CBR
COUNCIL FOR BUDGET RESPONSIBILITY

2015 General Government Budget Results

(based on the April notification of deficit and debt)

April 2016

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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 2015 general government deficit reached 2.97 % of GDP, exceeding the target of 2.49 % of GDP. Adjusted for the impacts of the economic cycle and temporary effects, structural deficit reached 2.6 % of GDP and, for the second consecutive year, deteriorated by 0.1 % of GDP year-on-year. Also thanks to one-off revenues, gross debt reached 52.9 % of GDP, 1.5 % of GDP below the budgeted forecast, and fell from the second to the first sanction zone under the debt rule.

At the time of its approval, the budget contained significant negative risks. In May 2015, after the 2014 results had been published, the Council for Budget Responsibility (CBR) revised its estimate and warned that the deficit might reach the upper limit of 3.0 % of GDP[1]. Most of the identified risks indeed materialised, even beyond the original estimates, making the deficit worse than expected. The most significant negative risks which the CBR pointed out included shortfalls in dividends from the *SPP*, sale of CO_2 allowances, financial corrections to EU funds, and higher expenditures of the local government and healthcare sectors. Moreover, the government implemented additional expenditures, which were partly financed from the reserves for worse-than-expected macroeconomic development and from higher tax revenues. The total impact of these negative effects on the budget reached 2.1 % of GDP. The deficit remained below the three-percent threshold thanks to the positive effects in the amount of 1.6 % of GDP, mainly due to higher tax revenues and lower transfers to the EU budget.

The 2015 budget results suggest several main conclusions:

On the side of expenditures and non-tax revenues, the budget consistently contains significant risks which the CBR had identified already at the time of its approval. Similarly as in 2013 and 2014, these risks were eliminated in 2015 thanks to a number of positive effects, in particular the higher tax revenue. Although this approach may work on a short-time basis, mainly in times of economic upswing, a truly credible fiscal policy requires that the most significant risks be taken into account already at the stage of budget preparation.

While the changes in the structure of expenditures, mainly the use of reserve funds and other savings to finance additional expenditures in the amount of 0.9 % of GDP, made the budget management more flexible, they opened doors to spending the revenues generated by positive effects to finance additional expenditures. **The existing legislative framework should be adjusted to make sure that the revenues generated by positive effects are used to step up consolidation.** The **expenditure ceilings**, whose introduction is also foreseen by the Fiscal Responsibility Act, represent the most suitable instrument.

The failure to use positive effects to step up consolidation, as well as the negative effects in 2015, confirmed the CBR's quantification of the risks to meeting the 2016 budgetary objective in the amount of 1.93 % of GDP. **If the government does not adopt new measures or the situation does not improve thanks to better-than-expected** macroeconomic development and higher tax revenues, the risk of **not meeting the 2016 objective increases.**

The government uses one-off resources to reduce gross debt which, in the short run, reduces the need to adopt permanent measures. **From the perspective of the entire general government, such debt reductions do not improve the net worth of Slovakia.** The decline in general government debt is offset by the decline in the value of companies with capital participation of the state (Slovak Telekom, Eustream/SPP, Cargo) or by impairment in the long-term sustainability (opening of the fully-funded pillar of the pension system).

[1] If all expenditures connected with the motorway bypass of Bratislava (PPP project) materialised, the deficit could have neared 3.5 % of GDP.

1. Summary results

On 21 April 2016, Eurostat released the general government deficit and debt figures for 2015. It was the first set of data (April notification) subject to revision in the autumn (October notification).

The budget, as approved, anticipated deficit reduction from the estimated 2.93 % of GDP in 2014 to 2.49 % of GDP in 2015. Gross debt was expected to increase by 0.3 % of GDP to 54.4 % of GDP. Compared with the deficit of 2.7 % of GDP in 2014, the 2015 deficit increased to almost 3.0 % of GDP. On the other hand, the debt declined to 52.9 % GDP, which is 1.5% GDP below the budget assumption and 1.0 % GDP below 2014 debt level.

The inclusion of the *ŽSSK* railway company into the general government sector represented a major methodological change which, at the end of 2015, increased gross debt by EUR 312 million (0.4 % of GDP). Apart from *ŽSSK,* the budget did not reflect several new entities established in 2015, nor did it reflect the entities included in the general government sector after the budget had been approved. Their aggregate negative impact on the general government balance reached EUR 13 million.

The total sum of positive effects on the balance reached EUR 1.3 billion (1.6 % of GDP). The 2015 macroeconomic development surpassed the budget assumptions, mainly due to the more favourable economic development of Slovakia's main trading partners and the stronger domestic demand supported by accelerated drawing of EU funds. Along with further improvements in the effectiveness of tax collection, tax revenues increased by EUR 898.2 million (1.2 % of GDP). This positive development also improved the expenditure-side of the budget, because it contained reserve funds in the amount of EUR 455.8 million (0.6 % GDP) for the coverage of potential risks. Apart from these factors, the budget balance also improved thanks to higher receipts from gambling and other non-tax revenues, as well as lower transfers to the EU budget and lower expenditures on benefits to those in the material need.

