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RADA PRE ROZPOČTOVÚ ZODPOVEDNOSŤ

Evaluation of Compliance with the Balanced Budget Rule in 2014

(update to the July 2015 evaluation)

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This report presents the official positions of the Council for Budget Responsibility in line with its mandate laid down in Act No. 523/2004 on the General Government Budgetary Rules.

This publication is available at the CBR website (http://www.rozpoctovarada.sk).

Any suggestions or comments on the report are welcome at sekretariat@rrz.sk.

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Summary

The general government structural deficit in 2014 reached 2.8 % of GDP, up 0.4 % of GDP year-on-year. Thus the medium-term objective of attaining a nearly balanced budget (structural deficit up to 0.5 % of GDP) was not achieved. As a result of considerable consolidation in 2013 and fiscal easing in 2014, the structural balance in 2014 reached the level set by the adjustment path towards meeting the objective by 2017. This conclusion is also confirmed by the evaluation of the development in the adjusted expenditure which, since 2012, increased in line with the expenditure benchmark. In light of the above, the CBR concludes that no significant deviation occurred in 2014 and hence there is no need to trigger a correction mechanism.

Compared with 2012, the 2014 structural balance improved by a total of 1.6 % of GDP, which is the level assumed by the required steady improvements in the deficit by 0.8 % of GDP per year. The consolidation took place in 2013 when the balance improved by 2.1 % of GDP, followed by fiscal easing quantified at 0.4% of GDP in 2014. As part of its overall assessment, the CBR also took into account the effects of other factors, such as the lower contribution rates to the fully-funded pillar of the pension system, debt interest payments, and the costs associated with the decommissioning of nuclear facilities, which improved structural balance by a total of 0.2 % of GDP, yet they do not have a positive impact on the overall budgetary position in the long term[1].

In its July evaluation, the CBR noted that the structural balance had improved by a total of 1.3 % of GDP between 2012 and 2014. An update to the data which included, in particular, higher revenue from the corporate income tax for 2014 and more appropriate recording of EU corrections in individual years, has further improved this figure by almost 0.4 % of GDP (to 1.6 % of GDP). When taking into account the greater required change in the structural balance, the deviation of 0.2 % of GDP as presented in the CBR's opinion of July 2015[2] has thus been removed.

The conclusions of the CBR's independent evaluation are basically identical with the position of the Ministry of Finance. The approach of both institutions is identical in that the evaluation covers cumulative deviations since 2012 which are analysed against the assumption of steady improvements in the structural balance. The difference between estimates of the business cycle on the budget balance is now much smaller. When it comes to one-off effects, the two approaches continue to differ in the way in which certain revenues from dividends are recognised. In evaluating compliance with the expenditure benchmark, the CBR uses a broader list of measures based on its own 'no-policy-change' scenario while excluding one-off effects and cyclical expenditures on pensions from the calculation of adjusted expenditures. The Ministry of Finance took one-off measures into account within its qualitative evaluation of developments in 2014 (the so-called overall assessment). However, all these methodological differences have had a minimal impact on the overall assessment.

[1] For example, the reduced contribution rates to the fully-funded pillar should be reflected in a more stringent medium-term objective.

[2] In July, the CBR announced the potential positive impact of the higher-than-expected revenue from corporate income tax at 0.2 % of GDP, which was indeed the case. The structural balance improved by 0.36 % of GDP whereas the required improvement increased by 0.05 % of GDP (the overall impact thus represents 0.31 % of GDP), which means that the original negative deviation from the adjustment path at 0.24 % of GDP has turned into a positive difference of 0.06 % of GDP (the total change represents 0.31 % of GDP).

Tab 1: CBR assessment - compliance with the balanced budget rule in 2014

	Definition	CBR assessment	Criterion	Outcome in 2014	Fulfillment
Structural balance	**1. General government structural balance** **Target value of the general government structural balance: deficit not exceeding 0.5% of GDP; deficit may be as high as 1% of GDP, if both following conditions are met (A, B)**		**>= - 0.5 % of GDP**	**-2.8 % of GDP**	✘
	A. debt significantly below 60 % of GDP	debt below 40 % of GDP	< 40 % of GDP	53.5 % of GDP	✘
	B. low risks in terms of long-term sustainability of public finances	long-term sustainability indicator of not more than 1 % of GDP	<= 1.0 % of GDP	2.4 % of GDP	✘
		risk assessment by the EC using the S2 indicator	low risk	not assessed	
Analysis of additional indicators and escape clauses	**2. Change in structural balance** **Rapid convergence towards MTO: steady improvement in the structural balance between 2012 and 2017 by 0.8 % of GDP annually**		**>= 1.6 % of GDP***	**1.6 % of GDP**	✓
	3. Development in adjusted expenditure **Rapid convergence towards MTO: expenditure growth rate that ensures an improvement in the structural balance by 0.8 % of GDP**		**>= 1,6 % of GDP***	**1,6 % of GDP**	✓
	4. Exceptional circumstances **Exceptional circumstances occur if at least one of the following conditions is met (C, D, E, F)**		**at least one**	**0**	✘
	C. event with a major impact on the financial position	public expenditure incurred to restore the proper functioning of the banking sector affected by the financial crisis, public expenditure incurred to remedy the consequences of natural disasters and catastrophes in the Slovak Republic, and public expenditure incurred in connection with commitments arising from international treaties that have exceeded 3 % of GDP in a single year	> 3 % of GDP	0 % of GDP	✘
	D. period of a negative annual growth in real GDP	a year-on-year drop in real GDP	< 0 %	2.5 %	✘
	E. protracted period of very low GDP growth relative to potential	negative output gap at least at 3 % of potential GDP	<= -3 %	-0.9 %	✘
	F. severe economic downturn in the euro area (a period of a negative annual real GDP growth or a protracted period of very low GDP growth relative to potential economic growth)		taking into account EC´s assessment		✘
Examination of deviation	**5. Significant deviation** **Significant deviation occurs if both following conditions are met (G, H). If only one is met, an overall assessment is performed.**		**both conditions fulfilled**	**0**	✘
	G. change in structural balance: deviation of the cumulative change in structural balance since 2012 from the required cumulative change stemming from the rapid convergence towards MTO is assessed; the deviation is significant, if it reaches at least 0.5 % of GDP		<= 1.1 % of GDP**	1.6 % of GDP	✘
	H. adjusted expenditure growth: cumulative impact on the balance since 2012 is assessed by comparing the actual growth rate of adjusted expenditures with the reference rate of growth according to the expenditure benchmark; the deviation is significant, if the total negative impact on the balance reaches at least 0.5 % of GDP		<= 1.1 % of GDP**	1.6 % of GDP	✘
	6. Assessment of compliance with the balanced budget rule		**fulfilled**		✓

** Assessed on a cumulative basis (years 2013 and 2014)*

Source: CBR

*** Over the period of 2013 and 2014, the required cumulative improvement in the structural balance reached 1.6 % of GDP. Significant deviation occurs when the balance improves by 1.1 % of GDP at most (1.6 - 0.5 = 1.1 % of GDP)*

1. Update to the CBR's evaluation

The first evaluation of compliance with the balanced budget rule in 2014 was published by the CBR[3] in July 2015. It was based on the data contained in the April deficit and debt notification by Eurostat prepared in line with the ESA2010 methodology. The outcome of the evaluation was that the target value of the structural deficit had not been achieved and that the cumulative pace of deficit reduction between 2013 and 2014 had deviated from the required improvement. However, the deviation was not significant and there was no need to trigger the correction mechanism.

The CBR has updated its evaluation based on the revised data in the October notification by Eurostat with more precise deficit and debt figures in comparison with the April notification. It also contains CBR opinion on the evaluation[4] published by the MF SR on 30 November 2015. The process of the CBR's evaluation remains the same (see Annex 2 for a schematic presentation of individual steps).

1.1 Level of the structural balance

The Act on the General Government Budgetary Rules sets the upper limit for the structural deficit at 0.5 % of GDP. If the general government debt is significantly below 60 % of GDP and there are minimal risks in connection with the long-term sustainability as defined under the Fiscal Responsibility Act, the structural deficit may reach up to 1 % of GDP. The CBR has linked the terms 'significantly lower debt' and 'minimal risks to long-term sustainability' to the rules and indicators laid down in the Fiscal Responsibility Act.

- **The 'significantly lower debt' is a debt level which, in the long term, carries no sanctions defined in the Fiscal Responsibility Act.** It is a gross debt **below 40 % of GDP**. The CBR has chosen a fixed value in order to disconnect the debt level from the transitional provisions of the Act[5]. At the same time, such a debt level can be considered relatively safe[6].

- The CBR has defined the '**minimal risk to long-term sustainability**' as the **value of the long-term sustainability indicator not exceeding 1 % of GDP.** Simultaneously,

3 CBR, Evaluation of compliance with the balanced budget rule in 2014, July 2015.

4 The evaluation of the occurrence of a significant deviation is carried out twice a year. The law prescribes to the MF SR two deadlines for its publication (30 June and 30 November). The description of the balanced budget rule and of the roles of individual institutions is contained in Annex 1.

