Evaluation of Compliance with the Balanced Budget Rule in 2015

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This report presents the official positions of the Council for Budget Responsibility in line with its mandate laid down in Act No. 523/2004 on General Government Budgetary Rules and in Act No. 493/2011 on Fiscal Responsibility.

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

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

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Summary

The structural deficit of the general government in 2015 reached 2.7 % of GDP and increased for the second year in a row. Thus the medium-term objective of attaining a nearly balanced budget (structural deficit up to 0.5 % of GDP) was not achieved. Since 2012, the cumulative deviation from the adjustment path set to meet the original medium-term objective by 2017, reached almost 0.6% GDP. The adjusted expenditure since 2012 increased by 6.4 p.p. above the expenditure benchmark (with a negative impact on the balance at 2.4 % of GDP). In addition to these two indicators, in its evaluation the CBR also took into account the impact of other measures which widen the deviation (reduced contribution rates to the fully-funded pillar, windfall revenues, anticipated future financial corrections to EU funds[1]) or which may narrow it (increased effectiveness of VAT collection, lower co-financing expenditures and upward revision of the 2015 tax revenue). Moreover, the CBR took into account the fact that albeit the debt still remains within the sanction brackets set by the Fiscal Responsibility Act[2] the government has not yet adopted sufficient measures to reduce it. With all relevant factors taken into consideration, the CBR concludes that the 2015 deviation from the adjustment path was significant and it would be necessary to trigger the correction mechanism[3].

Unless the MTO deadline is amended, the correction mechanism should eliminate the deviation in order for the original medium-term objective to be met by 2017. Since in April 2016 the deadline for meeting the medium–term objective (MTO) has been postponed to 2019, the expenditure ceilings should be set at least at the level of the present plans presented in the Stability Programme for 2016–2019 (published in April 2016). This would, at least partially, prevent repeated future postponements of the MTO in line with the principles of fiscal compact[4].

Compared with 2012, the structural balance in 2015 improved by 1.9 % of GDP, which is 0.6 % of GDP below the required change of 2.5 % of GDP assuming steady deficit improvements by 0.8 % of GDP annually. The entire budget consolidation took place in 2013 when the balance improved considerably (by 2.2 % of GDP), followed by fiscal easing in 2014 and 2015. As part of its overall evaluation, the CBR also took into account the effects of other factors. In the case of structural balance, these mainly included the reduced contributions (by 0.3 % of GDP) to the pension system's fully-funded pillar, which, from the long-term perspective, do not influence

1 If a decision is taken in the future on financial corrections attributable to the year 2015, both the CBR and the Ministry of Finance will reflect them retrospectively in the 2015 structural balance.

2 The Fiscal Responsibility Act (Constitutional Act No. 493/2011).

3 The correction mechanism is defined in Act No. 523/2004 on Budgetary Rules and comprises the setting of the public expenditure ceiling and the measures applicable to the period of correction from the significant deviation. The setup of the mechanism is proposed by the Ministry of Finance and approved by the Cabinet.

4 Common principles on national fiscal correction mechanisms /* COM/2012/0342 final */: "the correction mechanisms should be instrumental in providing critical elements of stability in the budgetary framework, so as to prevent the "moving-target syndrome" typically associated in response to budgetary slippages. To that end, the correction mechanisms should ensure adherence to key fiscal targets as set before the occurrence of the significant deviation".

the fiscal position favourably[5]. The positive effect of windfall revenues on the 2015 structural balance reached 1.1 % of GDP. The more precise data for 2015 to be released as part of the second debt and deficit notification this autumn may move the deficit either way. Provided that there are no other significant revisions, the higher-than-expected 2015 revenue from the corporate income tax may improve the structural deficit and narrow the deviation by 0.1 % of GDP. On the other hand, the deviation may be negatively affected by the retroactive application of financial corrections which may be approved in the years to come. In evaluating compliance with the expenditure benchmark, the CBR took into account the higher expenditures on co-financing to EU funds, which generate higher tax revenues, and the increased effectiveness of VAT collection, which, for the purpose of evaluation, was considered as a government measure.

In spite of the fact that the Ministry of Finance and the CBR quantified the main indicators almost identically, the conclusions of both institutions diverge. The reason lies in the way in which the additional factors have been considered. According to the Ministry of Finance, the 2015 deviation from the original adjustment path towards meeting the MTO by 2017 was considerable, yet only temporary and immaterial in terms of keeping the pace of adjustment adequate to reach a balanced budget in the years to come. In comparison with the CBR's evaluation, the Ministry of Finance did not take into consideration the windfall revenues of the budget, the measures with a neutral impact on the long-term sustainability and the potential financial corrections to EU funds in the future, which increase the structural balance deviation. On the other hand, the Ministry of Finance is adjusting the structural balance for the effects of higher co-financing which, in the CBR's view, has a more-or-less neutral impact on the structural balance. According to the Ministry of Finance, the revision of the adjustment path towards meeting the MTO by 2019 has put less strain on the annual consolidation effort and thus the correction mechanism does not need to be triggered. However, the CBR is of the view that the evaluation for 2015 should be based on the adjustment path and the objectives then applicable. Consequently, the extension of the MTO deadline should not be a reason for not activating the correction mechanism.

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

Tab 1: CBR assessment - compliance with the balanced budget rule in 2015

Section		Definition	CBR assessment	Criterion	Outcome in 2015	Fulfillment
Structural balance	1.	**General government structural balance** **Target value of the general government structural balance: deficit not exceeding 0.5% of GDP; deficit may be as high as 1% of GDP, if both following conditions are met (A, B)**		**>= - 0.5 % of GDP**	**-2.7 % of GDP**	✘
	A.	debt significantly below 60 % of GDP	debt below 40 % of GDP	< 40 % of GDP	52.9 % 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	1.4 % of GDP	✘
			risk assessment by the EC using the S2 indicator	low risk	medium risk	
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**		**>= 2.5 % of GDP***	**1.9 % 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**		**>= 2.5 % of GDP***	**0.1 % 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	> 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 %	3.6 %	✘
	E.	protracted period of very low GDP growth relative to potential	negative output gap at least at 3 % of potential GDP	<= -3 %	-0.1 %	✘
	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**	**yes**	✔
	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		<= 2.0 % of GDP**	1.9 % 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		<= 2.0 % of GDP**	0.1 % of GDP	✔
	6.	**Assessment of compliance with the balanced budget rule**		**significant deviation**		

** Assessed on a cumulative basis (years 2013 till 2015)* *Source: CBR*

*** Over the period of 2013 till 2015, the required cumulative improvement in the structural balance reached 2.5 % of GDP. Significant deviation occurs when the balance improves by 2.0 % of GDP at most (2.5 - 0.5 = 2.0 % 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") offers its independent evaluation. In line with the principles published by the European Commission[6], 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 2015 based on the data contained in the April deficit and debt notification by Eurostat prepared in line with the methodology[7]. It also contains the CBR's opinion on the evaluation[8] published by the MF SR on 30 June 2016. The main line of the CBR's evaluation remains the same as in the past years[9] (see Annex 2 for the scheme of individual steps). In terms of methodology, the calculation of adjusted expenditures 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 to 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 deficit' 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 decouple the debt level from the transitional provisions of the Act[10]. At the same time, such debt level can be considered relatively safe[11].

6 In line with the "comply or explain" principle defined by the Communication from the Commission: Common principles on national fiscal correction mechanisms of 20 June 2012.
7 The description of ESA2010, including its accompanying documents, is published at the website of Eurostat.
8 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.
9 Namely the evaluations of compliance with the balanced-budget rule for 2013 and 2014.
10 Presently, the debt level up to 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 reductions would reflect the requirements of legislation, it would not be justified from the perspective of its sustainability.
11 Múčka (2015): Is the Maastricht debt limit safe enough for Slovakia?, CBR Working Paper no. 2/2015.

- 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[12] is also taken into account.