The negative effects exceeded the positive ones by 0.5 % of GDP and reached EUR 1.6 billion (2.1 % of GDP). In its evaluations, the CBR pointed out most of the sources of negative effects, yet their real impact was even more significant.

- The shortfall in **revenues from dividends** reached EUR 158.3 million (0.2 % of GDP). The shortfall is due to fact that these dividends, although paid to the budget, were based on the past profits of SPP subsidiaries from the revaluation of their assets. Under ESA2010, such revenues do not have a positive impact on the budget. Revenues from the **sale of CO_2 allowances** were lower by EUR 68.9 million due to lower market prices and a methodological change which the budget did not reflect. In 2015, the ***Cargo*** company repaid a loan of EUR 117.2 million, granted in 2009, from the receipts it raised through the sale of corporate assets (railway carriages). Since *Cargo* has been in the loss for many years, such an instalment cannot be considered under ESA2010 to have a positive effect on the balance, which meant that the shortfall in the actual versus budgeted revenues represented EUR 97.7 million. The planned, yet unrealised **sale of the government's surplus assets** caused that capital revenues were EUR 64 million below the expectation.
- The budget did not assume **financial corrections to EU funds,** even though this particular risk was identified back in 2014 when the budget was prepared. The amount of financial corrections reached EUR 304.3 million. The significant acceleration in the drawing of EU funds in the course of 2015 meant that, for the first time in history, the

drawing was faster than the budget had assumed, which also increased the amount of **co-financing** by EUR 58.8 million[2].

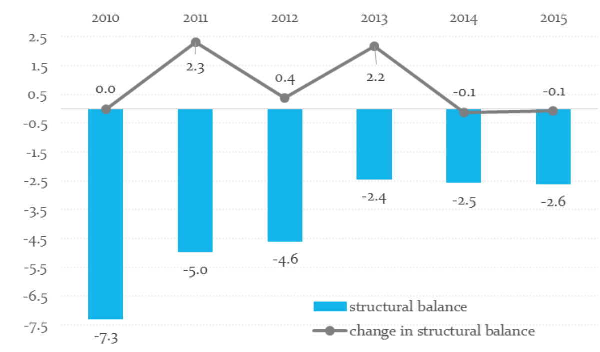
- The most negative effect is attributable to the **reallocation of government expenditures**. Through various budgetary measures, the government approved additional expenditures exceeding the budgeted amount by EUR 737.2 million.
- The **healthcare** sector's risk, as identified by the CBR, materialised. The budget did not assume any year-on-year increase in expenditures and did not specify concrete cost-reduction measures. Compared with the budget, the expenditures, including a rise in the liabilities of healthcare providers, increased by EUR 251.4 million. This increase could have been partly influenced by the additional funds made available to the sector through health-insurance contributions and payments by the state.
- **The budgets of municipalities and self-governing regions** ended up in surplus, although lower than budgeted. This was due to the steep rise in capital expenditures of municipalities, which regained the 2010 level. In the case of the self-governing regions, the increase was due to higher current expenditures on wages and on the purchase of goods and services.
- A relatively significant negative effect (EUR 163.5 million) is attributable to the deficits ran by **other general government entities**. Most of these entities worsened the balance, particularly the National Property Fund (due to expenditures related to the privatisation of Slovak Telekom) and MH Invest (a government agency preparing a strategic investment near the city of Nitra).

From the perspective of contribution to the long-term sustainability of public finances, the figures need to be adjusted for factors which have only a temporary impact on the budget (one-off effects and effects of the economic cycle) and their influence will ebb in the years to come. The thus adjusted balance, also known as "structural balance", shows whether the long-term sustainability of public finances has improved or not. Structural balance reached 2.6 % of GDP and deteriorated by 0.1 % of GDP year-on-year[3]. Ever since the robust consolidation in 2013, when the main objective was to bring the deficit below 3 % of GDP, the government has failed to adopt sufficient measures to meet budgetary objectives. Likewise, the unexpected **positive effects, which occurred during the year, were not used to improve the balance.**

2 The higher drawing of EU funds directly increases tax revenues; the magnitude of this impact depends on the specific use of EU funds.

