CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of compliance with the balanced budget rule in 2016

Summary

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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.

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

Evaluation of compliance with the balanced budget rule in 2016

The 'balanced budget rule'[1] is based on the medium–term objective – a structural balance which Slovakia's public finances should attain or approach as quickly as possible. The evaluation of compliance with the rule falls under the responsibility of the Ministry of Finance ("Ministry") which publishes its reports biannually, by 30 June and 30 November. Subsequently, the Council for Budget Responsibility ("CBR") provides its independent evaluation. In line with the principles published by the European Commission[2], the Ministry then publishes its position on the CBR evaluation.

The CBR prepared its initial evaluation of compliance with the balanced budget rule for the year 2016 based on the data contained in the April deficit and debt notification by Eurostat. It also contains the CBR's response to the evaluation published by the Ministry on 30 June 2017. The methodology of evaluation remained unchanged. In 2016, the government decided[3] to postpone the deadline for meeting the medium-term budgetary objective from 2017 to 2019. Due to this, the evaluation period has changed, with the baseline year shifted to 2015[4].

The 2016 general government's structural deficit reached 1.63 % of GDP, which means that the medium-term objective of attaining a close to balanced budget (structural deficit of not more than 0.5 % of GDP – Figure 1) was not attained. With the additional factors taken into account, the structural balance deviation may reach up to 0.5 % of GDP[5] and, in the case of adjusted expenditures, the deviation from the required adjustment path may exceed 0.5 % GDP. The main cause of differences between the two indicators lies in the significant decline in investments, which makes the evaluation more stringent in the case of growth in adjusted expenditures, but which is not reflected in the structural balance evaluation. Since the indicator of adjusted expenditures exceeded the benchmark deviation only slightly and the present evaluation is based on the 2016 preliminary data, the CBR is of the view that the deviation is not significant enough – in the overall evaluation – to trigger the correction mechanism.

The 2016 structural balance improved by 0.97 % of GDP against 2015, which is 0.44 % of GDP more than the required change of 0.52 % of GDP that is necessary to achieve the medium-term objective by 2019 (Figure 2). **In its overall evaluation, the CBR also took into account the impact of other factors which reduced the year-on-year structural balance improvement to 0.33 % of GDP and brought the deviation to 0.19 % of GDP**. These factors include, in particular, the positive impact of windfall revenues at 0.54 % of GDP and lower debt interest payments by 0.1 % of GDP, since these do not depend solely on the present fiscal policy.

The adjusted budgetary expenditure in 2016 increased by 0.64 p.p. (Figure 3) above the expenditure benchmark, with a negative impact on the balance at 0.25 % of GDP (Figure 4). With respect to the expenditure benchmark, the CBR took into account the lower expenditures on national co-financing to EU funds, associated with lower tax revenues, and the improved

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[1] The rule was transposed into Slovakia's national legislation on the basis of an obligation arising under the international Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. Its first evaluation took place in 2014 (for the 2013).

[2] Communication from the Commission: Common principles on national fiscal correction mechanisms of 20 June 2012 (/* COM/2012/0342 final */). The "comply or explain" principle.

[3] The new government that emerged from the 2016 parliamentary elections decided to postpone the meeting of the medium-term objective by two years. It defended the move arguing that the new objectives were in line with the rules of the Stability and Growth Pact and that they enable the financing of investment priorities.

[4] It is a year for which, when the government decided to postpone the MTO target year, the actual figures for general government budget were available. The previous evaluations took 2012 as the baseline year.

[5] This is the significant deviation threshold. A deviation of at least 0.5 % of GDP is considered significant.

effectiveness of VAT collection, which is deemed a government measure. **These additional factors have worsened the negative impact of the adjusted expenditure deviation on the balance to 0.59 % of GDP.**

In addition to evaluating these two indicators, the CBR also took into account the impact of the likely financial corrections associated with irregularities in the drawing of EU funds available under the 2nd programming period. Moreover, the CBR took into account the fact that the debt remains within the sanction zones defined by the Fiscal Responsibility Act[6] and that no sufficient measures to reduce it have so far been adopted.