The general government gross debt reached 52.9 % of GDP at the end of 2015, a level which triggers sanctions under Fiscal Responsibility Act[13], while the long-term sustainability indicator for the same period reached 1.4 % of GDP[14]. At the same time, the European Commission included[15] Slovakia among the countries at medium risk regarding the sustainability of public finances. 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[16].**

The 2015 structural deficit reached 2.7 % 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 of 2013[17], Slovakia should meet its medium-term budgetary objective expressed as a structural deficit of 0.5 % of GDP by 2017. In its update to the Stability Programme from April 2016 the government has decided to postpone the meeting of the MTO to 2019. **Since the original MTO deadline applied during 2015, the CBR (and the MF SR alike) evaluates the progress achieved towards meeting the medium-term budgetary objective against the original MTO deadline (by 2017).**

[12] The European Commission assesses the long-term sustainability of public finances (as part of the annual updates to stability programmes) on the basis of the analysis of the starting fiscal position (deficit and debt levels) and its long-term projections of the impacts of population ageing on public finances, categorising individual Member States as high, medium and low-risk countries.
[13] The sanctions attaching to the first sanction zone oblige the Ministry of Finance to substantiate the debt amount in the national parliament and propose measures for debt reduction. The sanctions will continue to apply until the debt amount falls below the first threshold (50 %) The approval of the new Government Manifesto is without prejudice to the application of the first- and second-zone sanctions; while the application of sanctions starting from the third-sanction zone is suspended (a debt of at least 55 % of GDP).
[14] CBR, Report on the Long-term Sustainability of Public Finances from April 2016.
[15] EC, Country Report Slovakia 2016 from February 2016.
[16] The Ministry of Finance presented this value of the medium-term budgetary objective also in the Stability Programme from April 2016.
[17] Council Recommendation of 9 July 2013, concerning the National Reform Programme 2013 of Slovakia and delivering a Council opinion on the Stability Programme of Slovakia for 2012-2016.

In the absence of specific guidance[18] 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**[19].

The 2012 structural deficit reached 4.6 % of GDP[20]; 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	**-4.6**	-3.8	-3.0	-2.1	-1.3	**-0.5**
Change*	-	**0.82**	**0.82**	**0.82**	**0.82**	**0.82**

** 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** (Table 3).

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

	2012	2013	2014	2015	cumulatively 2013-2015
1. GG balance	-4.3	-2.7	-2.7	-3.0	
2. Cyclical component	-0.1	-0.5	-0.2	0.0	
3. One-off measures	0.4	0.2	0.1	-0.2	
4. Structural balance (1-2-3)	**-4.6**	**-2.4**	**-2.6**	**-2.7**	
5. Change in structural balance		**2.16**	**-0.13**	**-0.13**	**1.90**
Required change in structural balance		**0.82**	**0.82**	**0.82**	**2.46**
p.m. output gap	-1.0	-1.5	-0.9	-0.1	

Source: CBR

The structural deficit in 2015 reached 2.7% of GDP. Following its significant year-on-year reduction by 2.2 % of GDP in 2013, the structural deficit increased moderately in 2014 and 2015. On the whole, the structural deficit improved by 1.9 % of GDP, yet the improvement under the adjustment path should have reached 2.5 % of GDP. **This means that the 2015 structural balance was 0.6 % of GDP worse than the balance calculated on the basis of the required annual improvement.**

18 The Commission has not published a guidance on how to meet the objective, i.e., annual improvements in the structural balance, which complicates the evaluation of compliance with the balanced-budget rule.

19 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

20 In comparison with CBR evaluation of December 2015, the components feeding into the calculation of the structural balance have been refined (deterioration of the structural balance by 0.1 % of GDP and a revision of the cyclical component estimate by 0.1 % of GDP), which brought the structural deficit in 2012 slightly up, from 4.4 % to 4.6 % of GDP.

1.3 Development in 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[21]; 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	2015	source
1. General government expenditure	**29 349**	**30 489**	**31 682**	**35 622**	Eurostat, T200*: TE
2. Interest payments	1 280	1 384	1 441	1 393	Eurostat, T200: D41
3. Expenditures on EU programmes fully matched by EU funds revenues	1 059	1 232	1 295	2 793	Eurostat, T200: P51G
- of which: capital expenditures on EU programmes	888	983	995	2 352	Eurostat, T200: ØP51G
4. Gross fixed capital formation (excl. EU expenditures)	1 500	1 386	1 898	2 479	CBR (estimate)
5. Gross fixed capital formation (excl. EU expenditures, average t-3 till t)	1 675	1 569	1 623	1 816	CBR (estimate)
6. Cyclical expenditures (unemployment, pensions)	-1	-28	-42	-3	CBR (estimate), MF SR
7. One-off expenditures	-93	-3	146	186	CBR (estimate)
8. Primary expenditure aggregate *(1-2-3-4+5-6-7)*	**27 278**	**28 087**	**28 567**	**30 589**	
9. Change in primary expenditure aggregate *(8t-8t-1)*		809	479	2 023	
10. Change in discretionary revenue measures and NA reporting		1 265	-15	223	MF SR, CBR: Annex 4
11. Nominal growth of expenditure aggregate adjusted for revenue measures ((9t-10t)/8t-1)		-1.7	1.8	6.3	
12. Change in GDP deflator		0.5	-0.2	-0.3	Eurostat
13. Real growth of expenditure aggregate adjusted for revenue measures (11-12)		**-2.2**	**1.9**	**6.6**	
14. Potential GDP growth		2.0	1.9	2.7	CBR (estimate)
15. Convergence margin (p. p.) CBR change in SB/*((1_{t-1}-2_{t-1})/GDP_t)*		2.2	2.2	2.2	Eurostat, T200: TE, D41, SO SR, CBR calculation
16. Expenditure benchmark *(14-15)*		**-0.2**	**-0.3**	**0.5**	
17. Impact of the deviation on the balance in the given year (16_t-13_t)*8_{t-1}/GDP_t		0.72	-0.85	-2.23	
18. Cumulative deviation in t-1 a t				**-2.36**	

[21] The CBR's calculation method slightly differs from the method presented in the Stability and Growth Pact. The differences, including supporting documents, are listed in Annex 4. In comparison with the December 2015 evaluation, the estimate of general government expenditures financed from the EU budget has been refined, while breaking down the expenditures to investments and other expenditures. This has made it possible to eliminate methodological inconsistency in the form of a double netting out of investments financed from EU funds from the expenditure (this methodological change was also incorporated in the methodology specified in the Stability and Growth Pact).

p.m. Gross fixed capital formation	2 389	2 370	2 893	4 831	*Eurostat, T200: P51*

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

Source: CBR, Eurostat, MF SR

As with 2014, the growth in expenditures in 2015 surpassed the expenditure growth rate as given by expenditure benchmark (which would ensure structural balance improvement by 0.8 % of GDP). In 2015, adjusted real expenditure increased by 6.6 %, whereas the expenditure benchmark assumed a 0.5 % increase year-on-year. Taking into account a lower growth in expenditures in 2013, the overall impact of expenditure development on the balance between 2013 and 2015 in comparison with the expenditure benchmark was negative and represented 2.4 % of GDP. **This implies that the deviation from the defined adjustment path has been confirmed by the above indicator as well.**

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[22]. 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[23], 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[24] on a yearly basis.
- **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.

[22] 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.

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

[24] 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.

- **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 (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 2015. The criteria of a severe economic downturn were not met either. Slovakia's economy grew 3.6 % year-on-year, output gap (based on CBR's estimate) reached -0.1 % of the potential output in 2015 and was significantly above the -3.0 % level. In 2015, the eurozone grew by 1.6 % year-on-year, and the output gap estimated by the European Commission reached -1.7 % of the potential output. The Commission did not evaluate[25] 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 2015**.

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 aggregate, and the occurrence of exceptional circumstances. Unless the conclusion is unambiguous, also other factors are taken into consideration. They are considered as long as they are verifiable and their impact on the balance is quantifiable.

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

In 2015, the structural balance deviated from the adjustment path by 0.6 % of GDP. If taking into account the following three additional impacts, the deviation would be even higher.

- The change in the structural balance was also influenced by **items[26] having a neutral impact in the long term**. Reduced contribution rates to the fully-funded pillar of the pension system, opening of the fully-funded pillar and changes in the levy payable by financial institutions have improved the structural balance between 2013 and 2015 by a

[25] 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 2016.

[26] 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.

total of 0.3 % of GDP. In the future, these changes will increase the general government expenditure and, therefore, they need to be taken into account.

- **Debt interest payments** are largely influenced by past government decisions and the development on financial markets; if their impact is taken into account in the change of the structural balance, we may get a more accurate picture of the present fiscal policy. Debt interest payments had an approximately zero cumulative impact in the period between 2013 and 2015.

- There were also **revenue windfalls**[27] which contributed to the improved structural balance. These represent tax revenues which exceeded the budgeted values[28] in 2015. The positive impact of revenue windfalls on the structural balance was 1.1 % of GDP in 2015.

