CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of Compliance with the Balanced Budget Rule in 2014

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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. 493/2011 on Fiscal Responsibility.

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

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Summary

The structural deficit of the general government in 2014 reached 3.0 % of GDP, up 0.9 % 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. Despite considerable consolidation in 2013, the fiscal easing in 2014 caused a minor deviation of 0.2 % of GDP from the adjustment path set to meet the objective by 2017. This conclusion is also confirmed by the evaluation of the development in the adjusted expenditure which, since 2012, increased by 0.7 p.p. above the expenditure benchmark (with negative impact on the balance at 0.3 % of GDP). In addition to these two indicators, the CBR took also into account the impact of other measures which widen the deviation (impact of the reduced contribution rates to the fully-funded pillar) or which may narrow it (upward revision of the corporate income tax revenue). Based on the above, the CBR concludes that the 2014 deviation was not significant enough to trigger the correction mechanism.

The government's fiscal objectives for the years to come put the ambition of meeting the medium-term objective by 2017 at risk. For 2015, the CBR has identified[1] several risks above and beyond the Ministry of Finance's estimates 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.

Compared with 2012, the 2014 structural balance improved by 1.3 % of GDP, which is 0.2 % of GDP below the required change of 1.53 % of GDP assuming a steady deficit improvements by 0.77 % of GDP per year. The entire budget consolidation took place in 2013 when the balance improved considerably (by 2.2 % of GDP), followed by fiscal easing in 2014. As part of its overall evaluation, 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 contribute positively to the overall budgetary position in the long term[2]. The more precise data for 2014 to be released as part of the second debt and deficit notification in the autumn of 2015 may move the deficit either way. Provided that there are no other significant revisions, the higher-than-expected 2014 revenue from the corporate income tax may improve the structural deficit and narrow the deviation by 0.2 % of GDP.

The conclusions of the CBR's independent evaluation are basically identical with the position of the Ministry of Finance. The CBR views as positive that the evaluation methodologies used by both the CBR and the Ministry of Finance have converged since the December report. The Ministry has replaced its adjustment path towards the structural balance improvement, derived from the rules of the Stability and Growth Pact (which would not lead to a nearly balanced budget by 2017), by an assumption of steady annual improvements in the structural balance. The approaches of both institutions are identical also in that they evaluate cumulative deviations

[1] CBR, Evaluation of Medium–term Budgetary Objectives, May 2015.

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

from the year 2012. As for the 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. However, all these methodological differences have had a minimal impact on the overall evaluation.

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**	**-3.0 % of GDP**	✘
	A. debt significantly below 60 % of GDP	debt below 40 % of GDP	< 40 % of GDP	53.6 % 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**		**>= 1.5 % of GDP***	**1.3 % 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**		**>= 1,5 % of GDP***	**1,2 % 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 %	2.4 %	✘
	E. protracted period of very low GDP growth relative to potential	negative output gap at least at 3 % of potential GDP	<= -3 %	-1.1 %	✘
	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		<= 1.0 % of GDP**	1.3 % 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		<= 1.0 % of GDP**	1.2 % of GDP	✘
	6. Assessment of compliance with the balanced budget rule		**no significant deviation**		

** 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 1.5 % of GDP. Significant deviation occurs when the balance improves by 1.0 % of GDP at most (1.5 - 0.5 = 1.0 % of GDP)*

1. CBR evaluation

Compliance with the balanced budget rule, transposed into Slovak law under an obligation arising from the international Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, was evaluated for the first time in 2014 (with 2013 being the first year subject to evaluation). The rule is based on the medium-term objective which Slovakia's public finances should attain or should be quickly approaching. The evaluation of compliance with the rule falls under the responsibility of the Ministry of Finance ("MF SR") which publishes its reports biannually, by 30 June and 30 November. Subsequently, the Council for Budget Responsibility ("CBR") provides its independent evaluation. In line with the "comply or explain" principle[3], the MF SR then publishes its position on the CBR evaluation.

The CBR prepared its first evaluation of compliance with the balanced budget rule for the year 2014 based on the data contained in the April deficit and debt notification by Eurostat prepared in line with the ESA2010 methodology[4]. It also contains CBR opinion on the evaluation[5] published by the MF SR on 30 June 2015. The main line of the CBR's evaluation remains the same as in the past year[6] (see Annex 2 for a schematic presentation of individual steps). In terms of methodology, the term 'significantly lower debt' has been revised and the calculation of the adjusted expenditure for the expenditure benchmark has been further refined.

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

[3] Communication from the Commission: Common principles on national fiscal correction mechanisms of 20 June 2012.
[4] The description of ESA2010, including its accompanying documents, is published at Eurostat.
[5] The evaluation of the occurrence of a significant deviation is done 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.
[6] Evaluations of Compliance with the Balanced Budget Rule for 2013 from July and December 2014.

transitional provisions of the Act[7]. At the same time, such a debt level can be considered relatively safe[8].

- **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, the **evaluation of long-term sustainability by the European Commission** is also taken into account[9].