If the conclusions of this evaluation are confirmed in its December update, the identified deviations will not jeopardise the meeting of the medium-term objective by 2019 based on the 2016 figures. The rule defines a deviation also in circumstances which have significantly and without direct government intervention improved the structural balance or reduced the pace of growth in expenditures. In these situations, the deviation should be interpreted as a reason to step up the consolidation effort. Taking into account the impact of windfall revenues at 0.54 p.p. and the contribution of lower investments to the balance improvement by 0.31 p.p. (compared with the higher-than-average investments in 2015) in 2016, the government's ambition should be to meet the medium-term objective ahead of 2019[7].

The evaluations of both Ministry and CBR concur in their conclusions. Neither of the two institutions concluded that the conditions for the activation of the correction mechanism were met. The Ministry published its evaluation of compliance with the balanced budget rule for the year 2016 on 30 June 2017. It states that the 2016 structural balance did not depart from the adjustment path and that the deviation from the expenditure benchmark was not significant. This conclusion is valid also with the additional factors taken into account; consequently, the Ministry did not propose to activation of the correction mechanism. The CBR's evaluation is less favourable in that it considers the structural balance deviation to be not significant, but classifies the expenditure benchmark deviation as significant.

The differences between the two evaluations stem mainly from how the additional factors and one-off effects have been reflected. The Ministry did not reflect the additional windfall revenues, the effect of the measures with a neutral impact on long term sustainability, and the potential EU financial corrections which, according to the CBR, may worsen the structural balance in the future. As far as one-off revenues are concerned, the Ministry is not taking into consideration revenues from dividends. At the same time, the Ministry has changed the way in which it reflects the impact of national co-financing on the structural balance. While in its 2015 evaluation the Ministry reflected the steep increase in expenditures on national co-financing due to the accelerated drawing of EU funds both in the expenditure benchmark and in structural balance, its 2016 evaluation reflects the same decline in expenditures due to the slower drawing of EU funds only with respect to the expenditure benchmark. Even though the CBR considers the current approach by the Ministry to be more precise[8], however thanks to the change in the approach, no significant deviation in the structural balance development has been identified[9].

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6 Constitutional Act No. 493/2011 on fiscal responsibility.

7 The unexpected revenues/expenditure shortfalls should be reflected in the evaluation of compliance with the requirement for structural balance improvement towards meeting the medium-term budgetary objective under the preventive arm of the Stability and Growth Pact (Article 5(1) of [Council Regulation No 1466/97 on the strengthening of the surveillance of budgetary position and on the surveillance and coordination of economic policies, as amended](#)).

8 The CBR is of the view that the change in expenditures on national co-financing has a neutral impact on the structural balance because it is offset by approximately the same change in tax revenues.

9 The application of the same approach in the 2015 and 2016 evaluations would have led to less favourable indicator outcomes. The application of the economically correct approach, i.e., the assumption of a zero impact of the changes in co-financing expenditures on the structural balance in 2015 would have turned 'compliance' into