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

	2013	2014	2015	cumulatively 2013-2015
Change in structural balance	2.16	-0.13	-0.13	1.90
Required change in structural balance according to CBR	0.82	0.82	0.82	2.46
Deviation from required trajectory	***1.34***	***-0.95***	***-0.95***	-0.56
Significant deviation				**yes**
Δ in measures with no impact on long-term sustainability	0.5	-0.1	-0.1	0.33
Δ in interest payments	-0.1	0.0	0.1	-0.02
Revenue windfalls	-	-	1.1	1.08
Change in structural balance including special factors	1.8	0.0	-1.3	0.51
Deviation from required trajectory taking into account special factors	***-0.99***	***0.85***	***2.10***	1.95

Source: CBR

When assessing the **adjusted expenditure** against the expenditure benchmark, a due account is taken of whether the cumulative deviation since 2012 has had an overall negative impact on the general government balance of at least 0.5 % of GDP. The rate of growth in adjusted expenditure from 2013 to 2015 reached 6.4 %, even though under the expenditure benchmark it was supposed to drop by 0.1 %. The negative impact of the higher growth of expenditure on the balance reached 2.4 % of GDP, causing a significant deviation. If the following three additional factors are taken into account, the negative impact of the deviation from the expenditure benchmark would be reduced to 1.5 % of GDP. Nonetheless, the **deviation remains significant**.

[27] Revenue windfalls and shortfalls are also taken into account by the European Commission in assessing whether the requirement of improving the structural balance towards meeting the medium-term budgetary objective under the preventive arm of the Stability and Growth Pact is fulfilled. (Article 5 (1) of Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies as amended). In its assessment of the Stability Programme for Slovakia for 2016-2019, the European Commission has identified revenue windfalls in 2015 without quantifying their amount.

[28] Adjusted for the impact of the economic cycle, higher revenues due to increased absorption of EU funds and the impact of government's measures aimed at improving VAT collection.

- **Measures without an impact on the long term sustainability** also influence, in addition to structural balance, the development of adjusted expenditures. These measures (listed in Annex 4) have increased the revenues between 2013 and 2015 by a total of 0.5 % of GDP. As they will be accompanied by higher public expenditures in the long term, additional revenues should not be used for financing the current expenditures.

- The development of adjusted expenditure was negatively influenced, particularly in 2015, by **an increase in co-financing expenditure**. As the growing absorption of EU funds also increases tax revenues through improved macroeconomic development, the higher tax revenues represented an additional source for covering[29] such expenditures. Co-financing expenditures grew 0.4 % GDP between 2013 and 2015.

- **Increased effectiveness in tax collection** represents another factor that has not been included in the calculation of adjusted expenditure. The government took several measures, in particular as regards VAT, to increase tax collection. The impacts of such measures are difficult to quantify as they are not clearly attributable to changes in the behaviour of taxpayers. If taking into account the estimate by the Ministry of Finance[30], improved VAT collection between 2013 and 2015 would bring an increase in revenues by 1.0 % of GDP.

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

	2013	2014	2015	cumulatively (2013-2015)
Real growth of expenditure aggregate adjusted for revenue measures (%)	-2.18	1.94	6.58	6.35
Expenditure benchmark (%)	-0.23	-0.34	0.50	-0.07
Deviation from expenditure benchmark (impact on GG balance)	***0.72***	***-0.85***	***-2.23***	**-2.36**
Significant deviation				**yes**
measures with no impact on long-term sustainability	-0.5	0.1	0.0	-0.5
y-o-y Δ in co-financing expenditures	-0.1	0.0	0.5	0.4
y-o-y Δ in effectiveness of VAT tax collection (MF SR estimate)	0.3	0.5	0.1	1.0
Deviation from expenditure benchmark taking into account special factors	***0.40***	***-0.28***	***-1.58***	***-1.46***

Source: CBR

The CBR's evaluation also covers other factors beyond those referred to above. Their potential impacts on individual indictors are not currently known and may manifest themselves in the future. At the same time, also qualitative factors were taken into account:

- The evaluation based on the data published by Eurostat[31] in April 2016 can be further extended to capture the **updated estimate of tax revenue**. Based on the forecast by the

[29] The CBR, in its report on the Evaluation of the Government Budget Proposal for 2015-2017 of November 2014, Annex 2, estimated that one euro spent on co-financing generates approximately one euro in additional tax revenues. Because the impact of the drawing of EU funds on the general government balance is approximately neutral, the CBR does not consider an increase in co-financing expenditure to be a relevant factor in terms of explaining changes in the structural balance.

[30] The CBR's own estimate is roughly the same as that of the Ministry of Finance.

[31] The data is published on Eurostat's website (http://ec.europa.eu/eurostat/data/database).

Tax Revenue Forecasting Committee dated 23 June 2016, tax revenues are estimated to increase by EUR 58 million (0.1 % of GDP) above the notified level, and this development can improve the structural balance. 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 2016.

- **Corrections associated with irregularities in the drawing of EU funds still available under the second programming period** may represent an additional negative risk with respect to the structural balance amount and the development of adjusted expenditure. The risk is raised by a relatively high absorption of funds in 2015 which may be associated with a higher error rate. Even though the decisions on possible corrections in the drawing of funds in 2015 will be made in the future (with a negative impact on the general government balance at the time of the decision), the negative impact on the structural balance and adjusted expenditure will be recorded in 2015. At the moment it is not possible to estimate the potential impact of corrections and the time period when such decision, if any, is to be made.

- One of the relevant factors considered in the evaluation is the fact that the **general government gross debt amount is still within the sanction brackets of the debt brake**. The deviations in the path towards meeting the medium-term budgetary objective may delay the return of the gross debt from the sanction brackets.

With all relevant factors taken into account, no exceptional circumstances occurred in 2015. Both indicators[32] showed a significant deviation from the medium-term objective adjustment path. This means that, in CBR's opinion, the correction mechanism should be triggered.

The correction mechanism is defined by Act No. 523/2004 on budgetary rules and consists of determining a public expenditure ceiling[33] and measures to be taken during the period of correcting a significant deviation[34]. The shape of the correction mechanism is determined by the government based on a proposal by the Ministry of Finance. In a standard situation, the correction mechanism should eliminate the deviation with a view to attaining the medium-term objective by the original deadline until 2017. Because, in the meantime, the medium-term objective has been put off to 2019, it would be advisable to determine the expenditure ceiling at least at the level planned in the Stability Programme of the Slovak Republic for 2016–2019, which

[32] Annex 5 compares the structural balance and adjusted expenditure developments in individual years.
[33] The public expenditure ceiling means the maximum amount of the total accrued consolidated general government expenditure.
[34] Taking 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 in accordance with separate regulations.

was prepared in April 2016. In this manner, the postponement of the medium-term objective could, at least partially, be prevented in the future in line with the fiscal compact principle[35].

Box 1: Structural balance development[36] until 2019

In the present Stability Programme, the Slovak government set its budgetary objectives by the year 2019 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 2019. When assessing the Stability Programme, the European Commission identified the risk of deviation from the medium-term objective adjustment path in 2016, whereas the year 2017 should see a planned improvement in the structural balance in line with the Stability and Growth Pact.

The relaxation of budgetary objectives resulted in the postponement of the deadline for meeting the medium-term budgetary objective by two years from 2017 to 2019, which also implies a delay in the deadline for achieving a balanced budget in accordance with the rule defined in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, as reflected in the Slovak legislation and Commission regulations (regulation (EC) No 1466/97, regulation (EC) No 1467/97).

The relaxation[37] of the rules of the Stability and Growth Pact and their flexible application by the European Commission also made it possible to put off the deadline for meeting the medium-term objective. While in 2013 the Council approved, at the proposal by the European Commission, country-specific deadlines for meeting the medium-term budgetary objective, the changes in the interpretation of the SGP rules (the so-called investment clause in 2014 and the reduced minimal consolidation effort depending on the economic cycle and the gross debt level) made the postponement of the deadline possible.

At the same time, however, this procedure runs counter to the requirement of rapid convergence towards the medium-term objective under the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and the principles which the European Commission issued in this context and which should have been reflected in the balanced budget rule. This specifically involves the principle[38] of determining such a correction mechanism that, in the event of a deviation from the MTO adjustment path, would lead to meeting the objective by the original deadline. This would prevent a situation where non-compliance with the current budgetary objectives would result in further postponements of the deadline for meeting the medium-term budgetary objective (the so-called moving-target syndrome).

35 Common principles on national fiscal correction mechanisms /* COM/2012/0342 final */: "the correction mechanisms should be instrumental in providing critical elements of stability in the budgetary framework, so as to prevent the "moving-target syndrome" typically associated in response to budgetary slippages. To that aim the correction mechanisms should ensure adherence to key fiscal targets as set before the occurrence of the significant deviation".

