CBR
COUNCIL FOR BUDGET RESPONSIBILITY

2016 General Government Budget Results

Summary results

(based on the April notification of deficit and debt)

May 2017

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This report presents the official positions of the Council for Budget Responsibility in line with its mandate laid down in Act No. 493/2011 on Fiscal Responsibility.

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.

Summary

The 2016 general government deficit reached 1.68 % of GDP and, unlike in 2014 and 2015, the budget target set at 1.93 % of GDP has been met. Adjusted for the impact of the economic cycle and temporary effects, structural deficit reached 1.9 % of GDP and improved by 0.8 % of GDP year-on-year. Also thanks to one-off revenues, gross debt reached 51.9 % of GDP, 0.2 % of GDP below the budgeted forecast, and remained in the first sanction zone under the debt rule.

At the time of its approval, the budget contained risks with both positive and negative impacts. The deficit fell below the budgeted level thanks to the positive effects amounting to 2.4 % of GDP, mainly due to higher tax revenues, lower expenditures on co-financing and transfers to the EU budget, as well as better fiscal performance of municipalities. On the other hand, the total impact of negative effects on the general government budget reached 2.1 % of GDP. Most of the negative risks identified by the CBR have materialised indeed, even beyond the original estimates. The most significant negative risks included in particular shortfalls in revenues from the sale of CO2 allowances, financial corrections to EU funds, or higher expenditures in the healthcare sector. Moreover, the government implemented additional expenditures, which were partly financed from the budgeted reserves. The risks related to capital expenditures of municipalities have not materialised. The risk associated with extraordinary dividends[1] still remains; the CBR quantified it at EUR 156 million. If this risk is being confirmed in the autumn notification[2], the deficit could rise by 0.2 % of GDP[3].

The 2016 budget results suggest several main conclusions:

On the side of expenditures and non-tax revenues, the budget consistently contains significant risks identified by the CBR already at the time of its approval. Similarly, as between 2013 and 2015, these risks were offset in 2016 thanks to positive effects, many of which were of temporary nature: better-than-expected economic development compared to the budget, temporarily lower drawing of EU funds, windfall revenues from dividends and the lowest capital expenditures of municipalities since 2004. Although this approach may work on a short-time basis, a truly credible fiscal policy requires that the most significant risks being considered already at the stage of budget preparation.

One-off effects have been contributing to the gross debt reduction since 2014. **From the perspective of the entire public sector, such debt reductions do not improve the net worth of Slovakia.** The decline in general government debt in 2016 is offset by lower receivables and higher liabilities towards the EU budget (reimbursement of projects implemented in the past and the provision of advance payments) and by the decline in the value of companies with capital participation of the state (eustream/SPP).

In 2016 a significant change in the structure of state budget expenditures arose. While the use of reserve funds and other savings to finance additional expenditures in the amount of 0.7 % of GDP made the budget management more flexible, it opened doors to spending the revenues generated by positive effects to finance additional expenditures as well. **It is advisable to amend the legislative framework in a way that will reinforce the binding nature of the approved budget, while also setting the rules for the creation and use of reserve funds.**

1 This involves the received dividends derived from profits earned due to the revaluation of assets.

2 More precise data on the government's fiscal performance for 2016 will be published by the Statistical Office of the Slovak Republic and by Eurostat as part of the October notification of deficit and debt. In addition to the revised quantification of extraordinary dividends, other items may be subject to changes as well, such as the amount of tax revenues, receivables and liabilities.

3 The dividends from the revaluation of assets or retained profits beyond the scope of regular operating profit should be treated, under the ESA2010 methodology, as superdividends without a positive impact on the balance of the budget.

The expenditure ceilings, whose introduction is also foreseen by the Fiscal Responsibility Act, represent the most suitable instrument.

