)

3.3 Consolidation measures

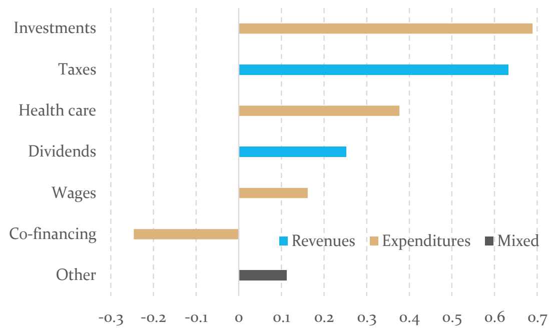
The budget proposal envisages a year-on-year drop in the deficit by almost 1 % of GDP, from the estimated 2.93 % of GDP in 2014 to 1.98 % of GDP in 2015. The largest contribution to this improvement comes from local governments, resulting from the fact that budgeted expenditures reflected the obligation to freeze them at the level of the 2014 budget[33]. A considerable contribution could also come from health insurance companies (they are a part of social security funds). According to the CBR estimate, the budget proposal contains measures[34] with an overall impact of 2.0 % of GDP in 2015 compared to the no-policy change scenario.

Figure 13: Contributions to y-o-y change in GG balance in 2015 - 2017 (% of GDP)



Source: CBR

Figure 14: The most important measures in 2015 (the budget proposal, % of GDP)



Note: (+) improves, (-) worsens GG balance *Source: CBR*

The most significant **changes on the revenue side involve the direct and indirect taxes** whose impacts were assessed by the Tax Revenue Forecasting Committee (described in section 3.2). In the case of dividends, their value has increased above the estimated value of revenues in 2014, but the budget proposal does not specify how this will be achieved[35].

A major saving is planned in the healthcare sector where the expenditures of health insurance companies are expected to drop by 3 % year-on-year in 2015. This would represent the largest cut in expenditures in the past ten years, accompanied by an envisaged improvement in the deficits produced by healthcare providers (chart 18). The budget proposal, however, lacks a detailed description of how these ambitious savings are to be achieved.

The budget proposal also foresees **the continuation of reforms in state administration - the so-called ESO project** - which should further reduce the operating and wage

33 The budget proposal anticipates an increase in local government expenditures in 2015 compared to the 2014 budget which is caused solely by the methodological inconsistency. While the local government budget for 2014 did not take into consideration extra-budgetary accounts, the amount of revenues and expenditures on such accounts are incorporated in the 2015 budget proposal, resulting in a year-on-year increase in local government revenues and expenditures.

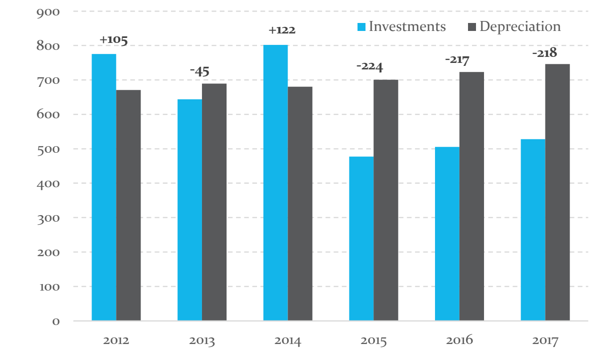
34 The measures incorporated in the budget proposal are described in the Draft Budgetary Plan for 2015. It is an analytical document prepared by the Ministry of Finance. Once approved by the government, the document is sent to the European Commission that assesses budgetary drafts prepared by the euro area Member States.

35 Risks associated with the budget proposal as identified by the CBR are described in section 3.4.

expenditures of the state budget. These changes are supported by the planned closure, merger and transformation of particular organisations, plus the streamlining of existing operations. However, the reduction in expenditures is not necessarily commensurately reflected in the deficit because, in some cases, unspent funds are re-allocated to cover other expenditures (for example, financing the field workers working with social security beneficiaries, or wages for teacher-assistants in the regional school sector).

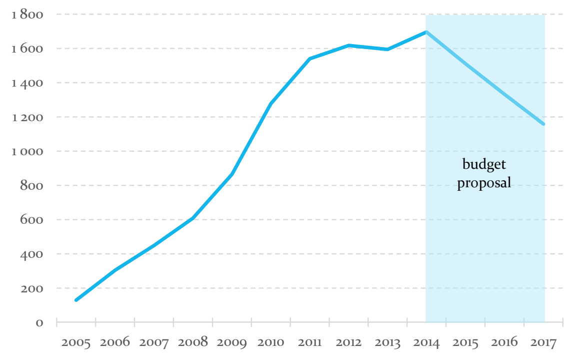
Major savings in expenditures should also be achieved at the **local government** level, particularly when it comes to capital expenditures. This assumption is partly justified by historical experience based on which investment activity ebbs after communal elections. On the other hand, these expenditures reached below-average levels in 2013 and 2014 already, and remain at a very low level throughout the entire three-year period covered by the budget. Such savings are non-sustainable in the long term, since they do not even cover the amount of depreciations.

Figure 15: Development of investments and depreciation in local governments (€ million)



** For the sake of comparability, data for 2014-2017 exclude investments and depreciation of municipal public transport companies, which will be classified in the general government sector in spring 2015. Source: MF SR, SO SR, CBR*

Figure 16: Cumulative difference between investments and depreciation since 2005 (€ million, constant prices)



Source: MF SR, SO SR, CBR

3.4 Risks to meeting the medium-term objectives

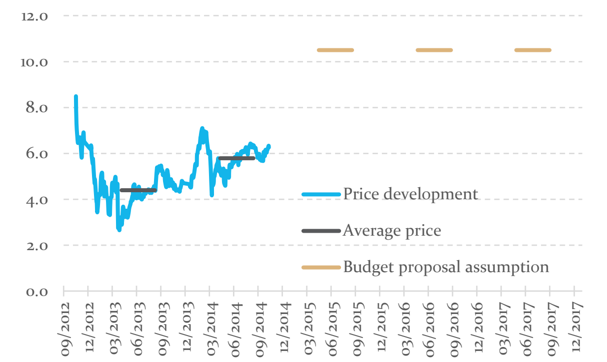
Beyond the possible risks associated with the forecast of economic development (described in section 3.1), the CBR sees additional risks in the budgeting of individual revenue and expenditure items.

The budget proposal overestimates certain non-tax revenues with an overall negative risk exceeding EUR 200 million a year. They particularly include:

- Expected **revenues from SPP dividend** correspond to the total current profit made by SPP subsidiaries in the past years, but the state only holds 51 % in those companies. In other words, in order to secure such high dividend payments, SPP subsidiaries would have to double their profits, or the loss-making parent company, wholly owned by the state, would have to considerably increase its own profit. The budget proposal does contain any justification for such an assumption, hence the CBR estimates this **risk at nearly EUR 150 million a year.**

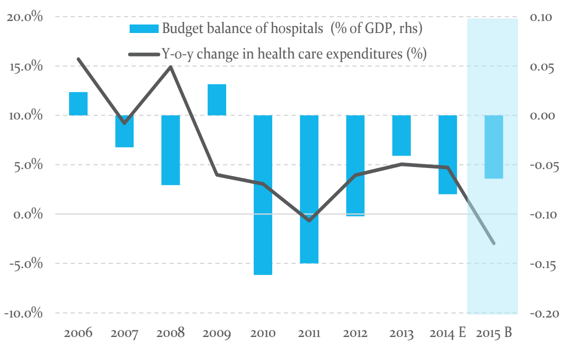
- Revenues from dividends paid out by ***Východoslovenská energetika*** (VSE) energy distribution company are based on an optimistic outlook regarding the profit generated by the company. In 2013, VSE posted individual after-tax profit of EUR 28 million, nearly EUR 40 million less than the year before. The drop was primarily caused by the missing dividend income from its subsidiaries and joint ventures, since their net profit fell to some EUR 9 million in 2012. Considering that these companies made a similar net profit in 2013, as well, no growth in the VSE net profit can be expected in 2014 that would make it possible to pay out regular dividends in the amount of EUR 36.5 million in 2015. The CBR expects the VSE's 2014 net profit to come in at the previous year's level; as a result, the state will receive roughly EUR 15 million in regular dividend payments in 2015. No considerable increase in net profits in 2016 and 2017 is envisaged, either. **The CBR estimates this risk at some EUR 21 million in 2015, and at EUR 16 million annually in subsequent years.**
- The budgeted revenues from the **sale of emission allowances** are planned at EUR 116 million, annually. Considering the current market conditions (low price, envisaged increase in the volume of auctions), a risk exists that these revenues will not materialise. Assuming that the average price remains at the 2014 average level (figure 17), this would annually represent a **shortfall in the amount of EUR 52 million.**
- Units 3 and 4 of the *Mochovce* nuclear power plant are expected to be put into operation in 2016 and 2017, respectively; the budget proposal incorporates an income from the contribution for their operation. With respect to the need to increase funds for their completion (as presented by the media), the launch of the two units may be postponed, which would also entail a **shortfall in budgetary revenues of approximately EUR 30 million in 2016 and 2017.**

Figure 17: Price development of EUA emission allowances (primary EU auctions, EUR/t CO_2)



Source: EEX, MF SR

Figure 18: Expenditure on health care and budget balance of hospitals



Source: MF SR, SO SR

Financial corrections to irregularities in the use of EU funds represent an additional potential risk. Since negotiations between the European Commission and the Slovak government on the conditions to unblock suspended payments from EU funds are still underway, it is impossible at this point to estimate their potential impact and the time at which they will negatively affect the deficit.

The budget proposal for 2015 foresees the largest ever year-on-year drop in **healthcare expenditures**, by 3.0 %, despite a moderate growth of 0.9 % in healthcare insurance revenues. The first reason is the assumption that, unlike 2014 when the health insurance companies are covering their payments from past years' balances (approx. EUR 60 million is expected), they will not use a portion of their funds next year and will increase their cash balances kept on accounts (EUR 38 million). Another reason is that they will use funds to repay their liabilities to shareholders in the amount of EUR 73 million. Adjusted for these items, the growth in expenditures would correspond to the slow growth in revenues. This slow growth in revenues is caused by decreasing the share of payments for persons whose health insurance contributions are covered by the state. Despite the significant cut in expenditures, the budget proposal paradoxically foresees a year-on-year improvement in the balances of healthcare providers classified in the general government sector. Without adopting resolute and clearly identifiable measures, the CBR believes this scenario represents a **risk for the budget quantified at EUR 50 million**.