36 The box does not contain a comparison between the adjusted expenditure aggregate and the expenditure benchmark between 2016 and 2019. This is due to the fact that certain revenues and expenditures with an approximately zero impact on the balance have not been budgeted.

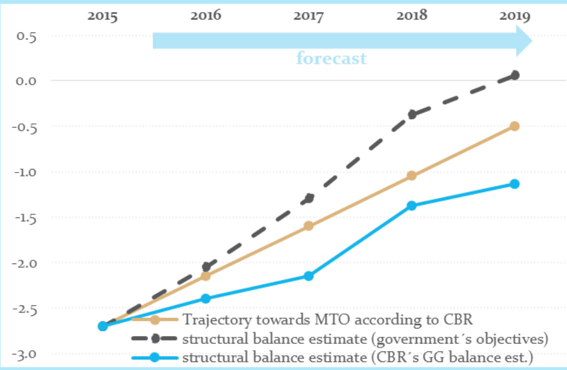
37 In January 2015, the European Commission communicated the way it will interpret the rules of the Stability and Growth Pact in assessing the fiscal policies of Member States.

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

The postponed deadline for meeting the medium-term budgetary objective will also lead to a change of the baseline year and adjustment path for the required improvement of the structural balance within the evaluation of the balanced budget rule. For the first time ever, this change will be applied during the evaluation of the results for 2016. The year 2015 will be the baseline year for determining the required improvement of the structural balance.

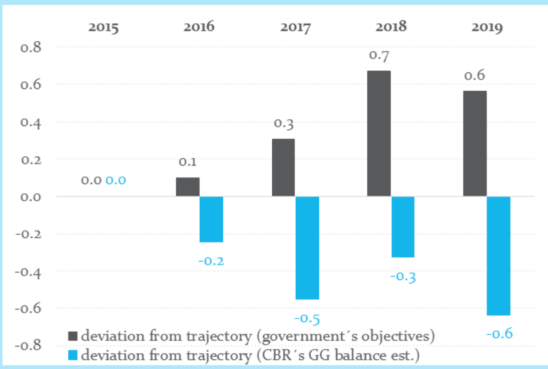
Figures 1 and 2 show the structural balance values, as estimated by the CBR, against the adjustment path set in the above described manner, assuming that the government achieves the targets set and that the risks identified by the CBR in the evaluation of the budgetary objectives[39] have materialised. Using the present macroeconomic forecast and assuming that the identified risks have materialised (such as overestimated non-tax revenues, underestimated expenditures of the state budget, local governments and the healthcare system) without the government adopting additional measures, there is a risk[40] of a significant deviation in 2017. On the contrary, if the targets set by the government are met, the CBR estimates that the medium-term budgetary objective could be met in 2018 already.

Figure 1: GG structural balance according to CBR in 2015-2019 (ESA2010, % GDP)



Source: CBR, MF SR

Figure 2: Deviation from trajectory according to CBR in 2015-2019 (ESA2010, % GDP)



Source: CBR, MF SR

39 CBR, Evaluation of Medium-term Budgetary Objectives, June 2016

40 Although the legislative provision regulating the activation 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.

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 2015[41] on 30 June 2016. The document concludes that the 2015 structural balance deviated from the defined adjustment path by 0.6 % of GDP and the 2013-2015 cumulative deviation from the expenditure benchmark reached 2.3 % of GDP. As far as compliance with the balanced budget rule is concerned, **the Ministry observed, in 2015, a significant deviation from the original adjustment path towards MTO set for 2017; however, this deviation is only temporary and not decisive in terms of adequate pace of towards a balanced budget in the upcoming years.** By updating the path towards MTO until 2019 while fully respecting the European fiscal rules, **the Ministry deems that the year-on-year need for consolidation has been relaxed.** This is why the Ministry did not propose activation of the correction mechanism.

The CBR believes that, even after taking into account the relevant factors, both indicators showed a significant deviation from the path towards MTO in 2015 and, for this reason, it is necessary to trigger the correction mechanism.

Even though the Ministry of Finance and the CBR made almost identical estimates of the basic indicators, the conclusions at which both institutions arrived in their evaluations are different. This was caused by additional factors that have changed the Ministry's evaluation. The final evaluation of both institutions is provided in the table below.

Tab 7: Comparison of evaluation of compliance in 2015, CBR vs. MF SR (ESA2010, % GDP)

	CBR	MF SR	difference
Medium term objective (MTO)	-0.5 (2017)	-0.5 (2017)	-
GG balance	-3.0	-3.0	0.0
Cyclical component	0.0	-0.2	0.2
One-off measures	-0.2	-0.2	0.0
Structural balance	**-2.7**	**-2.5**	**-0.2**
Compliance with the structural balance rule	**no**	**no**	-
Cumulative change in structural balance	1.9	1.7	**0.2**
Required cumulative change in structural balance	2.5	2.2	**0.2**
Compliance with the change in structural balance	**no**	**no**	-
*Cumulative deviation of change in structural balance from required trajectory**	-0.6	-0.6	0
Significant deviation**	**yes**	**yes**	-
Cumulative real growth of expend. aggregate adjusted for revenue measures	6.3	7.6	**-1.2**
Expenditure benchmark (cumulative)	-0.1	1.4	**-1.5**
Compliance with the expenditure benchmark rule	**no**	**no**	-
*Cumulative deviation in expenditure benchmark (impact on GG balance)**	-2.4	-2.3	**-0.1**
Significant deviation**	**yes**	**yes**	-

[41] MF SR, Plnenie pravidla vyrovnaného rozpočtu za rok 2015, (available only in Slovak), June 2016.

OVERAL ASSESSMENT	significant deviation	not significant deviation***

* sign (-) denotes noncompliance with the rule

Source: CBR, MF SR

** deviation is significant, if it reaches at least -0.5 % GDP

*** taking into account additional factors such as updated forecast of tax revenues in 2015, y-o-y change in co-financing due to ESIF, proper record of EU financial correction

The procedure for evaluating the structural balance and the development in adjusted expenditures is very similar in both institutions, with minimal methodological differences. There are still slight numerical differences between both institutions as regards determining the level of the structural balance in individual years and in the adjustment path[42], which is mainly due to the fact that, in estimating the potential output (and output gap), the CBR takes into account, apart from the MF SR forecast, also the forecasts of other institutions (Annex 6). The one-off effects considered by both institutions between 2013 and 2015 are identical (Annex 3).

In the calculation of the required pace of the expenditure growth, the differences 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 impacts of methodological changes, where the CBR uses a broader list of items[43]. At the same time, the CBR excludes one-off expenditures (corrections to EU funds) from adjusted expenditures, whereas the Ministry of Finance took them into account only as part of additional factors.

Both institutions have changed the method of calculating the adjustment expenditure so as to eliminate the double netting out of investments financed from EU funds (more details in Annex 4). The availability of data on general government expenditures financed from the EU budget and their breakdown to investments (gross fixed capital formation) and other expenditures are essential to introducing this change. However, there is no time series available for such data, because the current data collection setup does not allow for calculating these data accurately (more details in Box 2). The compilation of time series is even more complicated due to the retroactive classification of several entities within the general government sector without detailed data on the financing of their expenditures. Therefore, these expenditures were estimated by the Ministry and the CBR; however, the differences between both institutions are significant (Table 8) and are based on two factors:

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[42] 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 4.6 % of GDP, while the MF SR estimate is 4.2 % of GDP. The difference is attributable to the differing views of both institutions on the revenues from dividends and on the cyclical component of the budget as a consequence of the slightly different output gap estimates.

[43] The MF SR included the impact of changes in taxes and of the reclassification of new entities into the general government sector. On top of these changes, the CBR has also included the impact of changes in non-tax revenues and other methodological impacts. See Annex 4 for more information.

- The CBR has estimated[44] the expenditures financed from EU funds for those entities which were classified within the general government sector, but were not submitting the defined financial statements to the Ministry of Finance before being included in that sector (the ŽSR railway company (transport infrastructure), the NDS national motorway company, the ZSSK railway company (passenger transport), urban transport companies, hospitals). In its estimate, the Ministry used the data from available financial statements. As regards new general government entities, the uptake of EU funds was reflected in the final data as late as when the new entity submitted the defined financial statement[45] to the Ministry of Finance.
- The differences are also based on the breakdown of expenditures between investments and other expenditures. The CBR has used the financial statements for the state budget, because all financial resources from EU funds are transferred through the state budget. Any investments implemented under the state budget chapters and any capital transfer to other general government entities were treated as an investment. The Ministry of Finance did not provide more details concerning the method applied in breaking down the expenditures.