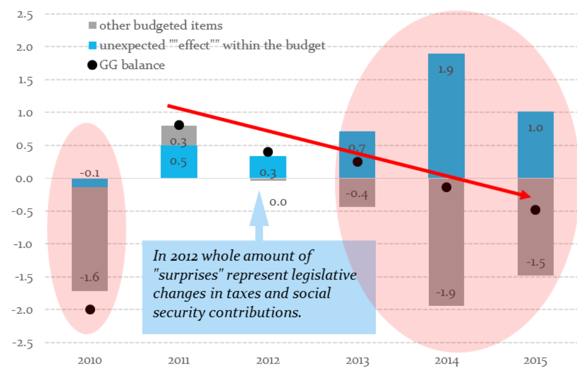
3 The evaluation of structural balance needs to take into account the manner in which financial corrections to EU funds are recorded. The CBR records these corrections in time to which they relate. This means that a large portion of financial corrections from 2015 is assigned retroactively to past years with their corresponding impact on structural balance in those years. If financial corrections are confirmed also in 2016, they will most likely relate to previous years, which may also worsen the 2015 structural deficit. The European Commission considered recognised corrections as one-off effects in the year in which the decision on them was taken. Since these corrections appear for the third year in a row, it may not consider them further and will revise the structural balance downwards.

Figure 1: GG structural balance in 2010-2015 balance (ESA2010, % GDP)



Source: CBR

Figure 2: Unexpected events within the GG balance in 2010-2015 (% GDP)



Source: CBR

The worse than expected result in 2015 will also negatively affect the government's ability to reach the 2016 budgetary objective. In its evaluation of the approved budget[4] for 2016 the CBR identified several risks in the area of non-tax revenues (revenues from dividends, mainly from *SPP*, and from the sale of CO2 allowances) and expenditures (healthcare, local governments and state budget). The development in 2015 suggests that the above risks continue to exist. A new one-off risk for 2016 is associated with the Resolution Fund since, as of 1 January 2016, the new and the already collected contributions will be transferred to the EU's Single Resolution Mechanism, which will have a negative impact on the balance in the amount of EUR 34 million. These risks can be covered by additional tax revenues. According to the estimate of the Tax Revenue Forecasting Committee from February 2016, the government will raise EUR 94 million more in tax revenues than budgeted. Since the budget contains a reserve for tax collection (EUR 150 mill.), the reserve can also be used to cover the risks.

General government gross debt reached 52.9 % GDP in 2015 and decreased by 1 % of GDP in comparison to previous year **mostly due to one-off transactions like extraordinary dividends from SPP, sale of Slovak Telecom share (privatisation) and opening the fully-funded pillar of pension scheme.** The impact of these factors in 2015 amounted EUR 1.9 bill. (2.4 % GDP); in case they would not materialise, the debt increases in 2015.

4 CBR, Addendum to the Evaluation of the General Government Budget for 2016-2018, Chapter 2.

Tab 1: Differences in GG budget in 2015 (ESA2010)

	ths. eur	% GDP
GG deficit in 2015 - approved	**-1 940 108**	**-2.49**
Tax revenues excl. sanctions	898 158	1.15
Contribution to EU budget	151 452	0.19
Cofinancing and GAP	-58 757	-0.08
EU financial corrections	-243 287	-0.31
EU financial correction related to state budget	-60 999	-0.08
Interest payments (state debt)	25 160	0.03
Dividends	-158 288	-0.20
State budget capital revenues	-64 000	-0.08
Revenues from sale of CO_2 allowances	-68 979	-0.09
Revenues from gambling	32 755	0.04
Other nontax revenues of state budget	143 287	0.18
Revenues of Cargo company	-97 720	-0.13
Contribution to capital share from SFA (capital transfer)	-6 687	-0.01
Balance of EBA (excl. taxes)	4 286	0.01
Other cash expenditure of state budget	-202 244	-0.26
Change in receivables of state budget	116 378	0.15
Change in payable of state budget	-187 548	-0.24
Healthcare expenditures	-260 888	-0.33
Transfer from public to private part of heath insurance (payables towards shareholders)	28 818	0.04
Nontax revenues and other expenditures of health insurance companies	1 258	0.00
Old-age and disability expenditures of Social Insurance Agency	1 743	0.00
Nontax revenues and other expenditures of Social Insurance Agency (incl. receivables and payables)	3 452	0.00
Forgivness of assigned receivables (Vahostav)	-6 350	-0.01
Balance of NPF (especially goods and services and transfers)	-44 929	-0.06
Balance of EF (excl. taxes and revenues from CO_2 allowances)	-19 439	-0.02
Balance of NNF	-5 413	-0.01
Balance of ŠFRB (excl. state budget cofinancing and Jessica)	-23 235	-0.03
Balance of hospitals	-19 371	-0.02
Balance of municipalities (excl. tax revenues and dicrepancies)	-105 089	-0.13
Balance of transport companies	-5 895	-0.01
Balance of SGR (excl. tax revenues and discrepancies)	-80 969	-0.10
Balance of NDS	-27 219	-0.03
Balance of ŽSR	-16 044	-0.02
Balance of ŽSSK	2 117	0.00
Balance of RF	-12 253	-0.02
Balance of contribution organisations of the state	2 734	0.00
Balance of local contribution organisations (SGR, municipalities)	10 446	0.01
Balance of MH Invest I company (excl. the received capital transfer)	-42 202	-0.05
Balance of other subjects	-19 132	-0.02
RF impact	33 510	0.04
SSC paid by state on behalf of group of people defined by law	7 016	0.01
Others	-3 765	0.00
Impact of change in nominal GDP	-	0.00
GG deficit in 2015 - results	**-2 318 239**	**-2.97**

Source: CBR

2. Macroeconomic development

The economic growth was faster than expected when the 2015 budget was prepared, by about 1.2 percentage points, and, according to the preliminary figures released by the Slovak Statistical Office, Slovak economy grew by 3.6%. The growth was fuelled mainly by stronger foreign demand for products made in Slovakia, as well as by increased activity across domestic economic sectors in connection with the close of the EU funds' programming period. The accelerated drawing of EU funds increased both investments (which account for about three-thirds of expenditures financed from EU funds) and government consumption.