The budget proposal foresees that **retained profits of private health insurance companies** will be paid out in 2015 only (Annex 3). Given the relatively high volume of retained profits (approximately EUR 250 million at the end of 2013), a risk exists they will also be paid out in **2016 and 2017.** The CBR has quantified this risk at **EUR 50 million a year,** which corresponds to the annual profit attained by both private health insurance companies in the past three years.

The three-year budget proposal **assumes that expenditures of local governments** will freeze at their 2014 budget level. This is required by the sanction mechanism contained in the constitutional act, which will eventually not apply (see Part 4 for more information). After incorporating this fact, along with non-realistic expectations concerning low capital expenditures, the CBR estimates the **risk at EUR 100-200 million**.

The General Government Budgetary Rules Act makes it possible to **carry over unspent capital expenditures to the subsequent year.** In the case of a positive impact on the deficit in 2014 (i.e., the volume of unspent expenditures carried over to 2015 will be higher than that carried over to 2014), the risk that they will be spent in the subsequent years increases. The potential risk for 2015 thus depends on the 2014 result.

The 2015 risks may potentially be covered by **unrealized expenditures for co-financing, estimated at EUR 190 million by the CBR.** This is due the fact that the budgeted absorption of EU funds exceeds the average absorption capacity within a single year; the CBR expects the absorption of EU funds at the level of 85 % of the amount specified in the budget proposal. The CBR foresees an accelerated drawing of EU funds within the ending programming period; considering the limited existing administrative capacities, such acceleration will result in a slower onset in the absorption of EU funds under the new programming period. The failure to use EU funds impairs the possibility to boost the economic growth potential, which brings along certain adverse budgetary implications (for example, lower collection of taxes). However, this risk has already been incorporated in the macroeconomic forecasts[36] used in the preparation of the budget proposal.

Another potential source to cover the risks is the proposed **cash reserve** which could cover the impact of potentially worse macroeconomic developments and/or other deviations contained in the budget.

[36] The macroeconomic forecast incorporated in the budget proposal foresees the drawing of EU funds at the level of 60% of budgeted values (roughly corresponding to an average rate of EU fund absorption in the past). Simply put, negative budgetary implications will occur in the case of below-average EU funds' absorption only.

Tab 7: Overview of risks and risk coverage in the budget proposal for 2015-2017 (€ million)

Risks in the present budget proposal	2015	2016	2017	Risk coverage in 2015	
1. Overestimated non-tax revenues:					
- revenues from dividends (SPP and VSE)	169	164	164		
- revenues - sale of emission allowances	52	52	52		
- revenues of the National Nuclear Fund from blocs 3 and 4 of the Mochovce NPP	0	29	35		
2. Corrections to EU funding	not quantified				
3. Underestimated health care sector expenditures:					
- health care expenditures	50	not quantified	not quantified	potential savings on co-financing	190
- repayment of liabilities to shareholders of private health insurance companies	0	50	50		
4. Underestimated local government expenditures, investments in particular	100-200	100-200	100-200		
5. Impact of potential expenditure savings in 2014 (for example, carry-over of capital expenditures)	not quantified	-	-		
6. Impact of additional measures foreseen in the budget proposal (health insurance allowance, wage increase in public administration)	200 – 230 annually			reserve for macroeconomic development	not quantified
Risk 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

Certain risks from the net worth perspective

The budget proposal contains items that improve the deficit at present, but they may be linked to higher expenditures in the future. A long-term view through the prism of net worth may identify such items.

The general government expenditures foreseen in the budget proposal indicate that a year-on-year drop of some 16 % in **investments** is expected in 2015; if the optimistic assumption on the absorption of EU funds is not met, this drop may be even greater. 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 we assume that the funds should serve to cover risks in the financial sector in the future, the levies, set in an actuarially fair manner, have a zero effect on the net worth, even though they improve the current balance of public finances[37].

[37] Assets are recorded on one side, potential future liabilities are recorded on the other side. The potential risks in the financial sector has yet to been clearly quantified, nor is it clear whether it represent a contingent or implicit liability.

4. Evaluation of the budget in terms of fiscal rules

The general government budget should respect the national rules, as well as the rules applicable to Slovakia as a member of the euro area. The most important national legislation is the constitutional **Fiscal Responsibility Act and the balanced budget rule** that implements the international Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. At the EU level, compliance with the requirements of the **Stability and Growth Pact** and related regulations is of particular importance.

The constitutional act contains the **rule on the development of the gross government debt to GDP ratio** and defines sanctions to be invoked when specified thresholds are exceeded. Based on the statistical data published in April 2014 (the so-called spring notification by Eurostat), Slovakia's public debt reached 55.4 % of GDP in 2013. The third debt threshold at 55 % of GDP was exceeded, triggering the obligation to block 3 % of state-budget expenditures and to prepare a general government budget proposal containing no increase in expenditures[38]. The 3-percent blockage has been in place since May 2014 and the general government budget proposal for 2015-2017 declared compliance with the requirement to freeze expenditures.

The Eurostat's autumn notification, the results of which only became known after the government had approved the budget proposal, revised the 2013 debt-to-GDP ratio down to 54.6 % of GDP due to the application of the new ESA2010 methodology (see Annex 4 for more details). It means that the sanctions triggered by the overrun of the third debt threshold do not apply. Only less stringent sanctions triggered by exceeding the second debt threshold remain in force, including the obligation for the government to submit to the parliament a proposal for debt-reduction measures and reduce the salaries of cabinet members to the previous year's level. The budget proposal foresees a freeze on salaries for cabinet members at the 2013 level. However, no measures have so far been proposed to cut the debt below the 50 % of GDP threshold.

The debt forecast contained in the budget proposal, prepared according to the ESA2010 methodology, foresees a gradual reduction of the debt-to-GDP ratio to the level of 51.0 % of GDP by the end of 2017. It means that if these values are met, the third debt threshold specified in the constitutional act will not be exceeded.

The constitutional act also contains a **debt rule for local governments**, to become effective from 2015; a failure to comply with the rule carries a penalty[39]. This rule is much more stringent than the debt rule for general government (with the same upper threshold at 60 %)

[38] Described in detail in the Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules for the Year 2013, dated August 2014 (available only in Slovak).

[39] If the total amount of debt of a municipality or a self-governing region reaches or exceeds 60% of its actual current revenues in the previous fiscal year, the municipality or self-governing region concerned shall pay a penalty imposed by the Ministry of Finance amounting to 5% of the difference between the total debt amount and 60% of its actual current revenues in the previous fiscal year.

because it is assessed in proportion to local governments' current revenues rather than to their economic performance. A total of 61 municipalities exceeded the threshold in 2013, while others were nearing this limit.[40] With the threat of penalty hanging over, these local government should consider it thoroughly when approving their budgets for 2015.

Another important domestic rule is the **balanced budget rule**, according to which Slovakia should be moving towards a balanced budget in the medium term (the objective is to achieve a structural deficit of 0.5 % GDP by 2017). The Ministry of Finance and the CBR evaluate compliance with the rule on the basis of actual data[41]. A closer look at budgetary objectives suggests that the balanced budget defined in this manner could be achieved in 2017. However, the trajectory along which the improving deficit will be moving is also important in that it is assessed individually every year. **Considering the current estimates, the CBR is of the view that the fiscal policy easing in 2014 could be considered a significant deviation[42] from the defined trajectory, one that will necessitate additional corrective measures.**

As regards the application of the **European budgetary rules**, **abrogation of the excessive deficit procedure in respect of Slovakia in the course of 2014** was an important step. This means that the **fiscal policy follows the preventive arm of the Stability and Growth Pact**, based on which Slovakia should be moving towards its medium-term budgetary objective and accomplish it in 2017. Conformity with these rules is declared in the budget proposal. Because the CBR does not quantify the change in structural balance strictly according to the methodology defined by the European Commission, the budgetary objectives in the budget proposal are not evaluated by the CBR in terms of compliance with the Stability and Growth Pact.

According to European rules, it is possible invoke the **so-called investment clause** allowing to relax the consolidation of public finances when implementing investments that are conducive to the long-term growth of the economy. Slovakia requested the application of this clause when compiling its 2014 budget, however, compliance with all the necessary criteria will be assessed by the **European Commission in the spring of 2015**.

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[40] Out of the total number of 2915 municipalities, 72 municipalities were in the 50-60% debt band. No self-governing region had a debt exceeding 50% of their current revenues in 2013. The data are taken from the Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules for the Year 2013.

[41] As assessed by the CBR in July, there was no significant deviation in 2013 and public finances were moving towards a balanced budget. In December, the assessment is updated on the basis of revised data under the ESA2010 methodology.

[42] In 2012, the structural deficit was at 4.4% of GDP. Assuming that the deficit will continue to steadily improve until 2017, it should reach 2.8 % of GDP in 2014. The CBR currently estimates the 2014 structural deficit at 3,4 % of GDP, thus meeting the definition of a significant deviation (a deviation of at least 0.5 % of GDP).

5. Fiscal transparency rules

The preparation of the budget, as well as the approved documents, should be in line with the transparency rules defined in the Fiscal Responsibility Act. The Act lays down the requirements for an independent assessment of macroeconomic assumptions and the tax revenue forecast which are necessary for a realistic compilation of the overall fiscal framework. Additional requirements are related to the publication of data ensuring better information about the overall situation in the budget and the policies that are being implemented.

The Macroeconomic Forecasting Committee and the Tax Revenue Forecasting Committee are responsible for ensuring that the macroeconomic assumptions and tax revenues are realistic. The committees operate independently and became standard and well-accepted parties to the budgetary process. **In 2014, the committees held three sessions and their forecasts were published in line with the constitutional Act.**

Tab 8: Draw up of the macroeconomic and tax forecasts by the Comittee in 2014

		1. Mandatory term till 15.2.	*2. Mandatory term till 30.6.*	*3.*
Macroeconomic Forecasting Committee	session of the MFC	4.2.2014	11.6.2014	16.9.2014
	release of the forecast	6.2.2014	16.6.2014	18.9.2014
Tax Revenue Forecasting Committee	session of the TRFC	12.2.2014	20.6.2014	24.9.2013
	release of the forecast	15.2.2014	24.6.2014	29.9.2014

Source: MF SR

The General Government Budget Proposal for 2015–2017 **formally contained all the necessary data**[43] in line with the requirements of the Fiscal Responsibility Act; however, in terms of content, **information was not always sufficiently explained and justified, which makes it difficult to evaluate and identify the potential risks.**[44]

In comparison with the General Government Budget Proposal for 2014–2016[45], there were several minor changes aimed at improving the transparency of the budget. The preparation of the tax expenditure manual, the inclusion of the costs associated with dimmissioning of nuclear facilities and implicit liabilities analysis, as well as the inclusion of the liabilities of the Chancellery of the Slovak parliament among contingent liabilities, represent measures that are regarded positively. On the other hand, the unclear formulation of objectives in terms of budget deficit, in particular for the upcoming year of 2015, needs to be perceived negatively. The fact that not all of general government revenues and expenditures have been budgeted needs to be viewed very negatively. The absence of a possibility to compare budgeted data with outcomes makes the interpretation of the government's measures very difficult. Moreover, should it become necessary to freeze the expenditures of the general government and local governments at the level of the previous budget due the debt brake sanctions, the failure in all expenditure items budgeting would result in the selective freezing of expenditures.