The development in 2016 has confirmed the negative risks identified by the CBR in terms of attaining the budgetary objectives for the years 2017–2019[4], in particular the lower-than-budgeted revenues from the sale of CO_2 allowances and higher expenditure growth in the healthcare sector. There is still some uncertainty related to capital expenditures development of municipalities and one-off revenues from dividends. However, taking into account the positive effects on the budget in 2017, in particular the higher tax revenues, the overall impact of risks identified by the CBR with respect to reaching a budgeted deficit of 1.29 % of GDP in 2017 is thus lower than the previous estimate.

4 CBR, Addendum to the Evaluation of the General Government Budget for 2017-2019, December 2016.

Summary results

On 24 April 2017, Eurostat released the general government deficit and debt figures for 2016. This is the first set of data (April notification) to be revised in the autumn (October notification).

The budget, as approved, anticipated a deficit reduction from the estimated 2.74 % of GDP in 2015[5] to 1.93 % of GDP in 2016. Gross debt was expected to decline by 0.7 % of GDP to 52.1 % of GDP. Compared to the actual deficit of 2.74 % of GDP in 2015, preliminary data suggest that the deficit dropped by 1.1 % of GDP to 1.68 % of GDP. The debt declined to 51.9 % of GDP, which is 0.2 % of GDP below the budget forecast and 0.5 % of GDP below the 2015 debt level.

Compared to the approved budget for 2016, the deficit has improved by 0.25 % of GDP. The total sum of positive effects on the general government balance reached EUR 1.9 billion (2.4 % of GDP)[6].

- Compared to the budget, **tax revenues were higher** by EUR 721 million (0.9 % of GDP)[7]**.** In terms of structure, this improvement is attributable particularly to social security and health insurance contributions, corporate income tax and personal income tax. On the other hand, lower revenues were seen in the value-added tax.
- Concerning non-tax revenues, the balance also improved thanks to higher **receipts from gambling**, **revenues from cancelled bearer deposits** and **other non-tax revenues of the state budget,** with the total impact reaching EUR 123 million (0.2 % of GDP).
- **Expenditures on national co-financing of EU funds and lower transfers to the EU budget** have contributed to the reduction in expenditures by EUR 260 million (0.3 % of GDP). Regarding lower co-financing, the net positive effect is, however, less prominent because the lower absorption of EU funds in comparison with budget assumptions also had an impact on lower tax revenues in tens of millions of euros[8].
- **Lower spending on social benefits,** particularly the material need benefit, contributed to the reduction in expenditures by EUR 77 million (0.1 % of GDP). The significant reduction was due the fact that the favourable development in 2015 has not been taken into account at the stage of budget preparation.
- As far as other entities are concerned, the **municipalities, public universities and the Railway Company of the Slovak Republic** have significantly outperformed their budgets, and their overall contribution to an improved balance reached EUR 297 million (0.4 % of GDP)[9].
- The additional expenditures of the state budget were covered by **budgeted reserves** with effects totalling EUR 443 million (0.5 % of GDP)[10].

The negative effects were 0.2 % of GDP below the positive ones and reached EUR 1.7 billion (2.1 % of GDP). In its evaluations, the CBR pointed out most of the sources of negative effects.

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5 The deficit target for 2015 was 2.49 % of GDP.

6 The document presents analytically adjusted contributions to the change in the balance. Therefore, the individual effects might not necessarily correspond to the data specified in the Final State Budgetary Account of the Slovak Republic for 2016. The document presents and draws on data based on the economic classification of the budget.

7 The impact of tax revenues has been analytically adjusted, taking into account the reduction in the VAT base rate (as reflected in the budget expenditures), the impact of 2% of income tax collected on expenditures on public purpose, tax credits and guarantee insurance.

8 The amount of this effect depends on the specific use of European funds and is included in the effect through other than budgeted macroeconomic development.

9 The list contains only the most important entities without the impact of tax revenues, which are presented separately, and other adjustments (such as internal transfers with no impact on the resulting general government balance).

10 The total amount of reserves in the envelope of the General Treasury Administration was budgeted at EUR 738 million. The reserves for wages, Slovakia's EU presidency and the reduction of the VAT base rate on foodstuffs were excluded from this amount, as they were used in line with their strictly defined purpose.

