2014 General Government Budget Results

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Theme: 2014 General Government Budget Results

The 2014 government deficit and debt figures[1] released yesterday by Eurostat are positive, however, we should point at significant changes in the structure of revenues and expenditures. In 2014, the government failed to seize the opportunity of moving towards more sustainable public finances when its structural deficit increased by 0.9 % of GDP year-on-year and reached 3 % of GDP.

The deficit of 2.87 % of GDP is higher than in 2013 and also higher than the budgeted target of 2.64 % of GDP; nevertheless, in the context of the risks identified by the Council for Budget Responsibility and against the backdrop of the more relaxed SGP rules, the deficit can be viewed as a fairly good result. The debt fell to 53.6 % of GDP, landing safely within the second, more comfortable zone of the debt-brake sanction mechanism. As early as in November 2013, the CBR pointed at certain risks[2] in one-off revenues, which ultimately contributed 1.3 % of GDP to the deficit increase. The total negative factors in the budget reached 2.4 % of GDP which, in the absence of additional measures and positive economic developments, would have shot the deficit to almost 5 % of GDP. The deficit remained below 3 % of GDP mainly thanks to the significantly higher-than-budgeted tax revenues, lower absorption of EU funds[3] and the retention of funds in the budget reserve. Although the gross debt decreased on year-on-year basis, it was also due to the reduction in cash reserves. Therefore, the net debt increased.

The deficit of 2.87 % of GDP oscillates around the EU average, while the government debt is the 11th lowest in the EU. Since the crisis in 2009, Slovakia managed to reduce its deficit by more than 5 % of GDP and stabilise its public debt below 55 % of GDP, **making it to the club of the 'more responsible' member states.** On the other hand, the mere size of the government deficit says nothing about the specific challenges for the country in the future, nor does it indicate whether the results have been achieved thanks to robust budgetary processes and management and better macroeconomic developments, or whether thanks to unforeseen and/or one-off factors which do not have to recur in the future.

In its evaluations[4] since November 2013, the Council for Budget Responsibility pointed out various budget risks and repeatedly emphasised that the meeting of budget

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1 Eurostat News Release: General Government deficit and debt (2014 - 1st notification)

2 CBR report: Evaluation of the General Government Budget Proposal for 2014-2016: http://www.rozpoctovarada.sk/svk/rozpocet/213/hodnotenie-rozpoctu-verejnej-spravy-na-roky-2014-az-2016

3 The lower expenditures on co-financing in 2014 had a positive impact on the budget only because the macroeconomic scenario and budgeted revenues were conservative given the assumed absorption of EU funds, while the budgeted expenditures on co-financing were optimistic.

4 CBR reports:Evaluation of the 2014-2016 Budget, Evaluation of Medium-term Objectives for 2015-2017, Evaluation of the 2015-2017 Budget

objectives hinged, in particular, on high revenues from additional one-off measures. Moreover, the CBR identified particular risks in the healthcare sector, in the financial corrections to EU funds, and in the current expenditures of local governments. The potential positive risks included lower expenditures on co-financing (EU-funded projects) and higher tax revenues (mainly VAT). In the course of 2014, the CBR fine-tuned its deficit estimate between 2.9 % and 3.4 % of GDP, depending on the amount of financial corrections to EU funds. **Most of the risks associated with one-off revenues materialised** and the impact of financial corrections to EU funds was lower than expected[5]. A more detailed evaluation of the risks identified by the CBR is in the Annex.

The total amount of negative impacts on the budget reached approximately 2.4 % of GDP. The most significant factors included a shortfall in revenues from the one-off and non-standard transactions, higher deficit in the healthcare sector, higher expenditure on pensions and wages, higher capital expenditures, and higher financial corrections to EU funds. **The positive factors, which curbed the deficit below 3 % of GDP, represented 2.2 % of GDP** and included, in particular, higher-than-budgeted tax revenues, retention of budget reserves, lower co-financing of EU-funded projects, lower spending on social transfers (other than pensions) and lower deficit in the pension system of the armed forces and police corps, plus a relatively low impact of financial corrections to EU funds.