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43 More details on individual data can be found in Annex 7.

44 The CBR additionally requested the Ministry of Finance to make the data available and provide answers to additional questions. The Ministry of Finance complied with the request and consulted some of the issues in more detail.

45 The CBR assessed the requirements of the general government budget for 2014–2016 in the [Report on Compliance with the Fiscal Responsibility and Fiscal Transparency Rules.]

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

The CBR evaluates the long term sustainability twice a year. In the spring, the Report on the Long-term Sustainability of Public Finances provides a detailed quantification of the long term sustainability based on the actual fiscal performance and adopted measures **for the previous year.** In the autumn, as a part of the evaluation of the budget proposal, the expected impact **on the upcoming year** is stated in a qualitative manner taking into account budgetary targets and proposed measures**.**

As noted by the CBR in the latest assessment of the long term sustainability, 2013 saw a year-on-year improvement in the long term sustainability in particular due to the government's better fiscal performance, as well as due to the adoption of the pension scheme reform of the armed forces and police corps. On the other hand, the approved 2014 budget was assessed negatively in particular due to the planned hiatus in the consolidation of public finances[46]. A detailed quantification and assessment for 2014 will be published by the CBR in the Report on the Long-term Sustainability of Public Finances in April 2015.

The long-term sustainability of public finances is affected by the **general government balance**[47], **the existing debt**[48] and **future liabilities**[49] primarily associated with population ageing. Since **the fiscal balance target** has not been clearly set in the budget proposal for 2015, both limiting cases are assessed.

Tab 9: Budget goals that affect long term sustainability (% of GDP, ESA2010)

	2012	2013	2014	2015	2016	2017
Structural primary balance* (fiscal balance target -1,98 % GDP)	-2.61	-0.11	-1.65	-0.35	0.17	1.13
Structural primary balance* (fiscal balance target -2,49 % GDP)	-2.61	-0.11	-1.65	-0.86	0.17	1.13
Governement gross debt (fiscal balance target -1,98 % GDP)	52.1	**54.6**	**54.1**	**53.9**	51.8	50.5
Governement gross debt (fiscal balance target -2,49 % GDP)	52.1	**54.6**	**54.1**	**54.4**	52.3	51.0

**structural balance as defined by the EC* *Source: CBR*

The CBR is of the view that, considering both of the targets, the government's fiscal performance in 2015 should contribute to the improvement of the long-term sustainability relative to 2014. However, the above year-on-year improvement will not be sufficient to compensate for the negative impact of the "one-year hiatus" in the consolidation effort and, therefore, the long term sustainability will still be worse if compared to the year 2013.

46 The budgeted year-on-year deterioration of the primary structural balance in 2014.
47 Depending on whether the government is capable of managing the revenues in a sustainable manner (a balanced budget) or whether it spends more and increases the debt for the future generations (deficit).
48 A lower level of debt will provide more fiscal space in the future when the negative effects of population ageing will be felt to their fullest extent.
49 In particular through higher expenditures on pensions and healthcare.

In terms of future liabilities associated with population ageing, the mechanism for the calculation of the Christmas pension bonus[50] has been modified in 2014, with a neutral impact on general government expenditures. At the same time, however, there is a one-off[51] supplement to the Christmas pension bonus scheduled to be paid out. At this point it is not clear whether it would indeed constitute a one-off supplement. If this is not the case, the impact of this measure on the sustainability of the public finances will be slightly negative. Nonetheless, the budget proposal does not introduce any measures that would have significant impact on the general government revenue and expenditure projections in the long term and, therefore, improve or worsen the sustainability of the public finances.

After taking into account all of the aforementioned effects, it can be concluded that 2015 will **see a year-on-year improvement in the long-term sustainability which, however, turns to deterioration if compared to 2013.** Although the renewed focus on the long term sustainability could be viewed positively, the one-year hiatus in the consolidation of public finances could be seen as a missed opportunity.

[50] Under the amendment to Act No. 592/2006 Coll., the maximum value of the Christmas bonus was raised from EUR 75 to EUR 87.26 and the coefficient of decline was adjusted from 0.1 to 0.18.

[51] In the amount of EUR 12.74 in 2014 for pensions not exceeding twice the subsistence minimum. As far as the legislation is concerned, the one-off allowance is stipulated in transitional provisions.

Annex 1 – Assessment of the budget risks in 2014

Tab 10: Overview of budgetary risks and reserves for 2014 (€ million)

Risks to meeting budgetary targets	Dec. 2013	May 2014	November 2014
1. Unattained additional tax revenue from wage increases in education sector	10	0	0 (included in the MFC forecast, i.e., also in current tax revenue forecast)
2. Budgets of local governments	120-180	100-200	100-200 (the MF SR estimate is 117)
3. Underestimation of healthcare costs (unbudgeted increase in debts)	50-100	50-100	177 (the MF SR estimate)
4. Contributions to registered capital (Eximbanka, SZRB)	max. 100	0	0 (MF SR does not expect these transactions to be effected)
5. Shortfall in revenues from the sale of emission allowances			55 (the MF SR estimate)
6. Lower impact of the ESO reform (lower revenue from the sale of assets and lower cuts in expenditures)	50-100	50-100	46 (the MF SR estimate)
7. Negative impact of the carryover of expenditures from 2013			0 (the MF SR estimate)
8. Carryover of unspent EU funds and the related co-financing to subsequent years	400[1]	max. 82	0 (the risk is carried over to subsequent years)
9. Financial corrections to EU funds	no quantification	68	150 (the MF SR estimate is 81)
10. Non-recognition of the carryover of dividends under ESA95	437	443	443 (incorporated in the MF SR estimate, part of the amount represented a revenue in 2013)
11. Lower revenue from SPP dividends	-	181	131 (an updated CBR estimate based on the actual economic performance of the SPP company)
12. Change of the ESA2010 methodology	no quantification	no quantification	Slightly positive effect (the MF SR estimate)
13. Lower non-tax revenues (digital dividend, fine)	-	41	41 (the MF SR estimate)
14. Payment of retained profits of private health insurance companies	-	-	26-96 (the MF SR estimate is 26)
Coverage of risks			
1. Better tax collection	no quantification	min. 189	498 (an estimate by the TRFC)
2. Saving in co-financing and accompanying investments (gap)	200-300	200	min. 191 (the MF SR estimate is 191)
3. Saving due to sanctions under the Fiscal Responsibility Act	-	max. 308	305 (amount subject to blockage)
4. Impact of the fiscal performance of ŽSR and VVŠ	-	0-50	0-50 (the MF SR estimate is 20)
5. One-off revenue associated with the levy on business operations in regulated sectors	-	-	43 (not incorporated in the MF SR estimate)
Risk from a net-worth perspective without impact on budget balance			
1. Reduced value of government assets due to the sale of state property (ESO)	54	54	9 (majority of planned sales were not completed, but carried over to the next year)
2. Reduced value of government assets due to restriction on capital expenditures	no quantification	no quantification	no quantification
3. Sale of assets of state corporations (CARGO) and the use of those revenues to cover current expenditures	98	98	98
4. Use of the revenue from the bank levy to finance current expenditures and occurrence of contingent expenditures	160	160	153 (updated estimate)

(1) The risk for the entire 2014-2016 budget horizon, which might not have necessarily been observed already in 2014. *Source: CBR, MF SR*

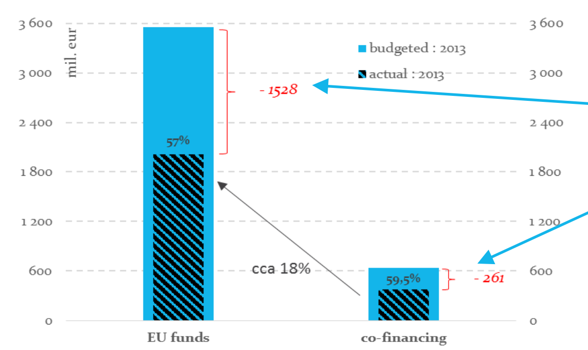
Annex 2 – Drawing of EU funds and impact on the budget balance

For a long time, Slovakia has not been able to spend expenditure financed from the EU[52] in line with the amounts planned in the budget[53]. In terms of public finances, this curbs expenditures on co-financing[54], **but, on the other hand, deflates tax revenues**. The total funds[55] that will thus remain unabsorbed could have been spent to finance investments, wages and final consumption. The most important effects can be observed in VAT[56], corporate income tax, social and health insurance and personal income tax.

The CBR estimates[57] that each euro spent on co-financing [58] increases additional tax revenues by approximately one euro. **The drawing of EU funds should be approximately neutral for public finances and, therefore, when it comes to increasing the economic potential and the living standard, it is very important to focus** on their spending and effective use.

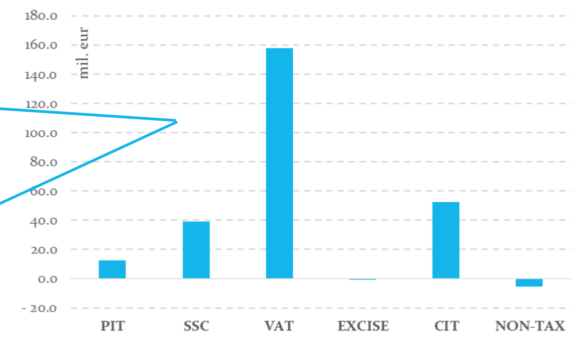
The situation is more complicated in terms of the **general government budget**, because the macroeconomic forecast in the budget is conservative, expecting lower uptake of the EU funds. **The shortfall in tax revenues is therefore already reflected in the budgeted tax revenues while expenditures on co-financing assume full spending of EU funds.** For this reason, the non-spending of the EU funds has a positive impact on the balance in comparison with the approved budget. On the other hand, **should EU funds be drawn in line with the budgeted amounts, tax revenues would increase considerably and their impact on the general government balance would be positive.**

Figure 19: Expenditures financed from the EU and co-financing in 2013



Source: GGB 2013 - 2015, MF SR

Figure 20: Estimated tax revenue shortfall due to lower EU fund absorbtion in 2013



Source: GGB 2013 - 2015, State treasury

52 In addition to the Structural Funds and the Cohesion Fund, this also applies to agricultural funds (direct payments, rural development).
53 For the past five years, the annual uptake is only 64 % of the budgeted amount.
54 In 2013, this amounted to EUR 261 million.
55 Unabsorbed funds from the EU, plus co-financing.
56 Where a beneficiary is not a VAT payer (some 70 % of contracted financial resources, in particular public administration projects), VAT is treated as eligible expenditure in the full amount, i.e., it is paid as part of overall expenditure in the corresponding ratio of the funding sources.
57 This is an indicative calculation due to data limitations and uncertainty surrounding the assumptions. The CBR has used the 2013 budget data and the data on the actual uptake broken down into a detailed structure in line with the economic classification.
58 The calculation assumes co-financing at approximately 18 % of revenues from the EU.