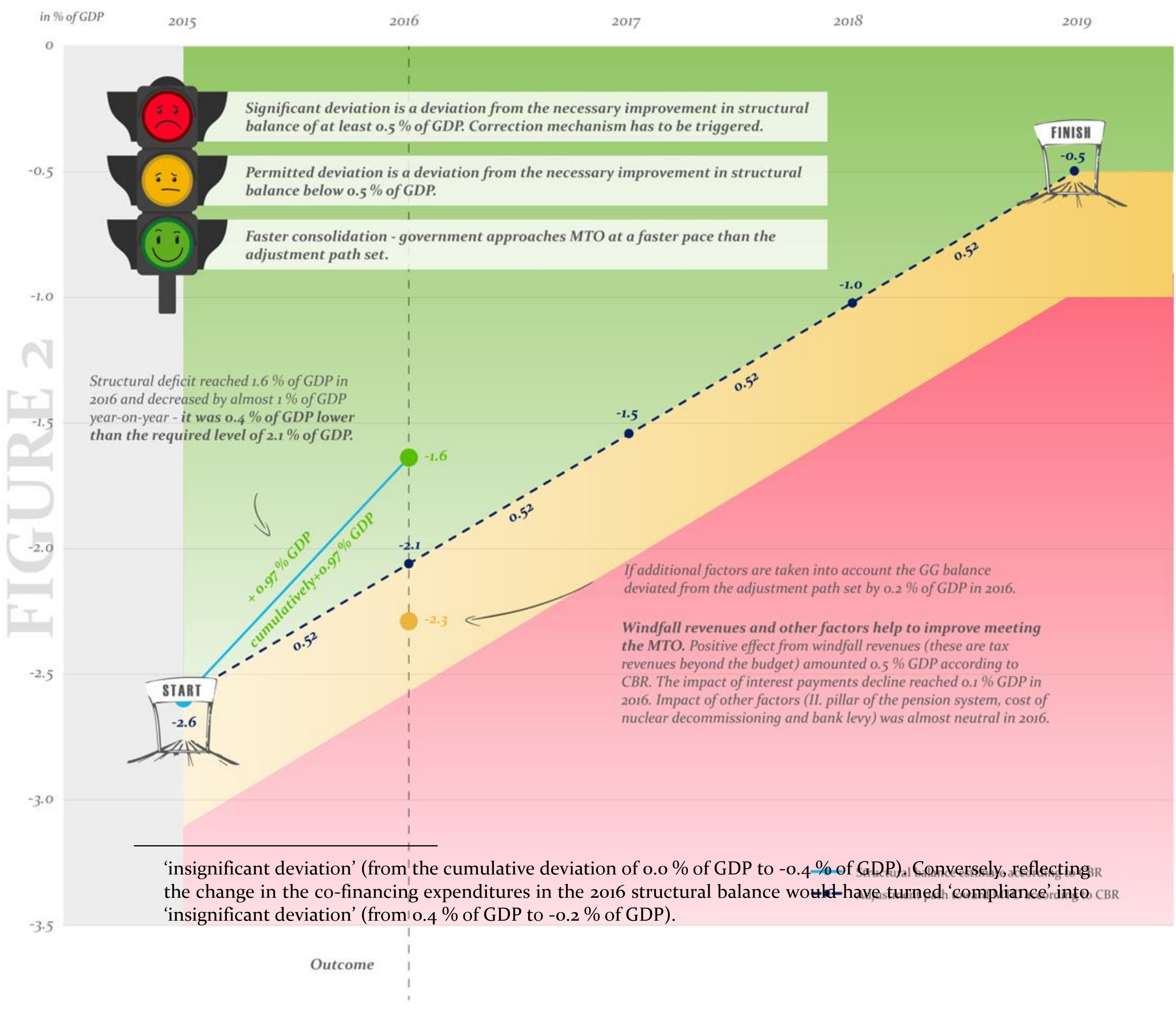
Structural balance

Given the level of the debt and long-term risks, a more stringent MTO has been set - structural deficit of 0.5 % of GDP.

FIGURE 1

The general government structural deficit stood at 1.6 % GDP in 2016, i.e. the medium-term objective of attaining a close to balanced budget (structural deficit up to 0.5 % of GDP) was not achieved.