The general government gross debt reached 53.6 % of GDP at the end of 2014, a level which triggers sanctions under Fiscal Responsibility Act, while the long-term sustainability indicator for the same period reached 2.4 % of GDP[10]. This means that, according to the CBR, neither of the two above-mentioned 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[11].**

The 2014 structural deficit reached 3.0 % 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 deficit** (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 suspended, occurred** (Part 1. 4).

1.2 Change in the structural balance

Based on Council Recommendation[12] and the present Stability Programme, 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.

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7 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 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. This change has had no impact on the outcome of the CBR's evaluations so far (evaluation of the year 2013).

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

9 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 on population ageing on public finances, categorising individual Member States as high, medium and low-risk countries. In the assessment of the latest Stability Programme of Slovakia dated April 2015 the Commission did not specified the level of risk of the long-term sustainability.

10 CBR, Report on the Long-term Sustainability of Public Finances, April 2015.

11 The MF SR presented this value of the medium-term budgetary objective also in the present Stability Programme.

12 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.

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**[13].

The 2012 structural deficit reached 4.3 % of GDP[14]; 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).

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	**-4.3**	-3.6	-2.8	-2.0	-1.3	**-0.5**
Change *	-	0.77	0.77	0.77	0.77	0.77

** 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 the 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 (ESA 95, % GDP)

	2012	2013	2014	cumulative (2013-2014)
1. GG balance	-4.2	-2.6	-2.9	
2. Cyclical component	-0.1	-0.4	0.0	
3. One-off measures	0.3	0.0	0.1	
4. Structural balance (1-2-3)	**-4.3**	**-2.1**	**-3.0**	
5. Change in structural balance	0.73	2.18	-0.89	1.29
Required change in structural balance		**0.77**	**0.77**	**1.53**
p.m. 1 Δ in measures with no impact on long-term sustainability *		0.5	-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)		1.84	-0.76	*1.08*
p.m.3 Output gap	-1.0	-1.6	-1.1	

** Impact of the fully-funded pillar of the pension system (cumulative contribution +0,4 % GDP), special levy in banking sector (0,0 % GDP) and the cost of decommissioning scheme of nuclear facilities (-0,1 % GDP).*

Source: CBR

The fiscal policy easing increased the structural deficit in 2014 by 0.9 % GDP, which partly offset its significant reduction in 2013. On the whole, the structural deficit improved by 1.3 % of GDP since 2012, yet the improvement under the adjustment path should have reached 1.5 % of GDP. The deviation is even slightly higher if we take into account the impact of such measures[15] which,

[13] The year 2012 was chosen also because the Commission set the deadline for meeting the medium-term budgetary objective based on the actual data for 2012.

[14] In comparison with s CBR evaluation of December 2014, all components in the structural balance calculation have been made more precise, which slightly reduces the 2012 structural deficit from 4.4 % of GDP to 4.3 % of GDP.

[15] 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.

on the one hand, improved the balance in 2013 and 2014 by 0.2 % of GDP (mainly the reduced contribution rates to the fully-funded pillar of the pension system), but, on the other hand, they are neutral in the long run because they will either increase public expenditure in the future or they are not under direct government control (debt interest payments). **The assessment of the change in the structural balance suggests a deviation from the adjustment path.**

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 benchmark**. In its evaluation, the CBR uses the concept defined by the Stability and Growth Pact[16]; 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	29 018	30 193	31 410	Eurostat, T200*: TE
2. Interest payments	1 286	1 393	1 447	Eurostat, T200: D41
3. Gross fixed capital formation	2 182	2 193	2 788	Eurostat, T200: P51G
4. Annual average gross fixed capital formation (t-3 to t)	2 378	2 328	2 437	Eurostat, T200: ØP51G
5. Government expenditure on EU programmes fully matched by EU funds revenue	171	249	301	SO SR, CBR (estimate)
6. Cyclical unemployment benefit expenditure	0.4	9.9	5.4	CBR (estimate)
7. Expenditure fully matched by an increase in revenues mandated by law	0	0	0	
8. Primary expenditure aggregate *(1-2-3+4-5-6-7)*	**27 756**	**28 677**	**29 305**	
9. Change in primary expenditure aggregate *(8t-8t-1)*		921	629	
10. Change in discretionary revenue measures		1 059	209	MF SR, CBR: Annex 4
11. Nominal growth of expenditure aggregate adjusted for revenue measures ((9t-10t)/8t-1)		-0.5	1.5	
12. Change in GDP deflator		0.5	-0.2	Eurostat
13. Real growth of expenditure aggregate adjusted for revenue measures *(11-12)*		**-1.0**	**1.7**	
14. Potential GDP growth		2.0	1.9	CBR (estimate)
15. Convergence margin (p. p.) CBR change in SB/$((1_{t-1}-2_{t-1})/GDP_{t-1})$		2.0	2.0	Eurostat,T200:TE,D41; CBR
16. Expenditure benchmark *(14-15)*		**0.0**	**-0.1**	
17. Impact of the deviation on the balance in the given year (16t-13t)*8t-1/GDPt		0.4	-0.7	
18. Cumulative deviation in t-1 a t			**-0.3**	

* 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, MF SR, Eurostat

[16] The procedure used by the CBR in its calculations slightly differs from the procedure specified in the Stability and Growth Pact. The differences make the evaluation more precise, they are listed (including supporting documents) in Annex 4.