Annex 3 – Retained profits of private health insurance companies

There are two private health insurance companies (*Dôvera, Union*) operating in Slovakia at present, and their activities in the area of public health insurance fall under the general government sector balance[59]. As part of their activities, these companies can generate profits, which, if paid out to shareholders, will have a negative impact on the general government balance. The negative impact on the balance is due to drain of funds from the healthcare system which could otherwise be used to finance the healthcare provided, for instance, by large hospitals. Large hospitals are currently generating losses that are further increasing, depending on the availability of resources. On the other hand, if profit in private health insurance companies is, economically speaking, generated as a result of higher efficiency (without reducing healthcare availability) compared to the state-run Všeobecná zdravotná poisťovňa, while considering that the debt-generating facilities are demonstrably ineffective, the negative impact on the balance might be questionable.

In the past, health insurance companies were generating profits which they started to distribute after a certain delay. Because the amount of retained profits is relatively high, in particular in the case of *Dôvera* health insurance company, the future risks for public finances are not negligible.

The following table gives an overview of the developments in retained profits of both private health insurance companies since 2009, including the amounts paid to shareholders. At the end of 2013, retained profits totalled some EUR 250 million[60] which, if their liquidity is sufficient, might be paid out in the future, which will have a negative impact on the deficit. This amount can be further increased by future profits of the insurance companies.

59 The general government sector includes that portion of private health insurance companies' operations which are related to public health insurance. Simply put, the general government balance is affected by revenues from health insurance contributions, healthcare-related expenditures, health insurance companies' operating expenditures (the maximum amount is determined in the applicable law) and other expenditures financed from the contributions, such as payment of profits accrued.

60 The calculation neither takes into account the possibility to reduce the registered capital of health insurance companies to the minimum value defined by law, nor does it consider the use of funds in the legal reserve. In the case of *Dôvera* insurance company, it also takes into account the liabilities towards shareholders with respect to the one-off profit from the valuation of the portfolio of *Apollo* health insurance company that was acquired by *Dôvera* in 2009.

Tab 11: Development of retained profits of private health insurance companies (€ thousands)

	2009	2010	2011	2012	2013
Dôvera Health Insurance Company					
Liabilities towards shareholders and retained profits as of 1.1.	**29 825**	**469 046**	**478 059**	**337 838**	**335 693**
(+) Payout of retained profits	-29 825	0	0	0	0
(+) Profit/loss	469 046	16 238	39 278	47 856	46 498
(+) Liabilities paid to shareholders financed by loans	0	0	-179 500	0	-87 405
(+) Liabilities paid to shareholders in the form of dividends*	0	0	0	-50 000	-61 000
(+) Other changes	0	-7 225	0	0	0
Liabilities towards shareholders and retained profits as of 31.12.	**469 046**	**478 059**	**337 838**	**335 693**	**233 787**
- repayment of loans*	0	0	-11 738	-25 807	-19 357

Source: Health Care Surveillance Authority, Dôvera annual reports

Union Health Insurance Company					
Retained profit/accumulated loss as of 1.1.**	**-39 916**	**-56 432**	**-58 697**	**-49 697**	**-35 513**
(+) Profit/loss	-16 513	-2 265	9 000	15 984	6 605
(+) Accumulated loss paid from registered capital	0	0	0	0	68 516
(+) Liabilities paid to shareholders in the form of dividends*	0	0	0	0	-17 020
(+) Increasing statutory reserve fund from profits	0	0	0	-1 800	-3 197
(+) Other changes	-4	0	0	0	0
Retained profit/accumulated loss as of 31.12.**	**-56 432**	**-58 697**	**-49 697**	**-35 513**	**19 392**

** impact on GG balance*

Source: Union annual reports

*** equity less registered capital and statutory reserve fund*

The general government balance is affected by instalments of loans taken by the health insurance company to pay its liabilities to shareholders and the retained profit in the form of dividends. These items are also envisaged in the budget proposal.

Tab 12: Overview of payments related to retained profits in the budget proposal (€ thousands)

	2012	2013	2014 E	2015 B	2016 B	2017 B
Loan instalments (liabilities towards shareholders)	-25 807	-19 357	-26 250	-26 250	-27 350	-26 250
Dividends (liabilities towards shareholders)	-50 000	-78 020	0	-47 000	0	0
Total*	**-75 807**	**-97 377**	**-26 250**	**-73 250**	**-27 350**	**-26 250**

** impact on GG balance*

Source: MF SR

Annex 4 – Impacts of the transition to the ESA2010 methodology on public finances

The change in methodology for the reporting of statistical data in the European Union (transition to the ESA2010 methodology) has been effective since September 2014. After this date, all macroeconomic and general government statistics have been revised.

The main change in Slovakia's public finances was the inclusion of several entities (such as the National Motorway Company, the Emergency Oil Stocks Agency, Eximbanka and healthcare facilities) into the general government sector, which had an impact on the level of the general government debt and deficit.

The non-recognition of one-off revenues from the 'opening' of the fully-funded pension system pillar represented another important change affecting the balance since it entails an increase in future liabilities. Other changes (such as capitalisation of expenditures on research and development, change in the classification of defence spending, the recording of tax credits) changed the structure of expenditures and increased the overall level of revenues and expenditures without affecting the general government balance.

Because the indicators of public finances are, for the most part, expressed relative to GDP, the revision of the nominal GDP level played an important role in their changes.

Tab 13: Contributions to the change in nominal GDP levels (perc. points)

	2010	2011	2012	2013
Nominal GDP (ESA95, € million) - April 2014	**65 897**	**68 974**	**71 096**	**72 134**
Nominal GDP (ESA2010, € million) - October 2014	**67 204**	**70 160**	**72 185**	**73 593**
Change in nominal GDP (%):	**2.0**	**1.7**	**1.5**	**2.0**
1. Capitalisation of expenditures on research and development	0.6	0.6	0.6	0.7
2. Capitalisation of military expenditures	0.1	0.1	0.1	0.1
3. Small tools	0.9	0.8	0.8	0.8
4. Change in sectoral classification	0.2	0.1	0.0	0.1
5. Other changes not related to ESA2010 transition	0.2	0.2	0.0	0.4

Source: SO SR, CBR

Between 2010 and 2013, the GDP level has increased by 1.5 % – 2 %. The most significant (some 50 percent) share in the above increase can be attributed to small tools. This is due to the change in the definition of capital expenditures. ESA95 stipulated a minimum price above which a particular tool was to be treated as capital expenditure[61], whereas this minimum price criterion had been repealed in ESA2010. The only criterion is the duration of use of the tool.

A different recording of expenditures on research and development, as well as military expenditures with the duration of use of more than one year, greatly contributed to the change as well. While they were recorded under intermediate consumption in ESA95 without affecting the GDP level, in ESA2010 they are recorded as investments. Furthermore, changes in the sectoral classification had an impact on GDP due to the different method used for quantifying the output of individual sectors of the economy.

[61] In accordance with ESA95, the tools priced at less than 500 ECU in 1995 prices were recorded under intermediate consumption (with no impact on GDP) regardless of the duration of their use. In the event that they are classified as capital expenditures, the entire invested amount would have an impact on GDP.

Tab 14: Contributions to the change in debt-to-GDP ratio (% of GDP)

	2010	2011	2012	2013
GG debt (ESA95) - April/October 2014	**41.0**	**43.6**	**52.7**	**55.4**
GG debt (ESA2010) - October 2014	**41.1**	**43.5**	**52.1**	**54.6**
Difference (in perc. points):	**0.1**	**-0.2**	**-0.5**	**-0.8**
1. New GG entities	0.9	0.5	0.2	0.3
- National Motorway Company	0.7	0.6	0.5	0.5
- Emergency Oil Stocks Agency	0.0	0.0	0.0	0.1
- healthcare facilities	0.2	-0.1	-0.3	-0.3
- Eximbanka	0.0	0.0	0.0	0.0
2. Impact of GDP revision	-0.8	-0.7	-0.8	-1.1

Source: SO SR, CBR

As a result of the transition to the ESA2010 methodology, the ratio of general government gross debt to GDP dropped from 55.4 % of GDP to 54.6 % of GDP at the end of 2013. The debt of the new general government entities contributed to the increase in the general debt with 0.3 percentage points, most of which can be attributed to the National Motorway Company. On the other hand, the debt of healthcare facilities has dropped due to changes in the recording of their liabilities[62]. Increase in the nominal GDP level (the denominator effect) by 2% in 2013 had an opposite impact. This contributed to a drop in the debt-to-GDP ratio by 1.1 p.p.

Tab 15: Contributions to the change in GG balance-to-GDP ratio (% of GDP)

	2010	2011	2012	2013
GG balance (ESA95) - April 2014	**-7.5**	**-4.8**	**-4.5**	**-2.8**
- update of tax revenues	0.0	0.0	0.0	0.3
- other regular updates	0.0	0.0	0.0	0.0
GG balance (ESA95) - October 2014	**-7.5**	**-4.8**	**-4.5**	**-2.5**
GG balance (ESA2010) - October 2014	**-7.5**	**-4.1**	**-4.2**	**-2.6**
Difference (in percentage points):	**0.1**	**0.6**	**0.3**	**-0.1**
1. New GG entities	-0.1	0.6	0.3	0.1
2. Exclusion of one-off revenues from the fully-funded pillar	0.0	0.0	-0.1	-0.3
3. Interest flows on swaps	0.0	0.0	0.0	0.0
4. Impact of GDP revision	0.1	0.1	0.1	0.1

Source: SO SR, CBR

In the case of the general government balance, the revisions were less significant. In 2013, the deficit increased from 2.48 % to 2.63 % of GDP[63]. Under ESA2010, the transfer of accumulated assets from the pay-as-you-go pillar is no longer treated as general government revenue, which increased the deficit by 0.3 % of GDP. This was only partially offset by positive fiscal performance of new entities and the increased GDP level.