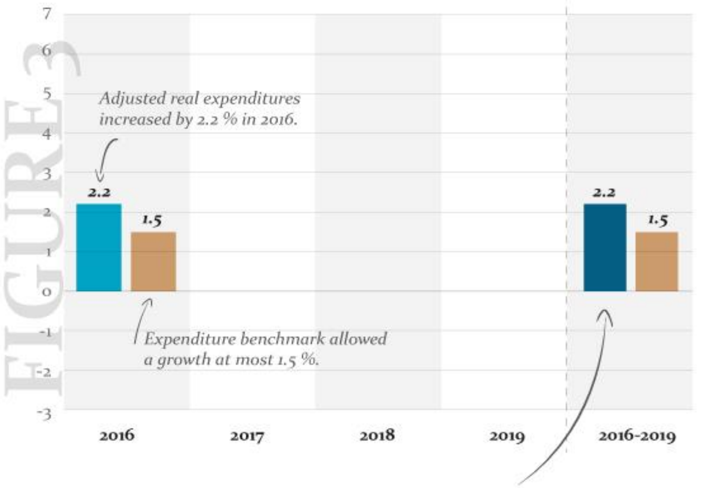
FIGURE 2



‘insignificant deviation’ (from the cumulative deviation of 0.0 % of GDP to -0.4 % of GDP). Conversely, reflecting the change in the co-financing expenditures in the 2016 structural balance would have turned ‘compliance’ into ‘insignificant deviation’ (from 0.4 % of GDP to -0.2 % of GDP).

Expenditure benchmark: The growth in expenditures in 2016 was higher than the growth given by the rule with a negative impact on the balance at the level of 0.25 % of GDP.

Expenditure growth in %

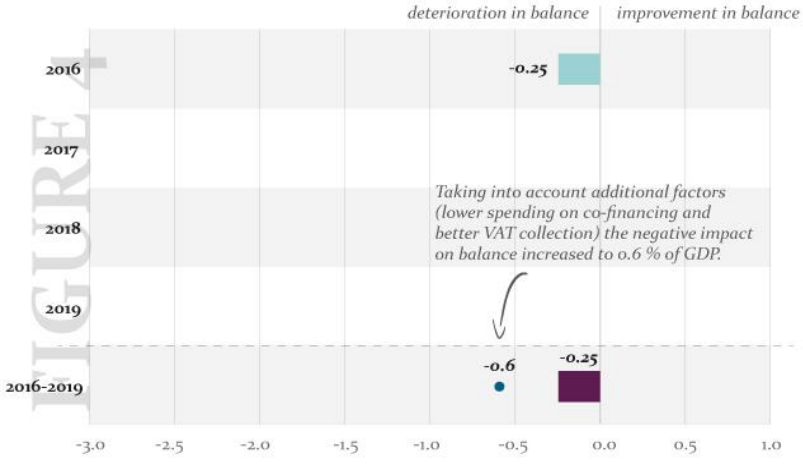


Adjusted real expenditures increased by 2.2 % in 2016, whereas the benchmark expected their growth at most 1.5 %.

Actual pace of expenditures growth

Expenditure benchmark (permitted growth in expenditures)

Impact on the balance (% GDP)



If the expenditures growth was in line with the expenditure benchmark, the deficit would be 0.25 % HDP lower in 2016, totalling 1.4 % GDP (the deficit reached 1.7 % GDP).

Taking into account additional factors the CBR´s as well as MF´s evaluation worsened

FIGURE 5

	CBR	MINISTERSTVO FINANCIÍ SLOVENSKEJ REPUBLIKY
Change in structural balance	fulfilled	fulfilled
Expenditure benchmark	deviation	deviation
Additional factors	worsened the evaluation	worsened the evaluation
Change in structural balance	deviation	fulfilled
Expenditure benchmark	significant deviation	deviation
Change in fully-funded pension pillar	without impact	not assessed
Cost of nuclear decommissioning	without impact	not assessed
Extended bank levy	without impact	not assessed
Interest payments	−	not assessed
Windfall revenues	−	not assessed
Debt within "debt brake" sanction thresholds	−	not assessed
Lower expenditures on co-financing	−	−
More effective VAT collection	+	+
Time-consistent recording of correction to EU funds	without impact	+
Potential shortfall in tax revenues (CIT)	without impact	−
Final evaluation	no significant deviation	no significant deviation

− + *effects increasing/decreasing deviation in structural balance or expenditure benchmark*

The main cause of dissimilar results of both of the indicators stem from a significant decline in investment (on y-o-y basis), which in case of the adjusted expenditures growth toughen the evaluation, whereas in case of the structural balance wasn't taken into account, National investment of the general government after adjusting cost of co-financing contributed to the structural balance improvement totaling 0.3 % GDP in 2016.

The interest payment decline contributed to the structural balance improvement by 0.1 % GDP in 2016.