The adjusted real expenditure in 2014 increased by 1.7 %, 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 2014 increase in expenditure partly offset the decline in 2013 when the expenditure decreased by 1.0 % on the back of a zero-increase requirement under the expenditure benchmark rule. The overall impact of development in these expenditures on the balance in 2013 and 2014 is negative compared with the expenditure benchmark and reaches 0.3 % of GDP**, which means that also this indicator shows a deviation from the defined adjustment path.**

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[17]. 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 or 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[18], 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[19].
- **A period of negative annual GDP growth** – 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 its potential.** 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

[17] 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.

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

[19] Under the constitutional act, exceptional circumstances last 36 months of their identification. This 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.

(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.

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 2.4 % year-on-year. The negative output gap in 2014 reached 1.1 % of the potential output and thus remained significantly below the 3-% threshold. The real GDP in the euro area increased by 0.5 % and the negative output gap, according to the Commission's estimates, reached 2.8 % of the potential output. The Commission did not evaluate[20] 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 evaluation 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.

The 2014 structural balance deviated from the adjustment path by 0.2 % of GDP and, also with the other relevant factors taken into account (for example, impact of the fully-funded pillar and debt interest payments), the deviation neared 0.5 % of GDP. It nevertheless remains below the 'significant deviation' threshold.

[20] 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.

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

	2013	2014	Cumulative (2013-2014)
Change in structural balance	2.18	-0.89	1.29
Required change in structural balance according to CBR	0.77	0.77	1.53
Deviation from required trajectory	***1.41***	***-1.66***	***-0.24***
Significant deviation			**no**
Change in structural balance including special factors	1.84	-0.76	1.08
Deviation from required trajectory taking account special factors	*1.07*	*-1.53*	-0.46

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. In 2013 and 2014, the adjusted expenditure increased by 0.6 %, although it should have declined by 0.1 % under the expenditure benchmark rule, which means that the negative impact of the higher expenditure growth on the balance reached 0.3 % of GDP and remained below the significant deviation threshold.

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

	2013	2014	Cumulative (2013-2014)
Real growth of expenditure aggregate adjusted for revenue measures (%)	-1.0	1.7	0.6
Expenditure benchmark (%)	0.0	-0.1	-0.1
Deviation from expenditure benchmark	***0.39***	***-0.67***	***-0.29***
Significant deviation			**no**

Source: CBR

Despite having different values in individual years[21], both indicators, when assessed cumulatively, suggest roughly the same magnitude of deviation. The evaluation based on the data published by Eurostat[22] in April 2015 can be further extended to capture the estimated revenue from the corporate income tax. Under the most recent forecast by the Tax Revenue Forecasting Committee dated 23 June 2015, this revenue is estimated to be EUR 134 million (0.2 % of GDP) above the notified level. Provided that the forecast is correct, the deviation in the structural balance would near zero. More precise data on revenues from certain types of taxes and the data from financial statements will be provided as part of the October notification, hence their impact on the balance is yet unknown. All these additional changes will affect the update of the evaluation to be prepared by the CBR in December.

With all relevant factors taken into account, neither the exceptional circumstances nor a significant deviation from the MTO adjustment path occurred in 2014. This means that there is no need at present to trigger the correction mechanism.

[21] Annex 5 compares the structural balance and adjusted expenditure developments in individual years.
[22] The data are available at Eurostat (http://ec.europa.eu/eurostat/data/database).

Box 1: Structural balance development[23] between 2015 and 2018

Since both the structural balance and adjusted expenditure development deviated in 2014 from the defined adjustment path, the nearly balanced budget objective can only be met by 2017 if consolidation effort steps up. 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), assessment of the budgetary objectives allows to indicate potential future risks.

In the present Stability Programme, the Slovak government set its budgetary objectives by the year 2018 in line with the rules of the preventive arm of the Stability and Growth Pact in order to meet the medium-term budgetary objective by 2017, which was also confirmed by the European Commission's assessment of the document.

Even though these objectives meet the requirements of the EU law, they fall short of meeting the requirements of the national law (balanced budget rule). This is partly due to the relaxed[24] rules of the Stability and Growth Pact which were not applicable when the deadline for the medium-term objective was set (i.e., in the course of 2013). However, there is a significant difference in the methodology used to quantify the structural balance. The uniform methodology used at the EU level, which does not reflect the specificities of Member States, leads to overly optimistic estimates for Slovakia's economic growth potential, which are hardly justifiable also according to the Ministry of Finance. Thus the resulting fiscal position appears more favourable, requiring less consolidation in the years to come.

When evaluating budgetary objectives from the perspective of the balanced budget rule and applying the national methodology for structural balance quantification, there is a risk that the balanced budget objective will not be achieved in 2017[25]. The CBR estimates that if the present balance estimate for 2015 (by the MF SR) materialises, a significant deviation could occur. Moreover, in its opinion[26] the CBR identified a number of risks to meeting the 2015 objective. These include, in particular, lower than budgeted non-tax revenue, higher expenditures in the healthcare and local government sectors, unbudgeted expenditure associated with a PPP-funded motorway bypass of Bratislava, and higher financial corrections to EU funds.

