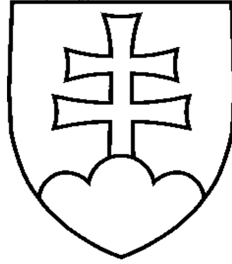

Ministry of Finance of the Slovak Republic

STABILITY PROGRAMME OF THE SLOVAK REPUBLIC FOR 2008 - 2012

April 2009

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INTRODUCTION

Slovakia successfully completed the process of its integration into the Economic and Monetary Union in 2008, thus accomplishing one of the basic objectives of its economic policy set out already in its first Convergence Programme of May 2004. Based on the recommendation of the European Commission, the European Council issued Decision No. 608 of 8 July 2008 whereby it declared that Slovakia fulfilled all the preconditions for adopting the single currency as from 1 January 2009. In keeping with the Decision, subsequently adopted Council Regulation No. 694/2008 of 8 July 2008 fixed the euro conversion rate for Slovakia at 30.1260 Slovak koruna. Following a successful euro changeover, Slovakia became the 16th member of the euro area.

One of the commitments arising for EU Member States from membership in the Economic and Monetary Union is the preparation of annual stability programmes by Member States of the euro area, and of convergence programmes by the remaining Member States. Starting in 2004, Slovakia prepared a total of five convergence programmes. Formal approval for Slovakia joining the euro area therefore means an obligation for the country to present its stability programmes replacing the previous convergence programmes.

Key objectives and messages under the Slovak Stability Programme until 2012:

- The Stability Programme was originally due for submission to the European Commission by 1 December 2008. However, in an effort to react to worsening prospects of economic development and external assumptions, the Slovak government inclined towards postponement of the aforementioned deadline for its submission. This is principally influenced by the necessity to update the macroeconomic forecasts and subsequently the fiscal framework.

- The programme builds on the latest official economic forecasts of 2 February 2009, prepared by the Ministry of Finance of the Slovak Republic. The presented fiscal objectives are consistent with this baseline economic scenario and included in a document, currently under preparation, entitled General Government Budget Framework for 2010-12, which presents the basic fiscal framework for the preparation of budget for the next period. A general government deficit at the level of 3% of GDP is projected for 2009, with gradual consolidation to 1.7% of GDP by 2012.

- The most recent economic developments indicate that the baseline economic scenario is confronted with a high negative risk. Therefore, Part IV of the programme describes possible impacts of a pessimistic economic scenario (a negative economic growth of 1% in 2009 and a moderate positive economic growth of 1% in 2010) on the budget deficit. The scenario shows the maximum risk associated the widening of deficits, as the entire shortfall in revenues from taxes and social contributions accompanied with higher interest payments compared to the baseline scenario are reflected in the deficit, i.e. no changes in expenditure policies are considered. Under such circumstances, the deficit would grow by 1.4% of GDP in 2009 and by 2.1% of GDP in 2010.

- Compared to the last Convergence Programme, the Slovak Stability Programme until 2012 is less ambitious in its fiscal objectives, due to the economic crisis and a considerably worse economic outlook. The revision of fiscal objectives reflects also the recommendations of the European Commission outlined in its "European Economic Recovery Plan" of 26 November 2008, approved by the European Council on 11 and 12 December 2008. Member States, whose fiscal situation enables them to do so, should let automatic stabilisers operate freely in 2009, and stimulate the economy through additional fiscal measures which should be timely, targeted and temporary. Notwithstanding, Slovakia continues to consider the rules of the Stability and Growth Pact to be at the core of prudent economic policy, and the revised objectives therefore respect the key objective of ensuring macroeconomic stability and achieving long-term sustainability of public finance.

- The main fiscal objectives remain unchanged compared to the last Convergence Programme; they are only modified in the light of the economic crisis. The aim is to resume fiscal consolidation efforts as of 2010 even if the economic outlook worsens further, and to continue with consolidation in the following years until a

balanced budget is attained. In the medium term, the Slovak government pursues two main fiscal objectives. The first objective is to avoid an excessive deficit procedure, i.e. to keep the general government deficit under the 3% of GDP level, provided that the baseline scenario described in this programme holds out. If the macroeconomic environment continues deteriorating, the aim is to unconditionally amend budgetary policies in such a way that the general government deficit will return below the 3% of GDP level as soon as in 2011. On the other hand, if the macroeconomic development is better than expected, the Slovak government will fully use such positive development for a more rapid reduction of the general government deficit.

- The fiscal policy in 2009 will be defined by the economic crisis and the need to stimulate economy on the one hand, and by preserving economic stability and sustainability of public finance on the other. The Slovak government has adopted a fiscal strategy that seeks to strike a balance between these two antagonistic objectives. Firstly, an increased deficit in 2009 fully reflects the shortfall in revenues which is expected to occur due to worse economic development than originally anticipated in a general government budget proposal for 2009-11 as approved by the Slovak government on 15 October 2008. It means that economic stabilisers have been left to operate freely. Secondly, the Government has decided to spend EUR 332 million (0.5% of GDP) under the ESA 95 methodology on a fiscal anti-crisis package, under condition, however, that the deficit will not widen. The fiscal anti-crisis package is counterbalanced by savings on the budget expenditure side. Thirdly, the Slovak government considers the size of the anti-crisis package adequate and sufficient with respect to an overall fiscal impulse in the economy in 2009-10. The fiscal impulse will have an expansive effect on the economy at the level of 2.4% of GDP in 2009 and 1.9% of GDP in 2010. Besides a year-on-year change in structural deficits, the fiscal impulse is also largely influenced by the increased drawing of EU funds, which was slower in the previous years, and by the launch of PPP projects for motorway construction. Another major investment project is expected to be launched this year (completion of the Mochovce nuclear power plant), but has not yet been included in the Programme since the project is still only in a preparatory stage.

The Stability Programme of Slovakia is subject to approval by the Government and submitted to the National Council for consideration. The content and the format of the document fully respect Commission guidelines. They are based on the *"Specifications on the implementation of the Stability and Growth Pact* and *"Guidelines on the format and content of stability and convergence programmes"*, approved in 2005 in order to improve the implementation of the Stability and Growth Pact which constitutes an essential part of the macroeconomic framework of the Economic and Monetary Union. The Stability Programme also reflects discussions, documents and recommendations of the Economic and Financial Committee. The presented Stability Programme for 2008-12 does not include a chapter on institutional aspects of public finance since no significant changes have occurred compared to the last Convergence Programme.

I. OVERALL POLICY FRAMEWORK AND OBJECTIVES

Economic policy objectives of the Slovak government respond flexibly to the present economic crisis; the top priority remains ensuring a sustainable economic growth which is essential in order to speed up improvements in living standard and catch up with more advanced Member States. Slovakia's entry to the euro area and the loss of independent monetary policy further increase the importance of a responsible fiscal policy aimed at the consolidation and effective operation of automatic stabilisers, and the importance of structural policies aimed at increasing market flexibility and potential economic growth.

I.1. Fiscal policy

Slovakia further pursues its medium-term consolidation objectives. The first of these objectives, reduction of general government deficit below 3% of GDP required to fulfil the Maastricht criterion of general government deficit, was attained in 2007 when general government deficit fell to 2.2% of GDP (April notification[1]). In the estimate of general government deficit in 2007 updated as of 1 October 2008, its level was revised down to 1.9% of GDP, i.e. 1.1% of GDP below the reference level.

The main fiscal objectives remain unchanged compared to the last Convergence Programme; they are only modified in the light of the economic crisis. The aim is to resume fiscal consolidation efforts as of 2010 even if the economic outlook worsens further, and to continue with consolidation in the following years until a balanced budget is attained. In the medium term, the Slovak government pursues two main fiscal objectives. The first objective is to avoid an excessive deficit procedure, i.e. to keep the general government deficit under the 3% of GDP level, provided that the baseline scenario described in this programme holds out. If the macroeconomic environment continues deteriorating, the aim is to unconditionally amend budgetary policies in such a way that the general government deficit will return below the 3% of GDP level as soon as in 2011. On the other hand, if the macroeconomic development is better than expected, the Slovak government will fully use such positive development for a more rapid reduction of the general government deficit.

I.2. Monetary policy

Sustainable inflation remains the key objective of monetary policy. Slovakia successfully accomplished its goal of entering the euro area on 1 January 2009, thus taking on the commitment of maintaining price stability. Even in the context of global growth of commodity prices, Slovakia was successful in keeping inflation rate below the reference value. To curb speculative price increases in connection with the entry into the euro area, the Slovak government adopted a package of anti-inflationary measures. However, in order to maintain price stability in the long term a responsible fiscal policy and structural policies aimed at enhancing the flexibility of the labour market and market in goods and services are required.

I.3. Structural policies

Macroeconomic policies ensure the stability of the economic environment while structural policies help strengthen economic potential, sound economic development and improve living standards. The euro area accession has increased the importance of structural policies in Slovakia because it has reduced room for macroeconomic policy responses to economic fluctuations.

The Slovak government has demonstrated the attached importance to structural policies by adopting a Modernisation Programme Slovakia 21 and drawing up a National Reform Programme for Slovakia in 2008–10, consisting of a package of concrete and clearly specified measures responding primarily to the conclusions of the European Council and its specific recommendations for Slovakia. Increased emphasis on the implementation of structural policies is a fundamental prerequisite for attaining the predetermined objectives.

[1] The EU Member States are required to provide information on deficit and debt twice a year, always by 1 April and 1 October. It is a part of the Excessive Debt Procedure, which serves as the basis for an overall assessment of statistical data provided by Member States.

In medium term, it will be necessary to focus on the quality of public finance and to reallocate more expenditure to those policy areas that will increase productivity – in particular education, research and development. An important precondition is the implementation of structural reforms in these areas aimed at effective use of additional funds.

I.4. Measures aimed at securing the stability of the financial market

The Slovak banking sector has so far suffered only minimum losses in connection with the global financial crisis when compared to other countries. In the tackling of the global crisis Slovakia advocates a coordinated approach, as the current crisis has a global character and requires a comprehensive and coordinated solution. In order to prevent the onset of crisis in Slovakia and to minimize the potential negative impacts the Slovak government and the National Bank of Slovakia (NBS) have adopted adequate measures.

After several years of positive news and a continuous growth the global economy and financial markets have been struck by a serious crisis. The current situation was originally triggered by the US mortgage crisis which gradually spilt over to global financial markets and now fully affects even the real economy of advanced countries. This has resulted in the financial markets reaching their long-term lows, collapses of large banks, fear of a world-wide recession, and undermined confidence in the stability of the financial and banking sectors. The banking sector in the US, as well as in several euro area countries is nowadays associated with negative economic results, the lack of liquidity and the need for state interventions. However, even in this international environment affected by negative developments, Slovakia remains a country whose banking sector has suffered only minimum negative effects from the financial crisis. Even in 2008 the Slovak banking sector reported high profits and a sufficient liquidity without any special state support schemes. The greatest risk currently faced by Slovak banks is the fears of companies being unable to repay their loans. This risk is the consequence of the crisis having spilt over to the real economy; the financial crisis is not a primary cause.

The profit rate of the banking sector has been continually on the rise since 2000, when the principal part of the banking sector restructuring was completed. In 2008 the banking sector posted a net profit exceeding EUR 0.5 billion, which is approximately four times the profit in 2000. In light of the ongoing crisis it is extremely important that the banking sector made approximately the same profit in 2008 as in 2007 and that massive losses or drops in profits, as faced by banks in the US and some countries of the euro area, have so far not occurred in Slovakia.

Exposure of Slovak banks to high-risk toxic assets is marginal. This is a result of the fact that at the time of inception of the causes of the current crisis the Slovak banking sector had started functioning in new conditions following its restructuring and recovery and its degree of development and integration was comparatively low at the time. Moreover, Slovak banks had very favourable conditions for the allocation of assets into loans in Slovakia, given the robust economic growth, expansion of business activities and growth of the purchasing power of the population.

The fact that the profits are realistic and sustainable is also evidenced by a still relatively strong year-on-year growth in corporate loans and loans to households in relation to the capital adequacy of the banks. These loans grew at a level of approximately 20% in the second half of 2008, yet a slowdown, on a monthly basis, has occurred over the recent months.

Banks in Slovakia have shown long-term prudence in the provision of loans with a relatively strict assessment of the clients' risk profile. As a result, the rate of credit defaults is very low. In December 2008, bad loans made up approximately 2.5% of all loans.

The stable situation in the Slovak banking sector is also reflected in relatively stable interest rates on newly provided loans. They have been moving within the range of 6.5 to 8.5% in the long term. No significant increase in interest rates occurred in 2008, they even fell at the end of the year in line with the cuts in base rate made by the central bank. The decline in interest rates has been counterchecked by higher interest margins applied by the banks in response to worse risk profiles of their clients.

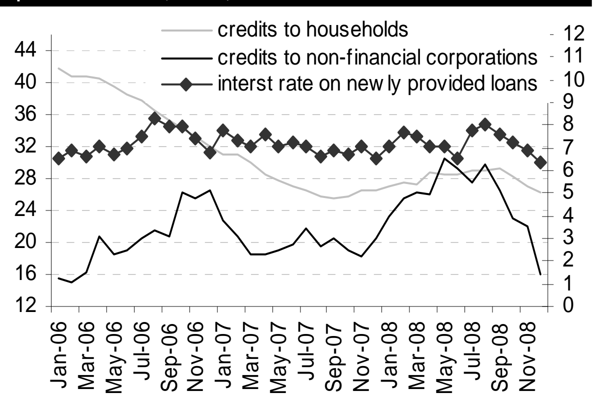
Banking sector profit in SR (EUR bn.) and stock of credits and deposits in SR (EUR bn., k 31.12.)

	net profit of the banking sector	credits	deposits
2000	0.145	11.68	16.94
2001	0.301	9.30	18.84
2002	0.393	9.67	21.68
2003	0.376	10.63	23.21
2004	0.408	11.57	24.86
2005	0.461	14.07	23.45
2006	0.590	17.55	26.39
2007	0.575	21.00	29.99
2008	0.549	24.76	35.21

Note: credits and deposits excluding banks and NBS

Source: National Bank of Slovakia

Credit growth (yoy, %, lhs) and average interest rate on newly provided loans (%, rhs)

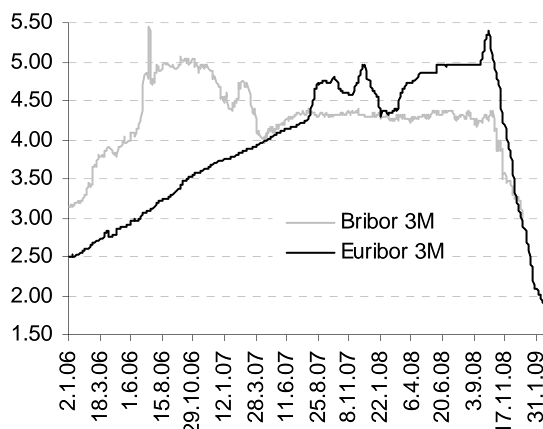


Source: National Bank of Slovakia

Besides the profit levels, the liquidity of banks was also relatively positive. After a short period of uncertainty around the time of general election in 2006, the interbank short-term interest rate (3-month BRIBOR) was extremely stable until September 2008, moving around the NBS base rate. Its subsequent decline reflected cuts in the NBS base rate. Unlike the interbank rate in the Slovak Republic, the short-term interest rate in the euro area (3-month EURIBOR) increased to as much as 5.5%; even this value was largely hypothetical, because the interbank market in the euro area functioned under unusual circumstances in the second half of 2008 and the banks refrained from borrowing due to concerns over the unclear situation. Recent months have seen a significant decline in interbank rates within the euro area, reflecting the cuts in the ECB base rate.