Table 1: Differences compared to the approved budget

	€ mil.	% GDP
Approved budget	**-2 000**	**-2.64**
Higher revenues from taxes and social security contributions	670	0.9
Co-financing of EU funded projects, corrections and transfers to EU budget	333	0.4
Lower government expenditures in other categories	191	0.3
Lower deficit in the pension system of the armed forces and police corps	60	0.1
Social transfers	38	0.1
Budgeted one-off and non-standard operations	-998	-1.3
Higher expenditures in the healthcare sector	-225	-0.3
Deficits of public transport companies	-46	-0.1
Other	-179	-0.2
Actual result	**-2 157**	**-2.87**

Source: CBR , MF SR, ŠÚ SR

In terms of their contribution to the long-term sustainability of public finances, these figures need to be adjusted for factors which have only a temporary impact on the budget (one-off and cyclical impacts) because their effect will fade away in the years to come. The thus adjusted balance, also known as "structural balance", shows whether the long-term sustainability of public finances has improved or deteriorated. **Structural balance deteriorated by 0.9 % of GDP,** which is above the original budget assumption (0.5 % of GDP). Since the assumptions for one-off revenues were unrealistic, positive effects could not be used to reduce the deficit. **If only a half of the**

5 2014 was influenced only by financial corrections in respect of which the respective procedures have been finalised. The total amount of corrections remains uncertain and hence their effect will also be felt in the years to come.

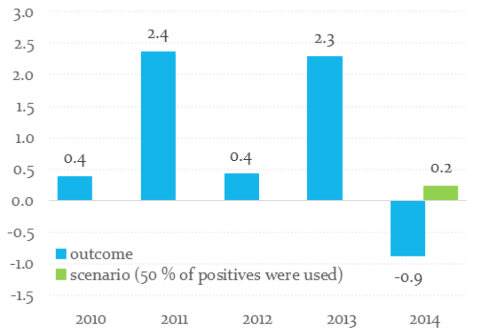
positive effects had been used to reduce the deficit, Slovakia would have taken another step towards sustainable public finances also in 2014.

Table 2: Change in GG structural balance in 2014 (% GDP)

	2013	2014
1. Budget balance	**-2.6**	**-2.9**
2. Impact of economic cycle	-0.5	0.0
3. One-off effects	0.0	0.1
4. Structural balance (1-2-3)	**-2.1**	**-3.0**
Change in structural balance (Δ4)		**-0.9**

Source: CBR

Figure 1: Change in GG structural balance in 2010-2014 (% GDP)



Source: CBR

The shortfall in revenues from dividends (by 0.9 % GDP), mainly from the Slovak Gas Company (SPP, a.s.) where the government contemplated several non-standard transactions, constituted the biggest negative item. The application of the ESA rules shows that such transactions may not be considered as budget revenues. Also the **other one-off revenues** were lower than budgeted, be it revenues from the sale of telecom licences, unrealised proceeds from the sale of superfluous assets within the ESO project, repeated overestimation of the prices of CO2 allowances, and unrealised transfer of the revenue resulting from the cancellation of bearer deposits. In addition, the government decided to shift the payment of an extraordinary instalment from Cargo, a.s. into 2015.

Table 3: Shortfall in budgeted one-off revenues (€ mil.)

	budget	outcome	difference	difference (% of GDP)
Revenues from dividends	991.2	283.0	-708.2	-0.9
Revenues from the sale of telecom licences	250.0	163.9	-86.1	-0.1
Sale of superfluous assets (ESO project)	54.0	8.0*	-46.0	-0.1
Revenue from the sale of CO2 allowances	116.7	63.4	-53.3	-0.1
Extraordinary instalment from CARGO, a.s.	97.7	19.5	-78.2	-0.1
Revenue from cancelled bearer deposits	26.0	0.0	-26.0	0.0
TOTAL	**1 535.6**	**537.8**	**-997.8**	**-1.3**

* CBR estimate from November 2014

Source: MF SR, CBR

In 2014, a traditional scenario has been repeated in the healthcare sector. **The contribution of the sector towards the deficit reached eur 160 million (0.22 % of GDP)** when expenditures increased by eur 222 million (0.3 % of GDP) and revenues by only eur 62 million (0.1 % of GDP). An amount of eur 53 million from public health insurance scheme was transferred to cover the costs incurred by private insurance companies. The expenditures of health insurers on the provision of healthcare grew more rapidly (compared to the budget) than their additional revenues from social and health insurance contributions, which increased their deficits and thus reduced cash balances on their current accounts (mainly the state-owned health insurance company - VšZP). Despite the higher amount of funds (by more than 5 %) received from the insurance companies, the healthcare facilities run a deficit of eur 62 million, most of which in unpaid invoices (increase in liabilities).

