CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Evaluation of compliance with the balanced budget rule for 2018

Analytical paper

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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 the General Government Budgetary Rules and 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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1. The CBR's evaluation

Compliance with the balanced budget rule, transposed into the Slovak law under a requirement 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 ("the 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[1], the Ministry then publishes its position on the CBR's evaluation.

The CBR prepared its first evaluation of compliance with the balanced budget rule for the year 2018 based on the data contained in the April deficit and debt notification by Eurostat, compiled under the ESA2010 methodology[2]. It also contains the CBR's response to the evaluation published by the Ministry[3] on 28 June 2019, and its update of 12 July 2019. The methodology of the CBR's evaluation remains unchanged compared to the previous evaluations[4] (see Annex 2 for a schematic presentation of individual steps). The year 2015 remains the base year of the evaluation[5].

1 Communication from the Commission: Common principles on national fiscal correction mechanisms of 20 June 2012. The "comply or explain" principle.
2 The description of the ESA2010 methodology, including accompanying documents, is published on the Eurostat website.
3 The description of the balanced budget rule and of the roles of individual institutions is contained in Annex 1.
4 Evaluation of compliance with the balanced budget rule for 2013 through 2017 (available only as a Summary in English).
5 The year for which reported data on the general government's fiscal performance were available at the time of the decision (in April 2016) to postpone the deadline for medium-term budgetary objective to 2019.

Table 1: CBR's evaluation – compliance with the balanced budget rule in 2018

		Definition	CBR assessment	Criterion	Outcome in 2018	Fulfillment
Structural balance fulfillment	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 % GDP	-1.24 % GDP	✘
	A.	debt significantly below 60 % of GDP	debt below 40 % of GDP	< 40 % of GDP	48.9 % 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	1.32 % of GDP	✘
			risk assessment by the EC using the S2 indicator	low risk	medium risk	
Analysis of indicators and escape clauses, incl. additional factors	2.	**Change in structural balance** **Rapid convergence towards MTO: steady improvement in the structural balance between 2015 and 2019 by 0.5 % of GDP annually**		>= 1.43 % of GDP*	-0.04 % of GDP	✘
	3.	**Development in adjusted expenditure** **Rapid convergence towards MTO: expenditure growth rate that ensures an improvement in the structural balance by 0.5 % of GDP**		>= 1.43 % of GDP*	0.50 % of GDP	✘
	4.	**Exceptional circumstances** **Exceptional circumstances occur if at least one of the following conditions is met (C, D, E, F)**		**at least one**	**0**	✘
	C.	event with a major impact on the financial position	public expenditure incurred to restore the proper functioning of the banking sector affected by the financial crisis, public expenditure incurred to remedy the consequences of natural disasters and catastrophes in the Slovak Republic, and public expenditure incurred in connection with commitments arising from international treaties that have exceeded 3 % of GDP in a single year	> 3 % of GDP	0 % of GDP	✘
	D.	period of a negative annual growth in real GDP	a year-on-year drop in real GDP	< 0 %	4.1 %	✘
	E.	protracted period of very low GDP growth relative to potential	negative output gap at least at 3 % of potential GDP	<= -3 %	1.1 %	✘
	F.	severe economic downturn in the euro area (a period of a negative annual real GDP growth or a protracted period of very low GDP growth relative to potential economic growth)		taking into account EC´s assessment		✘
Examination of deviation	5.	**Significant deviation** **Significant deviation occurs if both following conditions are met (G, H). If only one is met, an overall assessment is performed.**		**both conditions fulfilled**	**yes**	✔
	G.	change in structural balance: assessed on cumulatively basis since 2015, deviation of the level in structural balance in relevant year from the level set by the required improvement of at least 0.5 % of GDP y-o-y		<= 0.93 % of GDP**	-0.04 % of GDP	✔
	H.	adjusted expenditure growth: cumulative impact on the balance since 2015 is assessed, if the total negative impact on the balance reaches at least 0.5 % of GDP		<= 0.93 % of GDP**	0.50 % of GDP	✔
	6.	**Assessment of compliance with the balanced budget rule**		**significant deviation**		

** Assessed on a cumulative basis (years 2015 to 2018)* *Source: CBR*

*** The required cumulative improvement in the structural balance over the period 2015 to 2018 reached 1.43 % of GDP. Significant deviation occurs when the balance improves by 0.93 % of GDP at most (1.43 - 0.5 = 0.93 % of GDP)*

1.1 Level of the structural balance

The General Government Budgetary Rules Act requires the general government to have a balanced or surplus budget; this requirement is also complied with if the structural deficit does not exceed 0.5 % of GDP. If the general government debt is significantly lower than 60 % of GDP and there are minimal risks in connection with the long-term sustainability as defined under the Fiscal Responsibility Act, the structural deficit may be up to 1 % of GDP. From the very beginning of preparing its evaluations, the CBR links the terms 'significantly lower debt' and 'minimal risks to long-term sustainability' to the rules and indicators laid down in the constitutional Fiscal Responsibility Act:

- **The term 'significantly lower debt' refers to a debt below 40 % of GDP.** This level of debt is not associated with any sanctions under the constitutional act and, at the same time, is independent of the transitional provisions of the act[6].
- **The 'minimum risks to long-term sustainability**' are defined by the CBR as **a value of the long term sustainability indicator not exceeding 1 % of GDP.** At the same time, the CBR also takes into account **the long-term sustainability assessment by the European Commission (the Commission)[7].**

As the first step in its evaluation, the CBR examined whether **the structural balance target value set by the government complies with the minimum level defined in the Budgetary Rules Act** and whether **this target was achieved in 2018**.

The general government gross debt amounted to 48.9 % of GDP at the end of 2018, exceeding the 40 % of GDP threshold defined by the CBR. The long-term sustainability indicator was at 1.32 % of GDP for the same period[8]. At the same time, the Commission[9] included Slovakia among the countries at medium risk regarding the sustainability of public finances. It means that, according to the CBR, none of the aforementioned requirements enabling to meet the less stringent structural deficit target was met. **Therefore, the structural deficit target value cannot be higher than 0.5 % of GDP. The value of the medium-term budgetary objective expressed as a structural deficit of 0.5 % of GDP[10] is in compliance with the requirements under the balanced budget rule.**

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6 In 2017, the debt threshold from which sanctions are not applied stood 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 in 2027.

7 The European Commission assesses the long-term sustainability of public finances (as part of annual updates to stability programmes) on the basis of the analysis of the initial fiscal positions (deficit and debt level) 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.

8 CBR: Report on the Long-term Sustainability of Public Finances for 2018, April 2019 (available only as a Summary in English).

9 European Commission: Country Report Slovakia 2019, February 2019, pg. 21.

10 This 2019 medium-term budgetary objective value was approved by the government under the Stability Programme of April 2016 and was also confirmed in the subsequent programme updates (in April 2017, 2018 and 2019).

The 2018 structural deficit amounted to 1.24 % of GDP (Table 3), failing to reach the target value. 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 balance** (Part 1.2) and **development in the adjusted expenditure net of discretionary revenue measures** (Part 1.3). The CBR also **examines whether the exceptional circumstances during which compliance with the rule is suspended occurred or not** (Part 1. 4). **The conclusions are formulated based on an overall assessment** which also takes into account additional relevant factors (Part 1.5).

1.2 Change in the structural balance

The current evaluation is based on the government's medium-term budgetary objective of having the structural deficit reduced to 0.5 % of GDP by 2019[11]. Due to the lacking specification of a binding change in the structural balance in individual years, the CBR, as well as the Ministry, assumes **a steady improvement in the structural balance over the period between 2015 and 2019**[12].

The structural deficit was at 2.41 % of GDP in 2015; assuming it reduces evenly, it means that the structural deficit needs **to improve by 0.48 % of GDP on average each year** in order for the medium-term budgetary objective to be met by 2019 (Table 2).

Table 2: Change in the structural balance necessary to meet the medium-term objective by 2019 (ESA2010, % GDP)

	2015	2016	2017	2018	2019
Required level of GG structural balance according to the CBR	**-2.41**	-1.93	-1.46	-0.98	**-0.50**
Change*	-	**0.48**	**0.48**	**0.48**	**0.48**

** Steady improvement in the structural balance over the period of 2015-2019 that ensures achievement of MTO in 2019 (-0.5 % GDP)*

Source: CBR

The actual change in the structural deficit in a given year is assessed against the adjustment path set. **The change is assessed on a cumulative basis since 2015.** It means **that an overrun in one year may be offset by a slower pace of change in the structural deficit in the next year** (Table 3)[13].

[11] In the Stability Programme of April 2019, the government set a medium-term budgetary objective for the 2020-2022 period in the form of a structural deficit of 1 % of GDP. The worsening of the MTO is based on the minimum requirements under the Stability and Growth Pact but is not in line with the requirements under the balanced budget rule, according to the CBR.

[12] The year 2015 was chosen because the government also set the deadline for meeting the medium-term budgetary objective in April 2016 based on the actual data for 2015.

[13] In view of the missing specification by the Commission, the determination of a steady adjustment path and the method of calculating the deviation (cumulatively) is a national concept applied by both the CBR and the Ministry of Finance. This approach differs from the rules under the Stability and Growth Pact, the compliance with which is fully subject to assessment by the European Commission.

Table 3: Structural balance (ESA2010, % GDP)

	2015	2016	2017	2018	cumul. 2015-2018
1. General government balance	-2.56	-2.22	-0.79	-0.70	
2. Cyclical component	-0.16	-0.13	0.26	0.29	
3. One-off effects	0.01	-0.14	0.01	0.26	
4. Structural balance (1-2-3)	**-2.41**	**-1.95**	**-1.05**	**-1.24**	
5. Change in structural balance		**0.46**	**0.90**	**-0.19**	**1.17**
6. Required Δ in structural balance according to the CBR		**0.48**	**0.48**	**0.48**	**1.43**
7. Deviation (5-6)		**-0.02**	**0.42**	**-0.67**	**-0.27**
p.m. output gap	*-0.1*	*0.2*	*0.6*	*1.1*	

Note.: The difference in adding/subtracting on lines 4 and 7 is caused by rounding up. *Source: CBR*

The structural deficit reached 1.24 % of GDP in 2018, i.e., an overall improvement of 1.17 % of GDP against its 2015 level; however, according to the adjustment path set, it should have improved by 1.43 % of GDP over the three years. **It means that the 2018 structural balance was 0.27 % of GDP worse than the balance calculated on the basis of its required annual improvement since 2015, with the deviation from the adjustment path not being significant.**

1.3 Development in adjusted expenditures

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[14]; the reference expenditure growth rate is derived from the necessary change in the structural balance as calculated in Part 1.2 (i.e., by 0.48 % of GDP annually), which makes the approach to both indicators consistent.

Table 4: Expenditure benchmark (ESA 2010, € mil.)

	2015	2016	2017	2018	source
1. Total expenditure	**35,684**	**33,669**	**34,107**	**36,646**	Eurostat, T200*: TE
2. Interest payments	1,379	1,336	1,179	1,176	Eurostat, T200: D41
3. Expenditures on EU programmes fully matched by EU funds revenue	2,794	797	632	956	CBR
- of which: capital expenditures on EU programmes	2,352	510	440	748	CBR

[14] The CBR's calculation slightly differs from the procedure included in the interpretation of the Stability and Growth Pact rules (DG ECFIN (2019), Vade Mecum on the Stability and Growth Pact - 2019 Edition, Institutional Paper 101) in that that the CBR excludes one-off effects from the calculation of adjusted expenditures. The Commission excludes them only when considering additional factors. More distinct inter-institutional differences are in the manner how they estimate those items that are not taken from the Eurostat data. In the approach of CBR, this leads to a higher accuracy of a given indicator and to a reduction in the differences between the structural balance and the expenditure benchmark. The differences, including underlying data, are listed in Annex 4. No change has been made in the methodology compared to the December 2018 evaluation.