5 Presently, the debt level up which sanctions are not applied, stands at 50 % of GDP. Starting from 2018, the threshold should be reduced by one percentage point per year until it reaches the ultimate value of 40 % of GDP. Although the linking of the significantly lower debt threshold to these debt reductions copied the requirements of legislation, it was not justified in purely economic terms. Due to this, the CBR opted for a single value.

6 Múčka (2015): Is the Maastricht debt limit safe enough for Slovakia?, CBR Working Paper no. 2/2015.

the **evaluation of long-term sustainability by the European Commission** is also taken into account[7].

The general government gross debt reached 53.5 % of GDP at the end of 2014, a level which triggers sanctions under the Fiscal Responsibility Act, and the long-term sustainability indicator for the same period was 2.4 % of GDP[8]. This means that, according to the CBR, neither of the two preconditions enabling to meet the less stringent structural deficit target has been met. **Therefore, the target value for the structural deficit is up to 0.5 % of GDP[9].**

The **2014 structural deficit reached 2.8 % of GDP** (Table 3) and exceeded the target value considerably. For this reason, as the next step, the CBR examines whether Slovakia has made **sufficient progress towards meeting this target** through the **change in structural balance** (Part 1.2) and **development in the adjusted expenditure net of discretionary revenue measures** (Part 1.3). The CBR also **examines whether or not the exceptional circumstances, during which compliance with the rule is temporarily suspended**, occurred (Part 1. 4).

1.2 Change in structural balance

Based on Council Recommendation[10] and the present general government budget for 2016-2018, Slovakia should meet its medium-term budgetary objective expressed as a structural deficit of 0.5 % of GDP by 2017. However, the European Commission has not published a guidance as to how to meet the objective, i.e., annual improvements in the structural balance, which complicates evaluation of compliance with the balanced budget rule.

In the absence of specific guidance for changes in the structural balance in individual years, the CBR bases itself on the assumption of **steady improvements in the structural balance spread evenly over the years 2012 to 2017**[11].

The 2012 structural deficit reached 4.4 % of GDP[12]; this means that for the medium-term objective to be met by 2017 through steady improvements, the **average annual improvement should represent 0.8 % of GDP** (Table 2).

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7 In the past, the European Commission regularly assessed the long-term sustainability of public finances (as part of annual updates to stability programmes) on the basis of its long-term projections of the impacts of population ageing on public finances, categorising individual Member States as high, medium and low-risk countries. In assessing Slovakia's Stability Programme of April 2015, the Commission did not specify the level of risk of the long-term sustainability.

8 CBR, Report on the Long-term Sustainability of Public Finances of the Slovak Republic of April 2015.

9 The MF SR presented this value of the medium-term budgetary objective also in the current Stability Programme and the Draft Budgetary Plan.

10 Council recommendation of 9 July 2013, on the National Reform Programme 2013 of Slovakia and delivering a Council opinion on the Stability Programme of Slovakia, 2012-2016.

11 The year 2012 was chosen as the baseline year also because the Commission set the deadline for meeting the medium-term budgetary objective based on the actual data for 2012.

Tab 2: Calculation of required change in structural balance (ESA 2010, % GDP)

	2012	2013	2014	2015	2016	2017
Required level of GG structural balance according to CBR	**-4.4**	-3.7	-2.9	-2.1	-1.3	**-0.5**
Change*	-	0.79	0.79	0.79	0.79	0.79

** Steady improvement in the structural balance over the period 2012-2017, that ensures achievement of MTO in 2017 (-0.5 % GDP)*

Source: CBR

The actual change in the structural balance in a given year is compared against this adjustment path. **It is evaluated on a cumulative basis** because the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union defines the deviation from the adjustment path. **This means that an overrun in one year may be offset by a slower pace of improvement in the next year.** Such a situation occurred in 2013 and 2014 (Table 3).

Tab 3: General government structural balance (ESA2010, % GDP)

	2012	2013	2014	cumulative (2013-2014)
1. GG balance	-4.2	-2.6	-2.8	
2. Cyclical component	-0.2	-0.5	-0.1	
3. One-off measures	0.4	0.2	0.1	
4. Structural balance (1-2-3)	**-4.4**	**-2.4**	**-2.8**	
5. Change in structural balance	**0.51**	**2.08**	**-0.44**	**1.64**
Required change in structural balance		**0.79**	**0.79**	**1.58**
p.m. 1 Δ in measures with no impact on long-term sustainability		0.4	-0.1	0.4
p.m.2 Δ in interest payments		-0.1	0.0	-0.1
Change in structural balance including special factors (5-p.m.1-p.m.2)		*1.76*	*-0.33*	*1.43*
p.m.3 Output gap	-1.0	-1.5	-0.9	

Source: CBR

The fiscal policy easing increased the structural deficit in 2014 by 0.4 % of GDP, which partially offset its significant reduction in 2013. On the whole, the structural deficit improved by 1.64 % of GDP since 2012, while the improvement under the adjustment path was expected to reach at least 1.58 % of GDP. **This means that the 2014 structural balance was better by 0.06 % of GDP than the balance calculated on the basis of its required annual improvement.**

1.3 Development in the adjusted expenditure

The adjustment path towards the medium-term objective is also assessed by **comparing development in the general government's adjusted expenditure with the expenditure**

[12] In comparison with the CBR evaluation of July 2015, all components in the structural balance calculation have been made more precise, which slightly increased the 2012 structural deficit from 4.3 % of GDP to 4.4 % of GDP. The changes are presented in Annex 3.

benchmark. In its evaluation, the CBR uses the concept defined by the Stability and Growth Pact[13]; the reference expenditure growth rate is derived from the necessary change in the structural balance as calculated in Part 1.2 (i.e., by 0.8 % of GDP annually), which makes the approach to both indicators consistent.

Tab 4: Expenditure benchmark (ESA 2010, € mill)

	2012	2013	2014	source
1. General government expenditure	**29 077**	**30 284**	**31 462**	Eurostat, T200*: TE
2. Interest payments	1 280	1 384	1 441	Eurostat, T200: D41
3. Gross fixed capital formation	2 193	2 255	2 749	Eurostat, T200: P51G
4. Annual average gross fixed capital formation (t-3 to t)	2 381	2 346	2 445	Eurostat, T200: ØP51G
5. Current expenditure on EU program. fully matched by EU funds revenues	171	249	301	CBR (estimate)
6. Cyclical expenditure (unemployment, pensions)	0.0	-31.0	-48.0	CBR (estimate)
7. One-off expenditures	-103.0	1.3	140.3	CBR (estimate), MF SR
8. Primary expenditure aggregate *(1-2-3+4-5-6-7)*	**27 916**	**28 772**	**29 324**	
9. Change in primary expenditure aggregate *(8t-8t-1)*		856	552	
10. Change in discretionary revenue measures and NA reporting		1 286	94	MF SR, CBR: Annex 4
11. Nominal growth of expenditure aggregate adjusted for revenue measures ((9t-10t)/8t-1)		-1.5	1.6	
12. Change in GDP deflator		0.5	-0.2	Eurostat
13. Real growth of expenditure aggregate adjust. for revenue measures *(11-12)*		**-2.0**	**1.8**	
14. Potential GDP growth		1.9	1.9	CBR (estimate)
15. Convergence margin (p. p.) CBR change in SB/$((1_{t-1}-2_{t-1})/GDP_{t-1})$		2.1	2.0	Eurostat, T200: TE, D41, SO SR, CBR calculation
16. Expenditure benchmark *(14-15)*		**-0.1**	**-0.1**	
17. Impact of the deviation on the balance in the given year (16t-13t)*8t-1/GDPt		0.7	-0.7	
18. Cumulative deviation in t-1 a t			**0.0**	

* T200 is a standardised table of GG revenues and expenditures published by Eurostat, where individual items are labelled by ESA codes. TE stands for total expenditures, D41 interest payments a P51G gross fixed capital formation.

Source: CBR, Eurostat, MF SR

The adjusted real expenditure in 2014 increased by 1.8 %; however, the expenditure benchmark (which would ensure structural balance improvement by 0.8 % of GDP) assumed a decrease by 0.1 % year-on-year. The increase in expenditure in 2014 has almost fully offset their decline in 2013 when the expenditure decreased by 2.0 %, whereas the decrease required under the

[13] The procedure used by the CBR in its calculations differs slightly from the procedure specified in the Stability and Growth Pact; the differences make the evaluation more precise. In comparison with the July 2015 evaluation, several methodology adjustments announced by the CBR have been incorporated. These include, in particular, the exclusion of one-off revenues from discretionary measures and the exclusion of one-off expenditures and cyclical expenditures on pensions from the expenditure aggregate. The differences, including supporting data, are listed in Annex 5.

expenditure benchmark was 0.1 %. The overall impact of development in these expenditures on the balance in 2013 and 2014 is in line with the expenditure benchmark which means that **no deviation from the defined adjustment path has occurred in this indicator**.