- The shortfall in non-tax revenues reached EUR 103 million (0.1 % of GDP). The revenues from the **sale of CO2 allowances** were lower by EUR 52.2 million due to lower market prices. The 2016 budget assumed income from a **loan instalment payable by the Cargo company in the amount of EUR 19.5 million**. However, in 2015 Cargo also paid the instalment planned for 2016, thus redeeming the whole loan. The planned, yet unrealised **sale of the government's redundant property** caused that capital revenues were EUR 30.5 million below the expectation.

- The budget did not expect **financial corrections to EU funds**, even though this particular risk was identified back in 2015 when the budget was prepared. The total amount of financial corrections reached EUR 225 million (0.3 % of GDP).

- The most significant negative effect is attributable to **additional expenditure of the state budget**. In addition to an increase in wages in public administration and expenditures for the preparation of Slovakia's EU presidency which were financed from the respective reserves, the government implemented additional expenditures in the total amount of EUR 543 million (0.7 % of GDP). These expenditures were financed by reallocating funds from the remaining reserves and other savings in the budget that were not spent.

- The risk identified by the CBR in the **healthcare sector** has been confirmed and the negative effect attributable to higher expenditures stood at EUR 276 million (0.3 % of GDP). This was mainly due to higher expenditures of health insurance companies on healthcare provision, which rose 6.2 % year-on-year as compared to a 1.1 % increase envisaged in the budget. Persistent deficits in the budgets of hospitals also contributed to the worse outcomes.

- The **Social Insurance Agency's expenditures** on benefits have increased against the budget by EUR 53 million (0.1 % of GDP), which is attributable to an increase in expenditures on unemployment benefits and sickness benefits (sickness and maternity benefits).

- The effect of additional expenditures associated with the **purchase of land and landscaping works** for the Nitra-Mlynárce industrial park and the D4/R7 PPP project was significant as well, exceeding the budget by EUR 280 million (0.3 % of GDP).

- The **fiscal performance of other entities and other unspecified factors** had an overall negative impact of EUR 246 million (0.3 % of GDP). This includes, mainly self-governing regions, the Environmental Fund, the MH Manažment company and the National Highway Company. The effect of general government entities not included in the budget[11] (particularly due to their classification in the sector) was negligible. Even though the **budgets of self-governing regions** ended up in a surplus, it was below what the budget assumed. This was due to higher current and capital expenditures which increased more than the revenues of self-governing regions. Because expenditures did not exceed the standard level in comparison with previous years, the worsened fiscal performance can therefore be attributed to undervalued budgeting.

From the perspective of contribution to the long-term sustainability of public finances, the figures need to be adjusted for factors which have only a temporary impact on the budget (one-off effects and effects of the economic cycle) and their influence will vanish in the years to come.

[11] Non-inclusion of certain general government entities in the budget is attributable to the fact that no information as to their classification under the general government sector was available at the time of budget preparation (this involves, for instance, the companies JAVYS, MH Invest, MH Invest II).

The thus adjusted balance, also known as "structural balance", shows whether the long-term sustainability of public finances has improved or not. Structural balance reached 1.9 % of GDP and improved by 0.8 % of GDP year-on-year. **After two years of a stagnating consolidation effort, the structural balance thus saw a significant improvement which paved the way for reaching the long- term sustainability of public finances[12].**

Taking into account the actual development in the fiscal performance of the general government in 2016 in comparison with expectations prevailing at the time of budget preparation, there is a risk that the budgetary objective would not be met in 2017. In its evaluation of the approved budget[13] for 2017, the CBR identified several risks concerning non-tax revenues (revenues from dividends and revenues from the sale of CO_2 allowances) and expenditures (healthcare sector, local governments and the state budget). The actual development in 2016 suggests that some of the above risks persist and, as in the case of the healthcare sector, have even increased. At the same time, it is premature at this point to evaluate whether the risks which have not materialised in 2016 (fiscal performance of local governments, dividends) would outlast also in 2017. Additional tax revenues represent a source for the coverage of risks as well. According to the estimate of the Tax Revenue Forecasting Committee from February 2017, the government will collect EUR 176 million more tax revenues than budgeted.