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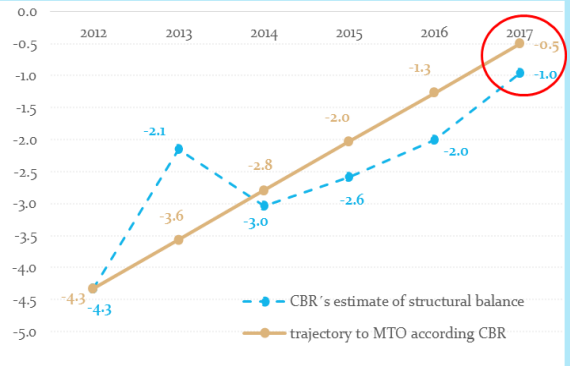
23 The box does not compare the adjusted expenditure with the expenditure rule between 2015 and 2018. This is due to the fact that certain revenues and expenditures with an approximately zero impact on the balance have not been budgeted, and also due to the missing measures designed to meet the budgetary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

24 In January 2015, the European Commission communicated the way it will interpret the rules of the Stability and Growth Pact in assessing the fiscal policies of Member States.

25 Also the MF SR, in its evaluation, suggests that given the present budgetary objectives the nearly balanced budget will not be achieved by 2017 (p. 10).

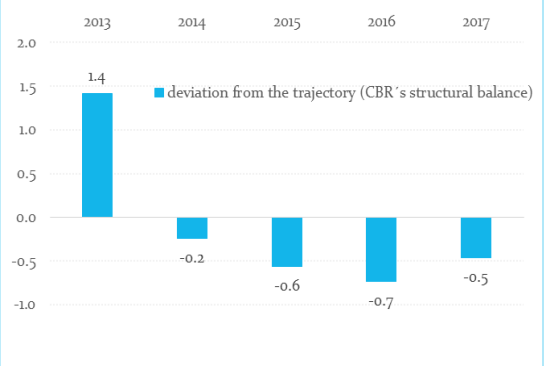
26 CBR, Evaluation of Medium-term Budgetary Objectives for 2016-2018, May 2015.

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



Source: CBR

Figure 2: Deviation from the CBR trajectory in 2013-2017 (ESA2010, % GDP)



Source: CBR

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 June 2015[27]. The document concludes that the 2014 structural balance deviated from the defined adjustment path by 0.3 % of GDP and the 2013-2014 cumulative deviation from the expenditure benchmark reached 0.2 % of GDP. As far as compliance with the balanced budget rule is concerned, the Ministry observed a deviation in 2014, which, however, was not significant. This is why the Ministry did not propose activation of the correction mechanism. **The final evaluations by both institutions concur** and the differences between the values of individual indicators are minimal (Table 7).

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

	CBR	MF SR	difference
Medium term objective (MTO)	-0.5 (2017)	-0.5 (2017)	-
GG balance	-2.9	-2.9	0.0
Cyclical component	0.0	-0.1	0.1
One-off measures	0.1	0.1	0.0
Structural balance	**-3.0**	**-2.9**	**-0.1**
Compliance with MTO	no	no	-
Cumulative change in structural balance	1.3	1.1	0.2
Required cumulative change in structural balance	1.5	1.4	0.1
Deviation from required trajectory	-0.2	-0.3	*0.1*
Significant deviation	no	no	-
Real growth of expend. aggregate adjusted for revenue measures	1.7	2.3	-0.6
Expenditure benchmark	-0.1	0.4	-0.5
Compliance with expenditure benchmark rule	no	no	-
Cumulative deviation – expenditure benchmark	-0.3	-0.2	-0.1
Significant deviation	no	no	-

Source: CBR, MF SR

The CBR notes with satisfaction that the evaluation methodologies used by both the CBR and the Ministry of Finance have converged since the December report. The Ministry has replaced its adjustment path towards the structural balance improvement, deriving from the rules of the Stability and Growth Pact (which would not lead to a nearly balanced budget by 2017), with the assumption of steady annual structural balance improvements. The approach of both institutions is identical also when it comes to assessing the cumulative deviation since 2012. There are still slight numerical differences between both institutions in determining the amount of the structural balance in individual years and in the adjustment path[28], which is mainly due

[27] MF SR, Plnenie pravidla vyrovnaného rozpočtu za rok 2014 (available only in Slovak), June 2015.

[28] 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. The difference 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 4.3 % of GDP, while the MF SR

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).

The approaches of both institutions to the expenditure benchmark are also converging. The Ministry, instead of using the multi-annual average to assess the economic growth potential and relying on the GDP deflator forecasts, now bases itself on the actual data for the year concerned. The approaches of both institutions continue to differ in that the Ministry primarily evaluates the development of expenditures in 2014 and only then, as part of the overall evaluation, 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. Both institutions also continue to differ when it comes to calculating the actual rate of growth in the adjusted expenditure. This is due to the estimation of the size of discretionary revenue measures and the impacts of methodological changes, where the CBR uses a broader list of items[29]. Nevertheless, this had no impact on the final evaluation since the combined effect of these differences was almost zero.

estimate is 4.0 % of GDP. The difference is attributable to the differing views of both institutions on the revenues from dividends and on the cyclical component of the budget as a consequence of the slightly different output gap estimates.