1.4 The beginning and end of exceptional circumstances

The concept of exceptional circumstances refers to the case of an unusual event outside the control of the country concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn[14]. This applies under the assumption that the temporary deviation of the country concerned from the medium-term objective does not endanger fiscal sustainability in the medium term. A period of severe economic downturn applies to a relevant country and the euro area as a whole.

Based on this definition, the CBR has identified **three situations concerning the Slovak economy** which can be considered as constituting **exceptional circumstances**:

- **An event with a major impact on the financial position.** The CBR applies the definition contained in the constitutional act[15], which provides for exemptions from the application of sanctions in such situations. This namely includes the **public expenditure incurred to restore the proper functioning of the banking sector affected by a financial crisis, public expenditure incurred to remedy the consequences of natural disasters and catastrophes in Slovakia and public expenditure towards commitments arising from international treaties that have exceeded 3 % of GDP in a single year**. For the purposes of assessing compliance with the balanced budget rule, exceptional circumstances last as long as such expenditure exceeds the threshold on a yearly basis[16].
- **A period of a negative annual growth in GDP** - The CBR will consider as an exceptional circumstance **an annual drop in real GDP**, subject to a comprehensive assessment of Slovakia's economic development.
- **A protracted period of very low GDP growth relative to the potential growth.** The CBR defines it as a **negative output gap reaching at least 3 % of the potential output**. The duration of this exceptional circumstance ends when the output gap begins to close (which means that the real economic growth outpaces the growth in the potential output) and falls below that threshold. Also in this case, Slovakia's economic development will be comprehensively assessed.

[14] Under the definition in the revised Stability and Growth Pact, a severe economic downturn is a period of a negative annual real GDP growth or an accumulated loss of output during protracted period of very low GDP growth relative to potential economic growth.

[15] Article 5, paragraph 11(b) of Act No. 493/2011 on Fiscal Responsibility.

[16] Under the constitutional act, exceptional circumstances last 36 months of their identification. It relates to the fact that debt is a stock value, hence any one-off expenditure leads to its permanent increase. This defined period provides room for fiscal policy to react to the debt increase. In the case of the general government balance, which is a flow value, one-off expenditures have impact only in the year concerned. Therefore, a longer duration of the period of exceptional circumstances is not justified.

The same definition (a period of negative annual GDP growth or a protracted period of very low growth relative to its potential) will apply when **assessing whether the euro area as a whole** has faced a severe economic downturn. Since the CBR does not evaluate the economy of the euro area as a whole, it will **take into account the Commission's opinion concerning compliance with the rules of the Stability and Growth Pact.**

None of the above-mentioned events with an overall negative impact on the balance reaching at least 3 % of GDP occurred in 2014. The criteria of a severe economic downturn were not met either. The economy of Slovakia grew 2.5 % year-on-year. The negative output gap in 2014 reached 0.9 % of the potential output and thus remained significantly below the 3 % threshold. The real GDP in the euro area increased by 0.9 % and the negative output gap, according to the Commission's estimates, reached 2.6 % of the potential output. The Commission did not evaluate[17] this development as a severe economic downturn. This means that **none of the events meeting the definition of exceptional circumstances occurred in the course of 2014**.

1.5 Significant deviation

The CBR assesses the existence of a significant deviation based on an overall assessment taking into account the change in the structural balance, development in the adjusted expenditure, and the occurrence of exceptional circumstances. Unless the conclusion is unambiguous, also other factors are taken into consideration. They are considered as long as they are verifiable and their impact on the balance is quantifiable.

The change in the structural balance is assessed on a cumulative basis since 2012, which means that a significant deviation is a deviation of the structural balance in a given year from the level calculated by the required structural balance improvement by at least 0.5 % of GDP.

In 2014, the structural balance was better by almost 0.1 % of GDP than the balance calculated on the basis of its required annual improvement. This result was also achieved by measures[18] (mainly reduced contribution rates to the fully-funded pillar of the pension system) which improved the balance in the short run but, on the other hand, they are neutral in the long run because they will increase public expenditure in the future. Should these impacts be taken into account, the deviation from the adjustment path would be almost 0.2 % of GDP. However, the structural balance remained below the significant deviation threshold.

[17] The classification of present developments as a severe economic downturn would, in all likelihood, be reflected in the Commission's recommendations for the fiscal policies of individual euro area members (as part of the evaluation of stability programmes and/or draft budgetary plans). Such a situation has not occurred in 2015.

[18] Here, the CBR includes changes which affect the fully-funded pillar of the pension system, the nuclear decommissioning scheme, and a special bank levy scheme which is there to finance potential future cost of rescuing the banking system.

Tab 5: Significant deviation – structural balance (ESA2010, % GDP)

	2013	2014	Cumulative (2013-2014)
Change in structural balance	2.08	-0.44	1.64
Required change in structural balance according to CBR	0.79	0.79	1.58
Deviation from required trajectory	*1.30*	*-1.23*	*0.06*
Significant deviation			**no**
Change in structural balance including special factors	1.76	-0.33	1.43
Deviation from required trajectory taking into account special factors	*0.97*	*-1.12*	-0.15

Source: CBR

When assessing the **adjusted expenditure** against the expenditure benchmark, a due account is taken of whether the cumulative deviation since 2012 has had an overall negative impact on the general government balance of at least 0.5 % of GDP. The expenditure benchmark was complied with in 2013 and 2014, which means that no significant deviation has occurred.

Tab 6: Significant deviation – expenditure benchmark (ESA2010, % GDP)

	2013	2014	Cumulative (2013-2014)
Real growth of expenditure aggregate adjusted for revenue measures (%)	-2.0	1.8	-0.27
Expenditure benchmark (%)	-0.1	-0.1	-0.22
Deviation from expenditure benchmark	***0.73***	***-0.72***	***0.01***
Significant deviation			**no**

Source: CBR

Despite having different values in individual years, both indicators, when assessed cumulatively, suggest roughly the same magnitude of deviation. This is a slight improvement against the July evaluation, which is attributable to the updated tax revenue (mainly the corporate income tax) having a positive impact on the structural balance at 0.2 % of GDP. Development in adjusted expenditure has also improved due to methodological changes which brought the calculation method closer to the concept of structural balance (exclusion of one-off revenues and expenditures, as well as expenditure influenced by the economic cycle).

With all relevant factors taken into account, no exceptional circumstances occurred in 2014. At the same time, there was also no significant deviation from the adjustment path towards the meeting the medium-term objective, which means that it is not necessary to trigger the correction mechanism.

In the years ahead, the general government budget approved by the Parliament put the ambition of meeting the medium-term objective by 2017 at risk (Box 1)**. For 2015, the CBR has identified[20] several risks above and beyond the Ministry of Finance's estimates**

[19] Annex 6 compares the structural balance and adjusted expenditure developments in individual years.
[20] CBR, Evaluation of the General Government Budget Proposal for 2016-2018, November 2015

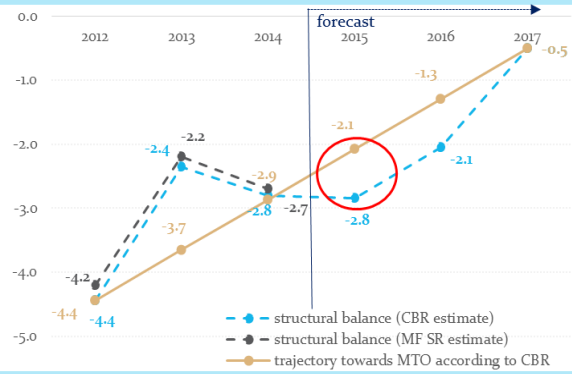
which, provided that they materialise, are bound to increase the deficit and widen the deviation from the path set to meet the medium-term objective.

Box 1: Structural balance development[21] between 2015 and 2018

In the approved general government budget for 2016-2018, the Slovak government set its budgetary targets with the aim to attain the medium-term objective in 2017, while most of the required consolidation effort is concentrated to 2017. This course of consolidation may be risky[22] in terms of meeting the balanced budget rule.

In evaluating the budget proposal[23], the CBR noted an increased risk in that the government might, in 2015, significantly deviate (based on the MF SR estimate of the GG balance) from the defined adjustment path towards the medium-term objective (Figure 1 and 2) and that the medium-term objective would not be attained in 2017. The deviation could be further increased if certain risks identified by the CBR in non-tax revenues, expenditures of local governments and healthcare materialise.

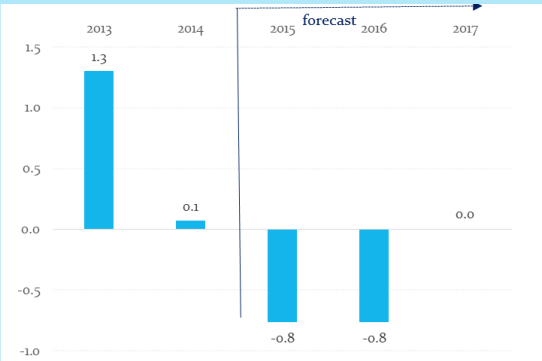
Figure 1: GG structural balance in 2012-2017 (ESA2010, % GDP)



Note: In 2015, the structural balance is estimated assuming the fulfilment of the MF SR´s general government balance estimate. In 2016 and 2017, the structural balance estimate assumes that the budgetary targets are met.