The gross debt of the general government has declined by 0.5 % of GDP year-on-year to 51.9 % of GDP. **Its decline in 2016 was mostly attributable to one-off sources, particularly from the EU funds** (reimbursement of projects implemented in the past and the provision of advance payments) and **extraordinary dividends** in the total amount of EUR 1.2 billion (1.4 % of GDP)[14]. Without them, the debt in 2016 would have risen slightly.

[12] Based on the results from 2016, Slovakia's public finances will be sustainable in the long term if the potential of favourable medium-term economic and demographic conditions is tapped in order to be reaching budget surpluses in the period after 2020 along with a substantial reduction in gross debt (for more details, see CBR, Report on the Long-term Sustainability of Public Finances for 2016, April 2017).

[13] CBR, Addendum to the Evaluation of the General Government Budget for 2017-2019, Chapter 2.

[14] The use of one-off sources for reducing the debt-to-GDP ratio is accompanied by a reduction in receivables, an increase in the liabilities towards the EU budget and a decline in the value of companies with capital participation of the state with no impact on the public sector's net worth.

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The general government deficit has improved by 195 million eur compared to the budget

TAB 1

Tax revenues* — 721 mil. eur — 0.89 % of GDP

Corporate income tax	266	0.33
Personal income tax	139	0.17
Value added tax	-144	-0.18
Social security contributions	265	0.33
Health insurance contributions	126	0.16

Social transfers and benefits — 24 mil. eur — 0.03 % of GDP

Social transfers and benefits paid by the Ministry of Labour	77	0.1
Expenditures of the Social Insurance Agency	-53	-0.07

Selected non-tax revenues — 20 mil. eur — 0.02 % of GDP

Revenues from dividends	-1	0,0
Repayment of a loan by the Cargo company	-20	-0.02
Revenue from the sale of emission allowances	-52	-0.06
Revenues from the sale of capital assets	-31	-0.04
Other non-tax revenues	123	0.15

Transactions with the EU budget — 34 mil. eur — 0.04 % of GDP

Transfers to the EU budget	43	0.05
Expenditures on co-financing	217	0.27
Financial corrections to EU fund	-225	-0.28

The budgets of municipalities and self-governing regions — 77 mil. eur — 0.10 % of GDP

Municipalities (excl. tax revenues and discrepancies)	136	0.17
SGR (excl. tax revenues and discrepancies)	-59	-0.10

Other general government entities — 20 mil. eur — 0.02 % of GDP

NDS (National Motorway Comp.)*	-28	-0.03
Environmental Fund*	-39	-0.05
MH Management	-37	-0.05
MH Invest II*	-31	-0.04
MH Invest*	36	0.04
Public universities	43	0.05
ŽSR (national railway operator)	46	0.06
Other	29	0.04

* excl. tax revenues, received capital transfer, discrepancies, and land purchase and treatment

Others — 12 mil. eur — 0.01 % of GDP

Approved budget
-1 557
(-1.93 % of GDP)

Change in the balance
195
(0.25 % of GDP)

Budget outcome
-1 362
(-1.68 % of GDP)

Other expenditures from the state budget — -151 mil. eur — -0.19 % of GDP

State budget reserves	443	0.55
Other expenditures from the state budget	-543	-0.67
Other influences	-51	-0.06

Healthcare sector expenditures — -276 mil. eur — -0.34 % of GDP

Healthcare expenditures	-191	-0.24
Payout of retained profits by private health insurance companies	-20	-0.03
Financial performance of hospitals	-69	-0.09
Expenditures concerning operations	4	0.00

Land purchase and treatment — -280 mil. eur — -0.35 % of GDP

MH Invest - industrial park Nitra	-156	-0.19
NDS - D4/R7	-125	-0.15

Sum of individual items might not be equal to the results presented due the rounding.

Total sum of positives is expressed as the sum of all numbers labeled with a green color.