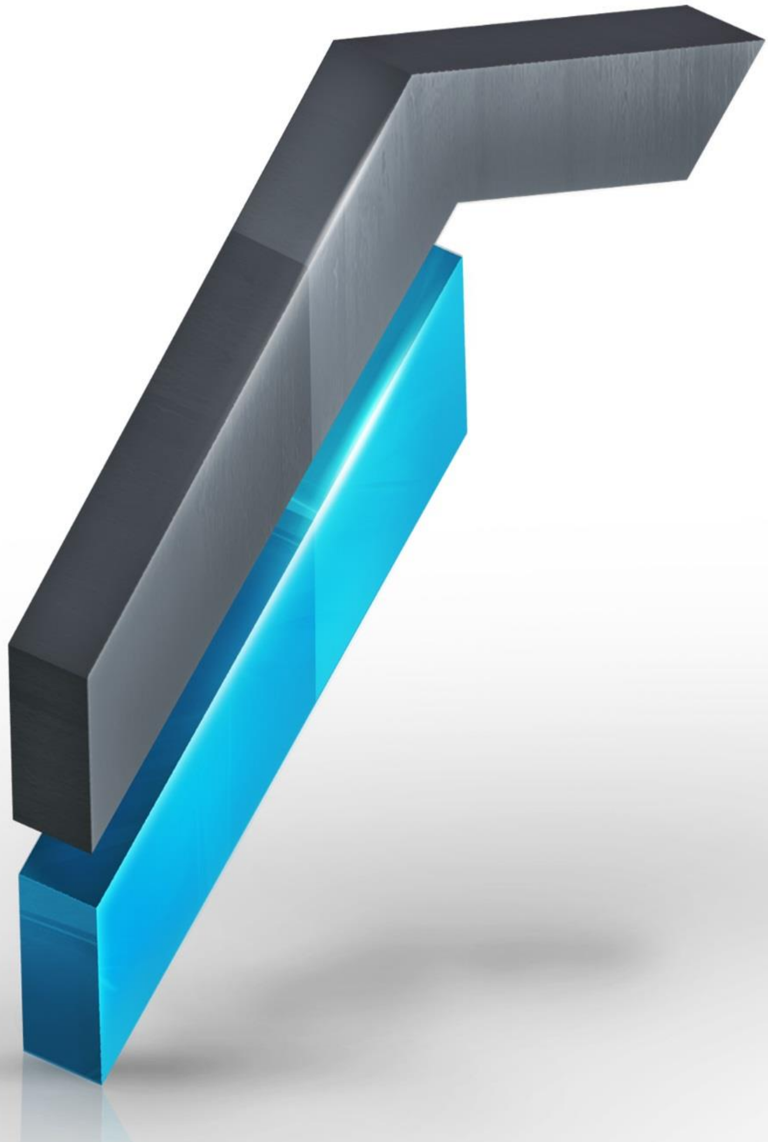
Windfall revenues improved the structural balance by 0.5 % GDP in 2016. The structural balance should thus improve more significant against the adjustment path set.

Lower EU funds withdrawing associated with lower cost on co-financing decreases tax revenues. The impact on structural balance is thus almost neutral.

Due to the lack of complete information about shifts in present corrections (reducing the deviation) and the missing estimate of future corrections (increasing the deviation), the CBR considered the actual level of corrections under ESA2010. According to the CBR, this level gives a more precise picture of the expected effect of corrections on structural balance in 2015 and 2016. The Ministry only considered the time in shift in present corrections which reduce the deviation.

According to the updated tax revenues estimate in 2016, a shortfall in revenues could be expected, amounted 0.4 % GDP (especially CIT collection). This change doesn't influence the CBR's evaluation, as the structural balance deterioration would be offset by a decrease in negative effect of windfall revenues.

Taking into account additional factors a deviation was identified in the case of structural balance, a significant deviation was identified when assessing the expenditure benchmark. As the adjusted expenditures exceeded the significant deviation threshold only slightly and the evaluation is based on preliminary data for 2016, according to CBR - after final evaluation - the deviation is not considered as significant and there is no need to trigger the correction mechanism.



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