[62] During the period when healthcare facilities did not fall under the general government sector, their growing liabilities were, due to a cautious approach and the expected bailout, also recorded in the debt irrespective of their character (trade credits, which account for most of the existing liabilities of healthcare facilities, are not – by definition – part of the Maastricht debt). Following their inclusion in the general government sector, only the liabilities meeting the given definition (loans) were recorded in the debt, which contributed to an overall reduction in the general government debt. However, the assumption concerning their bailout in the future remains intact.

[63] In April 2014, Eurostat notified a deficit of 2.77 % of GDP; however, its revision in October was also influenced by updated tax revenues (with a positive effect of 0.3 % of GDP) and updated receivables and liabilities in balance sheets (with a negative effect of less than 0.1 % of GDP). These changes are unrelated to the change in methodology; their purpose is to further detail the provisional data available in April.

Annex 5 – No-policy-change scenario

The no-policy-change scenario (NPC) is a standard part of CBR's outputs. It is used during the preparation of the Report on the Long-term Sustainability of Public Finances which is published every year in April and in which the long-term sustainability indicator is estimated by means of the baseline scenario (projection for the upcoming 50 years). It is compiled from the detailed actual data on public finances, which serve as the basis for defining detailed rules for the projection of individual items in the general government revenue and expenditure balance.

The NPC scenario can also be used for the assessment of the general government budget, and this was the first time when the CBR compiled it to assess the current budget proposal. The main difference against the scenario prepared in April is that it relies on the estimate of the general government balance for 2014 which, however, is less detailed than the actual data; for this reason, the scenario contains simpler rules for the development of individual items in the general government balance. The scenario compiled in this manner makes it possible to estimate the size of measures incorporated in the budget proposal and the contribution of the government's measures to permanent improvements in the balance.

Procedure applied by the CBR

The 2015–2017 NPC balance of general government revenues and expenditures has been itemised in accordance with ESA2010, and the indexation rules are also applied to such individual items. It does not consider a different macroeconomic scenario as a result of higher deficits in the NPC scenario (the forecasts of the Macroeconomic Forecasting Committee are used).

It is based on the Ministry of Finance estimate for 2014 at 2.9% of GDP, adjusted for the impact of interest payments that are responding to debt developments under the NPC scenario. Even though the CBR has identified the risks for 2014 (Part 1), some of which may be reflected in the subsequent years, they have not been incorporated in the estimate[64]. At the same time, the Ministry's estimate was adjusted for unbudgeted items with a neutral impact on the balance. These include, in particular, the impact of extra-budgetary accounts of the state and local governments and the balance of healthcare facilities' (estimated on the basis of actual figures for 2013 and the assumption of their net impact on the balance as incorporated[65] in the estimate of the Ministry of Finance for 2014).

[64] In the entire document, the CBR's calculations rely on the estimate of the balance as compiled by the Ministry of Finance.

[65] In its estimate, the Ministry of Finance envisages a negative impact of hospitals on the general government balance at EUR 60 million in 2014. The balance of hospitals incorporated in the CBR's no-policy-change scenario was therefore compiled in way that expenditures exceed revenues by the same amount of EUR 60 million.

Tab 16: Overview of changes in 2014 compared to the MF SR estimate (% of GDP)

	ESA item	
GG revenues		**2.74**
Social contributions	D.61 R	0.26
Sales	P.11+P.12+P.131	2.05
Current transfers	D.7 R	0.43
GG expenditures		**2.75**
Compensation of employees	D.1 P	1.31
Intermediate consumption	P.2	1.10
Social transfers	D.62 P	0.26
Interest expenditure	D.41 P	0.01
Current transfers	D.7 P	0.03
Gross fixed capital formation	P.51 G	0.11
Capital transfers	D.9 P	-0.08
GG balance		**-0.01**

Source: CBR

As the next step, the estimate for 2014 was adjusted for one-off effects (Table 17), which increased the deficit to 3.8% of GDP. Afterwards, the indexation rules shown in Table 18 were applied to the balance adjusted in this manner.

Tab 17: List of one-offs in the NPC scenario (% of GDP)

	ESA item	2014	2015	2016	2017
Basic VAT rate at 20%	D.2 REC	0.30	-	-	-
Dividends	D.4 REC	0.19	-	-	-
Revenues from telecommunication licences	D.7 REC	0.22	-	-	-
Penalty imposed by the Antimonopoly Office	D.7 REC	0.06	-	-	-
Repayment of a loan by Cargo (cap. transfer in 2009)	D.99 REC	0.13	0.03	0.03	-
Repayment of a loan by Vodohospodárska výstavba (cap. transfer before 2002)	D.99 REC	0.06	-	-	-
Revenues from the sale of oil reserves*	-P5.M	0.12	-	-	-
Expenditures related to the sale of oil reserves*	D.29 PAY	-0.12	-	-	-
Payment of VAT from a PPP project	P.2	-0.01	-0.01	-0.01	-0.01
Financial corrections to EU funds	D.99 PAY	-0.11	-	-	-
Total (impact on GG balance)		**0.85**	**0.02**	**0.02**	**-0.01**

** One-off measure without impact on GG balance*

Source: CBR

Tab 18: Overview of the indexation of the most important items in the NPC scenario

ESA item	Name	Rule
D.2 R, D.5 R, D. 61 R, D. 91 R	Tax revenues and social security contributions	- forecast by the TRFC: the values taken and adjusted for the impact of new legislation - contributions of armed forces and police corps: the CBR model - other: values from the 2014 estimate
D.4 R	Property income	- dividends: nominal GDP growth rate less compensation of employees - other revenues: indexation by means of the interest rate on deposits
D. 7 R, D.9 R, P.11, P. 12 P. 131	Other revenues	- revenues from EU funds: assumed absorption of funds from the second programming period at 90 % of the allocation (distribution of the undisbursed amount between 2015 and 2016 based on the ratio assumed in the budget proposal), the onset of absorption during the third programming period is the same as was the case in the second programming period (Table 19) - other: values from the 2014 estimate
D. 1 P	Compensation of employees	- expenditures from EU funds: projected revenues broken down into the structure of expenditures based on the absorption in actual figures expected in 2014 (also applicable to other expenditures) - co-financing: according to the percentage share in the absorption within the individual Funds (also applicable to other expenditures) - other: indexation by means of the wage growth rate in the private sector
D.62P, D.631P	Social transfers	- pensions under the universal system, pensions of armed forces and police corps, healthcare: models prepared by CBR - other: indexation by means of the relevant macro-indicator irrespective of the change in the number of beneficiaries receiving individual benefits and allowances
D.41 P	Interest expenditure	- the MF SR forecast adjusted for the impact of the higher debt presented in the NPC scenario, considering implicit debt rates that are identical to those presented in MF SR forecast
P. 2, D.3 P, D.7 P, D.29 P	Intermediate consumption and other current expenditures	- the rate of growth in price level measured by CPI
P.51 G, D.9 P	Capital expenditures	- the rate of nominal GDP growth
GD	Gross general government debt	- worse primary balances under the NPC scenario taken into account - no new measures of the government (i.e., the planned privatisation is not undertaken) - the cash reserve at the end of 2014 through 2017, covering the liabilities for the next 4 months (benchmark chosen on the basis of the average cash reserve value until 2012[66] and the value at the end of 2013)

Source: CBR

[66] The Stability Programme of the Slovak Republic for 2014 – 2017, Box 6, pg. 48.

Tab 19: Assumptions on EU funds drawdown in the NPC scenario of the CBR (% of GDP)

	2014 E	2015	2016	2017
Breakdown by funds and programming periods	**3.19**	**3.59**	**1.94**	**2.59**
- structural funds and Cohesion Fund - 2nd PP	2.43	2.71	0.14	0.00
- structural funds and Cohesion Fund - 3rd PP	0.00	0.07	0.95	1.72
- agricultural funds	0.76	0.81	0.85	0.87
Breakdown by final recipient	**3.19**	**3.59**	**1.94**	**2.59**
- general government	1.93	1.85	0.62	1.00
- entities outside the general government sector	1.26	1.75	1.32	1.59
Expenditures on co-financing	**0.60**	**0.62**	**0.34**	**0.44**

Source: CBR, MF SR

NPC scenario compiled by the CBR

According to the NPC scenario compiled by the CBR, there is a slight rise in the deficit from 3.8 % of GDP in 2014 (net of one-off effects) to 4.0 % of GDP in 2015. In the subsequent years, the deficit would slightly improve, and its value will depend on the forecast EU funds drawdown[67].

Tab 20: Comparison of the NPC scenario prepared by the CBR with MF SR (% of GDP)

	2014 E	2014 E (adj.)*	2015 NPC	2016 NPC	2017 NPC	Differences between CBR NPC in 2015 and MF SR NPC	Differences between CBR NPC in 2015 and Budget
GG revenues	**39.3**	**38.4**	**37.8**	**36.0**	**35.7**	**0.6**	**1.0**
Taxes on production and	10.5	10.2	10.0	9.8	9.5	0.0	0.3
Current taxes on income,	6.5	6.5	6.3	6.3	6.2	0.0	0.3
Capital taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	13.7	13.7	13.6	13.5	13.3	0.1	-0.1
Property income	0.7	0.5	0.5	0.5	0.5	0.2	0.2
Sales	4.2	4.2	4.1	4.0	3.9	0.0	0.1
Revenues from EU funds	1.9	1.9	1.8	0.6	1.0	0.3	0.3
Other transfers	1.8	1.4	1.3	1.3	1.2	0.0	-0.2
GG expenditures	**42.3**	**42.1**	**41.7**	**39.5**	**39.4**	**0.1**	**-1.0**
Compensation of employees	8.5	8.5	8.5	8.3	8.3	-0.1	-0.2
Interemediate consumption	5.7	5.6	5.5	5.2	5.1	0.4	0.2
Social transfers (excl.	13.8	13.8	13.7	13.3	13.1	0.0	-0.1
Healthcare expenditures	5.1	5.1	5.2	5.2	5.3	-0.3	-0.4
Subsidies	0.8	0.8	0.8	0.7	0.7	0.0	0.0
Interest expenditures	1.9	1.9	1.8	1.8	1.7	-0.1	-0.1
Gross fixed capital formation	3.7	3.7	3.6	2.7	3.0	-0.2	-0.7
Capital transfers	0.3	0.2	0.3	0.2	0.2	0.1	0.1
Current transfers and other	2.5	2.5	2.4	2.1	2.1	0.2	0.3
GG balance	**-2.9**	**-3.8**	**-4.0**	**-3.5**	**-3.7**	**0.4**	**2.0**
Primary GG balance	**-1.1**	**-1.9**	**-2.2**	**-1.7**	**-2.0**	**0.3**	**1.9**
Gross GG debt	**55.9**	**55.9**	**59.1**	**60.4**	**57.2**	**-**	**-**

** Adjusted for one-offs* *Source: CBR, MF SR*

[67] In 2016, the absorption is expected to slow down as it will no longer be possible to draw funds under the second programming period, and, at the same time, the onset of the new programming period will be slower.