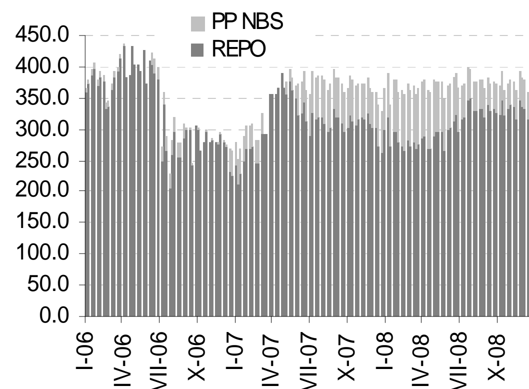
The high liquidity of the Slovak banking sector was also indicated by a high NBS sterilisation position until the euro changeover on 1 January 2009, which consistently moved around the level of EUR 12 billion. Given the excessive liquidity in the Slovak banking market, the NBS stopped performing refinancing repo transactions already some time before. Since January 2009, the system of deposit and marginal lending facilities has undergone, due to Slovakia's entry to the euro area, certain modifications in order to adapt to the ECB rules.

Interbank interest rates BRIBOR 3M and EURIBOR 3M (%, daily values)



Source: Reuters

NBS sterilisation position (EUR bn.)



Source: National Bank of Slovakia, Ministry of Finance

High profitability of the banking sector, banks' high liquidity, stable interest rates on loans, stable interbank interest rates, low exposure to toxic assets and a low bad loan rate indicate that Slovakia is one of the countries whose banking sectors have been least affected by the global crisis, even though the risks are increasing.

Given these minimum adverse impacts on its banking sectors, Slovakia does not have to adopt any special measures so far; nevertheless, the Government and the National Bank of Slovakia have opted for two basic measures with the principal aim of steadying the existing situation and enhancing confidence in the financial sector. The measures that have been implemented to support the stability of the financial market in the Slovak Republic include an amendment to the Act on Protection of Deposits and an NBS measure on liquidity management.

With effect from 1 November 2009, the amended Act on Protection of Deposits has introduced compensations for lost deposits in the full amount without any limit. The legislation in place until 1 November 2008 guaranteed that lost deposits would be compensated up to 90% of their volume, but not more than EUR 20,000. The present measure aims to increase the credibility and trustworthiness of banks and thus prevent a panic of bank clients. From 1 January 2009 foreign bank branches that accept deposits in the Slovak Republic under an EU single banking licence are permitted to join the Slovak deposit protection system.

The measure of the National Bank of Slovakia on the liquidity of banks and branches of foreign banks, in effect from 15 November 2008, introduced more stringent requirements on liquidity management, especially by means of a new liquidity indicator. The measure lays down the procedure for liquidity management and quantifies the liquidity indicators which the banks must observe in their business. Any bank or a branch of a foreign bank should as much as possible be capable of satisfying all of its obligations within one month, even in the case of adverse developments in financial markets. The indicator of bank liquidity in the time of a crisis in the banking sector will restrict the possibilities of a bank, or its parent company, to decrease the level of liquidity in the banking sector, with the result that each bank will be able to meet its obligations vis-à-vis the clients and business partners even in the short term.

I.5. Anti-crisis measures of the Slovak government

On 6 November 2008, the Slovak government approved "Draft Measures of the Government of the Slovak Republic Aimed at Overcoming the Impacts of Global Financial Crisis". The material included a total of 27 measures to be adopted in several sectors. In the wake of measures adopted by the European Commission and the European Council this document was updated on 17 December 2008. The measures specified by the European Commission and the European Council in the European Economic Recovery Plan have been incorporated in the Draft Measures of the Government of the Slovak Republic Aimed at Overcoming the Impact of Global Financial Crisis to a large extent. They include measures aimed primarily at accelerating public infrastructure investments, energy savings and energy security, reduced taxes for low-income employees, reducing administrative burdens on businesses, simplifying business start-up procedures, financial and legal reinforcement of EIB instruments, strengthening employment services, and speeding up payments by the state to businesses. In a certain sense the Slovak government outran the initiative of the EU bodies and adopted the relevant measures even before the approval of the EU plan.

The global economy kept deteriorating further at the end of 2008. In response to a worsened situation on the labour market, the Slovak government approved, upon proposal by the Ministry of Labour, Social Affairs and Family, "Draft Measures to Mitigate Impacts of the Global Financial Crisis and Economic Crisis on Employment" on 2 February 2009. The measures primarily focus on the labour market, with the aim of sustaining employment and mitigating the impacts of the global crisis on employees in businesses that are considering lay-offs and redundancies due to their operating difficulties.

On 9 February 2009, the Slovak government approved a "Proposal for the Third Package of Measures to Mitigate Impacts of the Economic Crisis" which consist of 24 measures in total (5 macro- and 19 microeconomic measures). The proposed measures concentrate mainly on boosting demand since a low aggregate demand is

the cause of the current crisis; only such measures will be effective that encourage consumption and investments. The measures to boost aggregate demand are backed by other measures to improve business environment with the aim of creating good conditions for re-launching dynamic growth of Slovak economy once the global economy is revived.

One of the measures approved involves speeding up the drawing of EU funds. There is quite a large room in this respect, since Slovakia has yet not used all the funds available under the 1st programming period (2004-06) and the spending of the funds earmarked for the 2nd programming period (2007-13) is still very low.

As far as the 1st programming period is concerned, the volume of financial resources drawn from Structural Funds stood at 92% of the total commitment as at 31 December 2008, while 68% of resources were spent from the Cohesion Fund. In addition, the Commission extended the possibility to use Structural Funds until 30 June 2009; resources from the Cohesion Fund may be spent until the end of 2010. As regards resources available in the 2nd programming period, their use should be compared with budgeted amounts for respective years. While no funds were drawn in 2007 (except for the funds for agriculture), their spending in 2008 stood approximately at 3% of the budgeted amount. The unspent funds were carried over to the next year.

The table below shows the most important measures adopted by the Slovak government, including their financial impact on budget expenditures in 2009 and 2010.

List of measures to mitigate impacts of the economic crisis (in EUR mill.)

No.	Name - description	Budgetary expenditures in 2009 and 2010					In force
		GG Budget		EU funds	Other	Total*	
		ESA 95	cash				
1.	Higher basic tax allowance on personal income tax and higher employee tax credit	367	337	-	-	367	1.3.2009 - 31.12.2010
2.	Decrease in the rate of contribution to the Social Insurance Agency, in particular the reserve fund of solidarity, from 4.75% to 2% for mandatorily insured self-employed	40	40	-	-	40	1.4.2009 - 31.12.2010
3.	Reduction of the period for refunding the VAT excessive deductions from 60 days to 30 days	2	511	-	-	511	1.4.2009
4.	Changes in depreciation rules of assets (adjustment of input price, accelerated depreciation and component depreciation)	34	13	-	-	34	1.3.2009
5.	Changes in tax legislation pertaining to businesses (VAT deductions in a subsequent tax period, group registration for VAT, retrospective registration and simplified record-keeping for tax purposes for small businesses)	0	0	-	-	0	1.3.2009 (income tax), 1.4.2009 (VAT)
6.	Simplification of legislative requirements for the establishment and maintenance of social enterprises with the focus on establishment of municipal social enterprises	34	34	195	-	229	1.3.2009 - 31.12.2010
7.	A subsidy equal to the amount of social contributions, provided to an employer who temporary curbs his operations in a way that he will not assign to his employees work in the extent of at least 4% of the set weekly working hours, for not longer than 60 days	28	28	-	-	28	1.3.2009 - 31.12.2010
8.	Financial support to wage for the unemployed who will find a job on their own	4	4	21	-	25	1.3.2009 - 31.12.2010
9.	Higher financial contribution to cover travelling costs for employees working outside the place of their permanent residence	2	2	10	-	11	1.3.2009 - 31.12.2010
10.	Financial support for the unemployed who will start a business	5	5	6	-	11	1.3.2009 - 31.12.2010

11.	Financial support paid to employers for each new employee who was previously unemployed, up to EUR 142 per employee in the Bratislava region, and up to EUR 284 in other regions	2	2	10	-	12	1.3.2009 - 31.12.2010
12.	Incentives for research and development activities carried out by the business sector (subsidies from the state budget and corporate income tax reliefs)	100	66	-	-	100	from 2009
13.	Funding of specific research and development projects	6	6	-	-	6	from 2009
14.	Incentives for small and medium-sized enterprises (SMEs) – subsidies from the state budget for programmes focused on assistance to existing and start-up SMEs	8	8	-	-	8	from 2009
15.	Subsidies from the state budget, grants from the Bohunice International Decommissioning Support Fund and EBRD loans for programmes aimed at increasing energy efficiency and improving energy infrastructure	8	8	-	125	133	from 2009
16.	The ´Obnovme si svoj dom´ (Let's Revive Our House) programme	10	10	-	-	10	from 2009
17.	Memorandum on cooperation and exchange of information for co-financing of small and medium-sized enterprises	0	0	-	-	0	15.1.2009 - 31.12.2010
18.	Increasing the registered capital of the Slovak Guarantee and Development Bank by EUR 33 million and of the Eximbanka by EUR 11 million, increasing resources in the Eximbanka funds by EUR 30 million; preparations for the drawing of an EIB credit line in the amount of EUR 50 million for development and financing of programmes for SMEs	0	74	-	50	124	in 2009
19.	Subsidy supporting purchase of new cars conditioned by liquidation of old cars (car scrapping scheme)	31	55	-	-	55	9.3.2009 - 31.12.2009
20.	Refundable financial aid provided to ŽS Cargo, a.s. and the Railways of the Slovak Republic	0	236	-	-	236	in 2009
	Total	680	1,439	242	175	1,940	

*Note: *total costs of individual measures always include a higher of the two figures from the general government budget to better reflect actual expenditures spent on the particular measure*

Measure 1

The basic tax allowance of personal income tax will increase from EUR 3,435.27/year to EUR 4,025.70/year, while the maximum amount of employee tax credit is set to EUR 181.03/year. A higher basic tax allowance will result in an increase by EUR 9.35 in a monthly income of employees (who claim the full amount of the basic tax allowance and pay the tax). Along with the employee tax credit, the higher basic tax allowance will have a positive impact even on lowest-income taxpayers, as a net monthly income on the level of the minimum wage will increase by EUR 15.09. The measure aims to reduce tax burdens on middle and low-income persons, i.e. to increase their disposable income, which should translate into a higher aggregate demand given the higher propensity to consumption of this group. This measure will only be applied during the 2009 and 2010 tax periods.

Measure 2

Contributions to the reserve fund of solidarity paid by mandatorily insured self-employed persons were cut from 4.75% to 2% of the assessment base for the period from 1 April 2009 to 31 December 2010. The costs of this measure are projected at EUR 13.3 million in 2009 and EUR 22.4 million in 2010.

Measure 3

The period for refunding the VAT excessive deductions will be shortened from 60 to 30 days for taxpayers who pay VAT on a monthly basis, provided that they meet certain additional requirements, such as that they have no outstanding tax or customs liabilities or outstanding compulsory social contributions for the period of previous 12 calendar months. The measure will decrease cash revenues of the general government; the only influence the measure will have on the general government balance in ESA95 are higher interest payments (reduction in state's liquid assets due to the drop in cash revenues). The aim is to improve companies' cash flow.

Measure 4
Changes in depreciation of assets include an increase of input price of a tangible asset from EUR 996 to EUR 1,700 and of an intangible asset from EUR 1,660 to EUR 2,400 in the case of personal and corporate income tax, accelerated depreciation with respect to certain types of assets, and component depreciation that will enable businesses to depreciate individual separable components whose input price exceeds EUR 1,700. These changes will improve companies' cash flow by reducing their tax liability, and may stimulate purchases of assets.

Measure 5
Changes in tax legislation pertaining to businesses include an option to deduct VAT in a subsequent tax period, group registration for VAT purposes (several persons who are Slovak residents may be considered a single taxable person even if they are legally independent, but have close financial, economic and organisational links), retrospective registration as taxpayers and simplified record-keeping for tax purposes for small businesses. These changes aim to improve the business environment, while they have no effect on the general government budget.

Measure 6
Simplification of legislative requirements for the establishment and maintenance of social enterprises by temporarily suspending the main criteria for the granting the status of a social enterprise for natural and legal entities, for legal entities that are municipalities, self-governing regions, associations of municipalities or associations of self-governing regions, and for legal entities established or founded by a municipality or a self-governing region. The temporary suspended criteria include in particular the requirement that disadvantaged employees constitute at least 30% of the total workforce, the requirement to use 30 % of their profit to create new jobs. Disadvantaged job applicants include recent school graduates, the long-term unemployed and persons with disabilities. The maximum amount of a contribution paid to a social enterprise per a disadvantaged employee in 2009 was EUR 472 per month and will be EUR 408 per month in 2010.

Measure 7
A monthly subsidy to sustain employment for an employer who was forced to temporary limit his operations to the extent that he has to limit his employees' normal weekly working time by at least 4% and pays the employees a substitute wage higher than 60% of the original wage. The subsidy for the employer equals to the amount paid by the employer and the employee on social and health insurance contributions from the substitute wage up to EUR 339 per month in 2009. The employer then uses the subsidy to pay back to the employee the social and health insurance contributions of the employee, i.e. effectively subsidizing both employers and employees social and health insurance contributions. The subsidy is provided for up to 60 days in a year.