Source: CBR, MF SR

Figure 2: Deviation from the adjustment path according to CBR in 2013-2017 (ESA2010, % GDP)



Source: CBR

[21] The box does not compare the adjusted expenditure with the expenditure rule between 2015 and 2018. This is due to the fact that certain revenues and expenditures with an approximately zero impact on the balance have not been budgeted, and also due to the missing measures designed to meet the budgetary objectives; therefore, the conclusions could be distorted. The structural balance calculation assumes that the missing measures will not be of a one-off nature.

[22] Although the legislative provision regulating the launch of the correction mechanism is not linked to the deviations quantified on the basis of forecasts (but rather on actual data), the assessment of the budgetary objectives allows to indicate potential future risks.

[23] CBR, Evaluation of the General Government Budget Proposal for 2016-2018, November 2015

2. Opinion on the evaluation by the Ministry of Finance

The Ministry of Finance published its evaluation of compliance with the balanced budget rule for the year 2014 on 30 November 2015[24]. The evaluation concludes that, although not attaining a balanced budget, Slovakia followed the adjustment path towards its medium-term budgetary objective and no significant deviation occurred in 2014. Despite slight differences in approaches applied by the CBR and the Ministry of Finance (Table 7), **the final evaluations by both institutions concur**.

Tab 7: Comparison of evaluation of compliance in 2014, CBR vs. MF SR (ESA2010, % GDP)

	RRZ	MF SR	difference
Medium term objective (MTO)	-0.5 (2017)	-0.5 (2017)	-
GG balance	-2.8	-2.8	0.0
Cyclical component	-0.1	-0.1	0.0
One-off measures	0.1	0.1	0.0
Structural balance	**-2.8**	**-2.7**	**-0.1**
Compliance with the structural balance rule	**no**	**no**	**-**
Cumulative change in structural balance	1.6	1.5	0.1
Required cumulative change in structural balance	1.6	1.5	0.1
Compliance with the change in structural balance	**yes**	**yes**	**-**
*Cumulative deviation of change in structural balance from required trajectory**	0.1	0.0	0.0
Significant deviation**	**no**	**no**	**-**
Cumulative real growth of expend. aggregate adjusted for revenue measures	-0.3	1.1	-1.4
Expenditure benchmark (cumulative)	-0.2	0.3	-0.5
Compliance with the expenditure benchmark rule	**yes**	**no**	**-**
*Cumulative deviation in expenditure benchmark (impact on GG balance)**	0.0	-0.4	0.4
Significant deviation**	**no**	**no**	**-**

** sign (-) denotes noncompliance with the rule*
*** deviation is significant, if it reaches at least -0.5 % GDP*
Source: CBR, MF SR

The differences between the CBR and the Ministry of Finance in evaluating the structural balance are minimal. The approach of both institutions is identical in that the evaluation covers cumulative deviations since 2012 which are analysed against the assumption of steady improvements in the structural balance. There are slight numerical differences in the estimated level of the structural balance in individual years and in the adjustment path[25],

[24] MF SR, Fiscal compact - Compliance with the Balanced Budget Rule for 2014, November 2015, (available only in Slovak).

[25] The required annual improvement in the structural balance according to the CBR reaches 0.8 % of GDP, while the MF SR estimates it at 0.7 % of GDP. This is due to the differing estimates of the structural deficit in 2012 based on which the necessary improvement is calculated. The CBR estimates it at 4.4 % of GDP, while the MF SR estimate is 4.2 % of GDP. The difference is attributable to the differing views of both institutions on the

which is mainly due to the fact that in estimating the potential output (and output gap), the CBR takes into account, apart from the MF SR forecast, also the forecasts of other institutions. The one-off effects considered by both institutions in 2013 and 2014 are identical (Annex 3).

In terms of evaluating the expenditure benchmark, the differences between both institutions are more pronounced. The approaches of both institutions continue to differ in that the Ministry of Finance primarily evaluates the development of expenditures in 2014 and only then, as part of the overall assessment, takes into account the cumulative impact for 2013 and 2014. The CBR, similarly as in the case of the structural balance, considers only the cumulative impact of expenditures on the balance.

The slight differences in the calculation of the required pace of the expenditure growth persist only due to the above-described different approaches to estimating the potential output's growth rate. The differences have increased[26] in the calculation of the actual rate of growth in the adjusted expenditure, which can be attributed to methodological changes that were incorporated in the CBR's approach as announced in the July 2015 evaluation. The CBR's calculation of adjusted expenditures does not include one-off effects and cyclical expenditures on pensions. The Ministry of Finance took into account one-off measures in its qualitative evaluation of developments in 2014 (the so-called overall assessment).

revenues from dividends and on the cyclical component of the budget as a consequence of the slightly different output gap estimates.

[26] Another reason why differences exist is that the CBR takes into account a broader list of items (such as non-tax revenues) in estimating the size of discretionary revenue measures and the impact of methodology adjustments. These differences were present already in this year's July evaluation.

Annex 1 - The balanced budget rule

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union entered into force on 1 January 2013. It is an intergovernmental treaty signed by 25 Member States, including Slovakia. Members of the euro area are bound by all provisions of the Treaty. The Treaty (specifically its Title III called Fiscal Compact) obliges the parties to t**ranspose the rule on the structural balance development and medium-term budgetary objective** (the balanced budget rule) **into their national legal systems** through permanent, binding and preferably constitutional provisions within one year of the entry into force of the Treaty. The time-frame for convergence to this objective should be proposed by the European Commission, taking into consideration country-specific sustainability risks.

The rule also contains a correction mechanism to be triggered should a significant deviation occur, and defines the exceptions when the mechanism is not applied. The correction mechanism shall be put in place by individual Member States on the basis of common principles published by the European Commission[27]. These principles foresee the existence of independent institutions responsible for the monitoring of compliance, specify their roles and define requirements concerning their independence.

The balanced budget rule was transposed into Slovak law by an amendment to the Act on the General Government Budgetary Rules[28] which entered into force as of 1 January 2014. The general government budget is considered balanced (i.e., the rule is respected) if the **structural deficit of the general government[29] reaches a maximum of 0.5 % of GDP.** If the general government debt is significantly below 60 % of GDP and the risks associated with the long-term sustainability of public finances as defined by the Fiscal Responsibility Act[30] are minimal, the structural deficit may be equal to or less than 1 % of GDP.

The correction mechanism is triggered in the event of a significant deviation from the objective or the adjustment path towards it; the term 'significant deviation' is defined in the preventive arm of the Stability and Growth Pact[31]. It is evaluated on the basis of an overall assessment of structural balance development and development in the adjusted expenditure net of discretionary revenue measures.

The correction mechanism will **specify the maximum amount of the accrued consolidated general government expenditure** (public expenditure ceiling) **and the measures taken during the period of correction from the deviation**. The correction should take into account the size of the deviation observed, respecting the attainment of the medium-term

[27] Communication from the Commission: Common principles on national fiscal correction mechanisms of 20 June 2012.

[28] Namely Section 30a entitled "Specific Provision on the Balanced General Government Budget", Act No. 523/2004 on the General Government Budgetary Rules.

[29] The structural balance of the general government is defined as the general government balance adjusted for impact of the economic cycle and one-off effects.

[30] Article 2 (a) of Act No. 493/2011 on Fiscal Responsibility.

[31] Significant deviation is defined in Article 6(3) of Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (the preventive arm of the SGP). The precise definition, including the application and evaluation of the balanced budget rule, is contained in Part 1.5 of this document.

objective, and annual reductions in the general government deficit to gross domestic product ratio based on the recommendations of the Council of the EU. The obligation to trigger the correction mechanism does not apply to periods of exceptional circumstances as defined in the Treaty[32].

The Act also describes the procedures and assigns the roles to individual institutions (Figure 1). In line with the procedures specified in the Stability and Growth Pact[33], the Ministry of Finance must report twice a year (by 30 June and 30 November[34]) whether a significant deviation has occurred. **The CBR, as an authorised independent institution, reviews and publishes its evaluation on the application or non-application of the correction mechanism.**

If the Ministry of Finance reports that a significant deviation has occurred, it will propose to the government a **public expenditure ceiling and measures to be taken during the correction period**. The decision on the correction mechanism rests with the government. **Prior to the government taking the decision, the proposal is reviewed by the CBR.** If the government decides not to apply the correction mechanism, it will submit to the parliament a written justification of such decision.