Total sum of negatives is expressed as the sum of all numbers labeled with a red color.

Source: MF SR, State Treasury, SO SR

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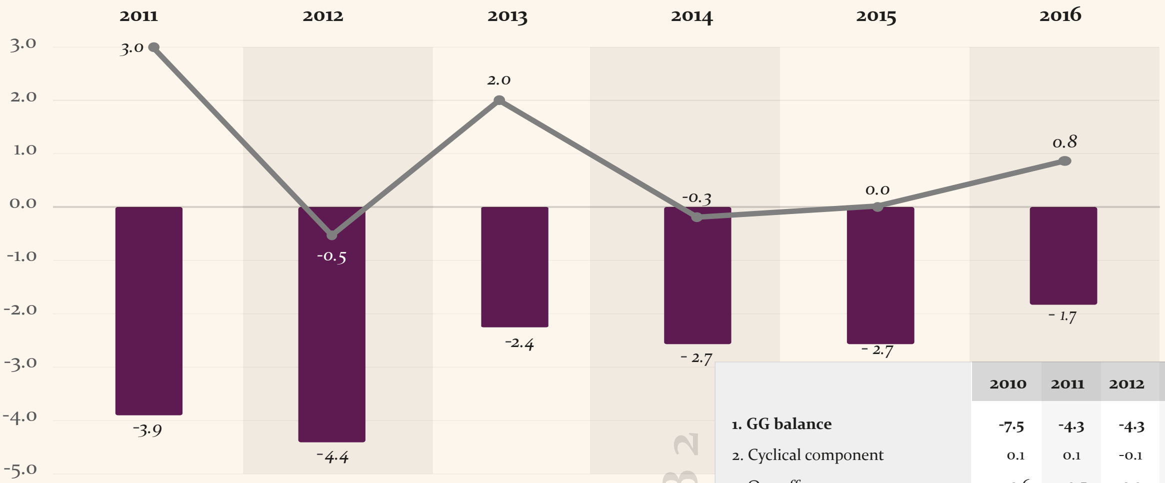
Change in structural balance in 2011-2016 according to CBR