Measure 8
Financial support for new employees who were beneficiaries of material-need benefits, officially registered as job seekers for at least 3 months, have found a job on their own and their gross monthly wage is below EUR 304. The monthly contribution represents EUR 153 in the first year of employment and about EUR 77 in the second year of employment.

Measure 9
Increase of allowances for employees working outside the place of their permanent residence or outside the district of their permanent residence; higher allowances are provided to persons travelling shorter distances. The maximum rates doubled for distances up to 120 km; rates increased by approximately 50% for greater distances. For people commuting to work 120 km, the allowance increased from EUR 63 to EUR 110. The allowance is only provided for the duration of up to 12 months.

Measure 10
Allowances for self-employed persons who were officially registered as job seekers for 3 months and received material-need benefits, or who were officially registered as job seekers and operate in an agricultural product processing or marketing sector. The self-employed persons must perform given activities for another 24 months in order to be entitled to the allowance. The monthly allowance is EUR 41 which corresponds to the amount of

social contributions paid by the self-employed from a minimum wage (EUR 296 in 2009). The allowance for the health insurance contribution is provided for the period of 22 months and the allowance for social insurance is provided from the 19th to 22nd month.

Measure 11
Financial support for newly created jobs to applicants who were registered as unemployed at least 3 months prior to the creation of a job. The monthly support cannot be higher than half of the wage of a new employee, however not more than EUR 142 in the Bratislava region and not more than EUR 284 in other regions. The newly created job must be preserved for at least 12 months.

Measure 12
Research and development incentives are designed for business entities (legal entities). The main goal is to specify the rules and procedures for the provision of research and development incentives in order to better encourage business to use research and developments results. Two types of incentives are provided: subsidies (grants) from the state budget and an income tax relief. The provision of incentives requires that the beneficiary creates a new, or enlarges the existing research and development facility using its own resources. The beneficiary is obliged to implement the project results in the territory of the Slovak Republic within the period of five years after receiving the government support. Expenditures in the amount of EUR 16.6 million are projected for 2009, another EUR 33.2 million are projected for 2010. The income tax relief will be below the amount invested by a legal person in a project, which represents a maximum loss in corporate income tax revenues corresponding to the amount of a direct grant provided.

Measure 13
Funding of specific research and development projects, including preparation of technical feasibility studies or projects on applied research and experimental development, support for cooperation between universities and the Slovak Academy of Sciences and the business sector, and support for youth participation in scientific activities and interest in a career in the area of science.

Measure 14
Funding of specific projects and programmes to help the existing and new small and medium-sized enterprises (SMEs), including business incubator programmes for innovative SMEs in a start-up phase, increasing the capacities of training and consulting programmes for selected groups interested in starting a business and the implementation of the consultancy and training support schemes for the business sector.

Measure 15
Funding of specific projects and programmes to improve energy efficiency and energy infrastructure, including a project to improve energy efficiency in public buildings, a project to support sustainable energy and a programme for a better utilisation of biomass and solar energy by households.

Measure 16
A grant system will be introduced to support tourism development. An increased attention will be paid to the restoration of cultural heritage sites, especially world cultural heritage sites. The funds will be used for cultural heritage sites in individual stages of their conservation, restoration and presentation.

Measure 17
Parties to the Memorandum on cooperation and exchange of information for the co-financing of small and medium-sized enterprises include the Ministry of Finance of the Slovak Republic, Eximbanka, the Slovak Guarantee and Development Bank and the Slovak Bank Association. The Memorandum was signed on 15 January 2009 and represents a separate measure outside the anti-crisis packages approved by the Slovak government. The state-controlled financial institutions (Eximbanka and the Slovak Guarantee and Development Bank), whose purpose is to support Slovak businesses through insurance, credit and guarantee products, will provide bank guarantees for loans provided by commercial banks to SMEs. The maximum amount of a guarantee

provided to a single SME is set to 55% of the principal amount of the loan; the maximum amount of the loan is EUR 340,000.

Measure 18

Increasing registered capital of the Slovak Guarantee and Development Bank by EUR 33 million of the Eximbanka by EUR 11 million, increasing resources in the Eximbanka funds by EUR 30 million (EUR 15 million to a guarantee fund and EUR 15 million to cover non-tradable risks). Resources obtained through the increase in registered capital will be used to finance clients through credit products (direct financing, re-financing and co-financing export credits). Increased capacity of insurance and guarantee funds will be used for pro-export projects of Slovak producers. A considerable portion of the funds will also be spent on SME-related projects; guarantee schemes and insurance will be actively used for the financing of SMEs through direct acceptance credits and factoring. This measure also includes preparations for the drawing of an EIB credit line in the amount of EUR 50 million to prepare and finance programmes for SMEs.

Measure 19

Subsidy supporting purchase of new cars conditioned by liquidation of old cars (car scrapping scheme). Subsidy can be provided to both a natural and a legal person. The total price of a new car cannot exceed EUR 25,000, VAT included. The provision of subsidies is limited by the volume of funds allocated from the state budget for this purpose; the measure will be in force until 31 December 2009. A discarded vehicle must be manufactured before 1 January 1999 and officially registered as owned by the respective natural or legal person on 31 December 2008.

In the first round of the car scrapping scheme two alternative amounts of subsidy were provided: EUR 1,500 and EUR 1,000. The former was provided if a car dealer granted an additional discount of at least EUR 500. The total amount of EUR 33.2 million was allocated from the state budget for this purpose.

In response to a high demand, the Slovak government decided to hold the second round of the car scrapping scheme. The maximum amount of the subsidy was reduced to EUR 1,000 under the condition that a car dealer grants an additional discount of at least equal value. EUR 22.1 million was allocated for the second round.

The measure is expected to boost demand for vehicles. A higher demand for cars will increase VAT revenues in a short-term, partially making up for increased state budget expenditures.

Measure 20

A repayable financial aid from state financial assets in the total amount of EUR 236 million will be provided to ŽS Cargo Slovakia, a.s. (rail freight transport services) and the Railways of the Slovak Republic (railway infrastructure operation and transport management) in 2009. The aim of this measure is to mitigate the impact of the global financial and economic on the economic performance of these two companies that are confronted with a large fall in the transported volumes.

II. ECONOMIC FORECAST AND ASSUMPTIONS

The Slovak economy grew at a very high pace even in 2008, but first impacts of the financial crisis on the real economy emerged at the end of the year. Slovakia's economic performance is expected to decelerate quite considerably in 2009 due to the culmination of the global crisis. The economic crisis has caused a significant decline in foreign demand, which in turn leads to a slump in Slovak exports and deceleration in dynamics in productivity, labour market and total domestic demand. The extent and duration of impacts the financial crisis will have on Slovakia's real economy due to weaker economic activities of Slovakia's major trade partners remain uncertain. But unlike other countries in the region, the Slovak economy will operate in a stable monetary environment resulting from its entry to the euro area. At the beginning of 2009 the Slovak economy was also hit by the gas crisis, however this should not be significantly reflected in the economic growth for the whole 2009. It is expected that the gas crisis will have impact in the first quarter of 2009.

II.1. External environment

The global economy is currently confronted with the worst economic crisis since the end of the Second World War. Having enjoyed an average 5-percent growth over the past four years, the global economy is expected to slow down to 3.4% in 2008 and to 0.5% in 2009.[2] These figures indicate the lowest growth in 60 years.

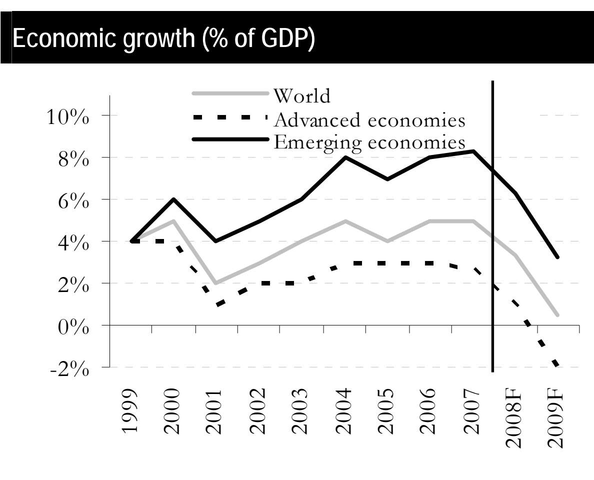
The financial crisis in recent months caused a significant weakening of the trust in financial institutions, deepened the uncertainty regarding the solvency of several major institutions, which resulted in a series of bankruptcies, distressed sales and government interventions in Europe and the US. The uncertainty regarding the future development and the credit crunch facilitate the spill-over of financial crisis into the real economy. The US economic growth is expected to reach a level of 1.1% in 2008 (compared to 2% in 2007) due to sizable fiscal stimulus in the first half-year and the effects of a weakening dollar. The US economy is most likely to feel the hardest impacts of the crisis in 2009, when its GDP is projected to contract by 1.6%. A drop in foreign demand, low global commodity prices and curtailed external financing will also have adverse effects on the development of emerging economies. The economies of China and India will maintain highest growth rates and largest shares in the global economic performance, however their deceleration is unavoidable. China's growth is expected to cut back from 11.9% in 2007 to 9.3% in 2008 and 6.8% in 2009. International Monetary Fund expects the advanced economies to contract by 2% in 2009, while the emerging economies are projected to grow by 3.3%.

Basic economic indicators

	2008	2009	2010
Economic growth			
China	9.3	6.8	8.0
USA	1.1	-1.6	1.7
EU	0.9	-1.8	-0.6
Long term interest rates			
Euro area	4.0	3.1	3.3
USA	3.7	2.4	2.6
Exchange rate (USD/Euro)	1.47	1.38	1.38
Oil prices (Brent, USD/barrel)	98.5	52.1	61.7

Source: Common external assumptions EC, Eurostat

Economic growth (% of GDP)



Source: IMF

[2] External assumptions used in the forecasts prepared by the Ministry of Finance of the Slovak Republic are based on the forecasts made by the European Commission. The Commission's Common External Assumptions and Interim Forecast published in January 2009 were used in the preparation of these macroeconomic forecasts. Description of the current trends in external environment also reflect the January 2009 update to IMF's Global Economic Outlook.

Similarly to the US, the euro area feels the full impact of the financial crisis. Confidence indicators are attacking their all time lows and a number of countries will see a slump in GDP in 2009. In 2008, the European economy enjoyed a real growth of 0.9%, with the euro area growing at a rate of 0.8%. In 2009, the real GDP is expected to shrink by 1.8% and, in the euro area, by 1.9%. The shrinking economic growth is fuelled by the impacts of the credit crunch on economic activity, decrease in foreign demand, as well as the expected corrections in the real estate market.

II.2. Development in 2008

Slovak GDP kept growing at a very strong rate of 6.4% in 2008. However, compared to the 2007 figure of 10.4% the Slovak economy slowed down, mainly due to poorer performance in 4Q2008. In terms of the structure of demand, the Slovak economy was driven by domestic demand; the contribution of foreign demand to the GDP growth was nil. Final consumption of households grew at 6.4% in 2008, slightly down from the 7-percent growth posted in 2007. The final consumption of households was backed by the growth in real wages and employment, which continued due to job creation in the domestic economy. In addition, the increasing volume of loans had also a positive impact. Investments (6.8-percent growth) decelerated on the previous year (8.7%), mainly due to the development in the fourth quarter when the first impacts of the crisis occurred.

Calculated using the labour force survey methodology, the number of employed persons rose by 3.2% in 2008, and by 2.8% according to ESA. The growth in employment helped to reduce the unemployment rate to a historically low level of 9.6% (labour force survey). The average nominal monthly wage rose by 8.1% year-on-year, while real wages increased by 3.3%. The fourth quarter also had adverse effects on the labour market. Pressures to cut wages increased and export-oriented industries faced a decline in employment. Employment in manufacturing fell by 1.2% in 4Q2008 year-on-year (ESA95).

II.3. Medium-term forecast of economic development

The most recent official forecasts of 2 February 2009 prepared by the Ministry of Finance of the Slovak Republic reflect deceleration in the Slovak economic growth driven by the global financial and economic crisis. The economic growth is expected to shrink considerably to only 2.4% in 2009 (down from 6.4% in 2008), but should gradually recover in the years to come and return to higher figures by the end of the forecast period.

Forecast of the selected economic indicators (up to 2 February 2009)

No.	Indicator	unit	Actual 2008	Forecast 2009	2010	2011	2012
1	GDP; current prices	EUR bn.	67.3	71.1	76.1	82.7	90.2
2	GDP; constant prices	%	6.4	2.4	3.6	4.5	5.1
3	Final consumption of households	%	6.1	3.1	3.5	4.4	5.0
4	Final consumption of government	%	4.3	4.0	2.4	2.3	1.9
5	Gross fixed capital formation	%	6.8	2.2	3.6	5.1	5.7
6	Export of goods and services	%	3.2	-2.7	3.1	6.2	8.1
7	Import of goods and services	%	3.3	-2.2	2.5	5.5	7.1
8	Growth of average monthly wages (real)	%	3.3	3.3	3.3	3.5	4.1
9	Average employment growth (ESA95)	%	2.8	0.1	0.4	1.0	1.0
10	Average unemployment rate (LFS)	%	9.6	10.5	10.4	10.1	9.8
11	Harmonised index of consumer prices (HICP) growth	%	3.9	2.2	3.6	4.1	4.2
12	Current account balance (share of HDP)	%	-6.1*	-5.6	-4.6	-4.0	-3.0

** forecast*

Source: Ministry of Finance

A decline in external demand will have the strongest impact on the economic growth. Against the backdrop of the global crisis the anticipated inflow of foreign investments to Slovakia, as well as Slovakia's production and export capacities will shrink. The most recent estimates of growth both in exports (-2.7%) and imports (-2.2%) for 2009 reflect notably lower dynamics in foreign trade, driven mainly by the falling demand by Slovakia's major trade partners. The contribution of foreign trade to a real GDP growth is expected to return to positive figures in the following years.

BOX 1 – Financial crisis and its impact on Slovakia

The current global financial crisis has enormous negative effects on the economies of individual countries and, given the fact that Slovakia is an extremely open economy, poses a significant risk for Slovakia.