4. Gross fixed capital formation (net of EU expenditures)	2,599	2,090	2,259	2,471	CBR
5. Gross fixed capital formation *(net of EU expenditures, Ø for t-3 through t)*	1,914	2,050	2,244	2,354	CBR
6. Cyclical expenditures (unemployment benefits, pensions)	-45.4	-4.5	-28.9	40.6	CBR(estimate)
7. One-off expenditures	6	52	6	6	RRZ
8. Primary expenditure aggregate (1-2-3-4+5-6-7)	**30,866**	**31,448**	**32,304**	**34,352**	
9. Year-on-year Δ in primary expenditure aggregate *(8t-8t-1)*		582	856	2,048	
10. Δ in revenues due to discretionary measures and methodology of national account reporting		-133	151	-206	MF SR, CBR: Annex 4
11. Nominal growth in expenditure aggregate net of Δ in revenues *((9t-10t)/8t-1)*		2.3	2.2	7.0	
12. Year on year change in GDP deflator		-0.5	*1.2*	*2.1*	Eurostat
13. Real growth in expenditure aggregate net of Δ in revenues *(11-12)*		**2.8**	**1.0**	**4.8**	
14. Potential GDP growth rate		2.9	2.8	3.6	CBR (estimate)
15. Decrease in expenditure growth (p.p.) CBR c.e./*(8(t-1)/GDP(t))*		1.3	1.3	1.3	ŠÚ SR, CBR
16. Expenditure benchmark *(reference expenditure growth rate) (14-15)*		**1.6**	**1.5**	**2.2**	
17. Deviation impact on the balance in a given year *(16t-13t)*8t-1/GDP$_t$*		**-0.45**	**0.18**	**-0.90**	
18. Cumulative deviation				**-1.17**	
p.m.1 Gross fixed capital formation	4,951	2,600	2,699	3,218	*Eurostat, T200: P51*
p.m.2 Required improvement in structural balance according to the CBR		0.48	0.48	0.48	*Recalculated by CBR*

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

Source: CBR, MF SR, Eurostat

In 2018, the adjusted real expenditures increased by 4.8 %, whereas the expenditure benchmark assumed a maximum increase of 2.2 % year-on-year. The significantly higher rate of expenditure growth in 2018 (and in 2016, too) above the level required under the expenditure benchmark was only partly offset by a lower growth in expenditures in 2017. **The overall impact of expenditure development on the balance between 2016 and 2018 in comparison with the expenditure benchmark was negative and represented 1.17 % of GDP. This implies that the deviation from the defined adjustment path was significant under this indicator.**

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[15]. 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 established **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[16], which provides for exemptions from the application of sanctions in such situations. This namely includes the **public expenditure incurred to restore the proper functioning of the banking sector affected by a financial crisis, public expenditure incurred to remedy the consequences of natural disasters and catastrophes in Slovakia and public expenditure towards commitments arising from international treaties that have exceeded 3 % of GDP in a single year**. For the purposes of assessing compliance with the balanced budget rule, exceptional circumstances last as long as such expenditure exceeds the threshold on a yearly basis[17].
- **A period of a negative annual growth in GDP.** The CBR will consider as an exceptional circumstance **an annual drop in real GDP**, subject to a comprehensive assessment of Slovakia's economic development.
- **A protracted period of very low GDP growth relative to its potential.** The CBR defines it as **a negative output gap reaching at least 3 % of the potential output.** The duration of this exceptional circumstance ends when the output gap begins to close (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

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15 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.

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

17 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.

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 2018. The criteria of a severe economic downturn were not met either. Slovakia's economy grew 4.1 % year-on-year; the output gap (based on CBR's estimate) reached 1.1 % of the potential product in 2018 and was significantly above the -3.0 % level. The euro area grew by 1.9 % year-on-year in 2018, and the output gap estimated by the European Commission reached 0.5 % of the potential product. The Commission did not assess[18] 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 2018.

1.5 Overall assessment

As part of the overall assessment, the CBR examines whether a significant deviation has occurred. It takes into account the change in the structural balance, development in adjusted expenditures (Box 1) **and whether the exceptional circumstances have occurred. Other factors are assessed as well.** They are considered as long as they are verifiable and their impact on the balance is quantifiable; the reasons for their consideration are described in more detail in Annex 5. In addition, when assessing the significant deviation the CBR also takes into account other factors which may affect the final assessment, especially in the case of ambiguous conclusions drawn from the quantified indicators. They are factors whose effect is currently unknown and may be felt in the future, and the qualitative factors linked with the long-term sustainability of public finances.

Box 1: Mutual links between structural balance and expenditure benchmark

The adjustment path towards the medium-term budgetary objective is assessed on the basis of the structural balance and development of adjusted expenditures against the expenditure benchmark. These are two indicators that complement each other and allow assessing the development in public finances from different perspectives.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union takes the structural balance as a benchmark indicator which should be complemented by the assessment of the development in adjusted expenditures. Even though the medium-term budgetary objective is defined as a structural balance, the hierarchy of the two indicators is not unambiguous. Also, the Stability and Growth Pact rules put increasingly more emphasis on the development of adjusted expenditures[19], which may lead to different conclusions regarding the deadline for the fulfilment of the medium-term budgetary objective, especially if the results of both indicators differ.

A situation may occur that a country has met the required change in the structural balance but a significant deviation has occurred under the expenditure benchmark. An overall assessment,

[18] 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 2018.

[19] Economic and Financial Committee (2016): Improving the predictability and transparency of the SGP: A stronger focus on the expenditure benchmark in the preventive arm, 14814/16, approved by the ECOFIN Council on 6 December 2016.

incorporating additional relevant factors, may lead to a conclusion that the significant deviation has occurred (for example due to the structural balance being affected by windfall revenues, a drop in debt interest payments or investments, and without these factors, a deviation would also have occurred in the structural balance). However, despite the significant deviation, the fulfilment of the medium-term budgetary objective within the set deadline does not have to be at risk. This particularly applies where the positive effects of economic development on public finances last for several years. If the significant deviation triggered the correction mechanism, the medium-term objective could be met by an earlier date because the unexpected positive effects could be used for an accelerated improvement of structural balance[20].

Otherwise, a situation may arise (for example, due to unexpected revenue shortfalls), when a country does not meet the required improvement in the structural balance, but complies with the expenditure benchmark. The outcome of the overall assessment may be that no significant deviation has occurred. On the other hand, a deviation from the required adjustment path towards the structural balance (especially where unfavourable effects last for a longer time) may result in the medium-term budgetary objective not being met within the set deadline. The outcome of the correction mechanism may also involve a postponement of the time limit for meeting the medium-term objective.

1.5.1 Additional factors

The change in the structural balance is assessed on a cumulative basis since 2015, 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 2018, the structural balance was better by almost 0.27 % GDP than the balance calculated on the basis of its required annual improvement since 2015. However, after taking into account the three following factors, the **deviation amounted to 1.47 % of GDP:**

- The change in the structural balance in individual years may be also influenced by **items having a neutral impact in the long term**[21] (the fully-funded pillar of the pension system, nuclear decommissioning scheme and levies paid by financial institutions[22]). These factors, particularly the gradual increase in contributions paid to the fully-funded pillar of the pension system, contributed to a 0.15 % of GDP increase in the structural deficit compared to 2015.

- **Debt interest payments** are largely influenced by the government's past decisions and by developments on financial markets; if their impact is taken into account in the

[20] Windfall and/or shortfall revenues should be taken into account when assessing the meeting of the requirement of improving the structural balance towards 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 positions and the surveillance and coordination of economic policies, as amended).

[21] For example, where a present improvement in the structural balance will lead to its deterioration in future.

[22] Contributions to the state financial assets, the Deposit Protection Fund, and the Investment Guarantee Fund. The Deposit Protection Fund and the Investment Guarantee Fund were reclassified as institutional units into the general government sector in the April 2018 notification.

change of the structural balance, we may get a more accurate picture of the present fiscal policy. They fell by 0.44 % of GDP[23] in 2018 compared to 2015.

- **Windfall revenues**[24] also contributed to the improvement in the structural balance. These are tax revenues in excess of budgeted values[25] in 2016 through 2018. The positive effect of windfall revenues on the structural balance amounted to 0.92 % of GDP, according to the CBR[26].

Table 5: Assessment of significant deviation – structural balance (ESA2010, y-o-y Δ, % GDP)

	2016	2017	2018	cumulatively 2016-2018
1. Change in structural balance	0.46	0.90	-0.19	1.17
2. Required change in structural balance according to the CBR	0.48	0.48	0.48	1.43
3. Difference against the required adjustment path (1-2)*	**-0.02**	**0.42**	**-0.67**	**-0.27**
4. Changes in measures with no impact on long-term sustainability	0.01	-0.07	-0.08	-0.15
5. Changes in interest payments	0.10	0.25	0.09	0.44
6. Windfall revenues	0.08	0.36	0.48	0.92
7. Change in structural balance, including additional factors (1-4-5-6)	**0.28**	**0.36**	**-0.68**	**-0.04**
8. Difference against the required adjustment path taking into account additional factors (7-2)*	***-0.20***	***-0.12***	***-1.15***	***-1.47***

**Positive values mean the rule is complied with, negative values mean a deviation. The significant deviation threshold is at -0.5 % of GDP.*

Source: CBR

The adjusted expenditures rose 8.8 % between 2016 and 2018 in comparison to 2015, while the growth rate permitted under the expenditure benchmark was 5.4 %. The deviation had a negative impact on the balance in the amount of 1.17 % of GDP. After taking into account the three following additional factors, **the negative impact of the deviation from the expenditure benchmark fell to 0.94 % of GDP:**

- **Measures with no impact on the long-term sustainability** also affect, in addition to the structural balance, the development in adjusted expenditures. Mainly due to

[23] The decrease in interest rates followed the development in the interest rates in the euro area as a consequence of the easement in the ECB's monetary policy. The credit spread against German government bonds, representing the risk premium, has been stable since 2014 and its development can largely be explained by global factors prevailing over the domestic ones. (Odor, L., and P. Povala (2016). Risk Premiums in Slovak Government Bonds. Discussion Paper No. 3/2016. Council for Budget Responsibility Slovakia and Amstad, M., Remolona, E., and Shek, J. (2016). How do global investors differentiate between sovereign risks? The new normal versus the old. BIS working paper.).

[24] Windfall and/or shortfall revenues should be taken into account when assessing the meeting of the requirement of improving the structural balance towards 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 positions and the surveillance and coordination of economic policies, as amended).

[25] Adjusted for the impact of the economic cycle, higher revenues due to increased absorption of EU funds and the non-budgeted revenues from improved VAT collection.

[26] The procedure for estimating windfall revenues is described in Annex 6. When estimating the size of windfall revenues for a period of several years, each year is assessed individually. In economically favourable times, this represents a less stringent approach to estimates compared to a situation where the size of the windfall revenues would be estimated against the assumptions of a multiannual budget in the base year of the evaluation.

legislative changes in the fully-funded pillar of the pension system (the possibility to opt out in 2015 and increases in the contribution rates in 2017 and 2018), these measures[27] had almost negligible negative effect on revenues (0.05 % of GDP). Since they will also be accompanied by lower public expenditures in the long-term, the shortfall in revenues should not affect the evaluation of the current rate of expenditure growth.

- The development in adjusted expenditures was positively influenced by a decline in the **expenditures on co-financing** in 2018 as compared against 2015. Since the decrease in the drawing of EU funds also leads to a decline in tax revenues, the lower co-financing expenditures were offset by a shortfall in tax revenues[28]. In order to ensure a neutral effect of the co-financing in the development in adjusted expenditures, as well (similarly as in the case of the structural balance), the CBR considered the impact of the shortfall in tax revenues caused by a slower uptake of EU fund at a level of 0.27 % of GDP[29].