Table 4: Impact of the healthcare sector on government deficit (€ mil.)

	2013	2014 R	2014	2014 - 2014R	2014/2013
	1	2	3	3 - 2	3 / 1 (%)
A. Health insurance companies	5	28	-70	-98	-
Revenues	3 940	3 962	4 024	62	2.1
Public insurance expenditures	-3 723	-3 795	-3 913	-118	5.1
Administration and operation costs	-114	-138	-128	10	11.8
Payments to shareholders	-97	0	-53	-53	-46.0
B. Deficit of hospitals	-30	0	-62	-62	-
C. Impact on GG deficit	-25	28	-132	-160	-

Source:CBR, MZ SR, MF SR

The increase in the expenditures of the **Social Insurance Agency** by eur 129 million was partly caused by a retroactive disbursement of pensions (one-off impact of eur 58.5 million), plus the current payment of pensions (eur 18.1 million) both based on court rulings[6]. Nevertheless, this negative impact was offset by lower expenditures under other insurance schemes and the lower expenditures on social benefits (e.g., material need benefits).

The other 'savings' include the unrealised expenditure of eur 60 million **towards the deficit of the pension system of the armed forces and police corps** which, after changes effective as of April 2014, reduced its deficit and improved its overall sustainability.

The amount of EU funds drawn in 2014 was approximately the same as in 2013. The lower absorption of EU funds (63 % of what was budgeted) reduced the expenditures on **co-financing** by eur 255.6 million. At the same time, the capital expenditures, which are related to EU-funded projects but do not constitute their part, were also lower[7]. According to CBR's estimates, the expenditures on co-financing are fully offset by revenues from taxes and social contributions generated as a consequence of the inflow

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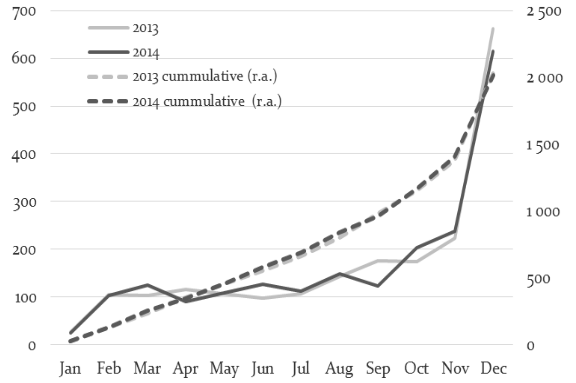
[6] The decision is about a retroactive disbursement of pensions to those who, for the most part of their carrier, paid contributions to the specific pension fund of the armed forces and police corps, and who, on leaving the armed forces, worked for a short period of time in the civilian sector without becoming entitled to pension for that part of their carrier. The courts decided that their pension entitlement must be recalculated with retroactive effect.

[7] This entails government expenditures beyond the co-financing component, which are indispensible to ensuring smooth drawdown of EU funds under the Operational Programme 'Transport'. These funds are drawn in situations when the EU refuses to fund a specific project which is related to an EU-funded project and which thus needs to be funded from the national envelope. These are so-called "induced" or "accompanying" capital expenditures. The impact is reflected in other government expenditures.

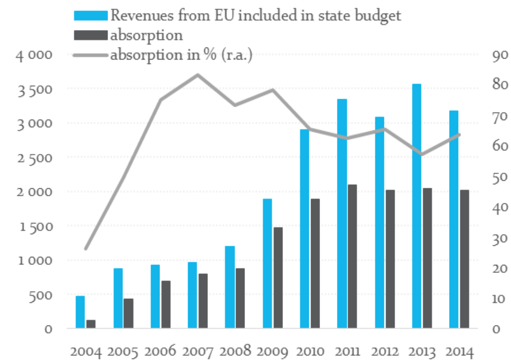
of EU funds into the economy. The impact on the government balance should therefore be neutral. The lower expenditures on co-financing in 2014 had a positive impact on the budget only because the macroeconomic scenario and budgeted revenues were conservative given the assumed absorption of EU funds, while the budgeted expenditures on co-financing were optimistic. Hence this 'saving' should not be viewed positively because it slowed down economic growth and increased the risk of not absorbing all the EU funds still available under the 2nd programming period by the end of 2015.

Figure 2: EU funds cash absorption in 2013 - 2014 (€ mil.)