The reason for this is the national co-financing of EU-funded investments; government consumption contributed to GDP growth positively, as opposed to the negative assumption built into the budget. The steady growth in household consumption was in line with expectations since the labour market situation continued to improve throghout 2015. The faster dynamics of growth in domestic demand produced a negative effect in that it pushed imports up fairly considerably and the import intensity of individual components was higher than in the past (hence the negative contribution of net exports to GDP growth).

The stronger growth impulses due to the drawing of EU funds, mainly in the construction sector and the related services, coupled with steady exports by the economy's flagship sectors, contributed towards labour-market invigoration. Compared with 2014, the labour market reported additional 50,000 new jobs above the budget assumption. These new jobs brought unemployment below 12%, compared to the 13-% assumption (LFS methodology). Moreover, the sufficient supply of jobs on the market also attracted people from outside the labour force and this higher participation slightly attenuated the decline in unemployment, which would have otherwise fallen below 11 %.

3 Major impacts on the balance

3.1 Tax revenues

The dynamics of growth in revenues from taxes and social contributions exceeded the budget expectations and the government harvested additional EUR 906 million (1.2% of GDP)[5]. In terms of structure, this additional revenue came mainly from the biggest taxes. Revenues from social security and health insurance contributions, value added tax and corporate income tax were EUR 200 million higher than expected, while the contribution of revenues from personal income tax was less significant.

More than a third of the additional tax revenue is attributable to better than expected **economic performance**. This contribution represented additional EUR 330 million. A larger portion of this amount was connected with improved macroeconomic development in 2015 (€255 m), the remainder (€75 m) can be attributed to the 2014 economic deviation[6]. The impact of the faster growth in the volume of wages in the economy and the drawing of EU funds available under the 2007-13 programming period was the most significant.

About a half of the additional tax revenue (€470 m) came from the faster growth in certain types of taxes (mainly CIT and VAT) as the economic development suggests. A major portion of this impact (€310 m) is connected with the revision of the 2014 results, which were unavailable at the time of budget preparation and which were transferred also to the year 2015.

The faster growth in VAT revenues is connected with effective **fight against tax evasions,** which contributed to higher tax revenues in recent years quite significantly. Although the increase in the effectiveness of tax collection slightly slackened in 2015, the government still collected EUR 100 million more than in the year before. The faster growth in CIT revenues was due to a number of factors, but their weight cannot be clearly quantified. Those factors include better economic performance, indirect effects of the fight against VAT evasions, plus a number of legislative measures.

Under the influence of different legislative provisions governing the health insurance allowance (compared to those assumed in the budget), a major portion of the shortfall in revenues rolls over from 2015 to 2016. This had a one-off positive impact of EUR 100 million compared with the budget.

3.2 Selected non-tax revenues

The impact of the most important non-tax revenues[7] on the balance was negative and reached EUR 212.9 million (0.3 % of GDP). The shortfall in revenues from dividends, from the sale of CO_2 allowances and the instalments payable by *Cargo* was offset by higher revenues from gambling and other non-tax revenues of the state budget.

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5 Beyond the framework of the Tax Revenue Forecast approved by the Tax Revenue Forecasting Committee, the parliament increased budgeted revenues by EUR 309 million.

6 The 2015-2017 General Government Budget was prepared in the beginning of QIII 2014.

7 Mostly revenues of the state budget and certain other general government entities. Does not include, for example, non-tax revenues of local governments, public universities and healthcare facilities, which are described in a separate chapter.

The revenue from **dividends and the NPF** was EUR 158.3 million lower. The difference was mainly due to the budgeting of SPP dividends, which were actually paid from retained profits and revaluation of assets of the SPP's subsidiaries (Eustream). Under ESA2010, such dividends are deemed superdividends and have no positive impact on the balance. The other significant deviations from budgeted revenues include the Slovak Telekom dividend (EUR 23.7 million less), while the dividend from the national electricity grid operator (SEPS) was EUR 51.2 million higher than budgeted.