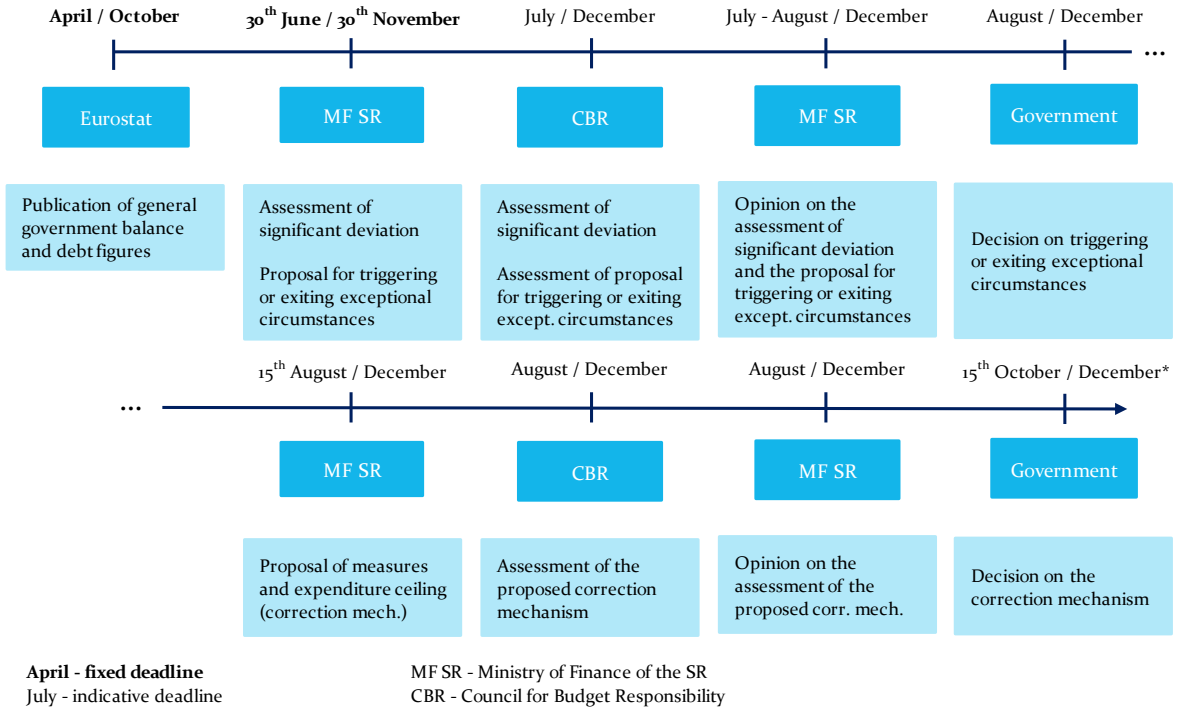
The beginning and end of the duration of exceptional circumstances is declared by the government based on a proposal by the Ministry of Finance. **Prior to the declaration, the proposal is reviewed by the CBR.** The Ministry of Finance publishes its opinions on all CBR evaluations (the "comply or explain" principle).

[32] Exceptional circumstances are defined in Article 3(3) (b) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

[33] Articles 5 and 6 of Regulation (EC) No 1466/97 and Article 3(4) of Regulation (EC) No. 1467/97 contain analytical indicators (change in the structural balance and change in the adjusted expenditure net of discretionary revenue measures) which are assessed, including the method for their calculation and the benchmark against which they are compared.

[34] The setting of these deadlines and the frequency of publication relates to the deadlines for the notification of debt and deficit to Eurostat. Every year, as of 1 April, Member States send to Eurostat preliminary figures on the general government revenues, expenditures, balance and debt for the previous year, and confirm the final figures for previous years. Then, in the second round as of 1 October, updated figures for the previous year are notified; unless there have been changes in methodology, these figures should not be significantly different.

Figure 3: Procedures and responsibilities of individual institutions

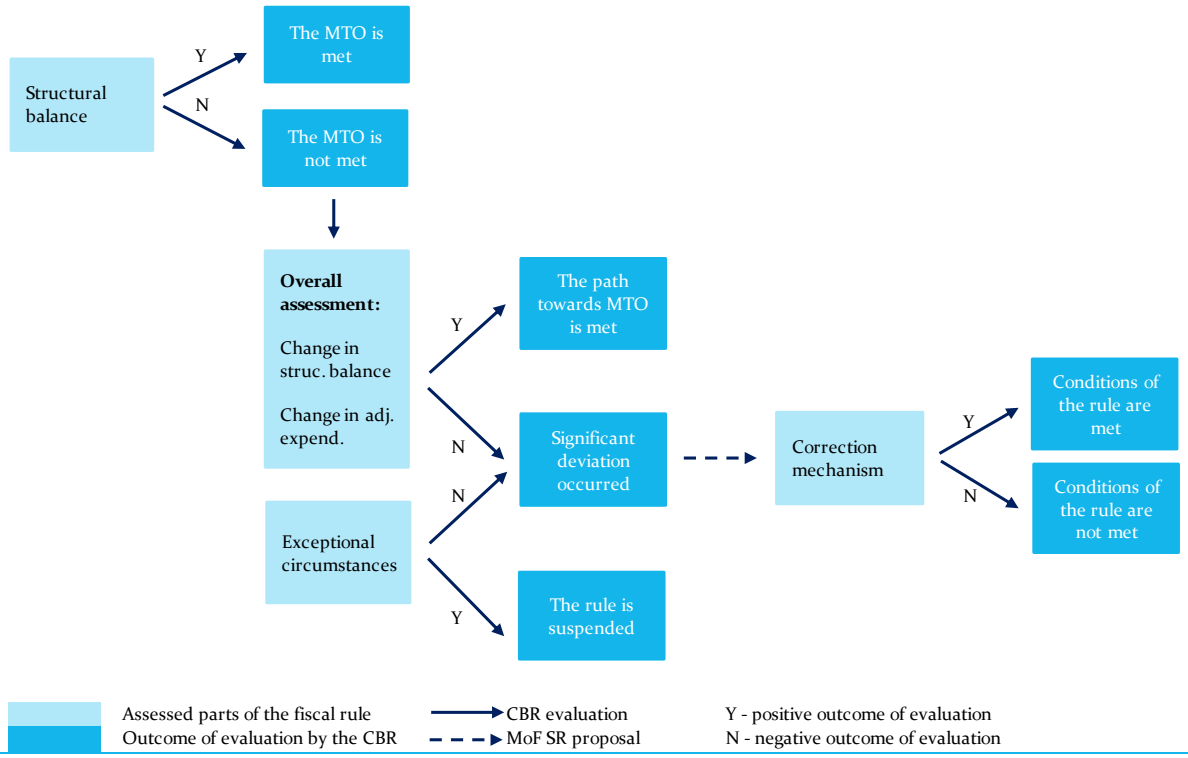


*Note: * Due to a short time period between the publication of the assessment of significant deviation by the Ministry of Finance (deadline until the end of November) and the end of the year, the proposed measures might be incorporated in the following year, either via an amendment of the adopted budget or within the next year´s budget preparation.* *Source: CBR*

Annex 2 - Process of the CBR's evaluation

The CBR's evaluation of compliance with the balanced budget rule consists of several steps (Figure 4) and is based on actual figures. As the first step, the **minimum amount of the structural deficit target value** pursuant to the Act on the General Government Budgetary Rules is set and **compared against the 2014 structural balance value**. **If it is not met**, the CBR will evaluate whether Slovakia has made sufficient progress towards meeting the objective, using two fiscal indicators. Specifically, it will **compare the change in the structural balance and in the adjusted expenditure net of discretionary revenue measures** cumulatively in 2013 and 2014 against the required change in these indicators. At the same time, the CBR will assess whether **exceptional circumstances have occurred (or persist)** during which the balanced budget rule does not apply. Based on these analyses, the CBR will **evaluate whether a significant deviation has occurred and whether or not the correction mechanism should be triggered**. **If the correction mechanism is triggered and the Ministry of Finance proposes corrective measures, the CBR will also evaluate this mechanism.**

Figure 4: Evaluation of the balanced budget rule - description of procedure



Source: CBR

Annex 3 - Changes in indicator results

In comparison with the CBR's document evaluating the development in 2014, which was published in July 2015, there were several changes in assessed indicators (the structural balance, the rate of expenditure growth), as well as in values against which these indicators are compared (the required change in the structural balance and the expenditure benchmark). Most of the changes can be attributed to the standard refinement of fiscal data, and some changes are related to the announced methodology adjustments (financial corrections to EU funds recorded in the appropriate periods of time, greater consistency between the expenditure benchmark and the structural balance).

Structural balance

Compared to July, the structural balance components were subject to minor adjustments only. The October notification by Eurostat adjusted the figures on fiscal performance of the general government in 2013 and 2014 by 0.1 % of GDP and, likewise, the impact of the update to the cyclical component is quantified at 0.1 % of GDP for the same years. As regards one-off effects, there were several refinements that are presented in more detail in Annex 4. One-off effects worsened the structural balance estimate by 0.2 % of GDP in 2012 and 2013. Due to the above changes, the structural deficit deteriorated by 0.1 % of GDP in 2012 and by 0.2 % of GDP in 2013, but improved by 0.2 % of GDP in 2014. In light of the worse baseline position in 2012, the pace of changes in the structural balance that is required for attaining a balanced budget in 2017 has increased from 0.77 % of GDP to 0.79 % of GDP.