Source: CBR, State Treasury

Figure 3: EU funds absorption in 2004 - 2014 (€ mil.)



Source: CBR, MF SR, State Treasury

As a consequence of irregularities, the negative impact of financial **corrections to EU funds** in 2014 reached eur 111.0 million. Although their impact in 2014 was lower than expected, the problem seems to have shifted into 2015[8]. The year 2014 was influenced by a positive correction (eur 87 million) to Slovakia's transfers to the EU budget. This amount represents the difference between what Slovakia actually contributed and should have contributed to the EU budget in the past. Combined with the reduced cash transfer[9], the total **saving on account of transfers to the EU budget reached eur 188 million**.

Table 5: Impact of transfers to/from EU budget on government balance

	€ mil.	% GDP
Impact of transfers to/from EU budget	**333**	**0.4**
Lower expenditures on co-financing	256	0.3
Financial corrections to EU funds	-111	-0.1
Lower cash contribution to EU budget for 2014	101	0.1
Positive correction for past transfers to EU budget	87	0.1

Source: CBR , MF SR

Furthermore, the additional **reduction in expenditures reached eur 191 million** (0.3 % of GDP)**.** The biggest contribution came from the reduced expenditures on goods

8 At the end of 2014, payments under five operational programmes were not released (Research and Development, Informatisation of Society, Competitiveness and Economic Growth, Healthcare, and the Regional Operational Programme.

9 Also thanks to the budgeted reserve of eur 57.5 million.

and services by eur 303 million (mainly **unspent reserves allocated in the budget**[10]), which was partly used to cover capital expenditures (eur 185 million). Moreover, the amount of expenditures carried over from 2014 to 2015 is higher than the 2013-2014 carry-over, which represents additional eur 73 million worth of unspent funds.

In terms of volume, the **higher revenue from taxes and social contributions (by eur 670 million or** 0.9 % of GDP) had the biggest positive impact on the budget. Since the budget itself contained an assumption of higher VAT revenue over and above the forecast approved by the Tax Revenue Forecasting Committee, the revenue of eur 920 million came in as a positive surprise. The effectiveness of VAT collection continued to increase steadily throughout 2014 and the revenues from corporate income tax[11], social security contributions and excise taxes are also expected to surpass expectations thanks to the more favourable economic environment.

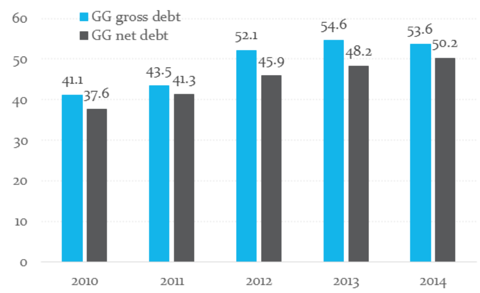
The debt reached 53.6 % of GDP, which is safely below the third threshold of the debt brake. Gross debt decreased by 1 % of GDP year-on-year. In contrast to the deficit where the new ESA2010 methodology had a negligible impact[12], the debt decreased by 0.7 % of GDP due changes in methodology. Another factor included the cash reserve reduction at the end of 2014 to a minimum, which is not sustainable in the long term. Due to this, it is more appropriate to look at the net debt development which, in 2014, rose by 2.0 % of GDP to 50.2 % of GDP.

Table 6: Impact of ESA2010 on public deficit and debt (% of GDP)

	Balance	Debt
1. Budget (without ESA2010)	-2.64	56.5
2. Outcome (with ESA 2010)	**-2.87**	**53.6**
3. Difference with ESA2010 impact (2-1)	-0.23	-3.0
4. ESA2010 methodology	**0.03**	**-0.7**
- Impact without GDP	-0.01	0.2
- Impact of GDP	0.05	-0.9
5. Reality without ESA2010 (2-4)	**-2.90**	**54.3**
6. Difference without ESA2010 impact (3-4)	**-0.26**	**-2.3**

Source: CBR , ŠÚ SR

Figure 4: GG gross debt in 2010-2014 (% GDP)



Source: CBR, MF SR, Eurostat

10 Mainly the unspent reserve for higher VAT collection despite the fact that the actual tax revenue was significantly higher than budgeted revenue. The 'saving' was also motivated by sanctions applicable under the Fiscal Responsibility Act according to which, as of May 2014, the government had to block 3 % of its budget expenditures. The sanction ceased to apply in October 2014 when the notified debt decreased below 55 % of GDP.