- The **improved effectiveness in tax collection** is another relevant factor that has not been considered in the calculation of the adjusted expenditures in the primary assessment. The government took a number of measures, especially as regards VAT, designed to improve tax collection. The impacts of such measures are difficult to quantify as they are not clearly attributable to changes in the behaviour of taxpayers and may be influenced by the cyclical development of the economy to a large degree[30]. Therefore, the CBR takes them into consideration as an additional factor. The improved VAT collection led[31] to an increase in revenues of 0.45 % of GDP in the 2016-2018 period compared to 2015.

27 The list of measures is included in Annex 4.

28 In its report on the Evaluation of the Government Budget Proposal for 2015-2017 of November 2014, Annex 2, the CBR 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 considers a change in the co-financing expenditures to be a relevant factor for explaining changes in the adjusted expenditures, but not in the structural balance.

29 In 2016, the co-financing expenditures dropped 0.59 % of GDP year-on-year, and another 0.05 % of GDP in 2017, and increased 0.09 % of GDP in 2018. However, due to using the average values of public investments (including those spent on the co-financing of EU funds), the impact of the adjusted expenditures indicator on the balance amounted to 0.27 % of GDP only. The method of calculation is included in Annex 6.

30 Given their macroeconomic base, tax elasticities vary in time depending on the cyclical development in the economy. Since the applied approaches which adjust the general government balance for the effect of economic cycle assume a constant long-term elasticity, the actual effect of economic cycle may be more significant in reality. The estimated increase in the effective tax rate, therefore, does not have to necessarily reflect only a permanent improvement in tax collection.

31 It is a CBR's estimate based on the data requested from the Ministry of Finance; the method of estimation has not changed compared to the previous evaluation. Compared to the Ministry of Finance's estimate used for discretionary revenue measures, the impact is lower due to taking into account the revision of macroeconomic data in 2016 and 2017 and the economic cycle.

Table 6: Assessment of significant deviation – expenditure benchmark (ESA2010, % GDP)

	2016	2017	2018	cumul. 2016-2018
1. Real growth in expenditure aggregate net of change in revenues (%)	2.80	0.99	4.77	8.8
2. Expenditure growth rate under expenditure benchmark (%)	1.61	1.49	2.24	5.4
3. Difference against expenditure benchmark (impact on the balance)*	**-0.45**	**0.18**	**-0.90**	**-1.17**
4. Measures with no impact on long-term sustainability	-0.02	0.03	0.04	0.05
5. Year-on-year change in expenditures on co-financing	-0.22	-0.07	0.03	-0.27
6. Year-on-year change in improved effectiveness of VAT collection	0.28	0.15	0.03	0.45
7. Deviation from expenditure benchmark taking into account additional factors (3+4+5+6)*	**-0.41**	**0.29**	**-0.82**	**-0.94**

** Positive values mean the benchmark is complied with, negative values mean a deviation. The significant deviation threshold is at -0.5% of GDP.*

Source: CBR

The CBR's evaluation also covers **other factors** beyond those referred to above. Their potential impacts on individual indicators are not currently known and may show in an update to the CBR's evaluation:

- The evaluation based on the data published by Eurostat in April 2019 was further extended to capture the **updated estimate of tax revenue**. In the Tax Revenue Forecasting Committee's forecast of 27 June 2019, the estimated tax revenues for 2018 decreased by EUR 18 mil.[32] compared to the originally notified data. The evaluation of the development in the structural balance after taking into account the additional factors would not be affected by this particular factor because the change in the balance would be accompanied by a simultaneous change in windfall revenues of the same size.

- In addition to providing more accurate data on tax revenues, the October notification will also **update data on receivables and payables of certain entities based on financial statements**; their impact on the balance is yet unknown. At the same time, the Statistical Office of the Slovak Republic is working on a so-called **benchmark revision of national accounts**[33] which may affect general government's revenues and expenditures in individual years. All these additional changes will be reflected in the update of the evaluation to be prepared by the CBR in December 2018.

- In its April notification, **Eurostat expressed a reservation on the quality of the data reported by the Statistical Office of the Slovak Republic** in relation to the recording of expenditures on extra budgetary accounts[34]. Based on the currently available data, the

32 Mainly due to the lower estimate of VAT revenues (EUR -9 mil.) and social security contributions (EUR -9 mil.).

33 According to the statement of the Statistical Office of the Slovak Republic, the benchmark revision of national accounts should be performed through July-September 2019. The revision is to be done by all EU Member States (in 2019 through 2024) in order to better specify the data about the most important macroeconomic indicators in line with the most recent available information.

34 With respect to the deficit and debt notification of 23 April 2019, Eurostat made a reservation concerning the quality of the data provided by Slovakia. It concerns some expenditures which may worsen the deficit in 2018 by 0.3 % of GDP. According to the Ministry of Finance's statement, the reservation is related to the change in recording on extra budgetary accounts.

transaction associated with the recording of a part of expenditures on extra budgetary accounts was classified by the CBR inside one-off effects because, due to its nature, the same positive effect on the balance is not likely to be seen in the years to come. A revision of the deficit, if any, under the October notification will not therefore have an impact on the evaluation of the balanced budget rule[35].

Box 2: Differences between the structural balance and adjusted expenditure development

The structural balance and the adjusted expenditure development are the two indicators used to evaluate the path of public finances towards a balanced budget. Although the structural balance plays an important 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.

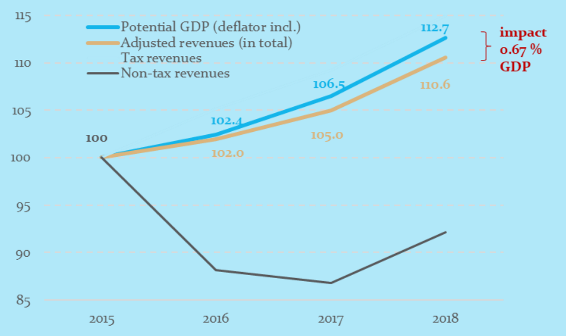
With additional factors taken into account, the change in the structural balance represented a deviation of 1.47 % of GDP. Based on the adjusted expenditures, the deviation amounted to 0.95 % of GDP, i.e., the difference between the two indicators is 0.53 p.p. The key reasons for this difference is the development in structural revenues net of legislative changes and own investments (all factors are described in detail in Annex 7).

The expenditure rule assumes a growth in revenues at the same rate of the potential output; this was not achieved between 2016 and 2018 and the indicator improved by 0.67 % of GDP in comparison to the structural balance (Figure 1). The decrease in non-tax revenues between 2016 and 2018 was only partially offset by a higher growth in tax revenues (structural tax revenues without new legislative measures and methodology impacts) for the same period. Meeting the expenditure benchmark at this rate of growth in revenues would not necessarily lead to meeting of the medium-term budgetary objective.

Year-on-year changes in the government's own investments (without EU funds and co-financing) fully affect the structural balance and are reflected as a four-year average in the expenditure benchmark. While they improved the 2018 structural balance by 0.2 % of GDP compared to 2015 (own investments were falling), their effect on the expenditures was negative, since the average amount of investments rose 0.3 % of GDP between 2015 and 2018 (Figure 2).

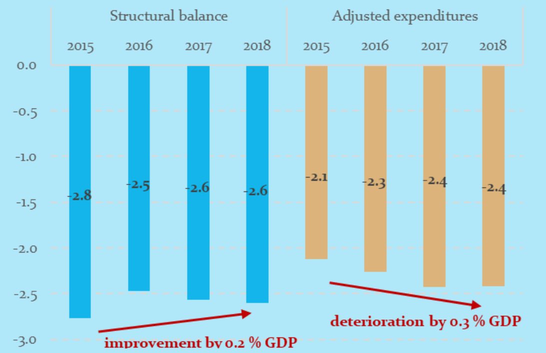
[35] Should there be no changes in the general government deficit after examining the transactions that were subject to the reservation and, at the same time, if their one-off effect turns out not to be the case, the evaluation of the structural balance would improve by 0.26 % of GDP. Even so, the deviation would exceed 1 % of GDP.

Figure 1: Development in individual GG revenue components (index, 2015 = 100)



Source: CBR

Figure 2: Effect of own investments on structural balance and adjusted expenditure (ESA2010, % GDP)



Source: CBR

1.5.2 Result of the overall assessment

With all relevant factors taken into account, it can be concluded that no exceptional circumstances occurred in 2018 (no unusual event outside the government's control and no severe economic downturn occurred). As regards the development in the structural balance, the deviation of 1.47 % of GDP was identified, while that in the adjusted expenditures amounted to 0.94 % of GDP[36], exceeding the 0.5 % of GDP level in both cases[37]. The significant deviations under both indicators suggest that the medium-term budgetary objective could have been attained as soon as in 2018, that is, a year earlier than envisaged by the government[38]. The reason is that the windfall revenues and the lower debt interest payments had created conditions for an accelerated fulfilment of the medium-term budgetary objective but the government failed to take this advantage.

The deviations in both indicators are significantly higher than the values permitted under the balanced budget rule; possible revisions of the general government balance in the October notification and updated estimates of analytical adjustments (for example, cyclical component, the effect of improved VAT collection, discretionary revenue measures) are very unlikely to mitigate these deviations in any considerable manner.

In view of the fact that both indicators clearly show that the significant deviation threshold was exceeded, the CBR believes there was a significant deviation from the adjustment path towards the medium-term objective in 2018 and, therefore, the correction mechanism needs to be triggered.

36 Annex 7 compares the structural balance and adjusted expenditure developments in individual years.
37 The threshold of significant deviation. A deviation becomes significant from 0.5 % of GDP upwards.
38 The expenditure benchmark defines a deviation also in circumstances which have significantly and without direct government intervention improved the structural balance or reduced the rate of growth in expenditures. In that case, achieving the full compliance with the benchmark (without deviation) may lead to meeting the medium-term objective before the deadline set by the government. A full compliance with the benchmark in 2018 would result in a structural surplus of 0.2 % of GDP, that is, above the medium-term budgetary objective set.

The correction mechanism is defined by Act No. 523/2004 on budgetary rules and consists of determining a public expenditure ceiling[39] and measures to be taken during the period of correcting the significant deviation[40]. The shape of the correction mechanism is determined by the government based on a proposal by the Ministry of Finance.

In a standard situation, according to the principles published by the European Commission[41], the correction mechanism should lead to eliminating the deviation so that the medium-term objective could be achieved by the original deadline, i.e., in 2019. Since it is the same year when the significant deviation was identified, **the government should approve a binding correction plan that would enable meeting the medium-term budgetary objective of having a structural deficit of 0.5 % of GDP within the shortest time possible. The need to adopt correction measures is also underlined by significant risks arising from the development in the general government balance in 2019[42]. If the correction measures do not result in meeting the medium-term budgetary objective in 2019, the MTO should be met in 2020 at the latest[43]. In order to meet this objective, a nominal year-on-year growth rate of adjusted expenditures should not exceed 5.1 % on average for both years[44].**

1.5.3 Medium-term outlook

Even though the adjustment path towards the medium-term budgetary objective is assessed on the basis of data reported by Eurostat for the previous year, looking at the expected development of public finances in the medium term can complement the CBR's evaluation. The identified risks, if any, have no impact on the current final evaluation, and if they do materialise, they will influence the future evaluations.

39 The public expenditure ceiling means the maximum amount of the total accrued consolidated general government expenditure.

40 Taking into account the size of the deviation observed, respecting the achievement of the medium-term objective, and annual reductions in the general government deficit to gross domestic product ratio in accordance with separate regulations.

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

42 The approved general government budget assumed that a zero balance be attained in 2019. If the government does not adopt additional measures during 2019, the general government deficit may amount to 1.0 % of GDP, according to the CBR's estimates, corresponding to a structural deficit at 1.2 % of GDP. To reduce the structural deficit to 0.5 % of GDP in 2019 in accordance with the requirements under the balanced budget rule will require the adoption of additional measures with a permanent effect in the amount of EUR 636 million (0.7 % of GDP).