Tab 8: Comparison to CBR´s evaluation in July - structural balance (ESA2010, % GDP)

	2012	2013	2014	2012	2013	2014	2012	2013	2014
	December	December	December	July	July	July	difference	difference	difference
1. GG balance	-4.2	-2.6	-2.8	-4.2	-2.6	-2.9	0.0	-0.1	0.1
2. Cyclical component	-0.2	-0.5	-0.1	-0.1	-0.4	0.0	0.0	-0.1	-0.1
3. One-off measures	0.4	0.2	0.1	0.3	0.0	0.1	0.2	0.2	0.0
4. Structural balance (1-2-3)	**-4.4**	**-2.4**	**-2.8**	**-4.3**	**-2.1**	**-3.0**	**-0.1**	**-0.2**	**0.2**
Change in structural balance		**2.1**	**-0.4**		**2.2**	**-0.9**		**-0.09**	**0.45**
Required change in structural balance		**2.08**	**1.64**		**2.18**	**1.29**		**-0.09**	**0.36**
Required cumulative change in structural balance		**0.79**	**1.58**		**0.77**	**1.53**		**0.02**	**0.05**
p.m. output gap	-1.0	-1.5	-0.9	-1.0	-1.6	-1.1	0.1	0.1	0.2

Source: CBR

Development in adjusted expenditure

The development in adjusted expenditure of the general government was partially influenced by revised fiscal and macroeconomic figures. However, a substantial change in the calculation of the expenditure aggregate was due to methodology adjustments announced by the CBR in its July report. Consistently with the structural balance concept, the cyclical expenditures now include expenditures on old-age pensions and disability pensions (in the same vein, the CBR

also takes them into account in the calculation of the cyclical component of the structural balance). At the same time, the primary expenditure aggregate has been adjusted for one-off expenditures (financial corrections to the EU funds, retroactive disbursement of pensions in the armed forces from the Social Insurance Agency, and the adjusted amount of the transfer to the EU budget), with one-off revenues being excluded from the discretionary revenue measures as well. As a result of these changes, the real expenditure aggregate declined by as much as 1 % of GDP in 2013 against the July report, but slightly increased in 2014 (up 0.1 % of GDP). The update to the expenditure benchmark allowed for a lower expenditure growth in comparison with the CBR's July evaluation (by 0.1 % of GDP). The cumulative deviation for 2013 and 2014 declined from 0.3 % of GDP to 0 % of GDP as a result of a significant drop in the real expenditure aggregate in 2013.

Tab 9: Comparison to CBR´s evaluation in July – expenditure benchmark (ESA2010, € mill.)

	2012	2013	2014	2012	2013	2014	2012	2013	2014
	December	December	December	July	July	July	diff	diff	diff
1. GG expenditure	**29 077**	**30 284**	**31 462**	**29 018**	**30 193**	**31 410**	**59**	**91**	**51**
2. Interest payments	1 280	1 384	1 441	1 286	1 393	1 447	-6	-9	-7
3. Gross fixed capital formation	2 193	2 255	2 749	2 182	2 193	2 788	11	62	-40
4. Annual average gross fixed capital formation (t-3 to t)	2 381	2 346	2 445	2 378	2 328	2 437	3	18	8
5. Current expenditures on EU programmes fully matched by EU funds revenues	171	249	301	171	249	301	0	0	0
6. Cyclical expenditures (unemployment, pensions)	0.0	-31.0	-48.0	0.4	9.9	5.4	-0.3	-40.9	-53.3
7. One-off expenditures	-103	1	140	0	0	0	-103	1	140
8. Primary expenditure aggregate *(1-2-3+4-5-6-7)*	**27 916**	**28 772**	**29 324**	**27 756**	**28 677**	**29 305**	**160**	**95**	**19**
9. Change in primary expendit. aggregate *(8t-8t-1)*		856	552		921	629		-65	-77
10. Change in discretionary revenue measures and NA reporting		1 286	94		1 059	209		227	-115
11. Nominal growth of expend. aggregate adjusted for revenue measures ((9t-10t)/8t-1)		-1.5	1.6		-0.5	1.5		-1.0	0.1
12. Change in GDP deflator		0.5	-0.2		0.5	-0.2		0.0	0.0
13. Real growth of expenditure aggregate		**-2.0**	**1.8**		**-1.0**	**1.7**		**-1.0**	**0.1**
14. Potential GDP growth		1.9	1.9		2.0	1.9		-0.1	0.1
15. Convergence margin (p. p.) CBR change in SB/$((1_{t-1}-2_{t-1})/GDP_{t-1})$		2.1	2.0		2.0	2.0		0.1	0.1
16. Expenditure benchmark *(14-15)*		**-0.1**	**-0.1**		**0.0**	**-0.1**		**-0.1**	**0.0**
17. Impact of the deviation		0.7	-0.7		0.4	-0.7		0.3	0.0

on the balance in the given year (16t-13t)*8t-1/GDPt			
18. Cumulative deviation in t-1 a t	**0.0**	**-0.3**	**0.3**

Source: CBR

Annex 4 - One-off measures

This part describes the one-off measures which have been taken into account in evaluating compliance with the balanced budget rule. In comparison with the July report by the CBR, they were subject to a revision with an overall impact representing 0.2 % of GDP in 2013 and 0.0% of GDP in 2014.

Box 2: CBR's update of one-off effects

The table below shows in more detail the differences in one-off measures in 2013 and 2014. There are three differences in comparison with the CBR's July report. The financial corrections to EU funds underwent a more extensive revision, the primary purpose of which was to ensure that corrections to EU funds are properly assigned to those periods of time to which they actually apply. In addition to that, the amount of the transfer to the EU budget in 2014 was specified on the basis of updated data, and the VAT receipts were updated on the basis of completed audits.

Tab 10: Comparison to CBR´s evaluation in July - one-off measures (ESA2010, € mill.)

	2013	2014	2013	2014	2013	2014
	December	December	July	July	difference	difference
VAT receipt from a PPP project (Granvia)	-5.8	-5.8	-5.8	-5.8	0.0	0.0
digital dividend	-	163.9	-	163.9	-	0.0
retroactive disbursement of pensions in the armed forces	-8.1	-58.5	-8.1	-58.5	0.0	0.0
adjusted amount of transfer to the EU budget	-	57.8	-	87.4	-	-29.6
financial corrections to EU funds	12.6	-133.8	-124.5	-111.0	137.1	-22.8
accrualisation of VAT revenues	94.2	-57.8	79.7	-83.5	14.5	25.7
penalty imposed by the Antimonopoly Office	-	44.8	-	44.8	-	0.0
repayment of loans provided to Cargo, a.s.	19.5	19.5	19.5	19.5	0.0	0.0
repayment of loans provided to Vodohosp. výstavba	30.3	48.1	30.3	48.1	0.0	0.0
TOTAL	**142.7**	**78.2**	**-8.9**	**104.9**	**151.6**	**-26.7**
(% GDP)	*0.2*	*0.1*	*0.0*	*0.1*	*0.2*	*0.0*

Source: CBR

1. **VAT receipt from a PPP project** – In 2011, the imputation of a claim towards the Granvia company as a consequence of VAT payment in connection with a PPP project for the R1 motorway in the amount of EUR 174 million had a one-off positive effect on the deficit. In the next 30 years, this claim 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 for 30 years.
2. **Digital dividend** – In 2014, the sale of frequency bands through auction, the so-called digital dividend, had a one-off positive effect on non-tax revenues. The positive impact of the sale on the 2014 balance reached EUR 163.9 million.
3. **Retroactive disbursement of pensions in the armed forces** – In 2014, based on a court decision, the Social Insurance Agency made a retroactive calculation of pension

entitlements for certain categories of pensioners. The court ruled on 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 were, for a short time after leaving the armed forces, insured in a pension scheme for the civilian sector, as a result of which they were entitled to a low pension only or no pension at all. The negative impact on the budget of the one-off retroactive disbursement of pensions based on the above-mentioned court ruling reached EUR 58.5 million in 2014.

4. **Adjusted amount of transfer to the EU budget** – The amount of the transfer payable to the EU budget from sources based on VAT and GNP is estimated annually by the European Commission. Based on the calculations done in September 2014 (revision of the GNP time series for the period between 1995 and 2013), the original amount has been significantly revised and the deadline for payment by Member States has been set to 1 December 2014 and 1 September 2015, respectively. In Slovakia's case, the adjusted calculation of the transfer had a positive impact on the 2014 budget in the amount of EUR 58 million.

5. **Financial corrections to EU funds** – Due to irregularities identified in the spending of EU funds, the costs of certain projects are not reimbursed from EU funds despite the fact that Slovakia has already received the corresponding EU allocation or the costs have been pre-financed from the national budget. Once the correction is imposed and accepted, it has a negative impact on the balance. In 2014 alone, financial corrections to EU funds reached EUR 134.0 million[35].