29 The MF SR included the impact of changes in taxes and of the reclassification on new entities into the general government sector. It updated the measures concerning the corporate income tax based on the forecast presented at the June meeting of the Tax Revenue Forecasting Committee which, in some cases, does not have to be consistent with the figures of the April´s notification of Eurostat, those were used to evaluate compliance with the balanced budget rule. The CBR, above and beyond the changes in taxes consistent with the April notification and the reclassification of new entities, also included in its calculations the impacts of changes in non-tax revenues and other methodology impacts. See Annex 4 for more information.

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 **transpose 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[30]. 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[31] 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[32] 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[33] are minimal, the structural deficit may 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[34]. 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 objective, and annual reductions in the general government deficit to gross domestic product ratio based on

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

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

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

33 Article 2(a) of Act No. 493/2011 on Fiscal Responsibility.

34 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 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[35].

The Act also describes the procedures and assigns the roles to individual institutions (Figure 3). In line with the procedures specified in the Stability and Growth Pact[36], the Ministry of Finance must report twice a year (by 30 June and 30 November[37]) 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.

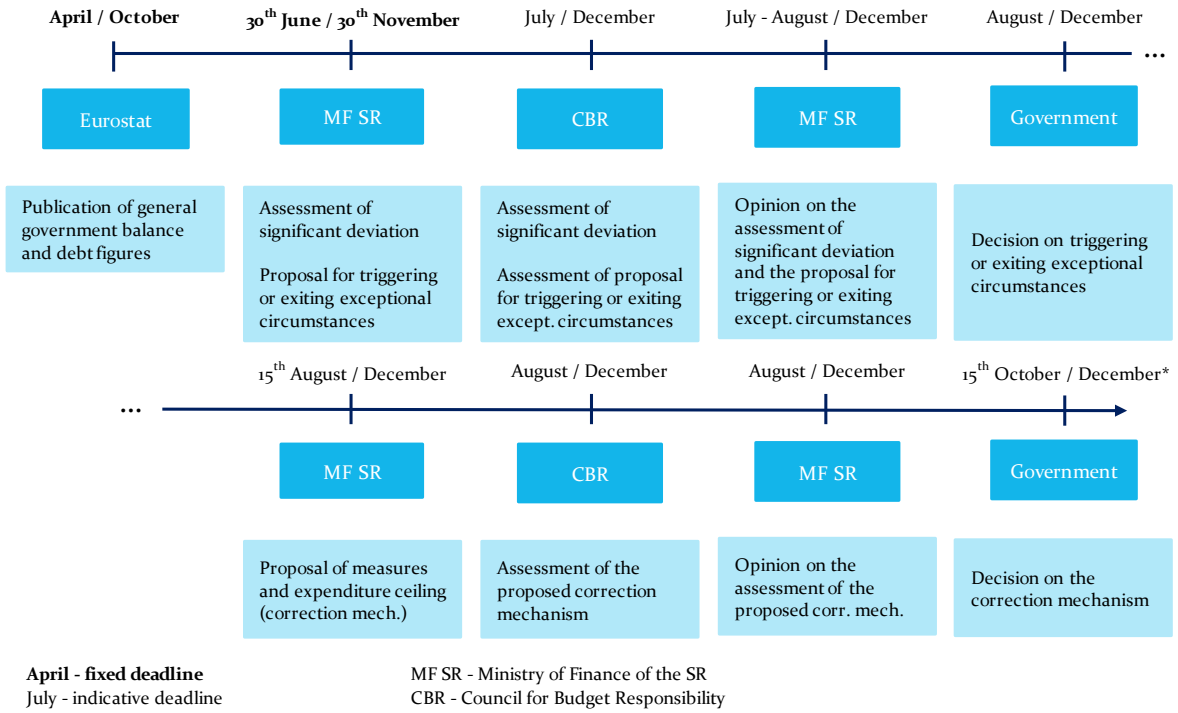
The beginning and end of the duration of exceptional circumstances is declared by the government based on a proposal by the Ministry of Finance. Prior to the declaration, the proposal is reviewed by the CBR. The Ministry of Finance publishes its opinions on all CBR evaluations (the "comply or explain"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

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

36 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.