Among the reasons behind the current crisis were the negative developments and the subsequent collapse of US mortgage markets. At the time when Fed rates were at their lowest level (1% in 2004), US banks kept providing mortgage loans even to clients with a low credit rating. These loans were then sold in a single package with other financial products to investors in the financial markets. The banks thus largely reduced their default risk, which in turn made them less prudent in providing high-risk loans. The subsequent increases in interest rates by the Fed (up to 5.25% in 2006 and 2007) accompanied with falling US real estate prices sped up by their problems with repaying the high-risk loans. Consequently, the banks and financial institutions were forced to write off their defaulted loans as a loss, which accounted for a considerable deterioration in their financial performance. The extent of these losses led to a series of bankruptcies and distressed sales of major financial institutions. Collapses of large companies and the overall uncertainty almost immediately translated into the loss of confidence among the investors in future development of financial institutions, which was reflected in the collapse of share prices. Several stock indexes fell to their lowest levels since 1998. An important consequence the mortgage crisis had on the financial sector is a limited access to loan capital. The high level of uncertainty regarding the possible impacts of the current crisis on their own liquidity and loan related risks causes a persistent reluctance to provide unsecured loans and aversion to higher-risk investments. More stringent lending conditions have already been introduced in a number of countries and the volume of consumer and corporate loans begun to shrink. Restricted access to loans has facilitated the spill-over of problems from financial markets to the real economy. The economic activity may be significantly affected by the credit restriction and a consequent slowdown of economic growth in most countries will inevitably multiply the consequences of the financial crisis.

The financial sector in the Slovak Republic is mainly focused on the domestic economy, thus it has a small share of investment in high-risk US mortgage and financial markets. Losses incurred on those markets pose no direct threat to the financial performance and solvency of Slovak financial sector institutions, therefore they have experienced only marginal direct effects of the global crisis so far.

Indirect impacts, in the form of a low demand by our major trade partners, seem to pose much greater risks for the Slovak economy (falling exports, decline in car production). A number of economies are currently confronted with a considerable slump, which has further negative bearings on the development of Slovak foreign trade. It means that Slovakia with its extremely open economy is very unlikely to avoid the consequences resulting from the worsened economic performance abroad. Nevertheless, the effect on the Slovak economic growth is mitigated by the following factors:

- *High import intensity – the Slovak export is still largely dependent on the import. Lower exports resulting from lower foreign demand will be accompanied by lower imports, i.e. the overall impact of the net export on the GDP growth will be lesser than the decline in export growth alone.*
- *Competitiveness - the Slovak economy preserves its price competitiveness due to the relatively low labour costs. The global decrease of demand should firstly hit companies with production capacities in countries with higher labour costs.*
- *Entry into the euro area – the most important benefit of the euro currency in the short-term horizon in relation to the financial crisis is the elimination of exchange rate volatility and lower interest rates, which have an expansive effect on the economy.*

Inflation rose in the first half of 2008 in Slovakia, driven mainly by rising global prices of oil and foodstuff. The highest inflation rates occurred in European countries in September 2008. Slovak inflation rate stood at 4.5%, calculated using the HICP methodology, in the same period. The following months saw a sharp decline in price growth which is largely influenced by weaker global demand induced by the economic crisis. The average inflation rate for 2009 is estimated at 2.2%.

Based on the experience of other countries which had already adopted the single European currency, Slovakia also identified the risk of a possible excessive increase of certain prices of goods and services. For this reason the government has adopted a set of measures, which should prevent speculative price rise.

BOX 2 – Anti-inflation measures with an emphasis on the prevention of speculative price increases in relation to the euro adoption

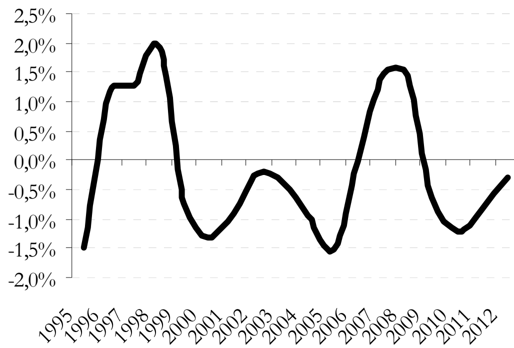
The continuing consolidation of public finance and structural policies aimed at increasing the potential growth of the economy will form the basis of the anti-inflation policy of the Slovak government. In the past the entry of countries into the Eurozone was accompanied by a moderate and one-off increase of the price level due to the rounding up of prices. The Slovak government has therefore endorsed a set of measures for the elimination of risks arising from a potential speculative price increase of goods and services in relation to the changeover to the common European currency (Resolution of the Government of the Slovak Republic No. 290/2008). The principal measures include:

- *A regular monthly report on inflation that analyses the development of consumer prices in Slovakia, compares them with prices abroad and monitors the development of prices in commodity markets. The report in submitted by the Ministry of Finance of the Slovak Republic at the sessions of the Price Council of the Slovak Republic, which is an advisory body of the Slovak Government. The report aims to provide information on the development of inflation at a disaggregated level and identify sectors, in which an excessive price increase is likely to occur. The Council has a limited mandate to operate until the end of 2009.*
- *Passing of an amendment to Act No. 18/1996 Coll. on Prices, which introduces the possibility of price regulation in extreme cases, if an abuse on the part of businessmen in the process of the euro currency changeover is identified.*
- *Passing of an amendment to Act No. 250/2007 Coll. on Consumer Protection, which lays down a stronger protection of consumers in the changeover to the euro currency;*
- *Performance of coordinated price inspections aimed at the adherence to price discipline and consumer protection;*
- *A document of the Statistical Office of the Slovak Republic entitled "People's opinions on the adoption of the common currency euro", which includes:*
    - *the monitoring of perceived inflation, which is important due to the prevention and mitigation of potential risks arising from concerns of the Slovak citizens regarding the new currency;*
    - *monitoring of prices by means of the consumer basket with a narrower scope and a higher data collection frequency;*
- *Monitoring of prices via the "Europrieskum" ("Euro-Survey") project, which is carried out by the non-governmental organization Association of Consumers of Slovakia, whereby the project also entails the drafting of the so-called black lists.*

II.4. Cyclical development

The most recent estimates of economic development by the Ministry of Finance, as well as the forecasts by other domestic institutions (NBS, commercial banks) indicate that due to the deceleration in the GDP growth caused by the financial crisis the Slovak economy will stay below its potential for the entire forecast period, with the output gap not expected to close before 2013.

Output gap (% of potential GDP)



	GDP**) (real growth, %)	Potential GDP (growth, %)	Output gap (% pot. GDP)
2004	5.2	5.8	-1.0
2005	6.2	6.8	-1.5
2006	9.1	7.5	0.0
2007	9.5	7.9	1.5
2008	7.3	7.3	1.5
2009F*	2.4	4.8	-0.6
2010F*	3.3	4.0	-1.2
2011F*	4.5	4.1	-0.9
2012F*	5.1	4.5	-0.3

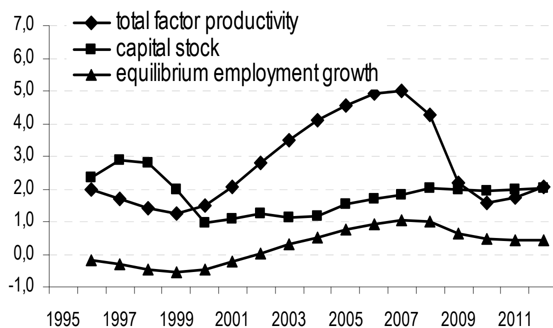
*) F - forecast

**) GDP growth adjusted for cigarettes stockpiling

Source: Ministry of Finance

A sharp dip in the contribution of the total factor productivity (TFP) growth to potential output growth is anticipated in 2009, down roughly by half. A steep decline in the real GDP growth in 2009 will result in a negative output gap at the level of 0.6%, which is expected to start closing in 2011, fuelled by gradual recovery.

Contributions of main factors to the potential GDP growth (p.p.)



	Pot. GDP (growth, %)	TFP*	Capital stock	Equilibrium employment growth
2004	5.8	4.1	1.2	0.5
2005	6.8	4.6	1.5	0.7
2006	7.5	4.9	1.7	0.9
2007	7.9	5.0	1.8	1.0
2008	7.3	4.3	2.0	1.0
2009F	4.8	2.2	2.0	0.6
2010F	4.0	1.6	1.9	0.5
2011F	4.1	1.7	2.0	0.4
2012F	4.5	2.1	2.0	0.4

* total factor productivity

Source: Ministry of Finance

BOX 3 – Adjusting the GDP to be net of the stockpiling of cigarettes and its influence on the output gap

For the sake of a more precise calculation of the output gap it was necessary to adjust the real GDP growth to be net of one-off effects of stockpiling of cigarettes, which caused the shift of a part of the excise tax between years and therefore distorted the GDP growth.

In line with the requirements for the harmonization of excise tax on tobacco products in the European Union Slovakia experienced repeated increase of its rate, whereby the latest one took place in 2009. So far, these increases have always been accompanied by the stockpiling of cigarettes – new cigarettes taxed with the original (lower) tax rate were released into circulation, whereby they were also sold after the new tax rate took effect. Such stockpiling has an impact both on the budget and on the GDP.

The price of a cigarette comprises of three parts:

- *excise tax,*
- *VAT,*
- *own price of the cigarette*

The own price of the cigarette has a neutral impact on the GDP, as their increased import is compensated by higher stockbuilding in the current year. Only the GDP structure is influenced. In the following year the stocks are released into

consumption. As far as taxes are concerned, VAT has also a neutral impact, on the GDP as well as on the budget, since it is paid on the sale of the cigarettes, which is not influenced by stockpiling. The only influence on the GDP, as well as on the budget, has the excise tax. The estimate of the amount of stockpiling has been discussed in the FPI commentary from February 2008.

The first significant stockpiling in Slovakia occurred when the average rate of the excise tax was increase by 25% with an effect as of 1 January 2006. The impact has been quantified at EUR 139.4 million. The stockpiling affected the GDP growth in three years. In 2005 the increased collection of excise tax boosted the nominal GDP growth by 0.3%, whereas in 2006 the missing tax together with the base effect lowered the GDP growth by 0.6%. The lower GDP in 2006 in turn lead to the increase of GDP in 2007 by 0.3% (the base effect).

As of 1 January 2008 another increase of the average excise tax rate by 26% took place, which again caused the transfer of a part of the excise tax revenues from 2008 into 2007. Just like in the previous case, the GDP values for three years were affected again. However, the stockpiling was more than twice the size of the previous case, therefore its effect on GDP was proportionately greater.

The next increase of the excise tax on cigarettes took place as of 1 February 2009. Due to the staggered effective date of the new rates from February it is expected that the originally estimated effect of stockpiling will be spread over the years 2008 and 2009 with a total amount of EUR 315.3 million. It is expected that EUR 166.0 million will be transferred into 2009, which will have a negative impact in 2008, however a positive one in 2009.

The aggregate effect of all waves of stockpiling on the real GDP growth (using the deflator of net tax on products) is summarized in the following table:

Total impact of stockpiling on real GDP growth

	2005	2006	2007	2008	2009f	2010f
Real GDP growth in %	***6.6***	***8.5***	***10.4***	***6.4***	***2.4***	***3.6***
Net effect of stockpiling in EUR mill.	*122.8*	*-119.5*	*268.9*	*-126.1*	*-129.5*	
GDP growth w/o stockpiling in %	***6.2***	***9.2***	***9.5***	***7.2***	***2.4***	***3.3***
Change in growth due to stockpiling	*0.3*	*-0.6*	*0.9*	*-0.9*	*0.0*	*0.3*

Source: Ministry of Finance

The use of the official GDP (including the effect of stockpiling) distorts the results in the calculation of the output gap, since it entails a shift of the collected excise tax. After adjustment to exclude the effect of stockpiling the development of the output gap for the monitored period is as follows:

Output gap adjusted for stockpiling

all figures in %	2005	2006	2007	2008	2009f	2010f
Potential GDP growth	*6.8*	*7.5*	*7.9*	*7.3*	*4.8*	*4.0*
Real GDP growth (with stockpiling)	*6.6*	*8.5*	*10.4*	*6.4*	*2.4*	*3.6*
Output gap (% of PP)*	*-1.2*	*-0.3*	*2.1*	*1.2*	*-0.9*	*-1.2*
Real GDP growth (w/o stockpiling)	*6.2*	*9.2*	*9.5*	*7.2*	*2.4*	*3.3*
Output gap (% of PP*)	***-1.5***	***0.0***	***1.5***	***1.5***	***-0.6***	***-1.2***
Difference	*-0.3*	*0.3*	*-0.6*	*0.3*	*0.3*	*0.0*

**) PP –potential product in constant prices*

Source: Ministry of Finance

III. THE PUBLIC FINANCE POSITION

The 2009–11 general government budget, as approved by the Government on 15 October 2008, aspired to confirm the commitments made under the last convergence programme and accept the views of the European Council which, in light of favourable macroeconomic development, had advised Slovakia to speed up its consolidation efforts. A sudden change in the development of macroeconomic environment has however called for the revision of basic budgetary frameworks, which means, basically, that the fulfilment of the medium-term objective is postponed beyond the framework of the present Stability Programme. The revision of fiscal objectives responds to the existing situation and is designed to facilitate economic growth, in particular during 2009. As of 2010, the government intends to resume the original pace of consolidation, thus declaring its commitment to carry on with fiscal consolidation in order to achieve a balanced general government budget. The ongoing improvement of the fiscal position is the Slovak government's basic strategy to prepare the public finance for the consequences of demographic development over next decades. Slovakia's entry into the euro area and the subsequent loss of its sovereign monetary policy has even more underscored the importance of the fiscal policy which will have increasingly substantial impact on the overall macroeconomic stability.

III.1. Policy strategy and objectives

The strategy behind fiscal policy is built around the primary objective, which is to safeguard long-term sustainability of the public finance, especially in the context of population ageing. At the moment, the Government's priority in the area of stabilisation policy is to ensure that the consolidation objectives do not pose a threat to preserving a sound economic growth. Based on the up-to-date macroeconomic scenario the Government outlined fiscal objectives until 2012, which comply with the basic rule of the Stability and Growth Pact, while general government deficits stay below the threshold of 3% of GDP. **The Government has pledged that even in the case of further deterioration in macroeconomic environment the general government deficit will not exceed 3% of GDP in 2011.** On the other hand, if the macroeconomic development is better than expected, the Slovak government will fully use such positive development for a more rapid reduction of the general government deficit.