43 According to the CBR, this should involve the meeting of the originally set value of the medium-term objective, i.e., the structural deficit of 0.5 % of GDP, since the significant deviation from the adjustment path towards this objective was identified in 2018. In the Stability Programme (April 2019), the government approved the easement of the medium-term budgetary objective in the form of a structural deficit to 1.0 % of GDP in 2020 based on the minimum requirements under the Stability and Growth Pact. According to the CBR, however, the conditions to ease the MTO pursuant to the provisions on the balanced budget rule contained in the General Government Budgetary Rules Act are currently not met.

44 In real terms, it is an annual growth in expenditures by 2.5 %. This value apply under an assumption that the general government revenues would grow in accordance with a potential output growth rate. In the case of a lower revenue growth rate, such as that which occurred, for example, in 2016 through 2018, the expenditure growth rate should be reduced so as to ensure the necessary improvement in the structural balance.

The fulfilment of the government's budgetary objectives set in the Stability Programme for 2019-2022 would, according to the CBR, lead to meeting the medium-term budgetary objective in 2019 (Box 3). However, based on the CBR's evaluation[45], there is a risk that the medium-term budgetary objective would not be met even in 2020.

Box 3: Development in structural balance and adjusted expenditure until 2022

In the Stability Programme of the Slovak Republic for 2019-2022, the objectives set by the government for the general government balance assume attaining and maintaining a balanced fiscal performance between 2019 and 2022. At the same time, the medium-term budgetary objective in the form of a structural deficit has worsened from 0.5 % of GDP to 1.0 % of GDP[46] for the period between 2020 and 2022. According to the assessment of the European Commission of 5 June 2019, there is a risk of a significant deviation from the adjustment path towards the medium-term objective both in 2019 (based on the assessment of years 2018 and 2019 taken together)[47] and in 2020 (based on the assessment of years 2019 and 2020 taken together)[48].

In assessing the medium-term outlook, the CBR focused on the development of the structural balance and took into account two scenarios, assuming the risks identified by the CBR when assessing the Stability Programme of the Slovak Republic for 2019-2022 would materialise and that the budgetary objectives set by the government would be met. The medium-term budgetary objective over the entire period is expressed as a structural deficit of 0.5 % of GDP because, according to the CBR, the conditions for the easement of the objective to 1 % of GDP as defined in the General Government Budgetary Rules Act have not been met so far (none of the necessary requirements has been met: the debt is not below 40 % of GDP and risks related to the long-term sustainability are not low). As regards the expenditure benchmark, the CBR estimated the amount of unbudgeted expenditure for the sake of better comparability of the reported and budgeted expenditure.

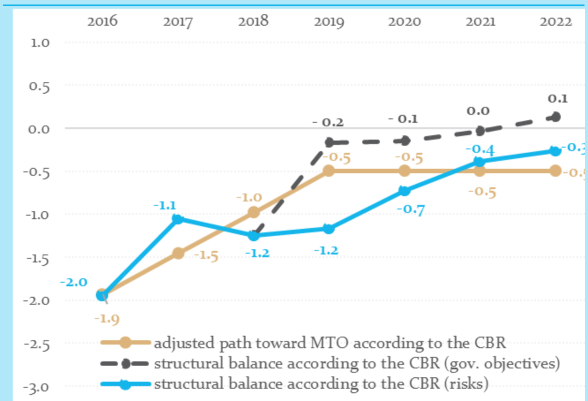
45 CBR, Evaluation of Medium-term Budgetary Objectives for 2019-2022, June 2019 (available in Slovak only).

46 In 2019, the medium-term budgetary objective is expressed as a structural deficit of up to 0.5 % of GDP.

47 „Based on the Commission 2019 spring forecast, there is a risk of significant deviation from the recommended fiscal adjustment over 2018 and 2019 taken together."

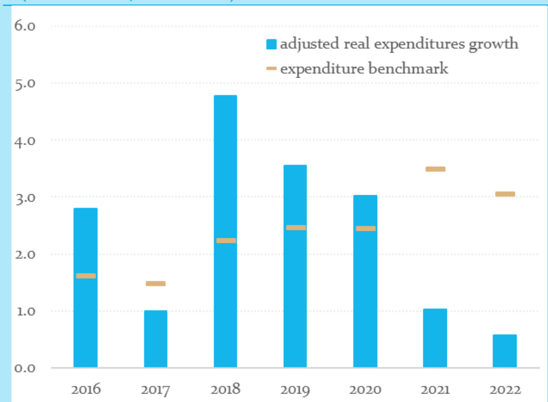
48 „Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement over 2019 and 2020 taken together… Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact."

Figure 3: General government structural balance in 2016-2022 (ESA2010, % GDP)



Source: Ministry of Finance, CBR

Figure 4: Expenditure benchmark based on CBR's calculations in 2016-2022 (ESA2010, % GDP)



Source: CBR

In Figure 3, the structural balance values are recalculated using the CBR's methodology against the specified adjustment path towards the medium-term budgetary objective. Considering the given macroeconomic forecast, the medium-term objective would be achieved in 2021, should the risks identified by the CBR indeed materialise and no additional measures are adopted. If the government's objectives are achieved through the adoption of additional measures, the medium-term budgetary objective would be met in 2019, according to the CBR's calculations.

Figure 4 illustrates the meeting of the expenditure benchmark based on CBR's calculations in the period between 2016-2022 and is for indicative purposes only. Should the risks identified by the CBR materialise, the rate of adjusted expenditure of the general government would exceed the rate allowed by the expenditure benchmark in 2019. Based on the data available from the Stability Programme of the Slovak Republic for 2019-2022 and on identified risks, the expenditure growth rate is expected to be lower than the potential economic growth. However, the assessment of the expenditure development, in particular between 2021 and 2022, can be considered as purely indicative due to the absence of the binding multiannual expenditure ceilings[49].

49 The data from the three-year general government budget are, for the second and third year covered by the budget, indicative only. In the absence of binding expenditure ceilings, the potential improvement of the tax revenue forecast assuming unchanged budgetary objectives could be reflected in additional expenditures that will increase the rate of their growth.

2. Opinion on the evaluation by the Ministry of Finance

On 28 June 2019, the Ministry of Finance published its evaluation of compliance with the balanced budget rule for 2018 which was updated on 12 July 2019 to correct numerical errors[50]. It concludes, based on preliminary data as notified by Eurostat, **there was only an insignificant deviation from the balanced budget rule,** therefore, **it did not propose to trigger the correction mechanism.** In the primary assessment, the Ministry identified insignificant deviations under both indicators. While the deviation is just below the significant deviation threshold[51] in the case of the expenditure benchmark, the deviation in the structural balance is negligible[52]. As regards the expenditure benchmark, the overall assessment increased the deviation to a significant one without any impact on the conclusions of the evaluation[53].

The Ministry's and the CBR's evaluations differ in their overall conclusions. The CBR believes that, even after taking into account the relevant factors, both indicators showed a significant deviation from the path towards MTO in 2018 and, for this reason, it is necessary to trigger the correction mechanism.

Further differences between the two institutions' primary assessments are mainly caused by a different approach to considering the one-off effects in the structural balance and discretionary revenue measures in the expenditure benchmark (Table 7). In terms of the structural balance, both institutions assessed the deviation as insignificant. As for the expenditure benchmark, the differences produced different evaluations. While the deviation exceeded the significant deviation threshold in the CBR's evaluation, this was not the case with the evaluation of the Ministry of Finance.

According to the CBR's opinion, the Ministry's primary assessment of the expenditure benchmark contains inaccuracies stemming from the fact that it did not review the estimated effects of discretionary revenue measures prior to 2018[54]. The Ministry did not include the updated 2015-2017 macroeconomic indicators in its estimate of the improved VAT collection, thus having overvalued its positive effects. As regards the allowance in health insurance contributions, it did not apply the more precise procedure for its estimate

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50 MF SR, Compliance with the Balanced Budget Rule for 2018, June 2019 (available in Slovak only). The data presented in the CBR's evaluation are based on the corrected version of the MF SR evaluation.

51 According to the Ministry, the expenditure benchmark deviation is 0.498 % of GDP, whereas the significant deviation threshold is set at 0.5 % of GDP. This implies that increasing the adjusted expenditure or reducing the effect of discretionary revenue measures by some EUR 2 million would cause that the significant deviation threshold will be reached.

52 The deviation in the structural balance is 0.01 % of GDP.

53 The Ministry's evaluation applies the approach used by the European Commission to assess the rules under the Stability and Growth Pact. Under this approach, a significant deviation from the balanced budget rule may occur if a significant deviation has occurred in at least one of the indicators in the primary assessment and this deviation is also confirmed by the overall assessment. (DG ECFIN, Vade Mecum on the Stability and Growth Pact, version 2019, Institutional Paper 101, April 2019, pg. 36, Table 1.2).

54 According to the CBR, such an approach is inconsistent and may lead to misrepresentations of the evaluation results when assessing the development in public finances cumulatively.

consistently[55] in all years (Box 4). **If these inaccuracies were removed, the significant deviation in the expenditure benchmark would occur even in the primary assessment. In that case, even the approach taken by the Ministry[56] could result, after the overall assessment, in a significant deviation with a recommendation to trigger the correction mechanism.**

Table 7: Primary assessment by the CBR and the Ministry (ESA2010, % GDP)

	CBR	MF SR	Difference
Medium-term budgetary objective	-0.5 (2019)	-0.5 (2019)	-
General government balance	-0.7	-0.7	0.0
Cyclical component	0.3	0.3	0.0
One-off effects	0.3	0.0	0.3
Structural balance	**-1.2**	**-1.0**	-0.3
Compliance with the medium-term objective	**no**	**no**	-
Change in structural balance	1.2	1.4	-0.2
Required change in structural balance	1.4	1.4	0.0
Compliance with the change in structural balance (cumulatively from 2016 to 2018)	**no**	**no**	-
*Deviation of the change in structural balance from the path**	-0.3	0.0	-0.3
Significant deviation**	**no**	**no**	-
Growth in expenditure aggregate net of revenue measures	8.8	7.1	1.7
Expenditure benchmark	5.4	5.6	-0.2
Compliance with the expenditure benchmark (cumulatively for 2016-2018)	**no**	**no**	-
*Deviation from the expenditure benchmark (impact on the general government balance)**	-1.2	-0.5	-0.7
Significant deviation**	**yes**	**no**	-

** the minus sign (-) means non-compliance with the benchmark*
*** a deviation is significant, if it reaches at least -0.5 % of GDP*
Source: MF SR, CBR
Note: The subtraction difference in the column labelled as "Difference" is caused by rounding.

Box 4: Description of differences in the primary assessment between the Ministry and the CBR

In evaluating the structural balance, both institutions use the same method. Due to the lacking specification of a binding change in the structural balance in individual years, the CBR, as well as the Ministry, assumes a steady improvement in the structural balance over the period between 2015 and 2019.

55 The more detailed procedure consists in that that neither the Ministry nor the CBR consider the effect of the fixed amount of the allowance in health insurance contributions which will lead to a gradual automatic reduction in the negative effect of the measure on the public finances over time to a be a discretionary measure.

56 The Ministry's evaluation applies the approach used by the European Commission to assess the rules under the Stability and Growth Pact. Under this approach, a significant deviation from the balanced budget rule may occur if a significant deviation has occurred in at least one of the indicators in the primary assessment and this deviation is also confirmed by the overall assessment.

The numerical difference in the 2018 structural balance was caused in particular by one-off effects. The Ministry did not include the effect of the incorrect recording of wages on extra budgetary accounts among the one-off effects, but took it into consideration within additional factors as a potential source of general government balance revision under the autumn notification. The slight numerical differences between both institutions in determining the amount of structural balance in individual years are also due to the fact that, in estimating the potential output (and output gap), the CBR takes into account, apart from the Ministry's forecast, also forecasts of other institutions.