11 The 2014 figures are estimates; the positive impact results mainly from better CIT revenues in 2013.

12 The effects of new entities mutually offset each other. The contributions of the ŽSR, NDS, EOSA and Eximbanka where positive, whereas the contributions of healthcare facilities and public transport companies were negative.

Annex Evaluation of budget risks and reserves for 2014 (€ million)

Table 7: Evaluation of budget risks and reserves for 2014 (€ million)

Risks to meeting budgetary targets	December 2013	May 2014	November 2014	April 2015
1. Unattained additional tax revenue from wage increases in the school sector	10	0	0 (included in the forecast of the MFC, i.e. also in the present tax revenue forecast)	Cannot be evaluated, the impact is a part of tax revenues
2. Underestimated current expenditures of local governments	120-180	100-200	100-200 (MF SR estimates 117)	€154m increase in current expenditures was offset by lower capital expenditures (€174m)
3. Underestimated healthcare costs (unbudgeted increase in debts)	50-100	50-100	177 (MF SR estimate)	222 (with higher revenues taken into account, impact on deficit is €160m)
4. Contributions to registered capital (Eximbanka, SZRB)	max. 100	0	0 (MF SR Finance does expect these transactions to take place).	Not implemented
5. Shortfall in revenues from the sale of emission allowances	50-100	50-100	55 (MF SR estimate)	53
6. Lower impact of the ESO reform (lower revenue from the sale of assets and lower cuts in expenditures)			46 (MF SR estimate)	46 (estimate from November 2014)
7. Negative impact of the carryover of expenditures from 2013			0 (MF SR estimate)	Net impact of the carryover from 2013 and into 2015 was positive at €73m
8. Carryover of unspent EU funds and the related co-financing to subsequent years (5)	400(1)	max. 82	0 (risk is transferred to subsequent years)	0 (risk is transferred to subsequent years)
9. Financial corrections to EU funds	no quantification	68	150 (MF SR estimates 81)	111 (total amount uncertain, but risk shifted to 2015)
10. Non-recognition of the carryover of dividends under ESA95	437	443	443 (incorporated in the MF SR estimate, a part of this revenue was recognised in 2013)	443
11. Lower revenue from SPP dividends	-	181	131 (updated CBR estimate based on the actual fiscal performance of SPP)	244
12. Change of the ESA2010 methodology	no quantification	no quantification	Slightly positive impact (MF SR estimate)	negligible positive impact
13. Unattained non-tax revenues (digital dividend, fine)	-	41	41 (MF SR estimate)	38 (48 was revenue from the fine and 86 was shortfall in revenue from the digital dividend)
14. Payout of retained profits of private insurance companies	-	-	26-96 (MF SR estimates 26)	53

Risk coverage				
1. Better tax collection	no quantification	min. 189	498 (TRFC estimate)	670
2. Reduced co-financing and lower induced capital expenditures (gap)	200-300	200	min. 191 (MF SR estimates 191)	256 in co-financing; GAP figure unavailable
3. Saving due to sanctions under the Fiscal Responsibility Act	-	max. 308	305 (funds blocked in this amount)	Sanction lifted in October 2014
4. Impact of ŽSR and VVŠ	-	0-50	0-50 (MF SR estimates 20)	18 (VVŠ had a deficit of €15m, ŽSR a surplus of €33m)
5. One-off revenue from a levy payable by economic operators in regulated industries	-	-	43 (not incorporated in the MF SR estimate)	transaction had no impact on the balance
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 (for the most part, the sale of assets has not yet taken place, shifted to the next year)	8 (for the most part, the sale of assets has not yet taken place, shifted to the next year)
2. Reduced value of government assets due to restriction on capital expenditures	no quantification	no quantification	no quantification	did not materialise (expenditures were higher by €112m)
3. Sale of assets of state corporations (CARGO) and the use of those revenues to cover current expenditures	98	98	98	20 (government decided to shift 78 into 2015)
4. Use of the revenue from the bank levy to finance current expenditures and contingent expenditures	160	160	153 (updated estimate)	153

(1) The risk applied to the entire 2014-2016 budget horizon and did not have to materialise necessarily in 2014.

Source: CBR, MF SR

Imricha Karvaša 1
Bratislava 1, 813 25
Slovenská republika

www.rozpoctovarada.sk