Consolidation effort of the government between 2007 and 2012 (ESA95, % of GDP)

	2007E	2008E	2009B	2010B	2011B	2012B
1. Net lending / net borrowing	-1.9	-2.2	-3.0	-2.9	-2.2	-1.7
2. Cyclical component	0.4	0.5	-0.2	-0.4	-0.2	-0.1
3. One-off measures	0.8	-0.3	0.4	0.1	0.1	0.1
4. Cyclically adjusted GG balance net of one-offs (MTO) (1+2-3)	-3.2	-2.4	-3.3	-2.6	-2.1	-1.7
5. Impact of the implementation of the 2nd pillar of pension scheme	-1.3	-1.3	-1.1	-1.1	-1.1	-1.2
6. Interest expenditure	-1.4	-1.2	-1.4	-1.2	-1.3	-1.2
7. Adjusted primary balance (4-5-6)	-0.5	0.1	-0.8	-0.4	0.3	0.7
8. Consolidation effort (y-o-y change in adjusted primary balance)*	0.3	0.6	-0.8	0.4	0.7	0.3

**(+) restriction, (-) expansion* *Source: Ministry of Finance*

E - estimate, B - budget

The basis for the adjustment of fiscal objectives is the general government deficit for 2009, which increased from the originally planned 1.7% of GDP to 3.0% of GDP. The decision taken on the deficit adjustment was influenced by two factors. The first was an overall impact of the change in macroeconomic development, in particular its impact on budgetary revenues from taxes and social contributions. The second factor was a decision that the government wishes to pursue such an economic policy which will facilitate economic growth and will not pose a threat to meeting the social objectives.

Following the revision of the 2009 deficit, the overall fiscal position is markedly expansive, at the level of as much as 2.4% of GDP, which the Ministry of Finance deems a sufficient fiscal impulse for the economy in the context of the existing economic conditions. The fiscal impulse already counts with a gradual launch of PPP projects in road infrastructure development; their contribution to the fiscal impulse is expected at 0.4% of GDP in 2009.

The increase at the level of more than 2% of GDP in the general government deficits in 2010 and 2011, when compared to the last Convergence Programme prepared in 2007, reflects, similarly as in 2009, mainly changes in the macroeconomic environment and a subsequent reduction in the forecast of general government tax revenues. In addition, the nature of the fiscal policy in connection with the output gap was also taken into account. The latest estimate by the Ministry of Finance envisages that, after the rise in the general government deficit, the fiscal policy will have an expansive counter-cyclical stance in 2010, the EU funds and PPP projects factored in; consolidation objectives are expected to tighten in 2011, with the fiscal policy being moderately pro-cyclical and restrictive. But the Slovak government is prepared, if necessary, to flexibly revise the fiscal objectives in order to stabilise the economy. Even though the fiscal policy will be expansive in 2010, the pace of consolidation will retain approximately an annual rate of 0.5% of GDP from 2010 to 2012, which is in line with the efforts to comply with the rules of the Stability and Growth Pact.

A fiscal policy strategy will be determined by the government's consolidation objectives. Since the contribution of economic growth to consolidation efforts will be significantly weaker than before, the main source of consolidation will primarily consist of a prudent budgetary policy. Similarly as in previous years, it has to be ensured that the increase in funds allocated for government spending policies is kept strictly in line with economic growth and with the increase in tax revenues, while respecting the government's consolidation objectives, as reflected in the budgeted general government deficits according to the ESA 95 methodology. On the revenue side, the support for low-income employees has been launched through the tax system (employee tax credit), with a negative impact on the budget. At the same time, budget expenditures reflect the government's priorities, in particular in health care, education, social affairs, science and research, and infrastructure development.

The Stability Programme builds on the approved 2009-11 general government budget. However, in response to a fast-changing macroeconomic outlook, the Stability Programme for 2008-12 already presents a new fiscal framework which has taken into account new fiscal objectives, lower general government revenues from taxes and social contributions, and expenditures revised to reflect the costs of anti-crisis measures.

The Stability Programme is based on macroeconomic and tax forecasts made in February 2009. A macroeconomic scenario, as well as projected tax revenues are subject to control by the professional public through committees comprised of national public and private sector experts.

III.2. Current developments and consequences for next year's budget

Assessment of the current situation in public finance is a key prerequisite for setting adequate and realistic fiscal objectives under the general government budget which is currently being prepared. Similarly as in the 2007 update of the Convergence Programme, this chapter of the Stability Programme for 2008-12 includes, in addition to general information on the general government deficit estimate for 2008, information concerning the accomplished and planned opening of the fully-funded (second) pillar, as well as up-to-date information on the launch of PPP projects.

Under the 2008-10 general government budget, the government's key fiscal objective for 2008 was defined as having a general government deficit in the amount of 2.3% of GDP (including a net effect[3] of the 2nd pillar of the pension system in the amount of 1.2% of GDP). The current estimate of the general government deficit at 2.2% of GDP (including a net impact of the 2nd pillar in the amount of 1.1% of GDP) is slightly below the budgeted value. The updated estimate of the costs associated with the 2nd pillar has a positive impact on the general government balance in the amount of 0.2% of GDP caused by a higher one-off effect of the transfer of funds of pension savers who left the 2nd pillar to save solely in the pay-as-you-go (PAYG) pillar.

[3] The net effect means a negative impact of the contributions transferred to the 2nd pillar minus the one-off positive impact of the funds transferred from the 2nd pillar to the Social Insurance Agency due to the opening of the 2nd pillar in the first half of 2008.

The state budget has helped to improve the general government deficit by EUR 4.3 million. The Social Insurance Agency performed by EUR 268.5 million better than the budget expected, also due to a higher-than-projected effect of the opening of the fully-funded pillar in the first half of 2008; the economic performance of higher territorial units improved by EUR 33.6 million. The savings achieved by the aforementioned entities is to a certain degree attenuated by worse economic performance of other general government entities; the largest downturn totalling EUR 289.9 million occurred in the performance of the National Property Fund.

Current estimate of the general government balance in 2008 (ESA95, EUR mill., unconsolidated)

	Latest update
General government deficit after approval of individual budgets in EUR mill.	-1542.7
General government deficit after approval of individual budgets in % of GDP	-2.34
A. State budget	4.3
- cash balance	357.4
- modifying factors	-335.4
- state financial assets and extra-budgetary accounts	-17.7
B. Other general government entities	61.8
- National Property Fund	-289.9
- Social Insurance Agency	268.5
- State funds	45.6
- Higher territorial units (local government)	33,6
- public universities	11.9
- Slovak Television and Slovak Radio	-9.0
- municipalities	4.1
Current estimation of general government deficit in EUR mill.	-1476.6
Current estimation of general government deficit in % of GDP	-2.19
of which: improvement of deficit by means of the GDP estimation update (in % of GDP)	0.05

(+) indicates increase and (-) indicates decrease of the GG deficit in the ESA 95 methodology *Source: Ministry of Finance*

The cash deficit of the state budget was by EUR 357.4 million lower than budgeted, driven mainly by higher non-tax revenues and lower expenditures on goods and services and current transfers. As far as the non-tax revenues are concerned, levies from gambling games were by EUR 38.4 million higher than budgeted, refunds to the state budget were up by EUR 37.7 million, and revenues from administrative fees by EUR 31.4 million. On the expenditure side, savings in the amount of approximately EUR 122.8 million were made on state social benefits, resulting from a continuous decline in the number of beneficiaries that occurred during the year. Lower expenditures of the state budget are also linked with social contributions paid by the state on behalf of certain groups in the amount of EUR 16.3 million, which however led to a drop in revenues of health insurance companies. Savings were also made in cash expenditures on interest payments of the state debt in the amount of EUR 25.8 million.

Modifying factors had a negative effect on the state budget in a total amount of EUR 335.4 million. The remission of a receivable from non-financial corporations amounting to EUR 236.5 million accounts for the largest portion of that.

As far as other general government entities are concerned, the economic performance of the National Property Fund had a considerably adverse effect in the amount of EUR 289.9 million on the general government balance. This was caused primarily by the assumption of a debt resulting from high-risk liabilities in connection with the privatisation of state-owned companies and a lower income from dividends.

A notable positive impact of the Social Insurance Agency's economic performance is caused by higher-than-budgeted revenues, by EUR 370.4 million, and due to higher revenues from social insurance contributions and a higher-than-expected impact of the transfer of pension contributors from the fully-funded pillar to the PAYG pillar

in the period from 1 January to 30 June 2008. However, the social insurance expenditures were by EUR 154.6 million higher than as projected in the budget.

The Environmental Fund also helped improve general government balance, through the sale of surplus emission quotas worth nearly EUR 75 million at the end of 2008.

The economic performance of municipalities and higher territorial units contributed to the improvement of general government balance by EUR 37.7 million.

Another part of this chapter discusses the opening of the fully-funded (second) pension pillar in the first half of 2008 and its re-opening for the period from 15 November 2008 to 30 June 2009, and the construction of motorway infrastructure through public-private partnerships (PPP).

BOX 4 – Temporary opening of the 2nd pillar

The opening of the 2nd pillar in the first half of 2008

Measures came into effect in 2008 that aimed at stabilising the pay-as-you-go pillar in a medium-term horizon. Among those measures was the temporary opening of the fully-funded pension system pillar from 1 January to 30 June 2008. All pension savers were allowed to leave the fully-funded pillar. At the same time, those who did not yet participate in the fully-funded pillar could join it. The measure aimed at permitting those pension savers who find the fully–funded pillar disadvantageous – either based on their previous experience or because they are now better informed – to revert to full coverage within the PAYG pillar.

Taking into account the laws which had extended the period after which a person is entitled to pension benefits from the PAYG and fully-funded pillar from 10 to 15 years, it was expected that the PAYG pillar would mainly be re-entered by people over 40 years of age.

Age structure of the second pillar contributors

	number of person		difference	% share	
	31.12.2007	31.07.2008		31.12.2007	31.07.2008
less than 20 years	53 253	56 518	3 265	3 %	4 %
From 21 to 30 years	548 478	553 877	5 399	35 %	37 %
From 31 to 40 years	573 168	553 351	-19 817	37 %	37 %
From 41 to 50 years	357 690	298 777	-58 913	23 %	20 %
more than 51 years	29 668	17 484	-12 184	2 %	1 %
Total	1 562 257	1 480 007	-82 250	100 %	100 %

Source: Ministry of Finance

Original estimates assumed that 68 thousand pension savers would leave the 2nd pillar, while 10 thousand would join in. As a matter of fact, more than 106 thousand left the 2nd pillar, compared to over 22 thousand pension savers who entered; the assumption that the 2nd pillar would mainly be abandoned by the individuals over 40 proved to be right (71 thousand persons). The overall positive impact of this measure on the general government revenue in 2008 may be quantified at EUR 160.0 million (0.2% of GDP); this figure may be broken down to the transfer of pension savings from the 2nd pillar in the total amount of EUR 132.3 million (0.2% of GDP) and the revenues of the Social Insurance Agency in the current year totalling EUR 27.7 million (0.0% of GDP).

Budgetary impact of opening the second pillar in the first half of 2008 on GG (EUR ths., ESA95)

	number of person	2008	2009	2010
Net impact on GG	**83 633**	**150 787**	**41 437**	**44 998**
Net impact on GG as a % of GDP	-	**0.2 %**	**0.1 %**	**0.1 %**
Impact of optional entry to the second pillar	22 804	-8 199	-12 713	-13 809
Impact of optional exit from the second pillar	106 437	159 986	54 150	58 807
transfer of accumulated funds	-	132 294	0	0
impact in a current year	-	27 692*	54 150*	58 807*

* estimate

Source: Ministry of Finance

The opening of the 2nd pillar from 15 November 2008 to 30 June 2009

From 15 November 2009 to 30 June 2009, all pension savers will again be given the chance to leave the 2nd pillar while, at the same time, those individuals who have not entered yet will be allowed to join in. When deciding to re-open the 2nd pillar, the government considered the existing structure of pension savers, as well as other conditions affecting their decision-making, the global financial crisis in particular. Although it was open in 2008, the 2nd pillar still includes pension savers for whom it does not represent the best solution possible; i.e. more than 316 thousand persons over 40 years of age. The second factor is the subjective perception of the risks associated with saving for pensions in the 2nd pillar, especially in the context of the financial crisis. Having adopted this measure, the government intends to allow the savers to re-think their decision, and to advice them on advantages and disadvantages of both pension system pillars through an information campaign to be carried out in the course of 2009.

Some 150 thousand savers are expected to leave and 10 thousand to enter the 2nd pillar. This should improve the Social Insurance Agency's economic performance by some EUR 301.8 million (0.4% of GDP) in 2009. The real movement of savers and their funds between the two pillars is expected to fully commence in 2009.

Estimated impact of opening the second pillar in the first half of 2009 on GG (EUR ths., ESA95)

	number of person	2009	2010	2011
Net impact on GG	**140 000**	**301 766**	**87 367**	**95 433**
Net impact on GG as a % of GDP	-	**0.4 %**	**0.1 %**	**0.1 %**
Impact of optional entry to the second pillar	-10 000	-5 609	-6 240	-6 804
Impact of optional exit from the second pillar	150 000	307 375	93 607	102 237
transfer of accumulated funds	-	231 494	0	0
impact in a current year	-	75 881	93 607	102 237

Source: Ministry of Finance

BOX 5 – Construction of motorway infrastructure through PPP projects

On 5 September 2007, the Slovak government approved a timetable for the construction of motorway infrastructure through PPP projects. Individual motorway and express way sections were divided into three packages. On 11 March 2009, the Government approved the signing of a concession contract with a private partner for the 2nd package and in case of the 1st package the concession contract was approved by the Government on 15 April 2009. Given the lack of long-term loan resources, implementation of the 3rd package remains uncertain. Total construction costs (in prices exclusive of VAT) of the first two packages have been estimated at EUR 3.3 billion (4.6% of GDP).

The decisive criterion for the selection of a wining bidder is not the price of works but an annual instalment required, i.e. a net current value of payments required for the access to individual motorway and express way sections (payments for availability). Payments made by the state will depend on whether the infrastructure meets the set parameters and is operational. Payments will be made over a 30-year period; the general government will start paying after individual sections are put into operation.

The original schedule of the implementation of the PPP projects for motorway infrastructure development will probably not be observed due to the lack of loan resources for the funding of long-term projects resulting from the financial crisis.

Since the final conditions for the implementation of the PPP projects were unknown at the time of preparation of the general government budget for 2009-11, the budget approved by the Government did not anticipate any state expenditure for these projects. The implementation conditions for the 1st and 2nd package are already known; the state is expected to make the first payment for availability in 2011. Payments related to the 2nd package are included in the general government budget framework being prepared for the period 2010-12.