37 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

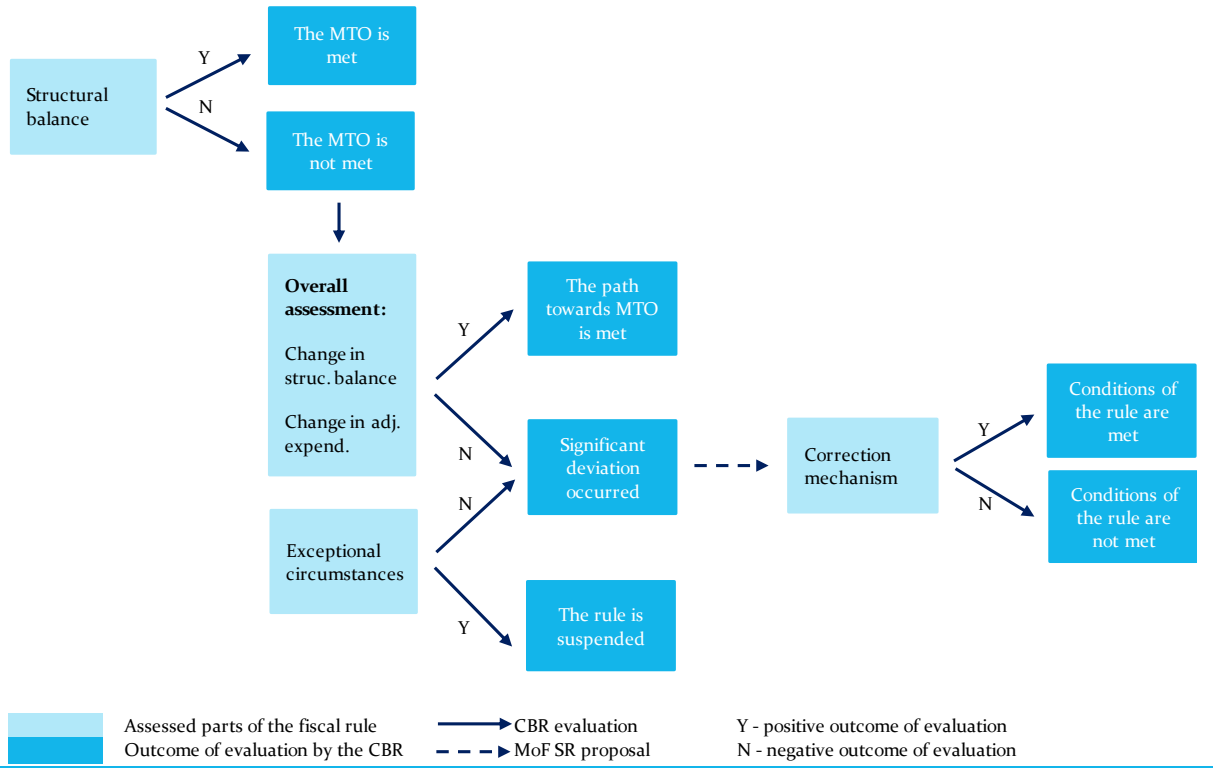


*Note: * Due to a short time period between the publication of the assessment of significant deviation by the Ministry of Finance (deadline until the end of November) and the end of the year, the proposed measures might be incorporated in the following year, either via an amendment of the adopted budget 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** 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 - One-off measures

This parts describes the one-off effects which have been taken into account in evaluating compliance with the balanced budget rule. This updated list of the one-off measures reflects the discussions with the Ministry of Finance which should result in the adoption of a joint national methodology for their identification[38]. Its outcome does not have to be necessarily identical with the following list of one-offs since, in certain cases, the institutions may have differing views on, for example, the legal force or substance of certain transactions[39].

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, on leaving the armed forces, worked for a short period of time in the civilian sector without becoming entitled to pension at all, or to a very low pension for that part of their carrier. The negative impact on the budget of the one-off retroactive disbursement of pensions based on the above-mentioned court ruling reached 8.1 million in 2013 and 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, the original amount has been significantly revised and the deadline for payment by Member States has been set to 1.12.2014 and 1.9.2015, respectively. The revision should be recorded on an accrual basis into the year 2014. The calculations done so far show that the revision had a positive impact on the 2014 budget in the amount of EUR 87.4 million.
5. **Financial corrections to EU funds** – These are the amounts which the European Commission refuses reimburse from the EU budget do to the irregularities ascertained in the drawing of EU funds by general government entities. The negative impact of financial corrections to EU funds reached EUR 124.5 million in 2013 and EUR 111 million in 2014.
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

[38] In its evaluation of the structural balance for the purposes of the European fiscal rules, the MF SR (e.g., Stability Programme of the Slovak Republic for 2015-2018) takes into account only those measures which are in line with the Commission's interpretation of one-off measures. The Commission does not publish a detailed methodology and a list of one-off measures together with justification.

[39] One of the points where the views differ are revenues from dividends. However, there is no difference between the MF SR and CBR in 2013 and 2014 (Table. 8).

influence VAT accrual receipts under ESA2010. Due this, the positive impact on VAT receipts amounted EUR 79.7 million in 2013 and a negative impact on VAT receipts reached EUR 83.5 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.
8. **Repayment of loans provided to Cargo, a.s.**[40] – 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 2013 and 2014, the instalments paid to the budget had a positive impact on the balance at EUR 20 million, respectively.
9. **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 revenue by EUR 48 million. Because, in the past, the loan was treated as a capital transfer with negative effect on the deficit under the ESA95 methodology, the transaction had a positive impact on the general government balance in 2014.

The following table presents the one-off measures included in the structural balance calculations by the CBR and MF SR; unlike in the last evaluation, the list of the one-off measures taken into account by both institutions is now identical.