FIGURE 1

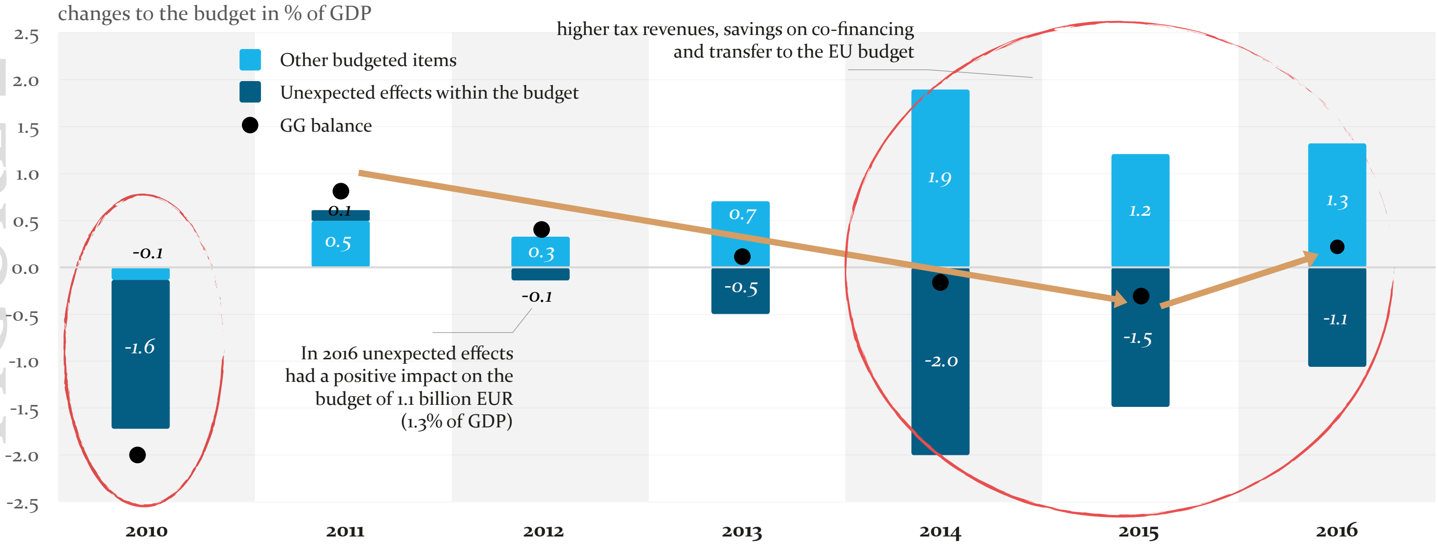


TAB 2

	2010	2011	2012	2013	2014	2015	2016
1. GG balance	-7.5	-4.3	-4.3	-2.7	-2.7	-2.7	-1.7
2. Cyclical component	0.1	0.1	-0.1	-0.5	-0.3	0.0	0.1
3. One offs	-0.6	-0.5	0.3	0.2	0.3	0.0	0.1
4. Structural balance (1-2-3)	-7.0	-3.9	-4.4	-2.4	-2.7	-2.7	-1.9
5. Change in structural balance (Δ4)/ Fiscal compact		3.0	-0.5	2.0	-0.3	0.0	0.8

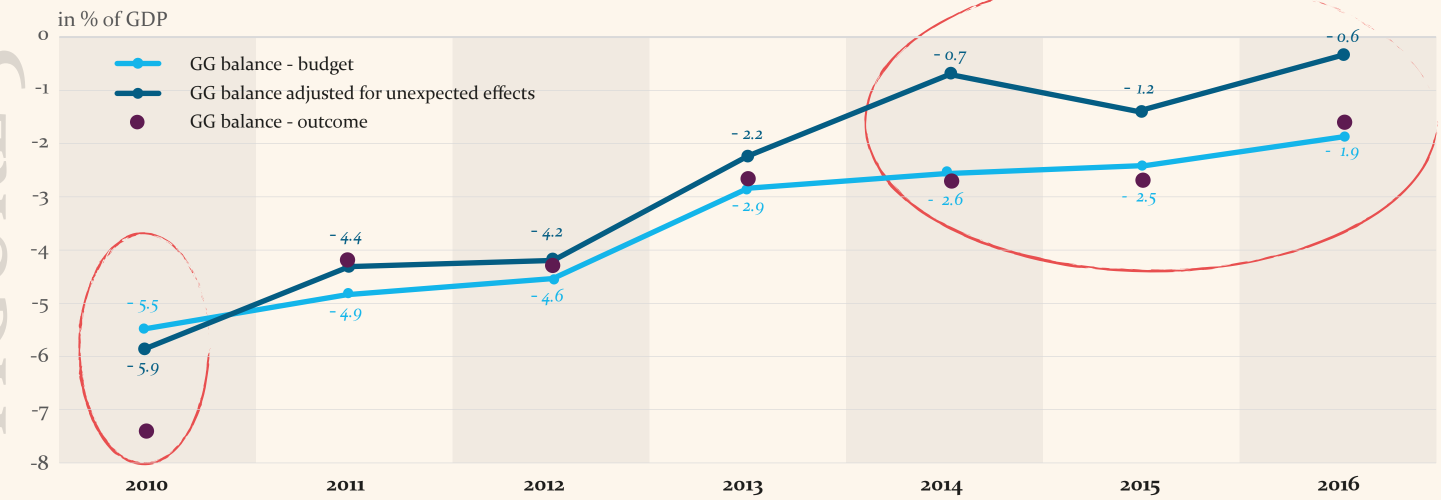
In 2016 unexpected effects had a positive impact on the budget of 1.1 billion EUR (1.3% of GDP)

FIGURE 2



Following the budget and making use of unexpected effects would decrease the GG deficit by 1.1% of GDP

FIGURE 3



Source: MF SR, CBR

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