In the calculation of the required pace of the expenditure growth, the minimum differences persist only due to the above-described different approaches to estimating the potential output's growth rate.

In comparison with the 2017 evaluation, the differences between both institutions became more prominent in the calculation of the actual adjusted expenditure growth rate. These are based on three different aspects in discretionary revenue measures with a total impact of 0.6 % of GDP[57]:

- **As was the case with the 2017 evaluation[58], the Ministry of Finance included the estimate of the effect of improved VAT collection among the discretionary revenue measures.** Since the previous CBR evaluation in December 2017, no qualitative change has been made in the estimate. A high degree of uncertainty of the estimate still persists[59], therefore, the CBR has not changed its existing approach and the effect of improved VAT collection is taken into account under additional factors. **In terms of the size of the effect, it is the largest contributor to the difference between the Ministry's and CBR's primary assessments** (contributing by 0.55 % of GDP).
  At the same time, the macroeconomic indicators have been updated, thus reducing the estimate of the effect of improved VAT collection in 2016 and 2017 (by a total of 0.06 % of GDP[60]). This change was not taken into account by the Ministry of Finance in its evaluation.

- The Ministry of Finance has changed its approach as regards the estimate of effects arising from the **introduction of the allowance in health insurance contributions**, a move that has been endorsed by the CBR[61] as well. The differences between the institutions have been

57 Without these differences, the negative impact of the deviation in the expenditure benchmark would have amounted to 1.1 % of GDP on a cumulative basis according to the Ministry's evaluation, which is close to the level indicated in the CBR's evaluation.

58 In the evaluations made before 2017, the effect of improved VAT collection was taken into account by the Ministry of Finance and the CBR in the same manner, i.e., within additional factors, due to a high uncertainty of the estimate and a simplified approach. The Ministry justified its approach as follows: "Additional revenues from measures aimed at improving tax collection, which we have been reporting in the long-term also as part of attaining the tax revenues, are not reflected in discretionary revenue measures due to their more complex estimation." (MF SR, Compliance with the Balanced Budget Rule for 2016; November 2017). Since 2017, the Ministry of Finance has not justified the methodology change.

59 The Ministry of Finance estimates the effect of improved VAT collection based on the rate of a year-on-year increase in the effective tax rate, net of other legislative measures (the effect would be zero, if the effective tax rate remained unchanged). This estimate is associated with a high degree of uncertainty as the individual government measures cannot be clearly attributed to changes in the behaviour of taxpayers. The effective tax rate is also influenced by the phase of the economic cycle, which further increases the uncertainty of the estimate.

60 The CBR took this difference into account in the overall assessment.

61 Setting a fixed amount of the deductible tax allowance will lead to an automatic gradual reduction of the negative impact of the measure on public finances over time (just as setting the method of increasing the tax allowance

caused by the fact that the Ministry of Finance applied the change in approach only as from 2018 (i.e., leaving the originally estimated effects on public finances in 2016 and 2017 under the discretionary revenue measures). The CBR has been applying this change consistently across the entire time series, therefore the figure in the CBR evaluation worsened by 0.04 % of GDP. At the same time, in 2018, the CBR's estimate regarding the legislative changes in the application of the allowance in health insurance contributions in proportion to the number of months worked is different as well. The CBR's estimate is based on the results of the annual health insurance settlement in 2018 and is less favourable than the Ministry's estimate, by 0.02 % of GDP.

- Setting the minimum threshold required for an impact of a measure to be regarded as discretionary[62] at EUR 10 million represented another methodology change made by the Ministry of Finance. This change has had a negligible negative impact between 2016 and 2018 and worsened the Ministry's evaluation by 0.01 % of GDP.

In the overall assessment (Table 8), the differences between the institutions have increased with regard to the structural balance, because the **Ministry of Finance did not take into account the impact of interest payments and windfall revenues**. In the past, these factors have also been taken into account by the European Commission[63], while the windfall revenues are directly specified in the rules of the Stability and Growth Pact[64]. At the same time, the Ministry of Finance also took into account the updated estimate of taxes in 2018[65], which the CBR mentions only under qualitative factors as it expects the tax revenues to be further specified with more precision.

In the case of the expenditure benchmark, the differences between the institutions have been reduced following the overall assessment. The reason is that the CBR took into account the impact of improved effectiveness in VAT collection, which the Ministry of Finance has already included in the primary assessment with slightly higher effects.

amount in the case of personal income tax leads to the so-called fiscal drag), while this is not considered a discretionary measure.

62 From the very beginning of preparing their balanced budget rule evaluations, both institutions used a list of discretionary measures without limiting the size of their effect. The Ministry justified the introduction of the minimum threshold by the need to align the list of measures with the Stability Programme; however, it is an arbitrarily determined threshold that is not stemming from the requirements under the Stability and Growth Pact. At the same time, it is the only component of analytical adjustments necessary for evaluating the balanced budget rule which is aligned with the Stability Programme (in the evaluation of the balanced budget rule, the cyclical component, one-off effects and methodology effects differ from those indicated in the documents submitted to the European Commission).

63 EK, Assessment of the 2018 Stability Programme for Slovakia, Commission staff working document, pg. 13

64 According to the rules of the Stability and Growth Pact, windfall revenues should be also taken into account as part of determining the year-on-year structural balance improvement and its subsequent evaluation.

65 Based on the June 2019 forecast of the Tax Revenue Forecasting Committee, the Ministry of Finance included in its evaluation the deterioration of tax collection by EUR 18 million when compared with the spring notification.

Table 8: Overview of additional factors considered in the evaluation (ESA 2010, % GDP)

	CBR		MF SR	
	CSB	AE	CSB	AE
1. Primary assessment*	**-0.27**	**-1.17**	**-0.01**	**-0.50**
2. Additional factors	**-1.21**	**0.24**	**-0.28**	**-0.26**
A. Factors with quantified effects:	**-1.21**	**0.24**	**-0.28**	**-0.26**
Measures with no impact on long-term sustainability	0.15	0.05	-	-
Interest payments	-0.44	-	-	-
Windfall revenues	-0.92	-	-	-
Expenditure on co-financing	-	-0.27	-	-0.26
Improved effectiveness in tax collection	-	0.45	-	PA**
Recording of wages on extra budgetary accounts	PA**	-	-0.26	-
B. Additional factors (only qualitative assessment):	**no quantification**			
Updated tax revenues	Y (-)	-	-0.02	-
Update made in other parts of the balance, including the prepared revision of national accounts	Y	Y	Y	Y
3. Overall assessment (1+2)*	**-1.47**	**-0.94**	**-0.29**	**-0.75**
	significant deviation has occurred		**significant deviation has not occurred**	

Notes.: CSB - change in structural balance, AE – adjusted expenditure; Y - included, N – not included among additional factors; (+) improves and (-) worsens the relevant indicator, (0) roughly neutral impact

Source: MF SR, CBR

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

*** covered within the primary assessment*

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 of the European Union, 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 proposed by individual Member States on the basis of common principles published by the European Commission[66]. These principles presuppose 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[67] which entered into force as of 1 January 2014. The general government budget is considered balanced (i.e., the rule is respected) if the **general government structural deficit[68] 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[69] 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[70]. It is evaluated on the basis of an overall assessment of structural balance development and development in the adjusted expenditure net of discretionary revenue measures.

The correction mechanism will **specify the maximum amount of the accrued consolidated general government expenditure** (public expenditure ceiling) and the **measures taken during the period of correction from the deviation**. The correction should take into account the size of the deviation observed, respecting the attainment of the medium-term objective, and annual reductions in the general government deficit to gross domestic product ratio based on

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66 Communication from the Commission: Common principles on national fiscal correction mechanisms z 20.6.2012.

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

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

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

70 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 2.5 of this document.

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[71].

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[72], the Ministry of Finance must report twice a year (by 30 June and 30 November[73]) 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.

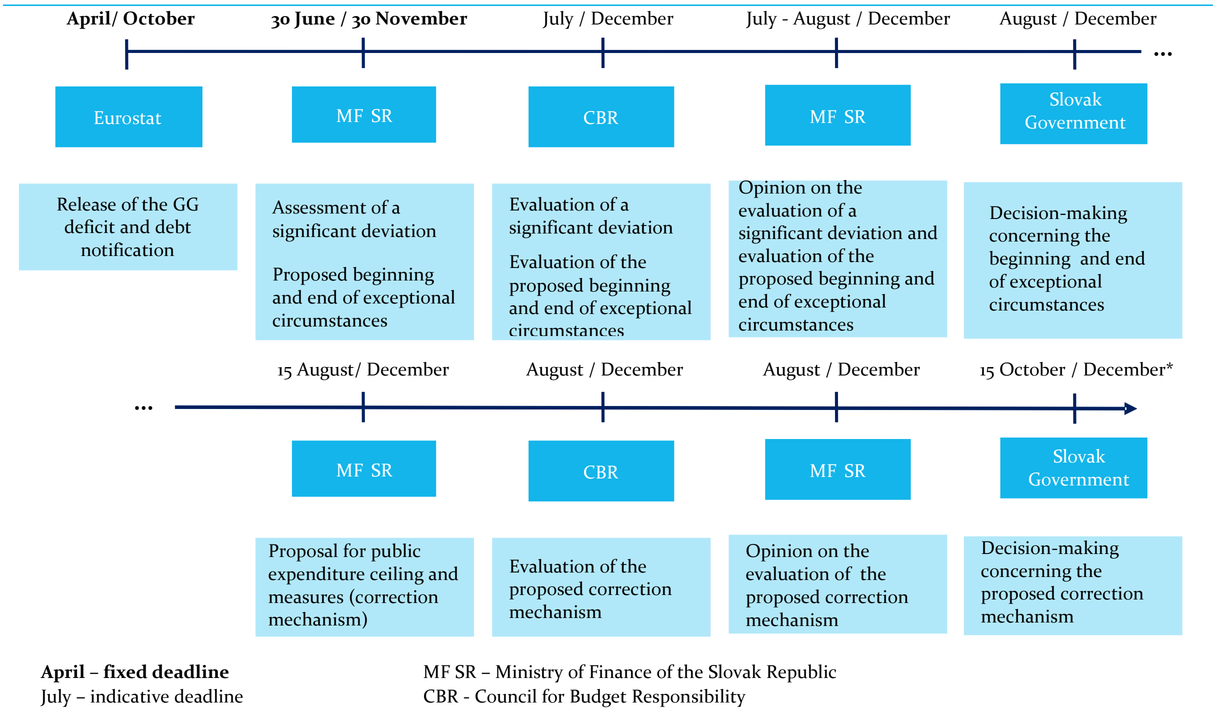
The **beginning and end of the duration of exceptional circumstances is declared by the government** based on a proposal by the Ministry of Finance. **Prior to the declaration, the proposal is reviewed by the CBR.** The Ministry of Finance publishes its opinions on all CBR evaluations (the "comply or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

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

72 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.