Tab 8: Estimate of expenditures financed from the EU budget (€ million)

	2009	2010	2011	2012	2013	2014	2015
1. CBR							
Expenditures from EU funds in the GG sector	895	870	1 034	1 059	1 232	1 295	2 793
- investments (GFCF)	585	669	877	888	983	995	2 352
- other, mainly current expenditures	310	200	156	171	249	301	441
2. MF SR							
Expenditures from EU funds in the GG sector	660	650	793	805	809	1 195	2 600
- investments (GFCF)	528	520	648	637	576	1 097	2 157
- other, mainly current expenditures	132	130	146	168	233	98	443
3. Differences (1-2)							
Expenditures from EU funds in the GG sector	**235**	**219**	**240**	**254**	**424**	**101**	**194**
- investments (GFCF)	**57**	**149**	**230**	**251**	**408**	**-102**	**195**
- other, mainly current expenditures	**178**	**70**	**10**	**3**	**16**	**203**	**-2**

Note: GFCF - gross fixed capital formation *Source: CBR*

A significant difference in the approach of both institutions that resulted in different final evaluations boils down to the **inclusion of additional relevant factors** (Table 9).

44 The CBR's estimate is based on data concerning state budget expenditures which the Ministry of Transport (as the managing authority for the Operational Programme 'Transport') and the Ministry of Health (the managing authority for the Operational Programme 'Healthcare') provided to the above entities from the Structural Funds and the Cohesion Fund. Assuming that the neutral impact of resources from EU funds on the general government balance is maintained, the revenues of the above entities from EU funds should be equal to expenditures financed from EU funds.

45 For instance, the National Highway Company submitted the financial statements to the Ministry of Finance in 2015 for the first time; however, based on the decision concerning its classification within the general government sector of October 2014, the company has been included in the sector since 2005.

Among additional factors, the Ministry did not include the impact of measures that improved the structural balance in the medium term (**changes in the fully-funded pillar of the pension system**) but are expected to result in higher general government expenditures in the long term, and the **impact of revenue windfalls**. At the same time, the potential negative impact of **corrections in the drawing of funds still available under the second programming period in 2015** was not mentioned in the Ministry's evaluation.

Another difference is caused by the **inclusion of co-financing expenditures** given their strong increase in 2015. The Ministry took into account the effect of increased expenditures in both indicators[46], without examining other impacts of the faster absorption of EU funds on public finances. The CBR believes that the effect of increased co-financing expenditures on the structural balance approaches zero, because the higher year-on-year drawing of EU funds associated with a surge in co-financing expenditure will be reflected in higher tax revenues due to improved macroeconomic development. As far as adjusted expenditures are concerned, it is reasonable to take into account the development in co-financing expenditures, in particular due to additional revenues resulting from a better macroeconomic development.

At the same time, the Ministry of Finance also took into account the fact that the **deadline for meeting the medium-term budgetary objective** has been postponed by two years. When considering the less stringent path towards the medium-term objective, the Ministry of Finance sees the deviation in 2015 as temporary, without describing it as a significant one. According to the CBR, this factor is not relevant because the change in the adjustment path will only affect the evaluation for 2016.

Tab 9: List of additional factor taken into account in the assessment

	CBR		MF SR	
	ΔSB	EA	ΔSB	EA
Factors affecting reported data (April 2016, EDP notification):				
Measures not affecting long-term sustainability	Y (-)	Y (-)	N	-
Interest expenditures	Y (0)	-	N	-
Windfall revenues	Y (-)	-	N	-
Expenditures on co-financing of EU funds	-	Y (+)	Y (+)*	Y (+)*
Increased effectiveness of tax collection	-	Y (+)	-	Y (+)
One-off impact of financial corrections	-	Y (+)**	-	Y (+)
Other potential changes in reported data:				
Updated tax revenue forecast (June 2016)	Y (+)	-	Y (+)	-
Potential future financial corrections	Y (-)	-	N	-
Other factors:				
Debt brake sanctions	Y (-)	Y (-)	N	N
Postponed MTO deadline	N	N	Y (+)	Y (+)

[46] The change in co-financing expenditure has been taken into account by the Ministry of Finance in the years 2014 and 2015, which has improved both indicators in comparison with a situation where the impact of the change in expenditure in 2013 would also be taken into account (in 2013, the expenditure-to-GDP ratio dropped year-on-year). The Ministry did not justify this approach.

Note: ΔSB - change in structural balance, EA - expenditure aggregate; Y - included, N - not included among the additional factors; (+) improves and (-) worsens the particular indicator, (0) approximately neutral impact

** Included only in 2014 and 2015*

Source: MF SR, CBR

*** Included in the methodology of calculation of the expenditure aggregate.*

Box 2: Expenditures fully matched by EU funds revenue

In evaluating the expenditure benchmark, general government expenditures are adjusted for expenditures fully matched by EU funds due to their expected neutral impact on the general government balance. In order to do so with the use of correct methodology, it is necessary to compile a time series for the years between 2009 and 2015, with expenditures broken down into investments and other expenditures. However, such a time series cannot be compiled from statements (the FIN-1 statement containing a breakdown of cash expenditures of entities by economic and source classification) which are submitted by general government entities to the Ministry of Finance for the purposes of quantifying the general government balance under the ESA2010 methodology. The reasons are threefold:

- The statements for all entities which are currently included in the general government sector and are drawing EU funds are not available. Several entities have been classified with the general government sector between 2009 and 2015 and incurred the liability to submit the defined statements to the Ministry of Finance in the period following the decision on their inclusion in the sector. Because a majority of these entities were included in the sector retroactively (for the years preceding the date of the decision on their inclusion), no statements are available for this period. The CBR has estimated the data on the basis of information on transfers granted from the state budget to selected entities (NDS, ŽSR, ZSSK, transport companies, hospitals) and financed from EU funds, while assuming that these entities had spent an identical amount of expenditures in that year.
- Not all of entities that were submitting the statements were[47] under an obligation to provide a classification of their revenues and expenditures by source. Exemptions were applicable, for instance, to NDS, ŽSR and ŽSSK which are drawing relatively high volumes of expenditures financed from EU funds. The CBR has estimated the data on the basis of information on transfers granted from the state budget to these entities and financed from EU funds, while assuming that these entities had spent an identical amount of expenditures in that year.
- In individual years, EU funds may not necessarily have a neutral impact on the general government balance – in compiling the general government balance under the ESA2010 methodology, the cash difference between state budget revenues and expenditures from EU funds is offset by a change in the amount receivable from the EU budget. This will ensure a neutral impact of EU funds on the state budget balance (i.e., at the level of paying units). The final beneficiaries of a portion of such funds are other general government entities, which means that the funds will be transferred from the state budget into these entities. In their case, there may be a time mismatch between revenues and expenditures financed from EU funds (for instance, due to the refund of expenditures that have already been incurred) that is not adjusted ex post, which means that the impact on the general government balance might not be neutral in a given year. Due to the missing data (point 1 and 2), the CBR assumed a neutral impact of EU funds on the general government balance.

[47] By an amendment to MF SR decree laying down the format, content, method, deadline and place of submission of accounting information and data necessary for the assessment of the general government budget execution, effective from 30 April 2016, all general government entities that are required to submit the FIN-1 statement must present the revenues and expenditures by source classification.

The introduction of the obligation to submit the source classification of revenues and expenditures for all general government entities will increase the quality of available data on the absorption of EU funds. In addition, however, the CBR believes that making additional changes would also be advisable:

- to collect, in addition to calculating the overall revenues and expenditures under the basic ESA2010 classification items, also the data based on source classification when including in the general government sector a new entity that is drawing EU funds.
- to verify whether the current method of recording EU funds in the general government sector leads to significant positive or negative impacts on the general government balance in individual years. In the event of significant impacts, it is advisable to consider modifications in the current methodology so as to ensure a neutral impact of financial resources from the EU funds on the general government balance.

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 should be put in place by individual Member States on the basis of common principles published by the European Commission[48]. 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[49] 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[50] 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[51] are minimal, the structural deficit may equal to or be 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[52]. 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

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

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

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

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

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

annual reductions in the general government deficit to gross domestic product ratio based on the recommendations of the Council of the EU. The obligation to trigger the correction mechanism does not apply to periods of exceptional circumstances as defined in the Treaty[53].

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[54], the Ministry of Finance must report twice a year (by 30 June and 30 November[55]) 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).