Planned PPP projects - construction of motorways and express ways				
	road	*length (km)*	*estimated construction costs (EUR bn.)*	*planned finalisation*
1st package	*D 1*	*75.0*	*2.4*	*2013*
2nd package	*R 1*	*51.5*	*0.9*	*2012*
3rd package	*D 1*	*24.8*	*1.4**	*uncertain*
Total**		***126.6***	***3.3***	

Note: D 1 - motorway between Bratislava and Košice

R 1 - express way connecting Bratislava and Banská Bystrica

** latest estimate*

*** 1st and 2nd package*

III.3. Structural balance, fiscal position, fiscal impulse

The consolidation of public finance should create room for long-term sustainable economic growth with low inflation, low interest rates, and positive expectations of stakeholders concerning future economic policy. This will positively influence the supply-side of the economy, and more than compensate for a lower contribution to aggregate demand.

The consolidation effort describes the path the government plans to take in order to meet its medium-term objectives. The consolidation effort as presented in this document takes into account, in addition to the cyclical component of the budget and one-off effects, the costs associated with the launch of the 2nd pillar of the pension system as an important structural reform contributing to the long-term sustainability of public finance, as well as the impact of interest payments due to the fact that they are not associated with the government's economic performance in the given period.

Consolidation effort in years 2007 and 2012 (ESA95, % of GDP)						
	2007	2008E	2009B	2010B	2011B	2012B
1. Net lending / net borrowing	-1.9	-2.2	-3.0	-2.9	-2.2	-1.7
2. Cyclical component	0.4	0.5	-0.2	-0.4	-0.2	-0.1
3. One-off measures	0.8	-0.3	0.4	0.1	0.1	0.1
- capital income of the general government	0.3	0.4	0.3	0.1	0.1	0.1
- stockpiling - excise taxes	0.5	-0.3	-0.2	-	-	-
- remission of receivables towards non-financial corporations	-	-0.4	-	-	-	-
- assumption of loans with state guarantees	-	-0.2	-	-	-	-
- exit from the 2nd pillar of pension scheme	-	0.2	0.3	-	-	-
4. Implementation of the 2nd pillar of pension scheme	-1.3	-1.3	-1.1	-1.1	-1.1	-1.2
5. Interest payments	-1.4	-1.2	-1.4	-1.2	-1.3	-1.2
6. Cyclically adjusted prim. balance net of one-offs and 2nd pillar (1-2-3-4-5)	-0.5	0.1	-0.8	-0.4	0.3	0.7
Consolidation effort	0.3	0.6	-0.8	0.4	0.7	0.3

Source: Ministry of Finance

In order to quantify the government's consolidation effort it is first necessary to divide the actual general government balance into its cyclical and structural components. The structural component refers to the situation in general government budget provided that the economy is at its potential level of output. The structural general government balance is the current general government balance, net of changes in the cyclical component which reflects the response of general government revenues and expenditures to changes in the output gap. The magnitude of the cyclical component depends on the size of the output gap and the elasticity of selected revenue and expenditure categories which respond to swings in economic activity. The Ministry of Finance has taken the

degree of sensitivity of the general government balance to changes in the output gap in full from OECD estimates.

The second item comprises one-off and temporary measures taken by the government. Five one-off effects have been identified for the years 2008 to 2012:

- The first one-off effect concerns capital income of the general government, adjusted for the purposes of consolidation effort quantification. Since all these revenues relate to the sale of tangible or intangible assets and all general government entities are involved to a certain degree, it is impossible to specifically identify a particular sale of assets as being a one-off revenue. Such revenues are usually generated every year, therefore their one-off effect may only be identified as a deviation from the long-term average. The Ministry of Finance took a conservative approach when estimating the long-term average; capital income in the amount of 0.2% of GDP is considered a regular income. The same amount was used for the adjustment of actual and budgeted capital income in the period of 2007-12.
- The second factor is the stockpiling associated with the increase in excise tax on cigarettes which occurred early in 2008 and in February 2009. A stockpiling effect means that in the last months prior to the effective date of new tax rates, a large quantity of tobacco products subject to original tax rates is released to circulation; these products will also be sold in the period following the effective date for new tax rates. It leads to one-off changes in tax revenues, but no variations occur in the final consumption of the products in question.
- The third effect includes the remission of receivables due from non-financial entities in a total amount of 0.4% of GDP. These receivables consist of loans, which the former National Labour Office provided within the framework of the active labour market policy, and the receivables resulting from the then state funds' loans to agricultural companies, which were transferred to the Ministry of Agriculture following their dissolution.
- The fourth factor entails a debt in the form of high-risk liabilities transferred from the National Property Fund of the Slovak Republic (FNM). They consist of guarantees for the liabilities of state-run companies toward third parties which the FNM provided during their privatisation. As regards the probability of recovery, the liabilities accounting for 0.2% of GDP were assessed as high-risk liabilities with a negative effect on the general government balance in 2008.
- The fifth relates to the opening of the fully-funded pillar of pension scheme in the first half of 2008 and, subsequently, in the period from 15 November 2008 to 30 June 2009[4]. This means that if a contributor decides to leave the fully-funded pillar, the move will be accompanied by the transfer of his/her funds from the fully-funded to the pay-as-you-go pillar. All assets accrued since his/her entry to the fully-funded pillar will be transferred, a portion of which, attributable to previous years, represents a one-off component. On that account, general government revenues were increased by a one-off amount of 0.2% of GDP in 2008 and an increase of 0.3% of GDP is envisaged for 2009.

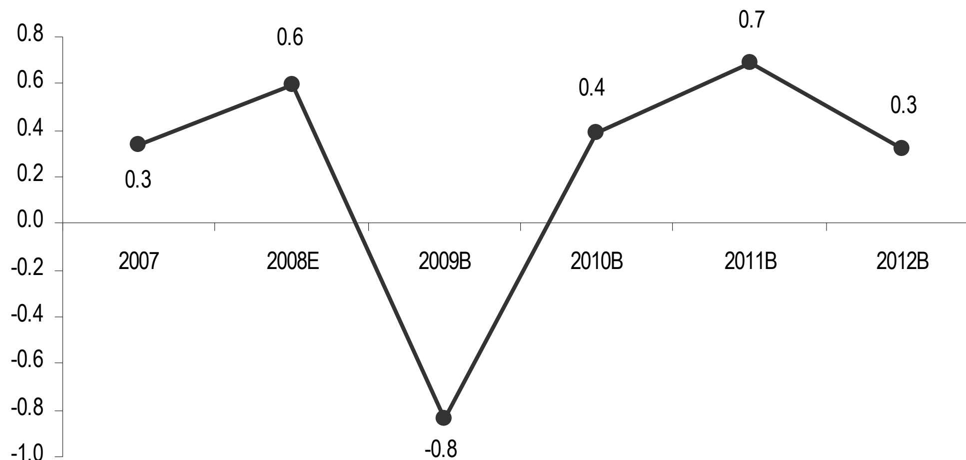
The third item considered in quantifying the government's consolidation effort are the costs related to the implementation of the fully-funded (second) pillar of the pension system. The costs of pension system reform amounted to 1.3% of GDP in 2008; between 2009 and 2011, these costs are expected to stand at 1.1% of GDP. The figures for 2008 and 2009 also include transfers (due to people leaving the 2nd pillar) of the funds of the contributors accrued during a current year. However, they do not include the transfer of contributors' funds accrued over past years. Since this represents a one-off transfer, it is presented under one-off effects. For 2012, the costs are projected at 1.2% of GDP mainly due to a lower number of contributors.

The last, fourth item includes interest payments. Given the fact that the amount of interest payments depends on the amount of the general government debt which is affected by the economic performance of previous governments and conditions on financial markets (interest rates and foreign exchange rates), this item should not influence government's consolidation effort in a given period. On that account, the general government balance is also given net of interest payments.

[4] The measure is described in more detail in Chapter III.2, Box 4.

The following chart clearly indicates that the fiscal consolidation will continue after 2009. The consolidation effort in 2008 was slightly above the minimum consolidation effort requirement set to 0.5% of GDP per year. In 2009, the consolidation effort will be negative due to the government's endeavours to respond to the impacts of the global financial crisis on the Slovak economy through an expansive fiscal policy. Following an anticipated economic recovery, the fiscal consolidation is expected to resume in 2010.

Consolidation effort between 2007 and 2012 (% of GDP)



Source: Ministry of Finance

The second part of this chapter discusses the fiscal impulse, measuring the contribution of general government budgets to the year-on-year change in aggregate demand. It indicates whether the government pursues an expansive or a restrictive fiscal policy. In conjunction with the output gap, it serves to characterise the fiscal policy as to whether it has either a stabilising or a pro-cyclical effect on the economy.

For the purposes of calculation of the fiscal impulse, the primary balance used in the calculation of the consolidation effort was adjusted to account for other items, which describe more closely the impact of fiscal policy on aggregate demand. They include the financial links to the EU budget and the effects of PPP projects undertaken in the construction of motorway and express way infrastructure.

The financial links to the EU budget are included because contributions of Slovakia to the EU budget lower aggregate demand, while, on the other hand, revenues from the EU, although they do not affect the deficit (since they are present both as revenues and expenditures), have an expansionary effect on the economy.

PPP projects for the construction of motorway and express way infrastructure represent a significant expansionary impulse. The reason for their inclusion in the calculation of fiscal impulse is that their impact on the economy is to be seen during the construction phase, but the general government balance will be affected only after regular instalments for the completed motorway sections are paid, i.e. with a considerable time-lag.

Fiscal impulse (ESA 95, % of GDP)

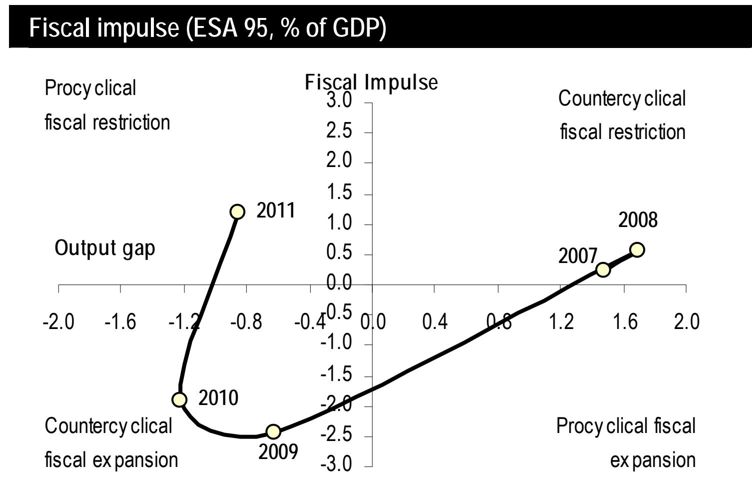
	2007	2008E	2009B	2010B	2011B
1. Net lending / net borrowing	-1.9	-2.2	-3.0	-2.9	-2.2
2. Cyclical component	0.4	0.5	-0.2	-0.4	-0.2
3. One-off measures	0.8	-0.3	0.4	0.1	0.1
4. Impact of the implementation of the 2nd pillar of pension scheme	-1.3	-1.3	-1.1	-1.1	-1.1
5. Interest expenditure	-1.4	-1.2	-1.4	-1.2	-1.3
6. Cyclically adj. prim. balance net of one-off effects and 2nd pillar (1-2-3-4-5)	-0.5	0.1	-0.8	-0.4	0.3
7. Financial links to the EU budget	0.6	0.6	1.8	2.7	2.5
8. PPP projects - motorway and express way infrastructure	-	-	0.4	1.9	1.5
9. Aggregate balance including the EU effect and PPP projects (6-7-8)	-1.1	-0.6	-3.0	-4.9	-3.7
10. Fiscal impulse	0.2	0.6	-2.4	-1.9	1.2
p.m. Output gap	*1.5*	*1.7*	*-0.6*	*-1.2*	*-0.9*

(+ restriction, - expansion) *Source: Ministry of Finance*

The table indicates that, in the years ahead, the stance of the fiscal policy will be notably affected by a massive inflow of resources from the EU funds and the launch of motorway construction through PPP projects. **Consequently, the fiscal policy will be very expansionary and countercyclical between 2009 and 2010, with a contribution of 2.4% of GDP and, respectively, 1.9% of GDP.** Taking into account the expansive stance of monetary policy and anticipated impacts of the global financial crisis, such a fiscal policy will provide sufficient stimuli for the Slovak economy. In 2011, the restrictive nature of the consolidation effort will be felt more on the fiscal impulse.

In order to live up to this scenario, however, the spending of resources from the EU funds at the level of budgeted amounts is essential. The drawing of EU funds also raises the question of their effective use in order to facilitate the growth in potential output of the economy. A possibility to increase the spending of resources from the EU funds will accentuate the role the government plays in the allocation of resources to priority areas with the aim of improving the quality of public finance.

Fiscal impulse (ESA 95, % of GDP)



Source: Ministry of Finance

III.4. General government debt and its development

The planned general government deficit figures for 2009 through 2011 will also contribute to gross debt increase. **By the end of 2011, the gross general government debt will reach 32.7% of GDP**, which is well below the Maastricht reference value. **In the same period, the net general government debt will reach 29.6% of GDP.**

General government debt indicators		2007	2008E	2009F	2010F	2011F
Gross debt (EUR mill.)		18 053	18 613	22 311	24 873	27 044
Net debt (% of GDP)	(2-1)	24.8	24.0	27.8	29.3	29.6
Liquid financial assets (% of GDP)	(1)	4.6	3.7	3.6	3.4	3.1
Gross debt (% of GDP)	(2)	29.4	27.6	31.4	32.7	32.7
Change in gross debt (p.p.)		-1.1	-1.7	3.7	1.3	0.0
growth in nominal GDP		-3.2	-2.5	-1.5	-2.1	-2.6
primary balance		0.6	0.9	1.7	1.7	1.0
interest payments		1.4	1.2	1.4	1.2	1.3
stock-flow adjustment		0.1	-1.4	2.2	0.5	0.4
p.m. Implicit interest rate (%)		*5.1*	*4.7*	*5.3*	*3.9*	*4.2*

Source: Ministry of Finance

The gross general government debt-to-GDP ratio has been steadily decreasing since the year 2000, when it reached its historic peak at 50.3% of GDP. By 2008, the ratio gradually fell by 22.7% of GDP to 27.6% of GDP; in the medium term, it is expected to increase slightly above 30% of GDP. The key factors behind this dramatic reduction in the general government debt primarily include the accomplishment of the consolidation objectives, the establishment of conditions for a robust and sound economic growth, improved efficiency in the management of the debt and of state financial assets, as well as the use of revenues from privatisation primarily to reduce the debt.

In nominal terms, the gross general government debt rose by EUR 560 million in 2008. The total value of negative factors increasing the government's liabilities amounted to EUR 597 million, most of which can be attributed to the state debt which rose by EUR 349 million year-on-year. As far as other general government entities are concerned, the debt of the National Property Fund rose by EUR 152 million, as did the indebtedness of higher territorial units, up by EUR 95 million. These negative impacts were partially counterbalanced by a reduction in the debt of municipalities by EUR 36 million.