73 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 5: Procedures and responsibilities of individual institutions



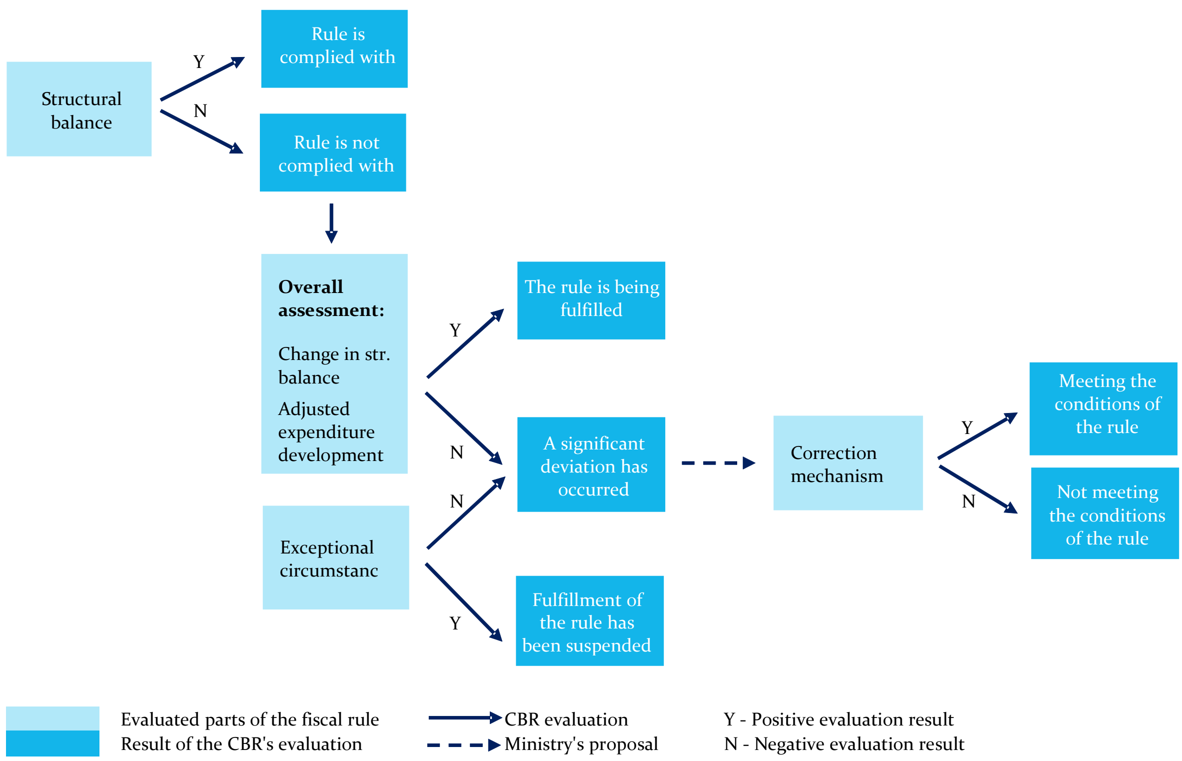
*Note: * Because of the short time period between the publication of the assessment of significant deviation by the Ministry of Finance and the end of November, there might be a situation that, for the purposes of adopting a correction mechanism, the proposed measures will be incorporated in the following year, either through an amendment to the approved budget for the relevant year or as part of the preparation of the next year´s budget.*

Source: CBR

Annex 2 - Process of CBR evaluation

The CBR's evaluation of compliance with the balanced budget rule consists of several steps (Figure 4) and is based on actual figures. The first step involves a comparison whether the **structural balance target value set by the government complies with the minimum amount defined in the Budgetary Rules Act** and whether **this target was achieved in the year assessed**. **If this target was not achieved**, the CBR will evaluate whether Slovakia has made sufficient progress towards meeting this target, using two fiscal indicators. Specifically, it will **compare the cumulative change in the structural balance and the change in the adjusted expenditure net of discretionary revenue measures** in 2018 against 2015 with the required change in these indicators. At the same time, the CBR will assess whether **exceptional circumstances have occurred (or persist)** during which the balanced budget rule does not apply. Based on these analyses, the CBR will evaluate whether a **significant deviation has occurred and whether or not the correction mechanism should be triggered**. **If the correction mechanism is triggered and the Ministry of Finance proposes corrective measures, the CBR will also evaluate this mechanism.**

Figure 6: Evaluation of the balanced budget rule – description of procedure



Source: CBR

Annex 3 - One-off effects

This part describes the one-off effects which have been taken into account in evaluating compliance with the balanced budget rule. One-off effects are identical with those used by the Ministry of Finance in its evaluation, except for the recording of effects on extra budgetary accounts identified by the CBR in 2018.

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. Over the next 30 years, the amount of the advance payment will be reduced every year by an aliquot portion amounting to EUR 5.79 million. This amount will continue to affect the general government budget deficit negatively for a period of 30 years.

2. **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. According to preliminary data, the impact of proper recording of VAT in 2018 is positive and amounts to EUR 4 million.

3. **Refunds paid to households for gas consumption** - In 2016, the general government expenditures were affected by a one-off government measure of July 2015 under its social package. The measure applied to all households which use gas for cooking, hot water, or heating. The Ministry of Economy started paying the gas refunds to households at the end of January 2016, with the impact on the general government balance representing EUR 46 million in 2016.

4. **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 fine in the amount of EUR 44.8 million[74] on 30 December 2013, which had a positive one-off effect on non-tax revenues in 2014. The companies appealed against the decision of the Supreme Court of the Slovak Republic, but the court confirmed the fine again in November 2016. Some of the companies have paid the liability towards the Antimonopoly Office, but the remaining amount of EUR 26.1 million (unpaid fine imposed on Mota – Engil, Engenharia e Construcao, S.A. and Strabag a.s.) has been transferred to Slovenská konsolidačná, a.s. and, due to assumed irrecoverability of these fines, it negatively affected the general government balance in 2016.

74 Of this amount, the penalties were imposed on the individual companies as follows: EUR 12.2 million for Strabag a.s., EUR 6.6 million for Doprastav, EUR 3.0 million for BETAMONT s.r.o., EUR 130,000 for Inžinierske stavby, a.s., EUR 9.0 million for Skanska DS, a.s., and EUR 13.9 million for Mota – Engil, Engenharia e Construcao, S.A.

5. **Recording of wages on extra budgetary accounts** – the change in the recording on extra budgetary accounts of the state budget (applicable mainly to the transfers of funds from state budget chapters to separate accounts) resulted, according to the CBR, in a positive one–off effect of wage expenditures[75] on the balance. The expenditures on wages of the state budget for December 2017 that had been paid from the extra budgetary accounts in January 2018 were not recorded in the expenditures of these accounts in 2018. The expenditures on wages for the January to November 2018 period were paid to employees directly from the state budget. The expenditures on wages for December 2018 were transferred from the state budget to extra budgetary accounts (to be paid in January 2019) and recognised as revenues of these accounts in 2018 while no other adjustment was made in the reported data. According to the CBR's estimate, the positive impact on the balance in 2018 amounted to EUR 233.1 million.

Table 9: One-off effects in 2015-2019 (ESA2010, EUR million)

	2015	2016	2017	2018	2015	2016	2017	2018	2015	2016	2017	2018
	CBR				MF SR				Difference			
- VAT receipt from a PPP project (Granvia)	-6	-6	-6	-6	-6	-6	-6	-6	0	0	0	0
- Accrualisation of VAT receipts	12	-34	15	4	12	-34	15	4	0	0	0	0
- Refunds paid to households for gas	-	-46	-	-	-	-46	-	-	-	0	-	-
- Penalty imposed by the Antimonopoly Office	-	-26	-	-	-	-26	-	-	-	0	-	-
- Incorrect recording of wages on extra-budg. accounts*	-	-	-	233	-	-	-	-	-	-	-	233
TOTAL	**6**	**-112**	**10**	**231**	**6**	**-112**	**9**	**-2**	**0**	**0**	**0**	**233**
(% GDP)	*0.0*	*-0.1*	*0.0*	*0.2*	*0.0*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.3*

** The Ministry of Finance took this factor into account as part of additional factors* *Source: CBR, MF SR*

[75] The CBR considered the expenditures on wages (economic classification categories 610 and 620) only, because they are paid in monthly intervals, which allows identifying potential irregularities from available reports. The expenditures on wages make up approximately 70 % of the funds transferred from the state budget to extra budgetary accounts in 2018.

Annex 4 - Expenditure benchmark – methodology and data

The adjusted expenditure and the expenditure benchmark are calculated, subject to some adjustments, in line with the procedure laid down in the Stability and Growth Pact[76]. The purpose of these adjustments is to make the calculation of indicators more precise, ensure the comparability of adjusted expenditure and the expenditure benchmark and narrow the differences between the structural balance and adjusted expenditure. They specifically include:

- **Use of actual data** as opposed to forecasts (GDP deflator) and multi-annual averages (potential output growth rate). 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 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 contributions paid by the state, reclassification of general government entities), or such changes in revenues which are automatically recorded under expenditures without any impact on the balance (contributions to the Single Resolution Fund paid by the Single Resolution Board) The list of impacts in individual years is presented in Table 10.
- **Exclusion of cyclical pension expenditure** – this change reflects the fact that, in estimating the cyclical component of the general government balance, the CBR also estimates the cyclical expenditure related to pensions. The CBR has thus aligned its approach to that used in estimating the structural balance.
- **Adjusting the expenditure base in the calculation of the required slower rate of growth in adjusted expenditure** – as opposed to the rules of the Stability and Growth Pact where the need for a slower rate of growth in expenditure for countries not meeting the medium-term budgetary objective is calculated from the level of primary expenditure, the CBR´s calculation is based on the primary expenditure aggregate. This will enable a mutually consistent comparison of the expenditure benchmark with the adjusted expenditure growth rate. This adjustment is necessary because neither the EU funds, nor cyclical and one-off expenditures or fluctuations in investments are contributing to the improvement of the structural balance. The result of this more accurate approach is that compliance with the expenditure benchmark will lead to the required improvement in the structural balance through adjusted expenditure (primary expenditure aggregate adjusted for discretionary revenue measures and methodology impacts).

In comparison with the December 2018 evaluation, no methodology changes were made; however, the effects of several measures were quantified with more precision.

[76] The method of calculation is contained in the 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 15 May 2017).

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's 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 measures related to the introduction and subsequent changes in the allowance on health insurance contributions, where the CBR applied its own estimate[77], are an exception. The other measures concerning 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 2015-2018 whose subsequent change was used as an input in the calculation of the adjusted expenditure development.

Table 10: Discretionary revenue measures and methodology impacts (ESA2010, EUR million, additional effects)

	2016	2017	2018
1. Discretionary measures	**-180,383**	**135,200**	**-124,072**
Introduction of the health insurance contributions allowance	-135,000	-	-
Opening of the second pension pillar	12,550	-	-
Less stringent conditions in claiming refunds on excess VAT	6,800	-	-
An increase in the quantity of cigarettes in a pack from 19 to 20 as of 1 March 2016	4,069	1,436	-
Weight-based taxation of cigars and cigarillos	-	6,494	-
VAT rate reduction for selected foodstuffs	-76,900	-	-
Support for capital market investments	-11,297	-	-
Changes in administrative fees in 2016	19,395	-	-
Corporate income tax reduction to 21 %	-	-121,341	-
An increase in the fee for emergency oil stocks storage	-	30,071	-
Special levy in regulated sectors – doubled rate, adjustments made in the conditions and calculation	-	62,586	-
An increase in excise tax on tobacco as of 1 February 2017	-	29,566	2,909
Interest rates on withheld excess tax refunds, more effective administration of taxes	-	2,700	-
SRB* revenues exempt from corporate income tax	-	-4,500	-
Flat-rate expenditures of 60 %, up to EUR 20,000	-	- 34,260	-

77 The reason comes down to inconsistent time series in the Ministry's estimate. The Ministry of Finance has changed its approach as regards the estimate of effects arising from the introduction of the helath insurance contributions allowance, a move that has been endorsed by the CBR as well. The rationale behind the change was that, as a result of growing wages in the economy, a fixed amount of the allowance would lead to a gradual automatic reduction in the negative effect of the measure on the public finances over time, while this is not considered to be a discretionary measure. The Ministry of Finance applied the change in the approach only as from 2018, while in 2016 and 2017 the originally estimated effects on the public finances (including the impact of the fixed amount) remained under discretionary revenue measures.