Tab 8: 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	-	87.4	-	87.4	-	0.0
- financial corrections to EU funds	-124.5	-111.0	-124.5	-111.0	0.0	0.0
- accrualisation of VAT revenues	79.7	-83.5	79.7	-83.5	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 Vodohospodárska výstavba	30.3	48.1	30.3	48.1	0.0	0.0
TOTAL	**-8.9**	**104.9**	**-8.9**	**104.9**	**0.0**	**0.0**
(% GDP)	*0.0*	*0.1*	*0.0*	*0.1*	*0.0*	*0.0*

Source: CBR, MF SR

[40] Even though individual instalments do not reach 0.05 % of GDP in each year, the CBR believes that the booking of these transactions should be consistent. The instalments are thus spread over the entire loan term and have a positive impact on the balance.

Annex 4 - Expenditure benchmark – methodology and data

The adjusted expenditure and the expenditure benchmark are calculated, subject to minor differences, in line with the procedure laid down in the Stability and Growth Pact[41]. The purpose of these differences is to make the calculation of indicators 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 hitherto 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. Compared with the last year's evaluation, the CBR has amended its procedure in that 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 CBR has chosen this approach 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 9.

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) 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 April 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

[41] The procedure for the calculation is specified in an 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).

discretionary revenue measures for 2012 to 2014 whose subsequent change was used as an input in the calculation of the adjusted expenditure development.

Tab 9: Discretionary revenue measures and methodological effects (ESA2010, € mill.)

	Total effect			Additional effect		
	2012	2013	2014	2012	2013	2014
1. Discretionary measures	**433**	**1 554**	**275**	**433**	**1 114**	**165**
Decrease of contributions to the fully-funded pillar of pension system*	159	507	-	159	338	-
Social insurance contributions paid by state	-	42	-	-	42	-
Extraordinary levy in the banking sector	40	-	-	40	-40	-
Extension of a special levy in the banking sector *	23	92	-	23	61	-
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 related changes	-	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	-
One-off revenues from dividends	186	12	-	186	-174	-12
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	-	-	72	-	-	72
Automatic decrease of rate of special levy in the banking sector	-	-	-42	-	-	-42
Introduction of licence fees for corporations	-	-	110	-	-	110
Decrease in the CIT rate from 23% to 22%	-	-	-87	-	-	-87
Change in rules of amortization of losses	-	-	35	-	-	35
Change in taxation of nonfinancial compensation (using company car)	-	-	-8	-	-	-8
Digital dividend	-	-	164	-	-	164
Increase of administrative fees	-	-	23	-	-	23
2. Change in methodology (additional effects)				**0**	**-56**	**43**
Changes in imputed social contributions				-	16	8

Changes in insurance contributions paid by state (in 2013 only health insurance contributions)	-	-72	-45
Inclusion of public transport companies to the general gov. sector	-	-	80
TOTAL (1+2)	**433**	**1 059**	**209**

** 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 5 - 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 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 balanced budget, the CBR evaluates the cumulative development in 2013 and 2014; both indicators reach almost identical values, (1.2 % and 1.3 % of GDP, respectively). However, the two indicators considerably differ, by up to 1. p.p., if we look at individual years (Table 10).

Tab 10: Development of adjusted expenditures (ESA2010, € mill.)

	2012	2013	2014	Cumulative (2013-2014)
1. Primary expenditure aggregate	**27 756**	**28 677**	**29 305**	
2. Year on year change in primary expenditure aggregate *(1_t-1_{t-1})*		921	629	
3. Change in revenues due to discretionary measures and methodology of national account reporting		1 059	209	
4. Nominal growth of expenditure aggregate adjusted for changes in revenues *((2_t-3_t)/1_{t-1})*		-0.5	1.5	
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)		**-1.0**	**1.7**	
7. Potential GDP growth		**2.0**	**1.9**	
8. Impact of change in expenditures on the balance ((7_t-6_t)*1_{t-1}/GDP_t)		**1.14**	**0.07**	**1.21**
p.m. Change in structural balance		***2.18***	***-0.89***	***1.29***

Source: CBR, SO SR, MF SR

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

- One-off effects – while the structural balance is adjusted for all one-off effects, the adjusted expenditure development also contains one-off revenue measures and all one-off measures on the expenditure side. From this point of view, the structural balance is a more precise indicator.
- Cyclical expenditures – the rate of growth in the adjusted expenditure is adjusted, in line with the Stability and Growth Pact methodology, only for the estimate of cyclical expenditures connected with unemployment (the only expenditure item influenced by the economic cycle). However, the CBR also estimates the impact of the cycle on pension expenditures. This gives the structural balance a better information value.
- 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 cannot always be identified as having a one-off nature and in order 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 0.7 p.p. apart.

- Debt interest payments – the expenditure rule 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[42].
- 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 effectiveness 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 in 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'[43]). 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 11: 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)	**1.14**	**0.07**
(-) Exclusion of one-off revenue measures	-0.31	0.22
(-) Exclusion of one-off expenditures	-0.18	0.07
(-) Exclusion of other cyclical expenditures	0.05	0.01

[42] 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'.