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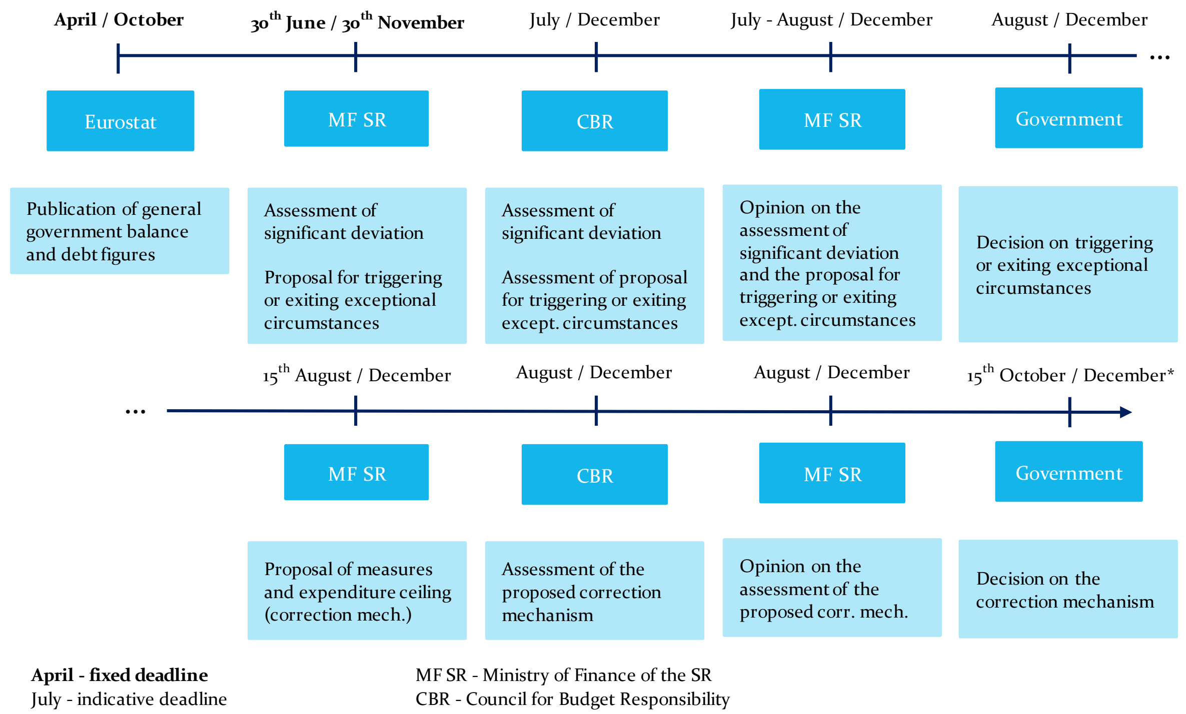
53 Exceptional circumstances are defined in Article 3(3) (b) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

54 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.

55 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

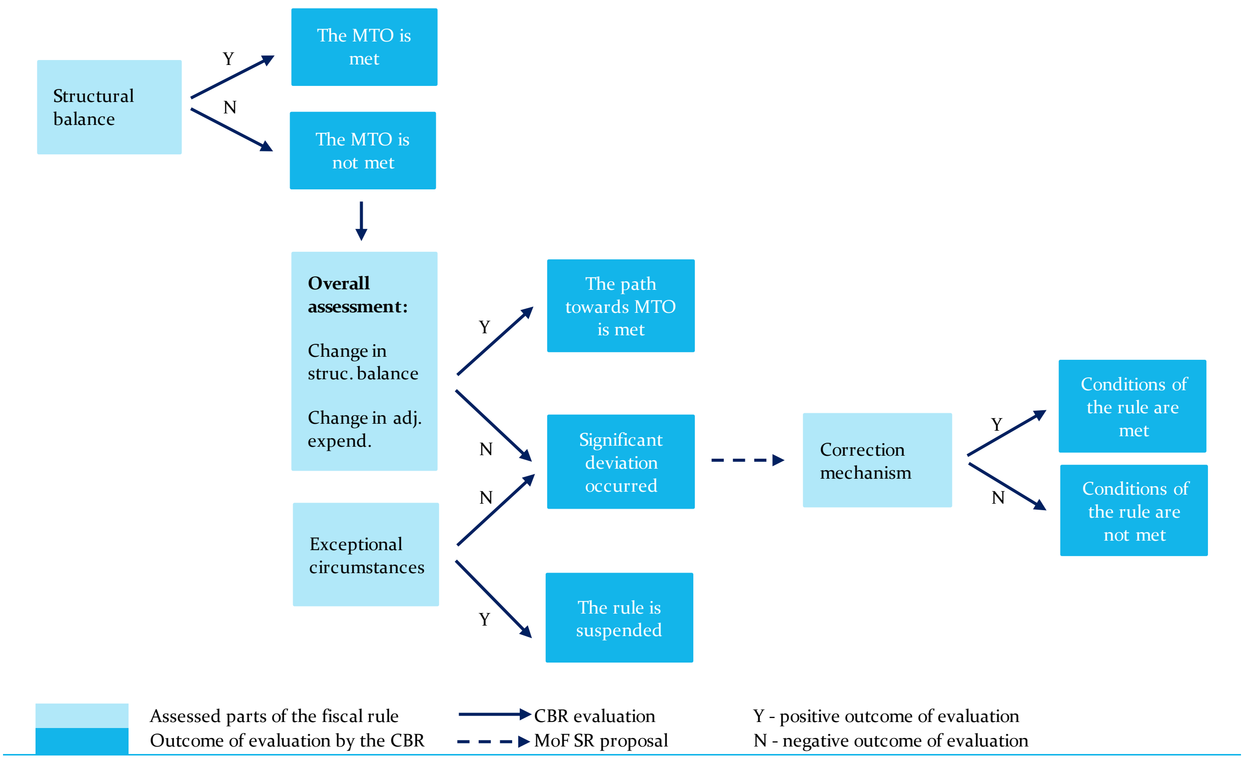


*Note: * Due to a short time period between the publication of the assessment of the significant deviation by the Ministry of Finance (deadline until the end of November) and the end of the year, the proposed measures might be incorporated in the following year, either via an amendment of the adopted 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 2015 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** between 2013 and 2015 against the required cumulative 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 part describes the one-off measures which have been taken into account in evaluating compliance with the balanced budget rule.

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, the balance of the advance payment will be reduced every year by an aliquot portion amounting to EUR 5.79 million. This amount will have a negative effect on the general government budget 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 career, 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 career. The negative impact on the budget of the one-off retroactive disbursement of pensions based on the above-mentioned court ruling reached EUR 58.5 million.

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 (revision of the 1995-2013 GNP time series) and the deadline for payment by Member States has been set to 1 December 2014 and 1 September 2015, respectively. In the case of Slovakia, the revised amount of the transfer had a positive impact on the 2014 general government balance in the amount of EUR 57.8 million.

5. **Financial corrections to EU funds** – Due to irregularities identified in the spending of EU funds, the costs of certain projects are not reimbursed from EU funds despite the fact that Slovakia has already received the corresponding EU allocation or the costs have been pre-financed from the national budget. Once a financial correction is assessed and accepted, it has a negative impact on the balance; some of these corrections relate to projects implemented in previous years. Their impact reached EUR 139.9 million in 2014 and EUR 180.0 million in 2015[56].

[56] The actual amount of financial corrections to EU funds reached EUR 209.0 million in 2014 and EUR 304.3 million in 2015. The amount of corrections presented in this document was taken from documents provided by the Ministry of Finance, where the impact of corrections in individual year is identified as a difference between the officially recorded correction affecting the balance and the analytically adjusted correction (correction assigned to the year in which it originated).

6. **Accrualisation of VAT revenues** - ESA2010 uses the method of accrued cash receipts based on which cash receipts are attributed to individual periods with a fixed time lag. This approach, however, does not fully reflect the reality, particularly when it comes to excess tax refunds. Tax audits and the related suspension of excess tax refunds may significantly influence VAT accrual receipts under ESA2010. Due to this, the positive impact on VAT receipts amounted to EUR 104.5 million in 2013 and a negative impact on VAT receipts reached EUR 34.7 million in 2014. The positive impact in 2015 was quantified at EUR 6 million.