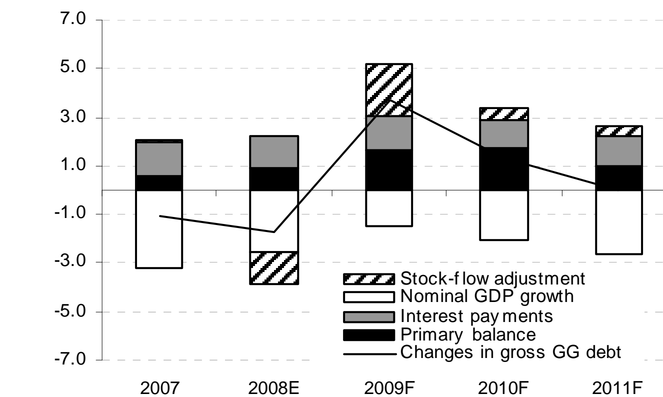
In the years to come, the debt will mainly be affected by the cash deficit of the state budget and changes in borrowings from the State Treasury. Other general government entities will also contribute to an increase in the debt, mainly by way of credit facilities that municipalities and higher territorial units take out in order to implement their investment plans.

The debt projection assumes that the amount of resources drawn from the State Treasury to cover the state debt will gradually decrease over the projected period by the amount of funds earmarked to finance the transformation costs of the pension reform in particular. The amount of resources in 2009 is also affected by other one-off effects, e.g. refundable financial aid provided to ŽS Cargo, a.s. and the Railways of the Slovak Republic. The lowered available liquidity in the State Treasury accounts highlights the need to refinance the state debt, more precisely the interim state budget deficit, by issuing new bonds.

During the forecast period between 2009 and 2011, the debt-to-GDP ratio will increase, with planned general government deficits contributing their share throughout the said period. This share will be significant because, in addition to interest payments, a primary deficit exceeding 1% of GDP is expected for the entire period. The contribution of stock-flow adjustment to the change in gross debt will also be positive and is quantified to exceed

2% of GDP in 2009. The only factor in favour of debt-to-GDP ratio reduction is the nominal GDP growth which will almost fully counterbalance all the above negative factors in 2011.

Contributions of factors to the change in gross general government debt (p.p.)



Source: Ministry of Finance

In 2009-11, the value of the stock-flow adjustment will be influenced by differences between the cash-based and accrual methodology, with respect to the tax revenues and interest payments in particular. Another important factor is the net accumulation of financial assets, because the forecast does not consider using the assets resulting from the surplus of some general government entities to repay the debt.

Stock-flow adjustment (% of GDP)

	2007	2008E	2009F	2010F	2011F
Stock-flow adjustment	0.1	-1.4	2.2	0.5	0.4
Differences between cash and accruals	-0.2	0.2	0.2	-0.2	0.2
Net accumulation of financial assets	1.1	-0.9	1.8	0.6	0.3
Other	-0.8	-0.7	0.2	0.1	-0.1

Source: Ministry of Finance

BOX 6 – State Debt Management Strategy

The State Debt Management Strategy *is a document which defines basic frameworks and goals of the debt management policy in the medium term The strategy only focuses on the portion of debt and liquidity which is controlled by the Finance Ministry; i.e. the state debt and liquidity of central government-controlled entities. This paper serves as the basis for the preparation of individual guidelines which specify in more detail the rules for the state debt risk management, limits of state positions and the control system. The strategy is prepared for four-year periods corresponding to the government's office terms, and is updated annually.*

Since 2003, the state debt and liquidity management has continuously been provided by the Debt and Liquidity Management Agency (ARDAL), the Ministry of Finance and the State Treasury within a comprehensive treasury system. The strategic goal of the treasury system was to introduce an active approach to debt and liquidity management. This active strategy has facilitated progress in a number of areas, particularly in market analyses and debt portfolio; it has further helped optimise the debt structure and costs, create a risk management system, restructure the state debt and government loan portfolio and better schedule bond maturity over a longer time period, introduce an electronic method of investors' participation in primary auctions, considerably improve communication with domestic and international financial markets, introduce a timetable for the publication of government securities auctions, make the day-to-day state debt

management more flexible, and separate the day-to-day debt and liquidity management from policy-making and control procedures.

The applicable State Debt Management Strategy prepared for the 2007-10 period builds on three main principles – transparency, preference given to medium- and long-term objectives, risk optimisation – and defines six key objectives:

1. *Reduction in the number of new issues of government securities and standardisation of the size of individual issues.*
2. *Improved transparency of the issuer's (Ministry of Finance) intentions and better communication with investors and financial markets.*
3. *Optimisation of state budget costs (expenditures) for state debt service.*
4. *Preserving an average maturity of the government securities portfolio and its duration.*
5. *Gradual increase in the foreign currency denominated debt- to-Slovak koruna denominated debt ratio.*
6. *Review and, if market conditions are appropriate, issue state bonds for the citizens.*

IV. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

The Stability Programme stems from a baseline scenario of economic development. This section presents alternative scenarios based on model simulations involving deceleration in foreign demand growth, lower oil prices and lower interest rates. The purpose of the first, pessimistic scenario is to demonstrate negative budgetary risks resulting from a drop in tax revenues and social contributions when compared to the baseline scenario.

IV.1. Scenarios

Scenario 1. The pessimistic scenario of Slovakia's economic development

The following scenario describes an alternative development of the Slovak economy, expecting GDP to drop to -1% in 2009 and return back to growth at 1% in 2010. Inflation will be slowed down by lower domestic demand. The unemployment rate will increase on the backdrop of economic decline.

Pessimistic scenario of economic development in 2009 and 2010
Change in values of the variables in comparison to the basic scenario is in p.p.

	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI inflation	GG balance (% GDP)	Interest expenditure
2009	-2.5	-3.2	-3.4	1.5	-0.7	-1.4	0.1
2010	-1.8	-2.3	-2.6	2.1	-0.5	-2.1	0.2

Source: Ministry of Finance

The effect on the general government balance comprises a drop in tax revenues and social contributions coupled with higher interest payments for the debt. This effect may be quantified based on the assumption that the decline in tax revenues and social contributions (down by 1.2% of GDP in 2009 and by 1.8% of GDP in 2010) will affect the general government balance to the full extent. Subsequently, additional funds to make up for this drop will have to be obtained in the form of a debt, causing the interest payments to increase. At the same time, the general government balance as a percentage of GDP will be modified due to changes in the nominal GDP.

Scenario 2. Weaker performance of the external economy

This scenario simulates a negative risk associated with deceleration in economic performance of Slovakia's trading partners, which would reflect in a subsequent slowdown in Slovak exports. The simulation builds on the assumption that the real foreign demand from Slovakia's trading partners will fall by 3 percentage points in 2009 compared to the baseline scenario and by 1.5 percentage points in 2010.

A drop in export, when compared to the baseline scenario, will increase the current account deficit. The loss of markets of export-oriented companies will result in a decline in investments (a lower overall foreign demand curtails the need for construction of new production capacities) and growing unemployment. This would translate into lower consumption. A weaker domestic demand along with higher unemployment would lead to lower inflationary pressures. The slower GDP growth will widen the negative output gap – as a result, the interest rates will fall and partially cushion the decline in consumption and investments. Decline in consumption and investments will reflect in lower imports, thus mitigating the trade balance deficit. As the decline is expected to last only for the period between 2009 and 2010, the lower interest rates should restore higher demand, investment and GDP in 2011 and 2012 when compared to the baseline scenario. As a result of the general slowdown in the economy until 2012, the general government deficit would be pushed up by the equivalent of 0.5 to 0.7 percentage points of GDP (p. a.) against the baseline scenario.

Drop in foreign demand by 3 p.p. in 2009 and by 1.5 p.p. in 2010								
Change in values of the variables in comparison to the basic scenario is in p.p.								
	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI inflation	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2009	-0.8	-1.5	-1.3	0.6	-0.9	-1.0	-0.8	-0.5
2010	-0.4	-0.2	-0.6	0.9	-0.5	-1.2	-0.6	-0.7
2011	0.1	0.4	0.2	0.8	0.1	-1.2	-0.6	-0.7
2012	0.2	0.2	0.2	0.6	0.3	-0.8	-0.5	-0.6

Source: Ministry of Finance

Scenario 3. Lower oil prices

The year 2008 saw a very sharp rise in oil prices, when they swelled up to as much as 140.3 USD per barrel, compared to the 2007 average of 72.9 USD per barrel. Recently, however, the oil prices have gotten back to their lower levels. The following scenario reckons with a positive risk of decreasing oil prices; the simulation involves a situation when oil prices fall, compared to the baseline scenario, by 10 USD per barrel for each projected year, while the exchange rate remains unchanged compared to the baseline scenario. The baseline scenario stems from the forecasts of oil prices and USD/EUR exchange rates as projected in the European Commission's *Common External Assumptions*.

A drop in oil prices would immediately result in lower prices of fuel, gas and heat for households. The effect on inflation following this price drop would be most visible at the beginning of the monitored period. Since the price of oil influences the global economy, the results of our simulation take into account the general context of the economic development of the Slovak Republic within the global economy (using a multi-country model).

The decline in inflation driven by lower prices of oil and oil products would allow the central bank to make cuts in interest rates. Lower inflation would translate into higher real income and, backed by lower interest rates, contribute to boosting household consumption. In addition, lower interest rates would facilitate growth in investments. The real economy would generally speed up, which would lead to a decrease in unemployment. An accelerated economic growth driven by the price drop, accompanied by a higher demand from our trading partners, would also have a positive effect on the current account deficit and the general government balance.

Decrease in oil price by 10$ in each year of forecast								
Change in values of the variables in comparison to the basic scenario is in p.p.								
	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI inflation	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2009	0.7	0.4	0.2	0.0	-1.3	-0.2	1.1	0.1
2010	0.9	1.0	0.5	-0.2	-0.6	-0.9	1.1	0.3
2011	1.6	1.7	0.7	-0.4	-0.2	-1.3	0.9	0.4
2012	2.1	1.8	0.9	-0.4	-0.4	-1.2	0.7	0.6

Source: Ministry of Finance

Scenario 4. Lower interest rates

The risk scenario deals with a simulated drop in interest rates by 1 percentage point below the baseline scenario level for two years, commencing in 2009.

The lower interest rates would make it easier for businesses and households to obtain loans, resulting in a higher household consumption and an increase in investments. This would be felt in an overall acceleration of the economic growth, translating into higher employment and, consequently, into a higher growth of household

consumption. However, the increase in the overall demand would bring upward pressures on prices, while higher employment would initiate such pressures on wages. Higher consumption and investments would boost imports, which would reflect in a worsened balance of the current account. An overall positive impact on the general government balance, including direct interest payments of general government debt, is quantified at 0.1-0.3% of GDP.

Decrease of interest rates of 1 p.p. Change in values of the variables in comparison to the basic scenario is in p.p.								
	Consumer expenditure	Gross fixed investment	GDP	Unemployment rate	CPI inflation	Short-term interest rate	Current account (% of GDP)	GG balance (% of GDP)
2009	0.3	0.7	0.1	0.0	0.1	-1.0	-0.2	0.1
2010	0.6	1.1	0.3	-0.1	0.2	-1.0	-0.2	0.2
2011	0.4	0.4	0.4	-0.1	0.0	0.0	0.0	0.3
2012	0.3	-0.1	0.3	-0.1	-0.1	0.0	0.2	0.3

Source: Ministry of Finance

General government interest expenditures (ESA 95, % of GDP)					
	2008E	2009F	2010F	2011F	2012F
A. Baseline scenario	1.2	1.4	1.2	1.3	1.2
B. Risk scenario	1.2	1.3	1.1	1.2	1.1
C. Difference (B-A)	0.0	-0.1	-0.1	-0.1	-0.1

Source: Ministry of Finance

IV.2. Comparison with the previous update

The Stability Programme of the Slovak Republic reflects the impact of the global financial crisis on the Slovak economy. Revisions made in respect of the development of macroeconomic and fiscal parameters presented in the last year's update to the Convergence Programme of the Slovak Republic suggest negative trends in the country's economic performance.

Comparison between the previous forecast and the updated forecast						
	ESA code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update*		8.8	6.8	5.8	5.0	-
Current update		10.4	6.4	2.4	3.6	4.5
Difference		1.6	-0.4	-3.4	-1.4	-
General government net lending (% of GDP)	EDP B.9					
Previous update*		-2.5	-2.3	-1.8	-0.8	-
Current update		-1.9	-2.2	-3.0	-2.9	-2.2
Difference		0.5	0.1	-1.2	-2.1	-
General government gross debt (% of GDP)						
Previous update*		30.6	30.8	30.5	29.5	-
Current update		29.4	27.6	31.4	32.7	32.7
Difference		-1.2	-3.2	0.9	3.2	-

*Note.: * Convergence Programme of the Slovak Republic for 2007 - 2010* *Source: Ministry of Finance*

V. QUALITY OF PUBLIC FINANCE

An important aspect in the quality of public finance is an appropriate link between fiscal objectives and Lisbon Strategy goals. As far as budgetary issues are concerned, it is necessary that structural policies and reforms respect the government's fiscal objectives which determine a financial framework for such policies. At the level of government's policy objectives and commitments, this involves coordination and integration of the Stability Programme with the National Reform Programme for 2008–10.

V.1. Policy strategy

The consolidation of public finance is the pivotal medium-term goal of the government underlying the government's measures in fiscal policy. The government, however, is aware of its key role in the shaping of economic policy, the main goal of which is facilitating the increase in the standard of living, and catching up with the advanced EU Member States. The priority of the government is therefore the harmonisation of policies, so that consolidation goals positively influence the stability of the economy. What is brought to the forefront is the question of qualitative aspects of public finance: a shift in its perception is based on the fact that it is the very increase in efficiency and effectiveness of public finance that may contribute considerably to increasing the potential growth of the Slovak economy.

The principal government policy objectives included in the general government budget for 2009–11 confirm the increased role of qualitative aspect of the public finance. Greater emphasis is placed on the sectors of education, science, healthcare and infrastructure. The government is also focusing on changes aimed at improving the institutional environment in the key areas of structural policies. At the same time, it introduces changes in the social sector in line with its Manifesto.

In response to the global financial and economic crisis, the Slovak government adopted measures aimed at reducing its impact on the economy and the living standard of the population. These measures are described in Chapter I.5. This chapter quantifies their effect on tax revenues and social contributions, including the sources of their funding from general government expenditures.