The 2015 budget assumed a revenue from loan instalment payable by ***Cargo*** in the amount of EUR 97.7 million (payment of an ordinary instalment and transfer of an extraordinary instalment, originally planned in 2014). However, in 2015 *Cargo* paid an instalment due in 2016 in the amount of EUR 19.5 million and thus redeemed the whole loan of EUR 117.2 million. The provision of the loan to *Cargo* in 2009 was recorded under ESA2010 as a transaction with negative impact on the balance because the company was not expected to generate sufficient profits to ever repay the loan (non-repayable subsidy). Nevertheless, *Cargo* began to repay the loan gradually, starting in 2012 (EUR 10-20 million a year) which was recorded symmetrically under ESA2010 as transactions with positive effects on the balance. Given the fact that *Cargo* has been in the loss on a long-term basis and was able to pay the 2015 instalments only thanks to selling most of its assets, Eurostat decided that such revenue was not capable of having a positive impact on the balance under ESA2010[8].

The 2015 budget expected a revenue from the **sale of CO_2 allowances** at EUR 116.7 million. The actual revenue reached EUR 69 million because of two factors. While the budgeted price of CO_2 allowances was EUR 10.5/tCO_2, the average market price in 2015 reached EUR 7.61/tCO_2. The second factor behind the shortfall included a methodological change for the recording of revenues from auctions, notified during 2015 by the Slovak Statistical Office[9].

The shortfall in revenues from the **sale of capital assets** in the amount of EUR 64 million is attributable to four ministries. The shortfall is due, among other things, to the fact that the government did not sell its surplus assets as part of the ESO project exercise.[10]

3.3 Social transfers and benefits

The social transfers and benefits paid by the Ministry of Labour and the Social Insurance Agency were by EUR 42.6 million lower than budgeted. The saving is mainly due to the lower disbursement of i) benefits to people in material need, ii) compensation contributions, and iii) survivor pensions.

The expenditures on selected benefit policies declined 0.2 percentage point year-on-year to 10.4 % of GDP. In the medium term (since 2009) these expenditures oscillated around the same level, although the overall share of expenditures on pensions is slightly increasing.

8 The so-called withdrawal of capital from the company. In other words, the budget revenue was financed by the decrease in the value of *Cargo*.

9 The new method for the calculation of revenues is based on the actually consumed emission allowances by companies in Slovakia. Their price reflects the fact that a portion of allowances is allocated to companies at no cost and a portion is purchased in auctions. The valuation of CO_2 allowances takes into account the development from the beginning of the trading period (2013-2020; the first allocation and the first auctions took place in 2012).

10 ESO – Efficient, Reliable and Open Public Administration (http://www.minv.sk/?eso-efektivna-spolahliva-otvorena-verejna-sprava, available only in Slovak).

Due to deflation, which has been reflected in indexation mechanisms, the year-on-year increase in **expenditures on pensions** slowed down and the budgeted values were respected. However, the expenditures on benefits and contributions payable to those in **material need** developed positively and declined by 17 % (EUR 43 mill.) compared with the budget. This was due to a marked decline in the number of beneficiaries as a consequence of positive developments on the labour market (lower unemployment) and significant legislative changes. The significant legislative changes, which reduced the number of beneficiaries, include a duty to work out the basic material-need benefit (applicable from 1.1.2014) and introduction of a special contribution payable to those beneficiaries who get a job (applicable from 1.1.2015).

3.4 Transactions with the EU budget and co-financing

From the perspective of budget expenditures, the impact of transactions with the EU budget was negative and reached EUR 211 million. Lower transfers to the EU budget had a positive impact, while co-financing and the substantial financial corrections played a negative role. However, the accelerated drawing of EU funds generated additional tax revenue and, with this effect factored in, the overall impact on the balance should be positive.

The acceleration in the drawing of EU funds in 2015 was connected with the fact that, under the n+2/n+3 rule, beneficiaries were able to draw EU funds available under the second programming period (2007-2013) only until the end of 2015. Under the rules applicable in Slovakia and the EU, the summary applications for payment may be submitted to the Ministry of Finance until the end of April 2016 and the requests for payment may be sent to the Commission until March 2017. The accelerated drawing of EU funds above the budgeted level triggered additional expenditures on **co-financing,** with a negative impact on the balance at EUR 49 million. Also the capital expenditures incurred in the rail and road transport sectors, which were related to EU-funded projects but not classified as their part, were higher than budgeted (by EUR 9.8 mill.). Athough these expenditures are not considered as EU-project expenditures, they are indispensable to its completion (induced investments).

The drawing of EU funds has a **direct impact on tax revenues,** the magnitude of which depends on the specific type of the EU funds' use. Also due to the lack of information, this impact cannot be clearly quantified. However, the CBR estimates that – against the budget's macroeconomic forecast assuming the drawing of EU funds only at about 60 % of the budgeted amount – the overall positive effect might have reached several millions of euros, which largely explains the increase in tax revenues.

In 2015, Slovakia **paid EUR 151.5 million less in contributions to the EU budget** than budgeted. This 'saving' is most likely attributable to the overestimation of expenditures during the budget preparation.