Comparison with the NPC scenario compiled by the Ministry of Finance

In its NPC scenario, the Ministry of Finance expects the deficit to reach 3.5 % of GDP in 2015. The deficit is by 0.4 % of GDP lower in comparison with the CBR's assumptions (Table 21). The main differences are due to different assumptions[68] concerning the development of several important items of the budget. The Ministry of Finance envisages a faster absorption of EU funds (at the level of the budget proposal), which entails higher expenditures on co-financing. Another difference is associated with the amount of dividends. Because the CBR considers a portion of dividends in 2014 to be one-off in nature, the amount reflected in 2015 will be lower. There are also differences in the assumptions concerning the development of healthcare expenditures. While the CBR uses its own model in the NPC scenario and assumes a year-on-year increase in expenditures by 5.3 %, the Ministry of Finance expects a slight drop. As regards the government's investments, different approaches have been applied in the projection of individual items. The CBR relies on aggregate (capital expenditures net of capital revenues), whereas the Ministry of Finance applies different rules to both components.

Tab 21: Main differences in NPC scenarios of MF SR and CBR (% of GDP)

	2015
1. GG balance in MF SR´s NPC scenario	**-3.53**
2. GG balance in CBR´s NPC scenario	**-3.96**
3. Difference (1-2):	**0.43**
Faster absorption of EU funds	-0.25
Higher revenues from dividends	0.25
Lower growth of healthcare expenditures	0.25
Lower growth of government investments	0.21
Lower interest expenditures	0.08
Other changes	-0.12

** The impact on GG balance is shown in the table* — *Source: MF SR, CBR*

Comparison with the budget proposal

In comparison with the CBR's no-policy-change scenario, the budget proposal includes measures that are almost evenly distributed between revenues and expenditures (Table 20), with an overall impact of 2.0% of GDP in 2015. Without taking into account the measures that have a neutral impact on the balance (revenues from the EU budget, social contributions paid by the state[69]), the ratio between the revenue-side and expenditure-side measures is 40:60. The only purpose of this comparison is to quantify the size of those measures and categories on the revenue and expenditure side which are subject to change. Their feasibility is assessed separately in the chapter discussing the risks of the budget proposal (Part 3.4).

[68] The Ministry of Finance compiles the NPC scenario in accordance with the published manual and uses a different classification of revenues and expenditures (economic classification). In addition, the assumptions for the indexation of certain revenue and expenditure items are different from those of the CBR.

[69] Revenues from the EU budget and social contributions paid by the state are increasing the revenues and expenditures of the budget proposal by the same amount, i.e., by 0.2 % of GDP in each case. Without them, the positive effect of measures on the revenue side and on the expenditure side would reach 0.8 % and, respectively, 1.2 % of GDP.

Annex 6 – Macroeconomic forecasts of the MFC

Tab 22: Forecasts of the MFC (ESA2010)

Indicator (in %)	Reality	Forecast (September 2014)				Change (September 2013)		
	2013	2014	2015	2016	2017	2014	2015	2016
GDP, real growth	1.4	2.4	2.6	3.5	3.5	+0.2	-0.3	+0.4
Consumer prices, year average	1.4	0.1	1.0	1.9	2.1	-1.6	-1.1	-0.4
Nominal wage, growth	2.4	4.2	3.3	4.2	4.4	+1.4	-0.1	+0.7
Real wage, growth	0.9	4.1	2.1	2.2	2.3	+3.0	+0.8	+1.0
Employment (ESA), growth	-0.7	1.0	0.4	0.5	0.6	+0.8	-0.2	-0.2
Unemployment rate (ILO)	14.2	13.5	13.0	12.2	11.3	-0.8	-0.6	-0.5
Private consumption, real growth	-0.8	2.9	2.4	2.7	2.2	+2.1	+0.3	+0.5
Investment, real growth	-2.7	4.8	2.7	1.4	1.9	+1.9	+2.8	+2.9
Export, real growth	5.2	4.6	4.3	6.0	6.1	+0.3	-0.2	+0.9
Weighted bases for budget revenues	1.2	4.0	3.5	4.5	4.6	+1.3	-0.4	+0.4

Source: MF SR, CBR

Annex 7 – Transparency rules – data requirements

The budget proposals prepared by general government entities should contain data on the fiscal performance for previous years, budgeted and estimated figures for the current year and data on budgeted items for the coming three years. The proposal should contain the consolidated balance of the general government budget, the government debt management strategy, tax expenditures, implicit liabilities, contingent liabilities, one-off effects and the performance of state corporations.

The requirements concerning the structure of the consolidated balance of the general government budget are not specified in the Fiscal Responsibility Act, yet only a detailed breakdown of revenue and expenditure items makes it possible to keep track of their development. The **consolidated balance** of general government **revenues and expenditures,** as contained in the General Government Budget Proposal for 2015 –2017, does include a breakdown of revenues and expenditures; however, a more detailed picture concerning the development of individual sub-items, such as those regarding social transfers and subsidies, would be desirable particularly on the expenditure side. In terms of effective application of the Fiscal Responsibility Act, the method of recording certain items is considered a serious shortcoming within the budgetary process. **The budget does not contain all revenue and expenditure items that are actually occurring regularly; for this reason, the actual values in the balance cannot be compared with the budgeted values**. Intensive discussions with the Ministry of Finance on this issue are already underway.

The **Government Debt Management Strategy** for 2015 – 2018 evaluates compliance with the strategy approved between 2011 and 2014 and presents the baseline macro-economic and fiscal position, while at the same time describing the current and anticipated developments on the financial markets. In terms of principles, the presented strategy follows up on the original debt management strategy and slightly modifies the quantitative objectives in the risk management of the government debt for the upcoming period.

The publication of **tax expenditures** makes it possible to better assess the costs of policies pursued by the government, thus increasing the transparency of the budgetary process. The budget proposal contains the quantification of tax expenditures in accordance with the manual of the Ministry of Finance, Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, as well as the Fiscal Responsibility Act.

Implicit liabilities are considered as hidden indebtedness of general government beyond the official debt statistics. 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. As opposed to the previous year, the analysis of implicit liabilities was extended by the impact of costs related to decommissioning of nuclear fascilities. In the future, the overall implicit liabilities should also include any PPP projects implemented by local governments, as well as risks arising from the performance of state corporations and companies of the National Property Fund (NPF).

Contingent liabilities of the general government are defined as other liabilities of an accounting entity which records them in the notes to individual financial statements.

Contingent liabilities are often very difficult to quantify and are, for the most part, described only in qualitative terms. At the end of 2013, they were quantified by the Ministry of Finance at EUR 11.1 billion, up 36.8 % year-on-year.

A separate section is devoted to **one-off effects** which are discussed in more detail and broken down into one-off tax and social contributions revenue and one-off non-tax and expenditure measures. One-off effects are also shown in a summary table.

The General Government Budget Proposal presents basic indicators concerning the **profit/lost of state corporations.** However, no detailed justification is provided with respect to the expected developments in these entities for the upcoming years, which makes it difficult to evaluate the potential risks for the general government in terms of their performance. In order to be able to thoroughly evaluate the risks, it is advisable to also include indicators concerning the performance of the NPF companies, along with a brief description of future developments.

As required by the European Commission, the **Draft Budget Plan of the Slovak Republic for 2015**, offering an analytical view of the general government's fiscal performance, has been submitted simultaneously. It defines the government's targets for the upcoming period and provides a more detailed quantification of measures aimed at achieving the targets set, as well as a quantification of alternative fiscal indicators such as structural balance of the budget, expenditure benchmark, or no-policy change scenario. As was the case in the previous year, the shortcomings in the budget proposal were partially offset by the **Draft Budget Plan of the Slovak Republic for 2015**.

Box 3: CBR recommendations to enhance transparency of the general government budget

- Improve the budgetary process so that the budget contains all revenue and expenditure items that are actually occurring, which will ensure comparability of the budgeted and reported items.
- Supplement the implicit liabilities with PPP projects undertaken by local governments, as well as with the risks arising from the performance of state corporations and NPF companies.
- Broaden the circle of entities reporting contingent liabilities (Deposit Protection Fund), place emphasis on new liabilities that have arisen in the course of the year. Improve the calculation methodology.
- Supplement the performance of state corporations and NPF corporations with a commentary on the payment of dividends and the impact on revenues from corporate income tax. Assess, at least in qualitative terms, the risks arising from the performance of state corporations and NPF companies.

Annex 8 – Budget sensitivity scenarios

Box 4: Methodology for assessing the forecast uncertainty

The uncertainty surrounding forecasts can be presented on the basis of an assumption regarding the forecast error, or by means of risk scenarios and a sensitivity analysis. The CBR Secretariat uses the MFC's forecast as the official forecast for assessing the assumptions concerning the development of the macroeconomic environment. Determination of the probability scenarios on the basis of past forecast errors is the most commonly used method for quantifying the uncertainty around macroeconomic forecasts. Such presentation is a standard part of regular assessments of macroeconomic assumptions of forecasts by fiscal institutions in the UK (OBR, 2014), Canada (PBO, 2014) or Ireland (IFAC, 2014).

In order to illustrate uncertainty, the simplest way is to construct the so-called fan chart showing the confidence bands for a point forecast of GDP growth while assuming that errors are evenly distributed between the lower and upper limits (symmetrical risk). In order to determine confidence intervals, we are using the MFC's autumn forecasts that were officially published on the website of the Ministry of Finance, taking into account the period from 2009 until 2013 with consistent dynamics of the economy since the beginning of the crisis.

Assuming a normal distribution of errors in the future with a zero expected average, the standard deviations (σ) of the individual forecasts for period t, t+1, t+2 a t+3 are calculated as follows:

$$\sigma = \sqrt{\frac{1}{N}\sum_{i=1}^{N}(y_i - \mu)^2} \qquad (1)$$

where N is the number of forecasts, y_i is the macroeconomic forecast in time i, and μ is the actual growth. Standard deviations with respect to GDP growth are increasing with the forecast horizon in accordance with rising , uncertainty in the forecasting period.