Abolition of the maximum assessment base for health insurance	-	96,521	-
An increase in the maximum assessment base for social insurance	-	70,444	-
An increase in the real estate tax rates	-	5,557	-
Introduction of the levy on non-tax insurance	-	16,259	14,032
Development fee (tax imposed on specific services)	-	2,649	-
Change in the gambling levy amount	-	9,800	-
Changes in administrative fees in 2017	-	-10,673	-
Increasing the contribution to the second pillar of the pension system	-	-28,110	-32,183
Abolition of tax licences	-	-	-115,000
Taxation of dividends, 7 % withholding tax (including the impact of the abolition of health insurance contributions)	-	-	23,665
Change in the application of the allowance in health insurance contributions	-	-	12,500
Increased deduction of expenditure on science and research	-	-	-9,013
Introduction of separate depreciation of technical upgrades (subsequent costs)	-	-	-142
Introduction of tax allowance for spa care	-	-	-1,924
Exemption of the so-called pensioners' "agreement contracts" from social contributions	-	-	-9,100
Introduction of the 13th and 14th salary with tax reliefs	-	-	-1,993
Abolition of the allowance in health insurance contributions for employers	-	-	19,200
Shortening the depreciation period from 40 to 20 years	-	-	-2,579
Exemption of advertising revenue for non-profit organisations	-	-	-1,366
Spas – a change in depreciation	-	-	-2,863
Changes in administrative fees in 2018	-	-	-20,215
2. Methodology impacts in revenues	**47,043**	**15,976**	**-81,801**
Changes in imputed social contributions	9,779	8,601	-996
Changes in insurance contributions paid by the state:	49,167	11,447	-82,315
- health insurance	43,236	-92,821	-110,302
- social insurance	5,931	10,555	31,576
- pension scheme of armed forces	0	93,713	-3,590
Changes in financial sector schemes (SRB)*	-11,903	-4,072	1,510
Total, including methodology changes (1+2)	**-133,340**	**151,175**	**-205,873**
*p.m. Measures with no impact on the long-term sustainability***	*12,550*	*-28,110*	*-32,183*

** SRB– Single Resolution Board* *Source: MF SR, CBR*

*** Measures with no impact on the long-term sustainability of public finances are printed with blue ink.*

Annex 5 - The list of additional factors

The estimate of the structural balance and of the rate of adjusted expenditure may be influenced by factors that are distorting the informative value of the relevant indicators. For this reason, these factors must also be taken into account when interpreting the results. Neither the legislation applicable to the balanced budget rule, nor the rules of the Stability and Growth Pact contain a well-defined list of factors that need to be taken into account. Therefore, the CBR´s identification of additional factors is based on the fundamental purpose of the balanced budget rule, i.e., establishing or rapidly converging towards such a fiscal position that will ensure the long-term sustainability of public finances (meeting the medium-term budgetary objective). In addition, as the primary focus is on evaluating the impact of government's measures, the CBR also considers the factors that are outside its control. They are considered only if they are verifiable and their impact on the general government balance is quantifiable. Specifically, the factors are as follows:

- **Measures with no impact on long-term sustainability**

Compliance with the medium-term budgetary objective is intended to lay the groundwork for the long-term sustainability of public finances. For this reason, when it comes to structural balance and adjusted expenditure, the CBR takes into account the government measures having a non-zero impact on the balance in the medium term, even though they are broadly neutral in the long term. **Specifically, this involves the impact of the second (fully-funded) pillar of the pension system, levies on financial institutions and the nuclear decommissioning scheme**. Lowering the share of the pension contribution towards the fully-funded pillar in 2012 while increasing the share of contribution towards the pay-as-you-go pillar of the Social Insurance Agency by the same amount has immediately improved the general government revenues, but will lead to higher expenditures on pensions in the future. The levies on financial institutions (towards state financial assets, the Deposit Protection Fund and the Investment Guarantee Fund), which are intended to cover the future costs associated with potential crises in the financial sector, have been increasing the general government revenues every year. The nuclear decommissioning scheme consists of contributions received from the operators of nuclear facilities and companies distributing the generated electricity. These contributions are aimed at covering the future costs associated with the decommissioning of nuclear facilities. The revenues are currently exceeding the expenditures, thus having a positive impact on the general government balance.

- **Impact of changes in interest payments**

Changes in interest payments are affecting the structural balance, but do not have an impact on adjusted expenditure. This factor is not under the direct control of the government (it depends on the government's past decisions – the amount of the accumulated debt and yields prevailing on the financial markets). The savings on interest payments in 2017 which had improved the structural balance were also noted by the European Commission in its assessment of the Stability Programme of the Slovak Republic for 2018-2021[78].

[78] EC, Assessment of the 2018 Stability Programme for Slovakia, Commission Staff Working Document, pg. 13

- **Windfall or shortfall revenues**

Different development in revenues against the assumptions of the budget contributes towards the improvement (windfall revenues) or worsening (unexpected shortfalls) of the structural balance, in which case the factors may be outside the control of the government (for instance, better-than-expected macroeconomic development reflected in additional tax revenues). A similar procedure needs to be applied also under the rules of the Stability and Growth Pact[79]. In the case of windfall revenues, the structural balance should thus improve more significantly against the set adjustment path.

- **Impact of expenditures on co-financing**

The drawdown of EU funds is negatively affecting the general government balance through the associated expenditures on co-financing. On the other hand, this leads to an immediate increase in tax revenues (be it in the form of indirect taxes, in particular VAT, or direct taxes such as the personal income tax and social and healthcare contributions, as well as the corporate income tax). The CBR estimates[80] that each euro spent on co-financing increases the tax revenues by approximately one euro. This means that the effect of increased expenditures on co-financing on the structural balance approaches zero, because the higher year-on-year EU funds drawdown associated with an increase in expenditures on co-financing will translate into higher tax revenues. Likewise, the lower drawdown of EU funds leads to savings on expenditure on co-financing and shortfalls in tax revenues. The CBR therefore considers the size of expenditure on co-financing only in the case of adjusted expenditure specifically due to their direct impact on tax revenues.

- **Improved effectiveness in tax collection**

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. The impacts of these measures are included in the structural balance, but these changes are not captured in the development of adjusted expenditure. For this reason, the improved effectiveness in tax collection was taken into account by the CBR in the development of adjusted expenditure, because it represents an additional source for financing the expenditures.

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79 According to the rules of the Stability and Growth Pact, windfall revenues should also be taken into account in determining the year-on-year structural balance improvement and in its subsequent evaluation.

80 Evaluation of the General Government Budget Proposal for 2015-2017, November 2014, Annex 2. This involves direct impacts on tax revenues estimated on the basis of the structure of EU funds drawdown within the economic classification. In its estimate, the CBR did not include the secondary impacts of EU funds drawdown (higher economic growth resulting in additional tax revenues) which are not negligible either.

Annex 6 - The procedure for estimating additional factors

Windfall revenues
In estimating the windfall or shortfall revenues, the CBR uses the tax revenues and social insurance contributions projected by the Tax Revenue Forecasting Committee. The year-on-year change in these revenues (net of tax credits and the 2 % allocation from taxes for public benefit purposes which are recorded on the expenditure side of the budget[81]), as expected at the time of approval of the relevant budget, is compared with the year-on-year change reported in the most recent notification. In estimating the size of windfall revenues over multiple years, each year is assessed separately and the amounts estimated for individual years, expressed as a share of GDP, are added up[82].

The overall tax revenues are adjusted for the following three factors:

- **Cyclical tax revenues** – which are excluded because of the fact that a part of tax revenues is attributable to the economic cycle and, therefore, has no impact on the structural balance,
- **EU funds drawdown** is connected with additional tax revenues. Each euro spent on co-financing increases, according to the CBR's estimate, the tax revenues by approximately one euro. Due to the neutral impact of the drawdown of EU funds on the structural balance, it is necessary to adjust the year-on-year changes in tax revenues induced by year-on-year changes in expenditures on co-financing. The CBR estimate is based on the assumptions in the Macroeconomic Forecasting Committee forecast concerning the drawdown of EU funds while applying the assumption about the co-financing rate on the basis of actual data.
- **Improved VAT collection estimate** – this is the result of non-quantified government measures for improving VAT collection, net of the impact of the economic cycle.

Differing impacts of legislative measures included in the budget assumptions are not adjusted for, because the CBR considers them a possible source of windfall or shortfall revenues as well.

The calculation of an estimate of windfall revenues is based on nominal values and does not reflect the impact of the different-than-expected GDP development in comparison with the budget assumptions (denominator effect). The reason is that the impact of GDP development on the structural balance is not only caused by a change in revenue, but also by a change in expenditure as a share of GDP. These impacts are, to a large extent, offsetting each other.

In comparison with the results of December 2018, the estimate of windfall revenues is more precise. The impact of economic cycle between 2016 and 2017, as well as the amount of tax revenues in 2017, were updated on the basis of the data in the autumn notification. At the same time, the estimate of windfall revenues for 2018 has been added.

81 Under the ESA2010 methodology, the tax revenues are recorded without the reduction by these items, while they are simultaneously recorded on the expenditure side.

82 In economically favourable times, this represents a less stringent approach to estimates compared to a situation where the size of the windfall revenues would be estimated against the assumptions of a multiannual budget in the base year of the evaluation. The CBR's approach reflects the fact that he multiannual budgetary framework is updated regularly (several times a year) and its binding nature is low.

In its evaluation for 2016, the CBR compared the adjusted tax revenues of the approved General Government Budget for 2016-2018 with data from the April 2019 notification (Table 11). Windfall revenues represented EUR 64 million (0.08 % of GDP) in 2016. In the evaluation for 2017, the CBR compared the adjusted tax revenues of the approved General Government Budget for 2017-2019 with data from the April 2019 notification (Table 12). Windfall revenues came in at EUR 304 million (0.36 % of GDP) in 2017. In its evaluation for 2018, the CBR compared the adjusted tax revenues of the approved General Government Budget for 2018-2020 with data from the April 2019 notification (Table 13). Windfall revenues stood at EUR 433 million (0.48 % of GDP) in 2018. **Overall for the three years, the windfall revenues amounted to 0.92 % of GDP.**

Table 11: Estimate of windfall revenues in 2016 (ESA2010, EUR million)

	GGB 2016-2018			DDN 2019/04			Windfall (+)/ shortfall (-) revenues
	2015	2016	Difference	2015	2016	Difference	
	1	2	3=2-1	4	5	6=5-4	7=6-3
1. Tax revenues	22,038	22,930	892	22,672	23,387	715	-177
- revenues from taxes and social security contributions (TRFC)	22,360	22,995	635	22,990	23,713	722	87
- improved tax collection (Parliament)*	0	250	250	0	0	0	-250
- 2% for public benefit purposes	-60	-56	4	-57	-62	-5	-9
- tax credits	-262	-260	3	-261	-264	-2	-5
2. Cyclical tax revenues	-17	62	79	-169	-112	57	-22
3. Impact of EU funds drawdown **	591	307	-285	748	269	-479	-194
4. Impact of improved VAT collection	0	250	250	0	226	226	-24
5. Overall impact (1-2-3-4)	**21,464**	**22,311**	**847**	**22,093**	**23,005**	**911**	**64**
- in % of GDP	**-**	**-**	**-**	**-**	**-**	**-**	**0.08**

Note: GGB – general government budget, DDN 2019/04 – deficit and debt notification of April 2019, TRFC – Tax Revenue Forecasting Committee

Source: SO SR , MF SR, CBR

** in DDN 2019/04: included in tax revenues*

*** amounting to the estimate of expenditures on co-financing included in the forecast of the Macroeconomic Forecasting Committee (provided that one euro in co-financing will increase the tax revenues by the same amount)*

Table 12: Estimate of windfall revenues in 2017 (ESA2010, EUR million)