[43] 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 ratios.

(+) Deviation of actual investment from average	-0.08	-0.65
(+) Development of interest payments	-0.14	-0.07
(+) Actual revenue growth beyond potential growth	0.86	0.07
(+) Inaccuracy in the calculation of the impact of revenue growth	-0.11	-0.07
(+) Impact of GDP growth (denominator effect)	0.08	0.05
Change in structural balance	**2.18**	**-0.89**

Source: CBR

Since certain differences contribute towards making the picture of how public finances develop more accurate, the CBR will consider changing the methodology used for the calculation of the adjusted expenditure so that it reflects only the relevant factors (Box 2).

Box 2: Proposed change in the methodology for the calculation of the adjusted expenditure

The present differences between the structural balance and the adjusted expenditure development indicators are, in some cases, unjustified and impair the information value of the latter. The CBR intends to discuss the methodology of calculation and suggest modifications. They specifically include:

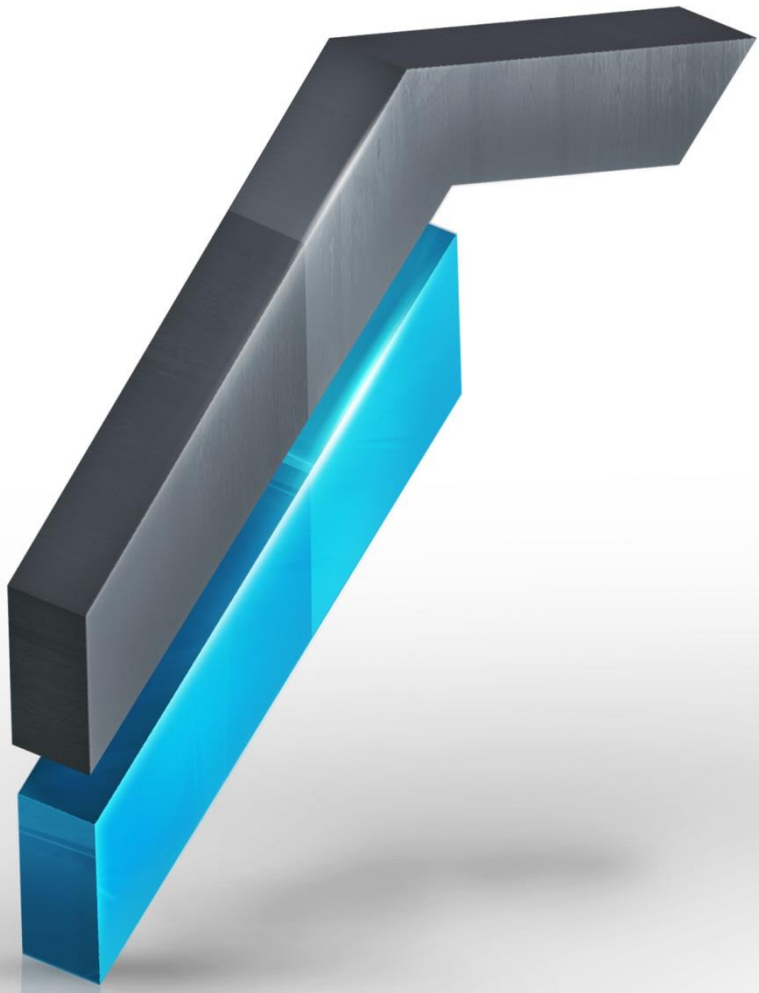
- One-off measures – the CBR believes that both indicators should consistently capture the effects of one-off measures. This means that the adjusted expenditure indicator should disregard those revenue measures which have a one-off effect and also those expenditures which can be considered as having a one-off nature.
- The adjusted expenditure indicator should not be influenced by the economic cycle, which means that, apart from the cyclical expenditures on unemployment benefits, it should also be adjusted for the cyclical component of pension expenditures.
- In addition, the modified methodology should eliminate inaccuracies in the calculation of the impact of the rate of growth in revenues on the balance, which requires that the set of data also include the so-called adjusted revenues (total general government revenues adjusted for revenues from EU funds, discretionary revenue measures, methodology impacts and one-off effects).

Had the modified methodology been applied using the actual figures for 2013 and 2014, the cumulative improvement in the balance using the adjusted expenditure indicator would have reached 1.2 % of GDP in 2013 and 2014. However, the resulting evaluation would not be that different from the evaluation based on the present methodology; i.e., there would be a deviation from the adjustment path (0.3 % of GDP), but it would not be significant.

Tab 12: Change in adjusted expenditures due to change in methodology (ESA2010, % GDP)

	2013	2014	cumulative (2013-2014)	trajectory
Change in adjusted expenditures (impact on the balance)	**1.46**	**-0.29**	**1.17**	**1.53**
(+) Deviation of actual investment from average	-0.08	-0.65		
(+) Development of interest payments	-0.14	-0.07		
(+) Actual revenue growth beyond potential growth	0.86	0.07		
(+) Impact of GDP growth (denominator effect)	0.08	0.05		
Change in structural balance	**2.18**	**-0.89**	**1.29**	**1.53**

Source: CBR



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