Tab 23: Standard deviations of autumn GDP growth forecasts (by the MFC, IMF, OECD and the EC; percentage points)

Variable/ institution	Year t	Year t+1	Year t+2	Year t+3
GDP growth – MFC	0.50	1.40	1.97	3.68
GDP growth – IMF	0.44	1.41	2.75	2.99
GDP growth – OECD	0.55	1.32	2.26	-
GDP growth – EC	0.56	1.43	1.67	-

Source: MF SR, CBR calculations

The standard deviations are subsequently reflected into the estimates of probability intervals for the selected confidence level α (0.20; 0.40; 0.60 and 0.80) with standard normal distribution of errors averaging at zero, thus yielding probability levels of 80 %, 60 %, 40 % and 20 %. The confidence bands for the point forecast estimate x are as follows:

$$x \pm z\left(\frac{\sigma}{\sqrt{n}}\right) \qquad (2)$$

where z is the critical value of the standard normal distribution (t-statistics or z-statistics), σ is the standard deviation for time t or $t+1$, $t+2$, $t+3$ and n is the number of observations (the number of past forecasts).

References:

- Irish Fiscal Advisory Council (2014). Fiscal Assessment Report. June 2014. http://www.pbo-dpb.gc.ca/files/files/EFO2014_EN.pdf

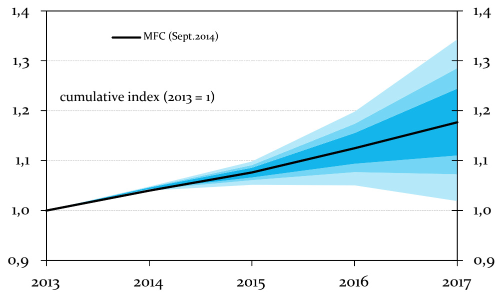
- OBR (2014). Economic and Fiscal Outlook. March 2014. http://cdn.budgetresponsibility.org.uk/37839-OBR-Cm-8820-accessible-web-v2.pdf
- Office of the Parliamentary Budget Officer (2014). Economic and Fiscal Outlook 2014. April 2014. http://www.pbo-dpb.gc.ca/files/files/EFO2014_EN.pdf

Tab 24: Forecasting risk of weighted bases for budget revenues

Indicator (in %)	Actual data	Forecast (September 2014) + confidence bands in scenarios			
	2013	2014	2015	2016	2017
Weighted bases for budget revenues (MFC)	1.2	4.0	3.5	4.5	4.6
- 40 % probability	1.2	3.9-4.2	2.6-4.2	2.6-6.4	1.5-7.7
- 60 % probability	1.2	3.8-4.3	2.2-4.6	1.5-7.6	-0.4-9.5
- 80 % probability	1.2	3.6-4.4	1.5-5.2	-0.1-9.1	-3.0-12.1

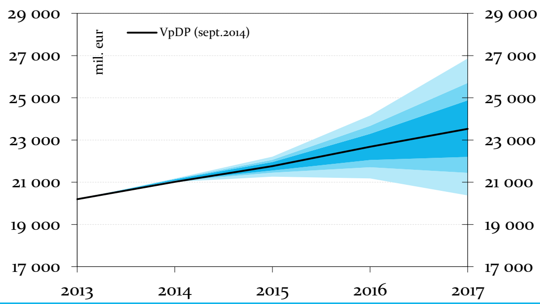
Source: Ministry of Finance of the Slovak Republic, CBR

Figure 21: Tax bases



Source: CBR

Figure 22: Tax revenues



Source: CBR

Annex 9 – One-off effects between 2013 and 2017

This part describes one-off effects that were taken into account in the calculation of the structural balance. In comparison with the last year's CBR report, the effects have been revised, with the overall impact representing 0.4 % GDP in 2014. In addition to excluding the measures brought by the new ESA2010 methodology (such as revenues of the fully-funded pillar), the updated list reflects the discussion with the Ministry of Finance which should lay the groundwork for joint national methodology aimed at identifying one-off effects. However, it might not necessarily yield an identical list of one-off effects because both institutions may, on a case-by-case basis, assess the legal force or substance of a transaction[70] differently.

Box 5: CBR's revision of one-off effects

The table shows the items that were struck out from the CBR's original list of one-off effects. The reasons for the revision can be broken down into three categories:

- **Changes in methodology (ESA2010)**: temporary 'opening' of the fully-funded pillar, debt of hospitals and healthcare facilities
- **Effects not complying with the specified minimum amount of 0.05% of GDP:** these include one-off contribution from the Javys company, taxation of retained profits, transfer of funds resulting from the cancellation of bearer deposits and revenues from the sale of state property (the ESO reform)
- **Other (such as duration, prolongation of legislation, additional information):** temporary entrepreneurial levy in regul. industries and special levy in the banking sector, reimbursement of EU sources in transport sector

Tab 25: Difference in one-off measures consideration in 2013-2017 (ESA2010, mil. eur)

	2013	2014	2015B	2016B	2017B
1. exit from the fully-funded pension pillar	240	-	-	-	-
2. accrualisation of hospitals´ liabilities	94	-	-	-	-
3. temporary entrepreneurial levy in regul. industries (incl. CIT)	67	56	58	62	-
4. taxation of retained earnings before 2004	4	5	-	-	-
5. special levy in the banking sector (incl. CIT)	157	119	82	84	-
6. cancelled "bearer" deposits	-	26	-	-	-
7. revenues from sales of state property (ESO)	-	9	-	-	-
8. reimbursement of EU sources in transport sector	-	50	-	-	-
9. JAVYS (voluntary grant)	30	0	-	-	-
10. Total revision of one-off measures	**592**	**266**	**140**	**146**	-
11. of which change in methodology (1+2)	*334*	-	-	-	-
Impact on the structural balance (10-11)	**258**	**266**	**140**	**146**	-
(% GDP)	*0.35*	*0.35*	*0.18*	*0.18*	-

Source: CBR

[70] A different approach to revenues from dividends paid by SPP is considered as one of the differences.

1. **Payment of VAT from a PPP project** – In 2011, the imputation of a claim towards *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 one-off effect on the budget deficit. In the next 30 years, the balance 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.

2. **Extraordinary revenues of the Telecommunications Regulatory Authority** – In 2014, the sale of frequency bands through auction, the so-called digital dividend, had a one-off positive effect on the non-tax revenues. The sale had a one-off positive effect on the general government balance in the amount of eur 163.9 million in 2014.

3. **Dividends** – These are one-off transfers of revenues from dividends unrelated to the respective fiscal year, and/or special agreements on the payout of dividends between the state and other shareholders which do not have to be considered under the ESA2010 methodology. According to CBR's calculations, these revenues accounted for eur 140 million in 2014 in dividends paid out by the SPP and Východoslovenská energetika companies.

   The General Government Budget Proposal for 2015–17 anticipates revenues from dividends eur 300 million from the SPP company which correspond to a 100-% government stake in the company's subsidiaries. However, the CBR takes into consideration only the payout of dividends from ordinary activities in the current year, corresponding to a 51-% state ownership All additional revenues are considered by the CBR as one-off revenues. Between 2015 and 2017, these revenues should represent eur 147 million.

Tab 26: Anticipated income from dividends in 2014-2017 (ESA2010, € million)

	2014	2015B	2016B	2017B
SPP				
1. Estimation/ GG proposal	268	300	300	300
2. Anticipated ordinary dividends (51 % ownership share)	136	153	153	153
One-off measures (1-2)	**131**	**147**	**147**	**147**
VSE				
1. GG proposal	24	-	-	-
2. Anticipated ordinary dividends	14	-	-	-
One-off measures (1-2)	**9**	-	-	-
Total	**140**	**147**	**147**	**147**

Source: CBR

4. **Financial corrections to EU funding** - Due to infringements of EU funding rules, several projects are not refunded from the EU even though Slovakia has already received the payment from the EU or the projects were already pre-financed from the state budget. The negative impact on the balance will occur as soon as the corrections are approved. In 2013, the corrections in respect of EU funds totalled eur 124.5 million and the Ministry of Finance estimates their amount to reach eur 81.0 million in 2014.

5. **Penalty imposed by the Antimonopoly Office** - In October 2006, the Antimonopoly Office ruled that the companies of *Strabag a.s., Doprastav, a.s., BETAMONT s.r.o, Inžinierske stavby, a.s., Skanska DS a.s.*, and *Mota – Engil, Engenharia e Construcao, S.A*. concluded a cartel agreement in conflict with the provisions of the Antimonopoly Act and the Treaty on the Functioning of the European Union. The cartel agreement concerned a public tender for the construction of the first section of the D1 motorways (Mengusovce – Jánovce). The Supreme Court of the Slovak Republic confirmed the legality of the fine in the amount of eur 44.8 million on 30 December 2013. The fine increased the non-tax revenues in 2014.

6. **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; this had a negative impact on the general government balance in 2009. Under the 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 2016. In 2013, the instalment had 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. Even though the individual instalments are less than 0.05 % of GDP in each year, the CBR is of the view that the transactions should be recorded consistently. The payment of instalments is thus taken into account throughout the entire repayment period and has a positive effect on the general government balance.

7. **Repayment of a loan provided to *Vodohospodárska výstavba, š.p.*** – In 2014, the payment of the last two instalments of a loan provided to *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 recorded under the ESA95 methodology as a capital transfer with a negative effect on the deficit, the transaction will have a positive effect on the general government balance in 2014. As with the loan to *Cargo*, the payment of instalments is, despite the relatively low amount in the individual years, recorded throughout the entire loan repayment period.