The overall impact also includes the **financial corrections to EU funds** in the amount of EUR 304.3 million paid as a consequence of irregularities identified in the use of EU funds (in breach of the rules). These financial corrections were effected either by reducing Slovakia's receivables from the EU (for projects where the EU refused to reimburse the cost of national pre-financing) or by the recovery (cash payment) of the funds already provided.

3.5 Other expenditures from the state budget

The measures taken by the government on the expenditure side of the budget increased the deficit by EUR 290 million (0.4 % of GDP). Compared with the approved budget, the overall increase in the category of 'other expenditures' represented EUR 737 million (0.9 % of GDP). Their financing, within the limit of the State Budget Act, was possible mainly thanks to the unrealised expenditures earmarked to cover the risks of macroeconomic development, but also thanks to higher tax revenues, lower contributions to the EU budget, and the lower subsidy to the Social Insurance Agency.

The approved general government budget also contained reserves to cater for the eventualities of **worse macroeconomic development and worse collection of taxes.** The creation of these reserves should be viewed positively because if the risks had indeed materialised, these reserves could have largely eliminated them and the budget target would have been met. Since the macroeconomic development and collection of taxes in 2015 were positive, the reserves did not have to be used for risk coverage. **However, had they not been used to finance other expenditures, the deficit would have been EUR 456 million lower (0.6 % of GDP).**

The comparison of the budgeted and final expenditures for individual expenditure programmes has identified **expenditures worth EUR 737 million (0.9 % of GDP)** in excess of the approved budget. These new expenditures, not provided for in the budget, increased progressively throughout the year.

Also due to the cash limit on expenditures and deficit, set by the State Budget Act, these expenditures had to be financially covered. Such an increase in 'new' expenditures was possible, apart from the abovementioned lower contribution to the EU budget[11], thanks to the use of the reserves and the lower subsidy towards the deficit of the Social Insurance Agency[12].

3.6 Healthcare sector

The budget did not assume any increase in expenditures compared with 2014, yet it failed to specify any concrete cost-reduction measures. Compared with the budget, the sector's expenditures, including a rise in the liabilities of healthcare providers, increased by EUR 251.4 million, confirming the risk identified by the CBR. This increase in expenditures could have been partly influenced by additional funds made available to the sector through health-insurance contributions and payments by the state.

Public funds in the healthcare sector increased by 6.2 % year-on-year and were positively influenced by three factors. The first factor was the better macroeconomic and labour market situation thanks to which the revenues from the health insurance contributions paid by the working population surpassed the budgeted amount. The second factor was that the health insurance allowance (HIA) was not claimed in the course of the year (advanced claims) to the extent originally anticipated, which increased the revenues from workers' contributions by

[11] Chapter "Transactions with the EU budget and co-financing".

[12] The transfer to the Social Insurance Agency does not have a direct impact on the balance as it is an intra-sectoral transfer. However, its amount is important in terms of respecting the cash limits applicable to budget expenditures.

about EUR 121 million. At the same time, the payment by the state, which was designed to offset the shortfall in revenues due to the introduction of the HIA, remained at the original (higher) level. The third factor related to the increase of the payment by the state in the last two months of 2015 designed to cover the funding needs of the sector, mainly the employer's commitments ensuing from the collective bargaining with regard to doctors' salaries. The payment by the state (for its insurees) was EUR 68 million higher than budgeted.

For the most part, the additional funds were used to **finance the provision of healthcare; the sector's expenditures increased by 3.8 % year-on-year.** A portion of the funds, in the amount of EUR 76.2 million, remained on the accounts of health insurance companies, probably due to the increased and still unspent funds paid in by the state.

The overall balance of the sector was also **influenced by the deficits of healthcare providers.** In 2015, the deficit of hospitals increased and reached EUR 69.4 million. Nevertheless, the net negative impact on the budget was only EUR 19.4 million because the budget contained a reserve of EUR 50 million earmarked for this purpose. The fiscal performance of healthcare providers is directly influenced by the amount of funds made available, but also by the efficiency of their spending. While the 5-% annual increase in funding in 2012 and 2013 was sufficient to improve the fiscal performance of hospitals, the same rate of increase in 2014 and 2015 deepened their deficits.

In spite of the fact that the sector's expenditures (including hospitals) overran the budgeted level by more than EUR 252 million, their annual increase at 3.8 % is only slightly higher than under the no-policy change scenario (3.3 %). This means that **no events which would have fundamentally changed the amount of actual expenditures occurred in 2015.** The difference compared with the budget is due to the underestimation of expenditures for 2015, which were budgeted at the 2014 level.

3.7 Municipalities

The municipal sector posted a surplus of EUR 64.5 million. In comparison with the approved budget, which assumed a surplus of EUR 145 million, this was EUR 80.5 million less. The increase in own investments (without EU funds) by EUR 184 million represented the most significant factor.