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.** [57] – On 4 March 2009, the government approved the use of state financial assets for the provision of a 'repayable financial assistance' to Cargo Slovakia a.s. in the amount of EUR 166 million, which had a negative impact on the budget in 2009. Under a contract with the Ministry of Finance and the Ministry of Transport, Post and Telecommunications, Cargo used the assistance to finance its payroll and personnel expenditures, charges for the use of the railway infrastructure, and its own financial expenses. The payment of interest was set to begin in 2009, the payment of principal in 2011, and the entire loan matures in 2016. In 2014, the instalment paid to the budget had a positive impact on the balance at EUR 20 million.

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 ESA2010 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[58]; unlike in the last evaluation, the list of the one-off measures taken into account by both institutions is now identical.

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57 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.

58 For the purposes of assessing the balanced budget rule, the MF SR takes into account one-off effects in line with the national methodology which is slightly different from that used by the CBR (differing views on, for example, the legal force or substance of certain transactions). 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 2016-2019) takes into account only those measures which are in line with the Commission's interpretation of one-off measures.

Tab 10: One-off measures in 2013-2015 (ESA2010, € mill.)

	2013	2014	2015	2013	2014	2015	2013	2014	2015
	CBR			MF SR			difference		
- VAT receipt from a PPP project (Granvia)	-6	-6	-6	-6	-6	-6	0	0	0
- digital dividend	-	164	-	-	164	-	-	0	-
- retroactive disbursement of pensions in the armed forces	-8	-58	-	-8	-58	-	0	0	-
- adjusted amount of transfer to the EU budget	-	58	-	-	58	-	-	0	-
- financial corrections to EU funds	17	-140	-180	17	-140	-180	0	0	0
- accrualisation of VAT revenues	104	-35	6	104	-35	6	0	0	0
- penalty imposed by the Antimonopoly Office	-	45	-	-	45	-	-	0	-
- repayment of loans provided to Cargo, a.s.	20	20	-	20	20	-	0	0	-
- repayment of loans provided to Vodohospodárska výstavba	30	48	-	30	48	-	0	0	-
TOTAL	**158**	**95**	**-180**	**158**	**95**	**-180**	**0**	**0**	**0**
(% GDP)	*0.2*	*0.1*	*-0.2*	*0.2*	*0.1*	*-0.2*	*0*	*0*	*0*

Source: CBR, MF SR

Annex 4 - Expenditure benchmark – methodology and data

The adjusted expenditure and the expenditure benchmark are calculated, subject to some differences, in line with the procedure laid down in the Stability and Growth Pact[59]. The purpose of these differences is to make the calculation of this indicator more precise and to narrow the existing differences between the structural balance and the 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.
- **Inclusion of methodology impacts on the level of revenues and expenditures** - these are the impacts which, due to the methodology of recording in the national accounts, may lead to changes in revenues and expenditures between individual years without any government intervention (social and health insurance contributions paid by the state, reclassification of general government entities). The list of impacts in individual years is presented in Table 12.
- **Exclusion of one–off effects** – as is the case with the structural balance which is adjusted for all one-off effects, the adjusted expenditure development has also been adjusted for one-off revenue measures and all one-off effects on the expenditure side. The CBR has chosen this approach in order to prevent the occurrence of unjustified differences between the structural balance and adjusted expenditure, because one-off effects distort the government's fiscal performance.
- **Exclusion of cyclical expenditure on pensions** – this change reflects the fact that, in estimating the cyclical component of the general government balance, the CBR also estimates cyclical expenditure on pensions. The CBR has thus aligned its approach to that used in estimating the structural balance.

The elimination of the double netting out of investments financed from EU funds from the expenditure represents the only methodological change in comparison with the December 2015 evaluation. Under the hitherto procedure, the total expenditure was adjusted for the expenditure financed from EU funds (including investments) and for the average value of total public capital expenditure (including EU funds). After the change, the total expenditure now excludes expenditure financed from EU funds and the average value of nationally-funded public capital expenditure (i.e., excluding EU funds). An identical change in methodology can also be found in the rules of the Stability and Growth Pact. The availability of data on general government expenditures financed from the EU budget and their breakdown to investments (gross fixed capital formation) and other expenditures are essential to introducing this change. Considering the limited availability of data due to the transition to ESA2010 (reclassification of entities which implement investments financed from EU funds) and the current data collection

[59] 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).

setup (several entities not reporting the expenditures by source of funding), the CBR has estimated the data on the basis of State Treasury reports and the data in the MF SR Budgetary Information System (Table 11)[60].

Tab 11: CBR´s estimate of expenditures financed from the EU funds (€ million)

	2009	2010	2011	2012	2013	2014	2015
EU funds in the GG sector	**895**	**870**	**1 034**	**1 059**	**1 232**	**1 295**	**2 793**
- financial statements reported in the State Treasury*	660	653	793	807	818	1 196	2 600
- additionally included GG entities (data from BIS)	235	216	240	252	415	99	194
Investments (GFCF) from the EU funds in the GG sector	**585**	**669**	**877**	**888**	**983**	**995**	**2 352**
- financial statements reported in the State Treasury*	349	453	637	636	569	895	2 158
- additionally included GG entities (data from BIS)	235	216	240	252	415	99	194

** includes also GG entities which were at the time of data reporting outside the general government sector*
Note: GFCF - gross fixed capital formation, BIS - Budgetary Information System *Source: State Treasury, BIS of the MF SR*

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, one-off measures and expenditures on joint projects financed from the EU budget), 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. The other (mainly non-tax) measures are estimated by the CBR on the basis of its no-policy-change scenario. The following table contains a list of the discretionary revenue measures for 2012 to 2015 whose additional y-o-y change was used as an input in the calculation of the adjusted expenditure aggregate development.

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

	total effect				additional effect		
	2012	2013	2014	2015	2013	2014	2015
1. Discretionary measures (excluding one-offs)	**242**	**1 471**	**77**	**80**	**1 257**	**-21**	**70**
Introduction of a special levy in the banking sector	74	-	-	-	-	-	-
Abolition of tax on emission allowances	-32	-	-	-	-	-	-
Decrease of contributions to the fully-funded pillar of pension	149	507	-	-	338	-	-
Extension of a special levy in the banking sector*	23	92	-	-	61	-	-
Levy on enterprises in regulated industries*	31	64	-	-	48	-64	-
Increasing the excise tax on tobacco	-	16	-	-	16	-	-

[60] The amounts financed from EU funds are recorded in general government revenues and expenditures only if their final beneficiary is a general government entity. Where an entity, which is drawing EU funds, is retroactively classified within the general government sector (for instance, in September 2014, due to the transition to the ESA2010 methodology, the National Highway Company was classified within the general government retroactively since its establishment in 2005), the general government revenues and expenditures financed from EU funds should increase automatically. However, such data is not available because, at the time when expenditure was effected by the entity concerned, it was not obliged to submit statements to the Ministry of Finance in the required structure (at that time it was not a general government entity). Therefore, the CBR estimated the data on the basis of funds provided from the state budget from EU sources to such entity through the relevant operational programme (which, in the case of NDS, is the Operational Programme 'Transport').

Increasing the vehicle registration fee*	6	27	-	-	21	-	-
Increasing other administrative fees (excl. the vehicle registration fee)	-	28	-	-	28	-	-
Changes in taxation of gambling	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)	-	-13	-	-	-13	-	-
Changes in income tax rates - CIT 23%, PIT 19% and 25%	-	385	-	-	385	-	-
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	-	-
Grant from JAVYS (state-owned nuclear decommissioning	-	30	10	-	30	-20	-10
Repayment of loan by Cargo (state-owned railway freight company)	-10	-	-	-	10	-	-
Social contributions relief for long-term unemployed	-	-	-4	-	-	-4	-
Extension of levy in regulated industries	-	-	75	-	-	75	-
Automatic decrease of rate of special levy in the banking sector	-	-	-42	-	-	-42	-
Introduction of licence fees for corporations	-	-	82	-	-	82	-
Decrease in the CIT rate from 23% to 22%	-	-	-95	-	-	-95	-
Change in rules of amortization of losses	-	-	37	-	-	37	-
Change in taxation of nonfinancial compensation (using company car)	-	-	-8	-	-	-8	-
Increase of administrative fees	-	-	23	-	-	23	-
Changes in health contributions paid from dividends	-	-	0	-8	-	0	-8
Automatic decrease of rate of special levy in the banking sector	-	-	-	-42	-	-	-42
Changes in depreciation rules for tax purposes	-	-	-	123	-	-	123
Extension of obligation to maintain records of revenues in electronic cash registers	-	-	-	54	-	-	54
Withholding income tax on financial and in-kind benefits from pharmaceutical companies	-	-	-	2	-	-	2
Introduction of thin capitalisation rules	-	-	-	47	-	-	47
Deduction of R&D expenditure from tax base	-	-	-	-24	-	-	-24
Audit of tax expenditures	-	-	-	12	-	-	12
Health contribution allowance	-	-	-	-56	-	-	-56
Change in administrative fees	-	-	-	-17	-	-	-17
Opening of the second pension pillar	-	-	-	16	-	-	16
Less stringent conditions related to VAT excessive deductions	-	-	-	-29	-	-	-29

2. Change in methodology (additional effects)	**7**	**6**	**153**
Changes in imputed social contributions	22	12	17
Changes in insurance contributions paid by state	-14	-86	136
Inclusion of public transport companies to the general government sector	-	80	-
Total (1+2)	**1 265**	**-15**	**223**
*p.m. Measures with no impact on the long-term sustainability***	*399*	*-42*	*-26*

** 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

*** Measures with no impact on long-term sustainability are marked in blue.*

Annex 5 - Differences between the structural balance and adjusted expenditure development

The structural balance and the adjusted expenditure aggregate 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 from 2013 to 2015, with both indicators reaching different values over this period (0.1 % versus 1.9 % of GDP). There are differences between the values of indicators in individual years; however, only in 2014, the deviation between both indicators is minimal.