6. **Accrualisation of VAT revenues** - ESA2010 uses the method of accrued cash receipts based on which cash receipts are attributed to individual periods with a fixed time lag. This approach, however, does not fully reflect the reality, particularly when it comes to excess tax refunds. Tax audits and the related suspension of excess tax refunds may significantly influence VAT accrual receipts under ESA2010. For this reason, the negative impact on VAT receipts reached EUR 57.8 million in 2014

7. **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 motorway (Mengusovce–Jánovce). The Supreme Court of the Slovak Republic confirmed the legality of the penalty in the amount of EUR 44.8 million on 30 December 2013. The penalty increased non-tax revenues in 2014. This one-off effect might be recorded in a different manner in the future because the Constitutional Court overturned the decision on the imposition of the penalty in June 2015 and referred the case back to the Supreme Court of the Slovak Republic.

8. **Repayment of loans provided to Vodohospodárska výstavba, š. p.** – In 2014, the balance of the last two instalments of the repayable financial assistance provided to Vodohospodárska výstavba (state corporation) before 2002 was paid, which increased the

[35] The amount of the financial corrections is taken from the MF SR documents (Draft Budgetary Plan of the Slovak Republic for 2016, Box 2). The impact of financial corrections in individual years is identified as the difference between the financial correction amount officially recorded under the general government balance and an analytically adjusted financial correction (the correction assigned to the year in which it occurred).

revenues of state financial assets by EUR 48 million. Because, in the past, the loan was treated as a capital transfer with a negative impact on the deficit under the ESA2010 methodology, the transaction had a positive impact on the general government balance in 2015.

9. **Repayment of loans provided to Cargo, a. s.**[36] – On 4 March 2009, the government approved the use of state financial assets for the provision of a 'repayable financial assistance' to Cargo Slovakia a.s. in the amount of EUR 166 million, which had a negative impact on the budget in 2009. Under a contract with the Ministry of Finance and the Ministry of Transport, Post and Telecommunications, Cargo used the assistance 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 principal in 2011, and the entire loan matures in 2016. In 2014, the instalment paid by Cargo had a positive impact of EUR 20 million; in 2015, Cargo is expected to repay EUR 98 million, including an extraordinary instalment.

For the purposes of evaluating the balanced budget rule, the CBR and the Ministry of Finance have taken into account identical one-off effects in the years 2013 and 2014[37].

Tab 11: One-off measures in 2013-2014 (ESA2010, € mill.)

	2013	2014	2013	2014	2013	2014
	CBR		MF SR		difference	
- VAT receipt from a PPP project (Granvia)	-5.8	-5.8	-5.8	-5.8	0.0	0.0
- digital dividend	-	163.9	-	163.9	-	0.0
- retroactive disbursement of pensions in the armed forces	-8.1	-58.5	-8.1	-58.5	0.0	0.0
- adjusted amount of transfer to the EU budget	-	57.8	-	57.8	-	0.0
- financial corrections to EU funds	12.6	-133.8	12.6	-133.8	0.0	0.0
- accrualisation of VAT revenues	94.2	-57.8	94.2	-57.8	0.0	0.0
- penalty imposed by the Antimonopoly Office	-	44.8	-	44.8	-	0.0
- repayment of loans provided to Cargo, a.s.	19.5	19.5	19.5	19.5	0.0	0.0
- repayment of loans provided to Vodohosp. výstavba	30.3	48.1	30.3	48.1	0.0	0.0
TOTAL	**142.7**	**78.2**	**142.7**	**78.2**	**0.0**	**0.0**
(% GDP)	*0.2*	*0.1*	*0.2*	*0.1*	*0.0*	*0.0*

Source: CBR, MF SR

[36] Even though individual instalments do not reach 0.05 % of GDP in each year, the CBR considers, the transactions should be recorded consistently. The instalments are thus spread over the entire loan term and have a positive impact on the balance.

[37] In 2012, the CBR's list of one-off revenues includes revenues from dividends resulting from non-standard one-off transactions which are to be recorded as general government revenues under ESA2010. The Ministry of Finance does not treat these transactions as one-off revenues.

Annex 5 - Expenditure benchmark – methodology and data

In calculating the adjusted expenditure and the expenditure benchmark, the procedure laid down in the Stability and Growth Pact[38] is taken into account, albeit with several differences. The purpose of these differences is to make the calculation of this indicator more precise and to narrow the existing differences between the structural balance and expenditure benchmark. They specifically include:

- **Use of actual data** as opposed to forecasts (GDP deflator) and multi-annual averages (potential output growth). The intention is, similarly as for the structural balance, to maintain a link to the actual development in a given year also when the expenditure benchmark is applied.
- **Elimination of the double netting out of investments financed from EU funds from the expenditure** since, under the procedure defined by the SGP, the total expenditure was adjusted for total investments by the general government and total expenditures financed from EU funds, including capital expenditures. In the CBR's evaluation, the item of expenditures funded from the EU budget includes only current expenditures. The drawback of this approach is that the adjusted expenditure is partially influenced by investments from EU funds because when the indicator is calculated, investments are averaged. Since these expenditures are covered by revenues in the same amount, they do not influence the deficit and, as such, should not feed into the expenditure benchmark calculation. The present approach is applied by the CBR due to the limited availability of data, since the transition to ESA2010 (reclassification of entities which implement investments financed from EU funds) causes that only the data for 2014 are available. In its next evaluation, the CBR intends to identify the sum of investments financed from EU funds also for the previous years.
- **Inclusion of methodology impacts on the level of revenues and expenditures** - these are the impacts which, due to the methodology of recording in the national accounts, may lead to changes in revenues and expenditures between individual years without any government intervention (social and health insurance contributions paid by the state, reclassification of general government entities). The list of impacts in individual years is presented in Table 12.
- **Exclusion of one-off effects** (a change from the July evaluation) – as is the case with the structural balance which is adjusted for all one-off effects, the adjusted expenditure development has been adjusted for one-off revenue measures and all one-off effects on the expenditure side. The CBR has chosen this approach in order to prevent the occurrence of unjustified differences between the structural balance and adjusted expenditure, because one-off effects distort the government's fiscal performance.
- **Exclusion of cyclical expenditure on pensions** (a change from the July evaluation) – this change reflects the fact that, in estimating the cyclical component of the general government balance, the CBR also estimates cyclical expenditure on pensions. The CBR has thus aligned its approach to that used in estimating the structural balance.

[38] The method of calculation is contained in the accompanying non-legislative document which specifies certain provisions of the Stability and Growth Pact (Specifications on the implementation of the Stability and Growth Pact of 3 September 2012).

The data necessary for the calculation of the expenditure benchmark and the adjusted expenditure growth are taken from the official statistics of Eurostat and from the CBR estimates (potential output, impact of the economic cycle, discretionary revenue measures, methodology impacts and one-off effects) complemented by the estimates of the Ministry of Finance. In the case of taxes, the discretionary revenue measures are taken from the MF SR estimates as presented in the respective forecast by the Tax Revenue Forecasting Committee. These data are consistent with the October notification of Eurostat. The other (mainly non-tax) measures are estimated by the CBR on the basis of its no-policy-change scenario. The following table contains a list of the discretionary revenue measures between 2012 and 2014 whose subsequent change was used as an input in the calculation of the adjusted expenditure development.

Tab 12: Discretionary revenue measures and methodological effects (ESA2010, € mill.)

	Total effect			Additional effect		
	2012	2013	2014	2012	2013	2014
1. Discretionary measures (excluding one-offs)	**207**	**1 542**	**144**	**207**	**1 337**	**47**
Decrease of contributions to the fully-funded pillar of pension system*	159	507	-	159	338	-
Social insurance contributions paid by state	-	42	-	-	42	-
Extension of a special levy in the banking sector*	23	93	-	23	70	-
Levy on enterprises in regulated industries*	28	64	-	28	48	-64
Increasing the excise tax on tobacco	-	20	-	-	20	-
Increasing the vehicle registration fee*	6	27	-	6	21	-
Changes in taxation of gambling	0	0	-	0	-1	-
Increase and unification of the maximum assessment bases	-	160	-	-	160	-
Increase in social security contributions for self-employed and other	-	27	-	-	27	-
Health and social security contributions for workers by agreement	-	130	-	-	130	-
Transition from 19% to 23% rate of PIT (already adopted measures)	-	-6	-	-	-6	-
Changes in income tax rates - CIT 23%, PIT 19% and 25%	-	401	-	-	401	-
Special PIT rate from revenues of selected constitutional officials	-	0	-	-	0	-
Tax exemption of in-kind benefits of miners	-	0	-	-	0	-
Tax exemption of local government revenues from sales of property	-	-10	-	-	-10	-
Abolition of television/radio licence fee	-	-72	-	-	-72	-
Re-introduction of television/radio licence fee	-	71	-	-	71	-
Changes in taxation of bonds	-	0	-	-	0	-
Taxation of retained profits from before 2004	-	4	-	-	4	-4
Increasing real estate tax	-	12	-	-	12	-
Increasing the waste disposal tax	-	4	-	-	4	-
Social insurance contributions of armed forces	-	11	-	-	11	-
Increasing other administrative fees (excl. the vehicle registration fee)	-	28	-	-	28	-
Grant from JAVYS (state-owned nuclear decommissioning company)	-	30	10	-	30	-20
Repayment of loan by Cargo (state-owned railway freight company)	-10	-	-	-10	10	-
Social contributions relief for long-term unemployed	-	0	-1	-	0	-1
Extension of levy in regulated industries	-	-	56	-	-	56
Automatic decrease of rate of special levy in the banking sector	-	-	42	-	-	42
Introduction of licence fees for corporations	-	-	82	-	-	82
Decrease in the CIT rate from 23% to 22%	-	-	-95	-	-	-95
Change in rules of amortization of losses	-	-	37	-	-	37
Change in taxation of nonfinancial compensation (using company car)	-	-	-8	-	-	-8