	GGB 2017-2019			DDN 2019/04			Windfall (+)/ shortfall (-) revenues
	2016	2017	Difference	2016	2017	Difference	
	1	2	3=2-1	4	5	6=5-4	7=6-3
1. Tax revenues	23,769	24,946	1,178	23,387	25,171	1,784	606
- revenues from taxes and social security contributions (TRFC)	24,079	25,263	1,184	23,713	25,501	1,788	604
- 2% for public benefit purposes	-59	-65	-5	-62	-63	-2	4
- tax credits	-251	-252	-1	-264	-266	-3	-2
2. Cyclical tax revenues	5	44	39	-112	188	300	261
3. Impact of EU funds drawdown*	356	399	43	269	227	-42	-85
4. Impact of improved VAT collection	0	0	0	0	126	126	126

5. Overall impact (1-2-3-4)	**23,408**	**24,504**	**1,096**	**23,230**	**24,630**	**1,400**	**304**
- in % of GDP	**-**	**-**	**-**	**-**	**-**	**-**	**0.36**

Note: GGB – general government budget, DDN 2019/04 – deficit and debt notification of April 2019, TRFC – Tax Revenue Forecasting Committee *Source: SO SR , MF SR, CBR*
** amounting to the estimate of expenditures on co-financing included in the forecast of the Macroeconomic Forecasting Committee (provided that one euro in co-financing will increase the tax revenues by the same amount)*

Table 13: Estimate of windfall revenues in 2018 (ESA2010, EUR million)

	GGB 2018-2020			DDN 2019/04			Windfall (+)/ shortfall (-) revenues
	2017	2018	Difference	2017	2018	Difference	
	1	2	3=2-1	4	5	6=5-4	7=6-3
1. Tax revenues	24,944	26,198	1,254	25,171	26,940	1,770	516
- revenues from taxes and social security contributions (TRFC)	25,272	26,532	1,260	25,501	27,279	1,778	518
- 2% for public benefit purposes	-63	-65	-1	-63	-68	-5	-4
- tax credits	-264	-269	-5	-266	-270	-4	2
2. Cyclical tax revenues	52	137	85	188	302	114	29
3. Impact of EU funds drawdown*	212	265	53	227	311	84	31
4. Impact of improved VAT collection	0	0	0	0	23	23	23
5. Overall impact (1-2-3-4)	**24,680**	**25,796**	**1,116**	**24,756**	**26,304**	**1,549**	**433**
- in % of GDP	**-**	**-**	**-**	**-**	**-**	**-**	**0.48**

Note: GGB - general government budget, DDN 2019/04 – deficit and debt notification of April 2019, TRFC - Tax Revenue Forecasting Committee *Source: SO SR , MF SR, CBR*
** amounting to the estimate of expenditures on co-financing included in the forecast of the Macroeconomic Forecasting Committee (provided that one euro in co-financing will increase the tax revenues by the same amount)*

Expenditures on co-financing

The state budget expenditures on co-financing declined by EUR 479 million (0.59 % of GDP) year-on-year in 2016, and dropped further by EUR 42 million (0.05% of GDP) in 2017, whereas 2018 saw an increase by EUR 84 million (0,09 % of GDP). The slower drawdown of EU funds compared with 2015 will also be reflected in a decline of tax revenues. In its evaluation, the CBR estimates that each euro spent on co-financing increases tax revenues by approximately one euro[83]. Under this assumption, the impact of the drawdown of EU funds, including co-financing, has a zero impact on the structural balance.

On the other hand, the basic method of calculating the adjusted expenditure development only takes into account the change in co-financing expenditures without including the impacts on tax revenues[84]. For this reason, it is necessary to make an adjustment under additional factors to ensure a zero impact. Considering the fact that a year-on-year change in expenditure on co-financing is not fully reflected in the development of adjusted expenditure (due to using the average values of investment expenditure, including co-financing), it is necessary to make adjustments to the year-on-year change in the expenditure on co-financing (Table 14).

83 CBR, Evaluation of the General Government Budget Proposal for 2015-2017, November 2014, Annex 2.
84 The expenditure benchmark assumes that the rate of the real revenue growth of revenue was on par with the economic growth potential.

As regards 2016, the calculation of adjusted expenditure reflects a year-on-year decline in expenditure on co-financing by EUR 177 million (a change in four-year averages of expenditure on investment and a change in other expenditure on co-financing in the full amount), a decline by EUR 63 million in 2017 and an increase by EUR 24 million in 2018, which improved the impact of the adjusted expenditure indicator on the balance by a total of 0.27% of GDP. Ensuring a neutral impact on the balance would require making such an adjustment within additional factors that would worsen the indicator by 0.27 % of GDP (assumption of a revenue shortfall in the specified amount).

Table 14: Expenditure on co-financing in adjusted expenditure (EUR million)

	2012	2013	2014	2015	2016	2017	2018
1. State budget expenditure on co-financing (a+b)	407	367	372	748	269	227	311
- a. current expenditure and capital transfers	233	183	193	339	185	148	186
- b. gross fixed capital formation (GFCF)	175	185	180	409	84	79	126
2. Average expenditure on co-financing for GFCF (for years *t* to *t*-3)	-	-	-	237	214	188	174
3. Co-financing in adjusted expenditure (1.a+2)	**-**	**-**	**-**	**576**	**399**	**336**	**360**
4. Year-on-year change in expenditure on co-financing (Δ3)					**-177**	**-63**	**24**
- in % of GDP					**-0.22**	**-0.07**	**0.03**

Source: MF SR, CBR

Annex 7 - Differences between the structural balance and adjusted expenditure development

The structural balance and the adjusted expenditure development are two indicators that are used for evaluating the path of public finances towards a balanced budget. Although the structural balance plays an important 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 the CBR evaluated the path towards a balanced budget between 2016 and 2018, both indicators reached, while taking into account additional factors, different values that exceeded the significant deviation threshold (a deviation of -1.47 % of GDP for the structural balance and of -0.94 % of GDP for the adjusted expenditure development). Considering the required structural balance improvement by 1.43 % of GDP, this means that the structural balance worsened by 0.04 % of GDP between 2016 and 2018, while the expenditure development contributed to the improvement of the balance by 0.50 % of GDP. The differences can be explained by the following groups of factors:

- **Deviation of actual own investments from the four–year average (excl. EU funds and co-financing)** – while the structural balance takes into account the amount of own investments in a given year, the adjusted expenditure reflects the average amount of investments for the past four years. If a significant change occurs, either as a consequence of consolidation or an increase in investment activity, it is not always possible to identify it 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 was also the case of the period between 2016 and 2018, when **investments declined year-on-year which explains, for the most part, the difference between the two indicators** (contribution of 0.46 p. p.).

- **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 of the economy. 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 the changes in the effectiveness of tax collection that were not taken into account. Therefore, particularly if the conclusions of evaluations differ, the causes behind these differences should be examined. Between 2016 and 2018, the (non-tax) revenues were growing at a rate slower than that of the potential output, with a negative contribution of some 0.67 percentage points.

- **Inaccuracy in the calculation of the impact of the revenue growth rate at the level of the potential** – the calculation of the impact of the deviation on the balance is based on the comparison of the rate of growth in the adjusted expenditure and the rate of growth in revenues at the level of the potential. Such a calculation is precise only if the budget is balanced (the same adjusted revenue and adjusted expenditure). In all other situations, the calculation of the impact on the balance is distorted since expenditures grow from a different base than revenues, while inaccuracies build up as the number of years subject to the evaluation increases. The years 2016 to 2018, when public finances ran deficits, can be used as an example. The positive impact of the adjusted expenditure development on the balance was therefore overestimated (with a negative impact of 0.28 % of GDP) because the assumed increase in revenues was higher than the actual increase.

- **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 year-on-year change in nominal GDP (the so-called 'denominator effect'[85]). The structural balance already reflects this impact (a contribution of -0.05 p.p. between 2016 and 2018) because it is calculated based on the year-on-year change in individual items expressed as a share of GDP.

Table 15: Change in the structural balance and the impact of adjusted expenditure from 2016 to 2018 - differences (ESA2010, % GDP)

	Cumulatively for 2016 to 2018		
	Impact	Required Δ	Deviation
Change in adjusted expenditure after additional factors	**0.50**	**1.43**	**-0.94**
(+) Deviation of the change in actual investments from the average	0.46		
(+) Actual revenue growth beyond potential growth	-0.67		
(+) Inaccuracies in the calculation of the rate of revenue growth (different base)	-0.28		
(+) Impact of GDP growth (denominator effect)	-0.05		
Change in structural balance after additional factors	**-0.04**	**1.43**	**-1.47**

Source: CBR

Considering the significant impact of investments on the difference between the change in the adjusted expenditure and the change in the structural balance, the CBR has analysed the causes behind these differences in more detail (Table 16). While the investments reflected in the adjusted expenditure (a four-year average, excluding EU funds and co-financing) contribute to a year-on-year deterioration of the balance by 0.30 % of GDP, investments in the structural balance contribute to the improvement of the balance by 0.17 % of GDP.

Table 16: Own investments in individual indicators

	EUR million				% GDP				p.p.
	2015	2016	2017	2018	2015	2016	2017	2018	cumul.
Own investments without EU funds	-2,599	-2,090	-2,259	-2,471	-3.28	-2.57	-2.66	-2.74	0.54
- own investments	-2,190	-2,006	-2,180	-2,345	-2.77	-2.47	-2.57	-2.60	0.17

[85] The denominator effect is based on the fact that the general government balance or structural balance are expressed in relation to GDP. The year-on-year GDP change then influences the above ratio.

- co-financing	-409	-84	-79	-126	-0.52	-0.10	-0.09	-0.14	0.38
Average investments without EU funds (years *t*-3 to *t*)	-1,914	-2,050	-2,244	-2,354	-2.42	-2.52	-2.64	-2.61	-0.19
- own investments average	-1,678	-1,836	-2,056	-2,180	-2.12	-2.26	-2.42	-2.42	-0.30
- co-financing average	-237	-214	-188	-174	-0.30	-0.26	-0.22	-0.19	0.11
Own investments in adjusted expenditure	**-1,678**	**-1,836**	**-2,056**	**-2,180**	**-2.12**	**-2.26**	**-2.42**	**-2.42**	**-0.30**
Own investments in str. balance	**-2,190**	**-2,006**	**-2,180**	**-2,345**	**-2.77**	**-2.47**	**-2.57**	**-2.60**	**0.17**

Note: (+) improving and (-) worsening the general government balance *Source: CBR, SO SR*

The expenditure benchmark assumes an increase in structural revenues of the general government net of discretionary revenue measures and methodology impacts at the level of potential economic growth. As regards the developments between 2016 and 2018, this was an optimistic assumption which contributed to an improvement in the adjusted expenditure indicator by 0.68 p.p. when compared to the structural balance. While the tax revenue growth rate was higher (4.7 % a year in comparison with 4.1 %), non-tax revenues saw a significant decline between 2015 and 2018, thus leading to a slower overall revenue growth (Table 17).

Table 17: General government revenue development between 2015 and 2018

	EUR million				Rate of growth			
	2015	2016	2017	2018	2016	2017	2018	Average
1. General government revenues	**33,657**	**31,864**	**33,439**	**36,017**	**-5.3**	**4.9**	**7.7**	**2.3**
2. Adjustments (EU funds, cycle, measures, one-off effects)	4,861	2,512	3,210	4,158				
3. Adjusted structural general government revenue (1-2)	**28,796**	**29,352**	**30,229**	**31,859**	**1.9**	**3.0**	**5.4**	**3.4**
- tax revenues	23,407	24,601	25,551	26,893	5.1	3.9	5.3	4.7
- receipts, property income	4,116	4,157	4,289	4,472	1.0	3.2	4.3	2.8
- grants and transfers received	1,274	594	390	494	-53.4	-34.3	26.8	-27.1
Rate of growth of the potential output adjusted for GDP deflator	-	-	-	-	**2.4**	**4.0**	**5.8**	**4.1**

Source: SO SR, CBR

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