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

	2012	2013	2014	2015	cumulatively (2013-2015)
1. Primary expenditure aggregate	**27 278**	**28 087**	**28 567**	**30 589**	
2. Year on year change in primary expenditure aggregate *(1_t-1_{t-1})*		809	479	2 023	
3. Change in revenues due to discretionary measures and methodology of national account reporting		1 265	-15	223	
4. Nominal growth of expenditure aggregate adjusted for changes in revenues *((2_t-3_t)/1_{t-1})*		-1.7	1.8	6.3	
5. Year on year change in GDP deflator		0.5	-0.2	-0.3	
6. Real growth of expenditure aggregate adjusted for changes in revenues (4-5)		**-2.2**	**1.9**	**6.6**	
7. Potential GDP growth		**2.0**	**1.9**	**2.7**	
8. Impact of change in expenditures on the balance ((7_t-6_t)*1_{t-1}/GDP$_t$)		**1.5**	**0.0**	**-1.4**	**0.1**
p.m. Change in structural balance		*2.16*	*-0.13*	*-0.13*	**1.9**

Source: CBR, SO SR, MF SR

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

- **Deviation of actual investments from the four–year average** – while the structural balance takes into account the amount of investments in a given year, the adjusted expenditure reflects the average amount of investments in the past four years. If a significant change occurs, either as a consequence of consolidation or increase in investment activity, it cannot always be identified as having a one-off nature and 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 and 2015 when investments soared, bringing the two indicators 0.6 p.p. and 0.5 p.p. apart in 2014 and 2015, respectively.
- **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[61].

- **The rate of revenue growth above 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. Between 2013 and 2015, this factor explained a significant portion of the difference between both indicators (with contributions ranging from 0.6 p.p. to 1.7 p.p.). This may include the impact of increased effectiveness in tax collection, tax revenue windfalls, as well as a higher increase in tax revenues due to accelerated absorption of EU funds, provided that this growth is not fully reflected in increased potential growth.
- **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 adjusted expenditure and the rate of growth in revenues at the rate of the potential output growth. 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 to 2015, 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 each year (approximately by 0.1 p.p. per year) because the estimated growth in revenues was higher than the reality.
- **Impact of nominal GDP growth** – the calculation of the rate of growth in the adjusted expenditure is based on the sums expressed in euros and does not take into account the impact of the annual change in nominal GDP (the so-called 'denominator effect'[62]). The structural balance indicator already reflects this impact because it is calculated based on the annual change in individual items expressed in relation to GDP.

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

	2013	2014	2015	cumulatively (2013-2015)	trajectory
Change in adjusted expenditures (impact on the balance)	**1.54**	**-0.03**	**-1.41**	**0.10**	**2.46**
(+) Deviation of actual investment from average	0.01	-0.61	-0.50		
(+) Development of interest payments	-0.14	-0.08	0.06		
(+) Actual revenue growth beyond potential growth	0.78	0.60	1.72		
(+) Inaccuracy in the calcul. of the impact of revenue growth	-0.12	-0.08	-0.09		
(+) Impact of GDP growth (denominator effect)	0.09	0.06	0.08		
Change in structural balance	**2.16**	**-0.13**	**-0.13**	**1.90**	**2.46**

Source: CBR

[61] 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'.

[62] 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.

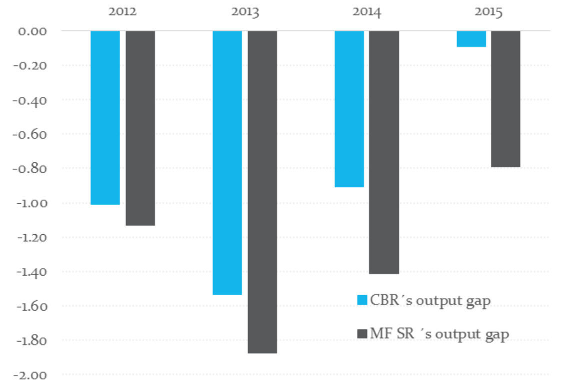
Annex 6 – The difference in cyclical component between the CBR and MF SR

This chapter explains the difference in estimates of the cyclical component and the output gap[63] between 2012 and 2015 based on the methodology applied by the CBR and the Ministry of Finance. In order to estimate the cyclical component of the structural balance, the CBR uses the so-called disaggregated approach[64] where individual revenue and expenditure items are directly linked to the trends in individual macroeconomic bases. The Ministry of Finance applies the same procedure in evaluating the balanced budget rule and uses the output gap estimate published in the Macroeconomic Forecasting Committee[65] as an input in the calculation of the cyclical component. As regards the calculation itself, the deviations from equilibriums are first computed for each macroeconomic base and the overall cyclical component is then calculated using the estimated budgetary elasticities.

The final estimate of the cyclical component is influenced by elasticities used, **gaps estimated in macroeconomic bases** and **input fiscal data adjusted for the government sector[66]**, where slight differences between both institutions exist. In the CBR's calculation of the output gap which affects further calculation of macroeconomic gaps, several output gap[67] estimates are used as an input. The Ministry's estimate of the cyclical component is solely based on its own estimate of the output gap. Figure 5 shows that the output gap estimates by both institutions follow the same trend, albeit with different values in individual years, whereas the highest difference between the estimates occurred in 2015. The difference in output gap estimate in 2015 was automatically reflected in the estimate of macroeconomic bases, with the highest difference in the estimate of compensations (impact on SSC, PIT and pensions) and private consumption (indirect taxes). In the period from 2012 to 2015, the difference in the cyclical component estimate by the CBR and the MF SR represents 0.15 % of GDP on average.

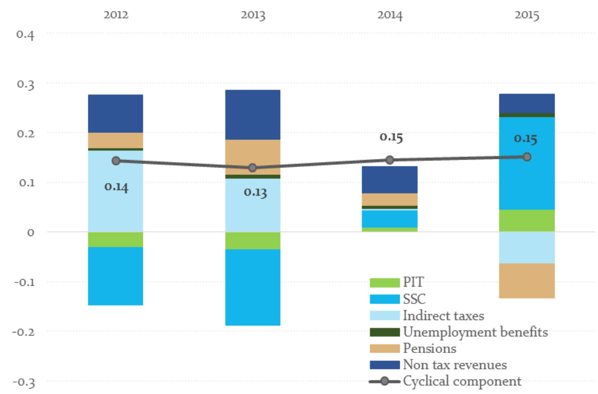
63 For details, please consult the CBR's document: Finding Yeti (2014)
64 For details, please consult the CBR's document: The „True" Deficit (2014)
65 An estimate reflecting the specificities of the Slovak economy and the methodology recommended by the European Commission
66 It is assumed that the government sector doesn´t respond to economic cycle fluctuations, so fiscal data (individual tax revenue and expenditure items) are for this reason adjusted for the government sector and the final calculation uses private sector only as an input.
67 National Bank of Slovakia´s output gap estimate, European Commission, MF SR estimate – national methodology, the CBR's own estimates (multivariate Kalman filter, principal component analysis (PCA) and a simple Hodrick-Prescott filter).

Figure 5: Output gap according to CBR and MF SR in 2012-2015 (ESA2010, % pot. GDP)



Source: CBR, MF SR

Figure 6: Difference in the cyclical component estimate in individual items (CBR vs. MF SR) in 2012-2015 (ESA2010, % GDP)



Source: CBR, MF SR

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