Increase of administrative fees	-	-	23	-	-	23
2. Change in methodology (additional effects)				**0**	**-51**	**47**
Changes in imputed social contributions				-	21	12
Changes in insurance contributions paid by state (in 2013 only health				-	-72	-45
Inclusion of public transport companies to the general government				-	-	80
TOTAL (1+2)				**207**	**1 286**	**94**

** Measures came into effect during 2012. The additional effect of 2013 is computed on a proportional basis. For example, if the measure is valid during three months in 2012 and during the next year, the additional effect in 2013 is equal to 9/12 of the revenue in 2013.*

Source: CBR, MF SR

Annex 6 - Differences between the structural balance and adjusted expenditure development

The structural balance and the adjusted expenditure development are the two indicators used to evaluate the path of public finances towards a balanced budget. Although the structural balance plays the main role (since this is how the medium-term objective for a country is defined), the analysis of expenditure development may, in certain situations, complement the evaluation. It is, however, essential to identify the reasons behind the differences between these indicators.

When evaluating the path towards a balanced budget, the CBR evaluates the cumulative development in 2013 and 2014; both indicators reach almost identical values (1.64 % and 1.56 % of GDP, respectively). However, the two indicators considerably differ, by some 0.5. p.p., if we look at individual years (Table 13).

Tab 13: Development of adjusted expenditures (ESA2010, € mill.)

	2012	2013	2014	cumulative (2013-2014)
1. Primary expenditure aggregate	**27 916**	**28 772**	**29 324**	
2. Year on year change in primary expenditure aggregate *(1_t-1_{t-1})*		856	552	
3. Change in revenues due to discretionary measures and methodology of national account reporting		1 286	94	
4. Nominal growth of expenditure aggregate adjusted for changes in revenues *((2_t-3_t)/1_{t-1})*		-1.5	1.6	
5. Year on year change in GDP deflator		0.5	-0.2	
6. Real growth of expenditure aggregate adjusted for changes in revenues (4-5)		**-2.0**	**1.8**	
7. Potential GDP growth		**1.9**	**1.9**	
8. Impact of change in expenditures on the balance ((7_t-6_t)*1_{t-1}/GDP_t)		**1.51**	**0.05**	**1.56**
p.m. Change in structural balance		***2.08***	***-0.44***	***1.64***

Source: CBR, SO SR, MF SR

The differences between these indicators can be explained by the following groups of factors:

- Deviation of actual investments from the four–year average – while the structural balance takes into account the amount of investments in a given year, the adjusted expenditure reflects the average amount of investments in the past four years. If a significant change occurs, either as a consequence of consolidation or increase in investment activity, it is not always possible to identify it as having a one-off nature and to adjust the structural balance accordingly. From this perspective, the adjusted expenditure indicator is a useful addition as it reflects the change only partially. This situation occurred in 2014 when investments soared, bringing the two indicators 0.5 p.p. apart.
- Debt interest payments – the expenditure benchmark does not take into account the development in debt interest payments, while the structural balance indicator does. Since debt interest payments are largely influenced by past government decisions, the

indicators adjusted for these expenditures may provide a more accurate picture of the present fiscal policy[39].

- The rate of revenue growth at the level of potential GDP growth – one of the advantages of the adjusted expenditure indicator is that, unlike the structural balance, the revenue side is not adjusted for cyclical impacts (due to the uncertainty associated with estimating the elasticity of revenues on the economic cycle); instead, the growth in revenue is estimated at the level of potential GDP growth. The differences between the two indicators may suggest problems in estimating the cyclical impacts of taxes on public finances, but they may also be attributable to changes in the efficiency of tax collection. Therefore, particularly if the conclusions of evaluation diverge, the causes behind these differences should be examined. In 2013, this factor explained the difference between both indicators (with a contribution of 0.9 p.p.). Since the outcome of evaluation based on the two indicators was the same, the CBR did not examine the causes for these differences.
- Inaccuracy in the calculation of the impact of revenue growth at the level of the potential GDP growth – the calculation of the impact of the deviation on the balance is based on a comparison of the rate of growth in the adjusted expenditure and the rate of growth in revenues at the level of the potential. Such a calculation is precise only if the budget is balanced (the same adjusted revenue and adjusted expenditure). In all other situations, the calculation of the impact on the balance is distorted since expenditures grow from a different base than revenues. The years 2013 and 2014, when public finances ran deficits, can be used as an example. The positive impact of the adjusted expenditure development on the balance was overestimated in both years (approximately by 0.1 p.p. per year) because the estimated growth in revenues was higher than the reality.
- Impact of nominal GDP growth – the calculation of the rate of growth in the adjusted expenditure is based on the sums expressed in euros and does not take into account the impact of the annual change in nominal GDP (the so-called 'denominator effect'[40]). The structural balance indicator already reflects this impact because it is calculated based on the annual change in individual items expressed in relation to GDP.

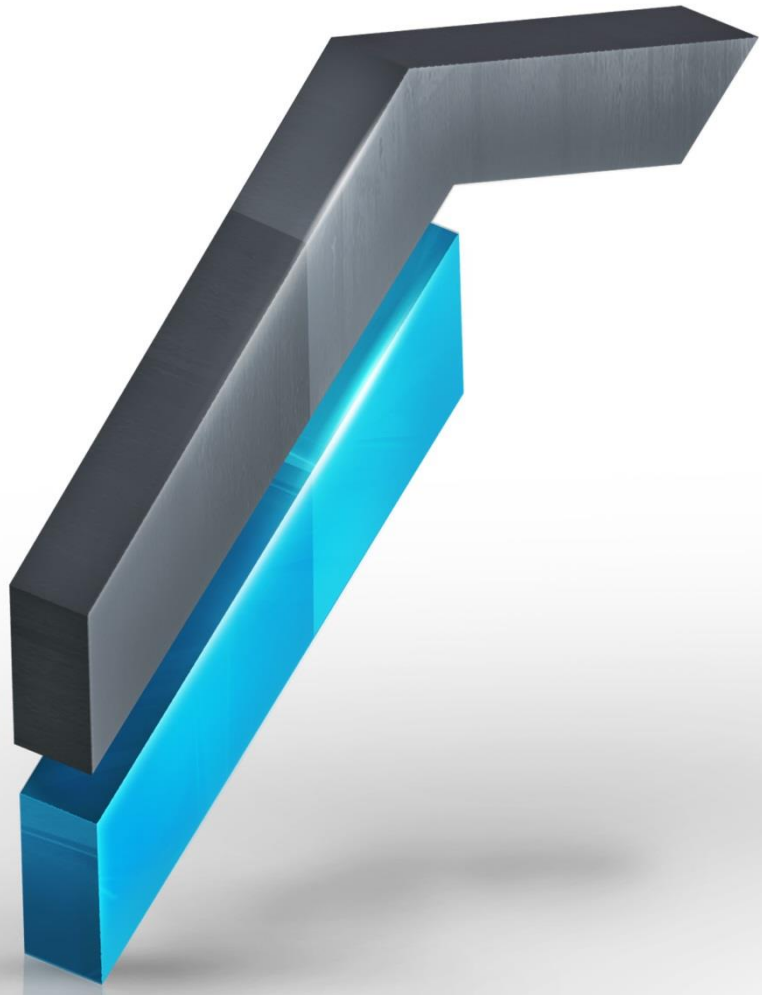
Tab 14: Differences between the change in structural balance and the impact of adjusted expenditures on balance (ESA2010, % GDP)

	2013	2014
Change in adjusted expenditures (impact on the balance)	**1.51**	**0.05**
(+) Deviation of actual investment from average	-0.13	-0.52
(+) Development of interest payments	-0.14	-0.08
(+) Actual revenue growth beyond potential growth	0.88	0.13
(+) Inaccuracy in the calculation of the impact of revenue growth	-0.12	-0.08
(+) Impact of GDP growth (denominator effect)	0.09	0.05
Change in structural balance	**2.08**	**-0.44**

Source: CBR

39 For this reason, the CBR takes into account development in debt interest payments for the structural balance indicator, as part of the so-called 'special factors'.

40 The denominator effect is based on the fact that the general government balance or structural balance are expressed in relation to GDP. An annual GDP change then influences the said ratio.



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