One of the specificities of the municipal sector is that certain revenues and expenditures are not budgeted in the process of budget preparation, but they are recorded as they incur. This impairs the comparability of the budgeted versus final revenues and expenditures. The overall impact of unbudgeted items on the balance is approximately neutral. Hence the impact on the balance is based on the items as budgeted.

The budgets of municipalities are traditionally characterised by a **steady rise in current expenditures and volatility of capital expenditures.** While the expenditures on wages and the purchase of goods and services would increase continually every year, including in 2015, the amount of capital expenditures fluctuated. The decline in capital expenditures was particularly dramatic in 2011 to 2013 when they plummeted from the original 900 million to less than 600 million EUR. The demand for investments in municipalities carried the risk of capital expenditures regaining their original level. Which is exactly what happened in 2015.

On the other hand, the **municipal sector's balance was positive**, although the surplus was lower than what the Ministry of Finance had expected when preparing the budget. Municipalities refrained from running deficits despite higher investments. In recent years, the municipal sector has been fiscally prudent in adjusting its expenditures to the existing budgetary constraints.

3.8 Self-governing regions (SGRs)

The SGR sector reported a surplus of EUR 58.1 million. In comparison with the approved budget, which anticipated a surplus of EUR 123.8 million, this was EUR 65.7 million less. The most significant factors included lower-than-budgeted non-tax revenues and higher expenditures on wages and subsidies, which were partially offset by lower capital expenditures.

Similarly as in the case of municipalities, certain SGR revenues and expenditures are not budgeted, but they are actually recorded.

The overall SGR expenditures were influenced mainly by compensations of employees, which exceeded the budgeted amount by EUR 64.4 million. Subsidies were also higher. Capital expenditures increased by 35 % year-on-year, mainly as a consequence of EU-funded investments. The SGR's own investments declined compared to the previous year.

3.9 Other general government entities

The negative contribution of 'other general government entities', without the impact of the most important factors, to the deficit represented EUR 163.5 million. The National Property Fund (NPF) and the newly established *MH Invest* influenced the deficit most negatively, while the impact of the Resolution Fund was the most positive.

The **National Property Fund** (NPF) overran its budgeted expenditures due to payments for legal services, contractual penalties for contract terminations and the court fees incurred in legal disputes. From the total impact of EUR 44.9 million, expenditures connected with the privatisation of Slovak Telekom represented EUR 25.1 million.

MH Invest is an organisation established for a specific purpose - to develop a strategic investment park for the incoming investment by Jaguar Land Rover. Its capital expenditures incurred in 2015 were funded through transfers from the state budget.

Credit institutions and securities' dealers are obliged to participate in the resolution of crisis situations in the financial sector by paying contributions to the **Resolution Fund**. Since the scheme in 2015 was purely national, the contributions paid then had a positive impact on the balance. As of 1 January 2016, the new contributions and those already collected will be transferred to the EU's Single Resolution Mechanism.

4 Impact of the year 2015 on risks in 2016

In its evaluation of the approved budget[13] for 2016, the CBR identified a number of risks in the area of non-tax revenues (revenues from dividends, particularly from *SPP*, and from the sale of CO2 allowances) and expenditures (healthcare sector, local governments and state budget). The actual development in 2015 suggests that the above risks continue to exist.

In the case of the **SPP dividend,** if the budgeted amount was to be attained, the revenue would have to more than double from one year to another (from EUR 127 million in 2015 to 300 million), yet nothing presently suggests such a steep rise in the profits of SPP and its subsidiaries. The increase in the **revenues from the sale of CO2 allowances** (from EUR 48 million in 2015 to 117 million in 2016) would need to be similar, which is, given the methodology of calculation[14], very unlikely.

The 2015 development of expenditures in the healthcare and local government sectors confirms that risks will persist also in 2016. The budgeted 2016/2015 increase in **healthcare** expenditures is below 1 %, although historical average is around 3.5 %. The higher **expenditures of local governments** in 2015 are likely to recur also in 2016, which means that the budgeted surplus of municipalities and SGRs at EUR 223 million is overestimated.

Another risk for the year 2016 emanates from those government expenditures which were not effected in 2015 and whose spending potential rolls over to the following years (for example, a part of the funds allocated for the purchase of land under the prepared PPP project for the D4 motorway bypass of Bratislava and the R7 express way). The total amount of rolled-over expenditures in 2015 increased (from 0.7 % of GDP to 0.9 % of GDP[15]), which indicates a higher risk in 2016.

The **Resolution Fund** represents a new one-off risk for 2016. Since the scheme in 2015 was purely national, the contributions paid then had a positive impact on the balance. As of 1 January 2016, the new and the already collected contributions will be transferred to the Single Resolution Mechanism of the EU, which will have a negative impact on the balance in the amount of EUR 34 million.

Apart from identifying the risks for 2016, the CBR has also identified potential sources for their coverage. The lower rate of the drawing of EU funds may **reduce the amount of expenditures necessary for co-financing**. However, it is premature at this point to evaluate whether this assumption materialises.