Tab 27: One-off measures in 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 (transfer from 2012)	-	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	0.13	0.03	0.02	-
repayments of loans Water-management development	0.04	0.06	-	-	-
Total	**-0.11**	**0.54**	**0.21**	**0.20**	**0.16**

Source: CBR

Annex 10 – General Government Budget

Tab 28: General Government Budget (ESA2010, € million)

	2014B	2014E	2015B	2016B	2017B
Total Revenue	26 049.2	27 480.9	28 081.1	28 524.4	29 724.6
Tax revenue	**12 024.2**	**12 780.5**	**13 234.4**	**13 751.6**	**14 176.9**
Taxes on Production and Imports	7 634.2	7 895.6	8 065.6	8 330.5	8 547.9
- VAT (incl. VAT directed to the EU)	4 816.6	4 917.1	5 099.1	5 314.0	5 546.2
- Excise taxes	1 944.1	2 013.7	2 042.7	2 079.0	2 107.0
- Taxes on Land, Buildings and Other Structures	233.2	232.5	233.6	239.3	245.6
Current Taxes on Income, Wealth etc.	4 390.0	4 884.9	5 168.8	5 421.1	5 629.0
- PIT	1 967.0	2 268.8	2 386.7	2 529.3	2 678.3
- CIT	1 913.0	2 120.1	2 311.2	2 406.4	2 525.2
- Withholding Tax	154.1	170.8	145.6	153.4	170.3
- Property Taxes and Others	107.7	107.4	107.9	110.5	113.4
Social Security Contributions	**9 927.3**	**10 058.9**	**10 321.7**	**10 820.0**	**11 276.2**
Actual Social Security Contributions	9 818.7	9 936.4	10 191.3	10 692.8	11 149.6
Imputed SSC	108.6	122.4	130.4	127.2	126.6
Nontax revenue	**1 943.4**	**2 137.6**	**2 283.9**	**2 274.7**	**2 333.6**
Sales	842.2	1 587.0	1 702.6	1 741.1	1 794.7
Property Income, of which	1 101.2	550.6	581.3	533.6	538.9
- Dividends	997.4	427.8	495.0	447.5	442.3
- Interest	50.5	58.3	39.2	38.5	49.2
Grants and transfers	**2 154.3**	**2 504.0**	**2 241.2**	**1 678.1**	**1 938.0**
of which: from EU	1 197.9	1 452.7	1 681.7	1 117.1	1 389.2
Total Expenditure	28 049.6	29 679.7	29 621.9	29 362.7	30 107.3
Current Expenditure	**26 563.4**	**26 618.2**	**26 868.3**	**27 155.6**	**27 749.5**
Compensation of employees	5 015.3	5 429.7	5 434.0	5 427.3	5 447.2
Intermediate Consumption	3 438.9	3 419.8	3 563.5	3 596.8	3 662.8
Taxes	122.8	122.8	34.2	34.5	34.4
Subsidies	989.1	594.7	585.1	585.3	594.9
Property Income	1 375.0	1 386.8	1 327.0	1 347.8	1 354.8
- Interest	1 375.0	1 386.8	1 327.0	1 347.8	1 354.8
Total Social Transfers	13 757.9	13 787.9	13 842.1	14 445.9	14 959.1
- Social benefits other than in kind	9 996.0	9 936.0	10 110.1	10 410.0	10 745.5
- Active Labor Market Measures	20.9	47.1	30.2	21.6	23.4
- Sickness benefits	432.0	393.9	416.5	432.6	442.5
- Retirement and disability pensions	6 112.2	6 153.0	6 356.0	6 536.5	6 791.4
- Unemployment benefits	179.2	163.5	157.3	151.7	148.8
- State social allowances	1 402.2	1 395.7	1 376.0	1 391.5	1 411.6
- SSC on behalf of certain groups	1 476.6	1 418.4	1 382.2	1 490.7	1 536.5
- Social transfers in kind (healthcare facilities)	3 761.9	3 851.9	3 732.0	4 036.0	4 213.6
Other current transfers	1 864.6	1 876.5	2 082.5	1 717.9	1 696.2
of which: Levies to the EU budget	683.1	720.6	738.0	749.9	746.5
of which: 2% of income tax to 3rd sector	49.3	50.5	54.4	50.5	53.6
Capital Expenditure	**1 486.1**	**3 061.5**	**2 753.6**	**2 207.1**	**2 357.8**
Capital investment	829.9	2 495.5	2 177.1	1 784.1	1 916.5
Capital transfers	656.3	566.0	576.5	423.0	441.3
Net lending/borrowing	-2 000.4	-2 198.8	-1 540.8	-838.3	-382.7
Fiscal space			399.3	336.5	-44.7
Net lending/borrowing - target	-2 000.4	-2 198.8	-1 940.1	-1 174.9	-338.0

Source: MF SR

Tab 29: General Government Budget (ESA2010, % of GDP)

	2014B	2014E	2015B	2016B	2017B
Total Revenue	34.4	36.6	36.0	34.7	34.3
Tax revenue	**15.9**	**17.0**	**17.0**	**16.7**	**16.4**
Taxes on Production and Imports	10.1	10.5	10.4	10.1	9.9
- VAT (incl. VAT directed to the EU)	6.4	6.5	6.5	6.5	6.4
- Excise taxes	2.6	2.7	2.6	2.5	2.4
- Taxes on Land, Buildings and Other Structures	0.3	0.3	0.3	0.3	0.3
Current Taxes on Income, Wealth etc.	5.8	6.5	6.6	6.6	6.5
- PIT	2.6	3.0	3.1	3.1	3.1
- CIT	2.5	2.8	3.0	2.9	2.9
- Withholding Tax	0.2	0.2	0.2	0.2	0.2
- Property Taxes and Others	0.1	0.1	0.1	0.1	0.1
Social Security Contributions	**13.1**	**13.4**	**13.2**	**13.2**	**13.0**
Actual Social Security Contributions	13.0	13.2	13.1	13.0	12.9
Imputed SSC	0.1	0.2	0.2	0.2	0.1
Nontax revenue	**2.6**	**2.8**	**2.9**	**2.8**	**2.7**
Sales	1.1	2.1	2.2	2.1	2.1
Property Income, of which	1.5	0.7	0.7	0.6	0.6
- Dividends	1.3	0.6	0.6	0.5	0.5
- Interest	0.1	0.1	0.1	0.0	0.1
Grants and transfers	**2.8**	**3.3**	**2.9**	**2.0**	**2.2**
of which: from EU	1.6	1.9	2.2	1.4	1.6
Total Expenditure	37.0	39.5	38.0	35.7	34.7
Current Expenditure	**35.1**	**35.4**	**34.5**	**33.1**	**32.0**
Compensation of employees	6.6	7.2	7.0	6.6	6.3
Intermediate Consumption	4.5	4.6	4.6	4.4	4.2
Taxes	0.2	0.2	0.0	0.0	0.0
Subsidies	1.3	0.8	0.8	0.7	0.7
Property Income	1.8	1.8	1.7	1.6	1.6
- Interest	1.8	1.8	1.7	1.6	1.6
Total Social Transfers	18.2	18.4	17.8	17.6	17.3
- Social benefits other than in kind	13.2	13.2	13.0	12.7	12.4
- Active Labor Market Measures	0.0	0.1	0.0	0.0	0.0
- Sickness benefits	0.6	0.5	0.5	0.5	0.5
- Retirement and disability pensions	8.1	8.2	8.2	8.0	7.8
- Unemployment benefits	0.2	0.2	0.2	0.2	0.2
- State social allowances	1.9	1.9	1.8	1.7	1.6
- SSC on behalf of certain groups	1.9	1.9	1.8	1.8	1.8
- Social transfers in kind (healthcare facilities)	5.0	5.1	4.8	4.9	4.9
Other current transfers	2.5	2.5	2.7	2.1	2.0
of which: Levies to the EU budget	0.9	1.0	0.9	0.9	0.9
of which: 2% of income tax to 3rd sector	0.1	0.1	0.1	0.1	0.1
Capital Expenditure	**2.0**	**4.1**	**3.5**	**2.7**	**2.7**
Capital investment	1.1	3.3	2.8	2.2	2.2
Capital transfers	0.9	0.8	0.7	0.5	0.5
Net lending/borrowing	-2.64	-2.93	-1.98	-1.02	-0.44
Fiscal space			0.51	0.41	-0.05
Net lending/borrowing - target	-2.64	-2.93	-2.49	-1.43	-0.39

Source: MF SR

Annex 11 – Structure and development of GG expenditures

Tab 30: Structure and development of GG expenditures (ESA2010, € million)

	2014E	2015B	2016B	2017B
Total expenditures	29 679.7	29 621.9	29 362.7	30 107.3
- EU expenditures	1 452.7	1 681.7	1 117.1	1 389.2
- Co-financing	448.4	672.8	488.8	540.9
- Interest paid	1 386.8	1 327.0	1 347.8	1 354.8
- SSC on behalf of certain groups	1 418.4	1 382.2	1 490.7	1 536.5
- Transfers to the EU budget	720.6	738.0	749.9	746.5
Adjusted expenditures	24 252.8	23 820.3	24 168.4	24 539.4
Mandatory	**10 328.8**	**10 258.1**	**10 200.8**	**10 145.7**
year on year (%)		**-0.7**	**-0.6**	**-0.5**
Compensation of employees	5 325.1	5 386.2	5 395.4	5 405.1
Wages	3 888.2	3 949.3	3 952.1	3 957.8
Employer social security contributions	1 436.9	1 436.8	1 443.3	1 447.2
Intermediate consumption	2 930.0	2 688.0	3 018.8	2 981.1
Taxes	122.8	34.2	34.5	34.4
Subsidies	482.8	496.6	467.2	458.6
Agricultural subsidies	8.7	3.9	3.9	4.9
Transport subsidies	320.5	326.7	308.4	301.7
Rail transport	205.0	218.5	218.4	218.4
Bus transport	143.5	107.2	89.0	82.2
Other	153.6	166.0	155.0	152.1
Social transfers	364.4	392.0	385.4	391.2
Other current transfers	1 103.6	1 261.3	899.5	875.3
Facultative	**12 046.3**	**12 095.0**	**12 601.0**	**13 063.9**
year on year (%)		**0.4**	**4.2**	**3.7**
Social transfers	11 995.8	12 040.6	12 550.6	13 010.3
Social benefits other than transfers in kind	8 143.9	8 308.6	8 514.6	8 796.7
Active labour market policy	37.7	2.9	2.3	2.3
Sickness benefits	393.9	416.5	432.6	442.5
Old-age and disability pensions	6 153.0	6 356.0	6 536.5	6 791.4
Unemployment benefits	163.5	157.3	151.7	148.8
State social allowances	1 395.7	1 376.0	1 391.5	1 411.6
Child allowance	319.9	318.7	320.2	320.6
Allowance for newborns	31.3	14.6	13.1	14.5
Parental allowance	357.4	358.4	361.5	373.5
Material needs benefits	250.5	256.1	257.0	255.0
Cash subsidies on compensation	238.8	248.2	255.5	261.9
Other	197.8	180.0	184.3	186.2
Social transfers in kind (Healthcare)	3 851.9	3 732.0	4 036.0	4 213.6
Other current transfers	50.5	54.4	50.5	53.6
of which: 2% of income tax to 3rd sector	50.5	54.4	50.5	53.6
Capital expenditures	**1 877.7**	**1 467.1**	**1 366.5**	**1 329.8**
year on year (%)		**-21.9**	**-6.9**	**-2.7**
Capital investment	1 356.0	1 012.8	1 026.4	980.6
Capital transfers	521.6	454.4	340.2	349.1

Source: MF SR, CBR

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