Additional tax revenues also represent a source for risks coverage. According to the estimate of the Tax Revenue Forecasting Committee from February 2016, the government will raise in tax revenues EUR 94 million more than budgeted. Since the budget also contains a reserve for tax collection in the amount of EUR 150 million, this reserve can be used to cover the existing risks.

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[13] CBR, Addendum to the Evaluation of the 2016-2018 General Government Budget, Chapter 2.

[14] The budget does not reflect the new approach to the calculation of revenues from the sale of CO2 allowances. It assumes cash revenues from auctions, yet the budgeted average auction price (EUR 10.5/tCO2) is approximately double the prevailing market price. The new calculation method, which was known at the time of budget preparation, also takes into account (apart from the revenues from auctions) the fact that a portion of allowances is allocated to companies at no cost (which reduces the average price of CO2 allowances). At the same time, general government revenues are calculated on the basis of the allowances actually consumed by companies in Slovakia (which are lower than the sum of the allocated and auctioned CO2 allowances in a given year, which also reduces the revenue).

[15] This means that the 2016 state budget has a margin for the spending of unbudgeted expenditures in the order of 0.9 % of GDP.

5 General government debt development

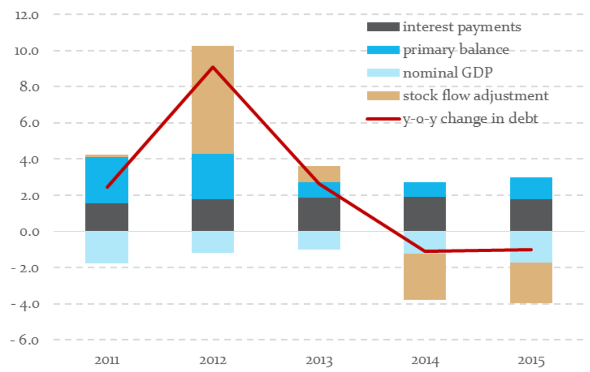
The gross debt of general government declined by 1% of GDP year-on-year to 52.9 % of GDP, falling into the first sanction zone under the debt rule. Its 2015 decline was largely attributable to one-off transactions in the amount of EUR 1.9 billion (2.4 % of GDP). Without them, the debt in 2015 would have risen.

The Fiscal Responsibility Act contains a **rule on the development of the gross debt-to-GDP ratio** and defines the sanctions to be invoked when specified thresholds are exceeded. The present debt level means that the minister of finance is obliged to send to the parliament a written substantiation of the debt amount, including the measures proposed for its reduction. The sanctions will continue to apply until the debt falls below the first threshold (50 %[16])

The gross debt-to-GDP ratio began to decline after 2013, however, **the decline has been largely attributable to one-off measures adopted by the government**, which do not improve the general government sector's net worth. In order to bring the debt development analysis closer to the net worth concept[17], the CBR has identified those one-off and temporary factors with impact on cash which do not improve the net worth or which influence it only temporarily. Adjusting gross debt for liquid financial assets and for these factors provides a picture of how the debt would develop under the influence of government's permanent measures. In 2015, the debt development was affected mainly by one-off factors which do not affect the balance but which do have impact on cash. These are the factors which cause the amount of cash to change simultaneously with changes in other (non-liquid) assets or those liabilities that are not part of gross debt.

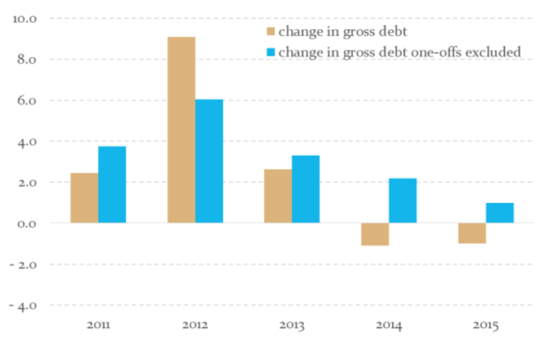
The CBR identified transactions involving state corporations, such as the sale of government stake (Slovak Telekom), payment of dividends beyond the profits earned from regular economic activity (mainly SPP), and revenues from repaid loans (Cargo). This also includes changes related to the fully-funded pillar of the pension system. Although the transfer of accumulated assets from private pension asset management companies to the general government sector increases the amount of cash available on government accounts, it also entails future expenditures associated with the payment of pensions to pension savers in the future.

Figure 3: Contributions to debt development (%)



Source: CBR

Figure 4: Change in debt development (%)



Source: CBR

[16] By the end of fiscal year of 2017, the sanctions apply to the brackets from 50 to 60 % of GDP. Starting from the fiscal year of 2018 until the end of the fiscal year of 2027, the brackets will decline by 1 percentage point annually to the level of 40-50 % of GDP.

[17] The reasons are described in detail in the Report on the evaluation of compliance with fiscal responsibility rules and transparency rules for the year 2014, August 2015, Annex 3 (available only in Slovak).

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