This chapter outlines the main trends of medium-term development of general government revenues and expenditures. The starting point for this analysis is the data in the economic classification and also consolidated data in the classification of the functions of government (COFOG) for the general government budget for 2009-11 is available for the first time. Such data, given the shortness of time series of available data in this classification and also because of absent data for 2008, represents only a supplementary source of information.

V.2. Revenue trends

The Slovak government continues to address its goals, including through modifications in the tax and social contribution system. The effects of approved measures, including those adopted to mitigate the impacts of the financial crisis on the Slovak economy, are summarized in the table.

Quantification of the impact of legislative changes on general government revenues (ESA95, EUR ths.)

	2008	2009	2010	2011
Total impact on general government revenues (EUR ths.)	-94 038	382 120	-117 580	108 495
Total impact on general government revenues (% of GDP)	-0.1	0.5	-0.2	0.1
Income tax	-	-151 850	-232 241	-37 127
- PIT from dependent activity	-	-131 610	-209 576	-32 434
- PIT from self-employment	-	-21 402	-23 827	-5 855
- CIT	-	-28 673	-52 982	-70 142
- Withholding income tax	-	1 162	1 162	1 162
VAT	166	2 756	-19 677	-21 289
Excise taxes	-168 990	148 344	-16 166	-16 929
Television and radio licence fees*	74 786	76 316	77 452	78 227
Social contributions – social and health insurance	-	306 554	73 052	105 613

Note.: (-) means decreasing general government revenues *Source: Ministry of Finance*

** Slovak television (STV) and Slovak radio (SRo) were classified into the general government sector within the Eurostat EDP notification in October 2007. Thus, these entities were not included in the 2008-10 general government budget. Due to the fact that they were included for the first time into the budgetary process within the 2009-11 general government budget, they are shown in the table.*

As for the personal income tax, two changes, significantly affecting revenues from this tax, were introduced as of 1 January 2009. The first includes the introduction of the employee tax credit in the form of negative tax. As regards the measures designed to mitigate the effects of the global financial crisis, the tax credit was temporarily increased for the tax periods of 2009 and 2010 (Box 7). The introduction of the employee tax credit is primarily aimed at reducing the tax burden for low-income employees, while leaving employer expenditures intact.

The second change is based on an adjusted mechanism for the setting of the minimum wage, which allows the government to issue a regulation determining the minimum wage above the level calculated on the basis of year-on-year average wage growth, a rule that used to be applied whenever the social partners failed to reach an agreement. In terms of year-on-year growth, the minimum wage is expected to rise by 9.9%, up by 2.7 percentage points compared to the original assumptions placing the average wage growth at 7.2%[5]. A higher minimum wage has a number of effects on the amount of tax revenues. Since more than 80% of self-employed persons pay social contributions as calculated from the minimum wage (minimum assessment base), the minimum wage increase will also translate into higher social contributions. On the other hand, higher social contributions reduce the tax base for personal income tax from self-employment, thus resulting in lower tax revenues. A higher minimum wage will also affect the employee tax credit parameters.

BOX 7 – Employee tax credit

The employee tax credit ("tax credit") concept is complementary to the existing tax system, whereas the existing basic tax allowance remains in force. The mechanism of the tax credit is the same as that of the existing tax credit on child: whenever the wage drops below a certain threshold (if the tax base drops below tax allowance), employees will not pay zero tax as applicable today, but will receive a pro-rata transfer from the state instead. The tax credit is very accurate in targeting a specific group as it only applies to low-income taxpayers.

In line with the defined objectives, the employee tax credit was so designed that it can only be claimed by low-income employees whose wages are subject to the payment of social and health insurance contributions. For the above reasons,

- *the tax credit only applies to income from dependent activity – i.e. income from regular employment, which may be concurrently combined only with income based on a contract for the performance of work and income that is subject to withholding tax (interest, participation certificates, etc.), as long as the taxpayer considers the tax related to such income to have already been paid (and the taxpayer thus refrains from claiming basic tax allowance in respect of such income in the tax return).*
- *no entitlement arises with respect to other types of income or concurrent earning of other types of income – i.e., income from business activities, rental, share of profit, etc.*

In terms of employee tax credit entitlement, it is necessary to underpin its motivating effects while preventing any misuse. For the above reason, the tax credit can only be claimed after having complied with the following criteria:

- *the taxpayer's income over the tax period must be at least six-times higher than the minimum wage*
- *the taxpayer must have worked for at least six months.*

Total time worked means a period during which employees earn their income from dependent activity – the months during which employees only receive benefits (sickness benefit, maternity benefit) or earn income from dependent activity on the basis of contracts for the performance of work, or a combination thereof, are not included in such period.

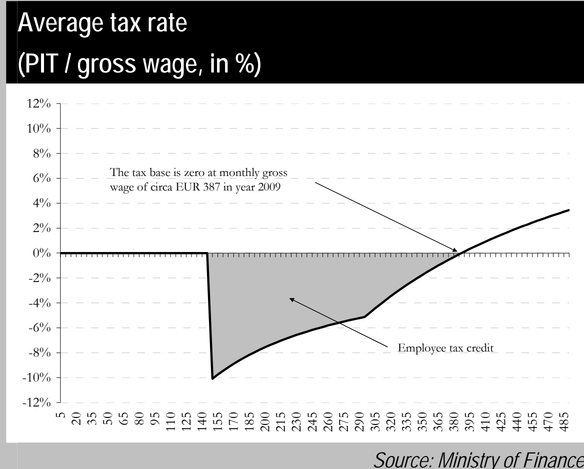
The highest employee tax credit amount of EUR 181.03 EUR per year (in 2009) will be received by employees with income between one half of the minimum wage and the full minimum wage, provided that the time worked was 12 months (increase of disposable income by 13 percentage points or, respectively, 6.5 percentage points). As the employee tax credit is designed to benefit working individuals, its amount will be adequately reduced based on the number of months worked in a calendar year. Due to extensive paperwork it was decided that the tax credit can be paid within the framework of the annual clearing of tax advances or by filing a tax return. The possibility of the concurrent provision of employee tax

[5] If social partners fail to reach an agreement, the rule for the setting of the minimum wage growth was based on the average wage growth in the year T-2. This means that, in accordance with this rule, the minimum wage in 2009 would increase by 7.2% (average wage growth in 2007).

credit and an allowance aimed at encouraging low-income employees to stay in their jobs, granted pursuant to Act No. 5/2004 on employment services, is not contemplated.

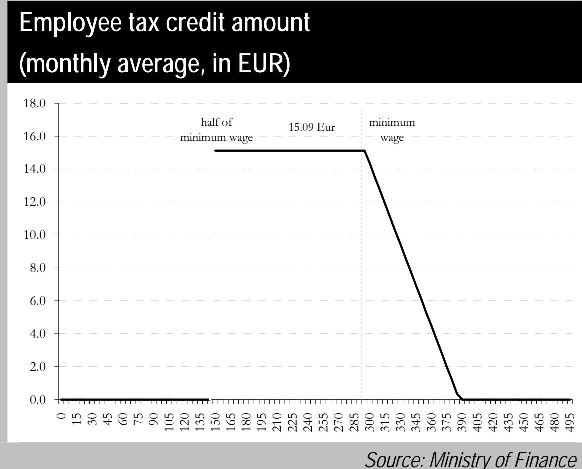
When introduced, the employee tax credit will effectively reduce the burden on low-income taxpayers in terms of taxes and social contributions. The tax wedge will drop 3.8 percentage points for the minimum wage amount, and 7.6 percentage points for one half of the minimum wage amount.

Average tax rate (PIT / gross wage, in %)



Source: Ministry of Finance

Employee tax credit amount (monthly average, in EUR)



Source: Ministry of Finance

In the case of value added tax and excise taxes, the Council Directive 2007/74/EC on the exemption from value added tax and excise duty of goods imported by persons travelling from third countries in their personal luggage was transposed as of 1 December 2008. It is expected that tax revenues will be primarily affected by stricter quantity limit for cigarette imports by modes of transport other than air.

As of 29 April 2009, VAT revenues will be adversely affected by the transposition of Council Directive No. 2007/46/EC which deals with the approvals for N1 category vehicles on a global level. Global approval is to supersede the system of national type approvals applied by the individual Member States. The negative effect is based on expectations that taxpayers would rather opt to purchase an N1 category vehicle with a VAT deduction option instead of an identical vehicle falling under M1 category where VAT deduction is not available. The effect on the corporate income tax will be positive.

Excise tax is subject to other changes as well. The first relates to the increase of excise tax on tobacco and tobacco products as of 1 February 2009, and this change has concluded the process of tax rates harmonisation with the EU. The increase of rates was already announced in the last Convergence Programme update, but the exact change in tax rates and the date were negotiated as late as 2008. Setting the date was also important with a view to estimating the stockpiling effect on tax revenues (Box 8). In order to ensure better control of this effect, cigarettes subject to original tax rates may only be marketed by the end of September 2009.

Further changes apply to the revenues from the excise tax on mineral oils which have been adversely affected since the exemption of LPG from tax as of 1 July 2008. The revenues from this tax will also be affected by the increase of the volume of bio-components in fuels as of 1 January 2009, as prescribed by an amendment to Government Regulation No. 246/2006 Coll. The mandatory minimum share of bio-components in energy content of the total volume of petrol and diesel placed on the Slovak market will gradually rise from 2% in 2008 to 3.4% in 2009 and 5.75% in 2010.

BOX 8 – Stockpiling in the increase of excise tax on tobacco and tobacco products

Having joined the EU, one of Slovakia's commitments was to gradually harmonise the rates of excise tax on tobacco products. The tax rate increases seen over the past few years resulted in a stockpiling effect: in the last months prior to the effective date of new tax rates, a large quantity of tobacco products (cigarettes in particular) subject to original tax rates will be released to circulation; these products will also be sold in the period following the effective date of new tax

rates. As regards the budgetary impact of stockpiling, the tax revenues will rise in the last months before the tax rate increase to subsequently drop during the first months following the effective date of new tax rates. The volume of stockpiling cannot be accurately predicted in advance, therefore stockpiling represents a risk in terms of state budget revenues and fiscal consolidation.

Stockpiling in 2007

The tax rates increased as of 1 January 2008. The volume of stockpiling, expressed as higher excise tax revenues, reached as many as EUR 315 million in 2007 (0.5% of GDP) which approximately accounts for 8.5-month consumption. In 2008 this resulted in a drop of tax revenues quantified at approximately the same level.

Stockpiling in 2008 and 2009

The last planned increase of tax rates took place on 1 February 2009, thus completing the process of tax burden harmonisation. This date will divide the stockpiling effect between 2008 and 2009, and the Ministry of Finance estimates stockpiling to be on par with the volume registered in 2007. In order to meet this objective, tobacco products subject to tax rates from 2007 can only be sold by September 2009, a restriction imposed through the approved legislation. Due to stockpiling, the full effect arising from higher tax rates is expected to occur as late as 2010.

For 2008, the Ministry of Finance estimates stockpiling to stand at EUR 149 million (0.2% of GDP), partially counterbalancing the drop caused by stockpiling in 2007. The continuation of stockpiling at the beginning of 2009 is estimated at EUR 166 million (0.2% of GDP). The net stockpiling effect would therefore amount to - 177 million Euros (-0.3% of GDP) in 2008.

In the approved general government budget for 2008–10, the tax rates were projected to increase as of 1 January 2009, with stockpiling estimated at EUR 73 million (0.1% of GDP). However, due to delayed effective date for new rates, the impact on the tax revenues in 2008 was different. According to the approved budget for 2008, stockpiling at the end of 2008 should compensate for a revenue drop due to year-end stockpiling in 2007, therefore the net impact on the tax revenues was expected to be approximately neutral. Considerably higher actual stockpiling at the end of 2007 (0.5% of GDP) and delayed effective date of new tax rates in 2009 had a negative impact (quantified at 0.3% of GDP in 2008 and 0.2% of GDP in 2009) on the general government balance.

Net effect of stockpiling						
	2008-10 GG Budget			*2009-11 GG Budget*		
Date of tax rates increase in 2009	*1 January 2009*			*1 February 2009*		
	2007	*2008*	*2009*	*2007*	*2008*	*2009*
Budgetary impact (% of GDP)	*0.1*	*0.0*	*-0.1*	*0.5*	*-0.3*	*-0.2*

The adoption of the single euro currency in Slovakia as of 1 January 2009 necessitated amendments to tax legislation. These changes involved, in particular, the formulation of tax rounding rules; however, substantial changes also apply to VAT. A summary of the estimated impact on tax revenues is provided in the box below.

BOX 9 – Impact of euro adoption on the tax revenues of the general government

The adoption of the single euro currency in the Slovak Republic is interlinked with amendments to tax legislation. The changes in the individual laws are, for the most part, rounding-related, though in these cases the impact is negligible. VAT, however, underwent further changes. The most important one is the change of the annual turnover threshold for tax registration from EUR 49 791 (SKK 1.5 million) to EUR 35 000, i.e. down by EUR 14 791. In 2009, this change will result in a one-off VAT revenue drop worth EUR 16.3 million because of the possibility to write off the tax upon registration. On the other hand, a higher number of taxpayers will deliver an additional EUR 5.3 million in tax revenues every year. When these impacts are taken into account, tax revenues should drop by some EUR 11.1 million in 2009, but should rise again in the subsequent years by EUR 5.6 million or, respectively, EUR 6.1 million.

Impact of tax legislation amendments connected with euro adoption on tax revenues (ESA95, EUR ths.)			
	2009	***2010***	***2011***
Personal income tax from dependent activity	*-66*	*-66*	*-66*
VAT	*-10 987*	*5 709*	*6 174*
- deduction of tax at registration	*-16 298*	*-*	*-*
- additional revenue	*5 311*	*5 709*	*6 174*
Excise taxes	*-33*	*-33*	*-33*
Total tax revenues	***-11 086***	***5 610***	***6 075***

Source: Ministry of Finance

As regards revenues from social contributions, the changes are primarily expected due to the reopening of the fully-funded pillar: from 15 November 2008 until the end of June 2009, all contributors are again given the chance to revert to full coverage under the PAYG pillar of the pension system while, at the same time, all contributors who have not entered the second pillar yet will be allowed to join in (Box 4).

There will also be changes with respect to health insurance contributions. The contributions paid by the state on behalf of persons set by law increased from 4.5% to 4.9% as of 2009. The above measure, hand in hand with other measures taken in the previous years (reduced VAT rate for medicaments and selected medical aid tools; a gradual increase, from 4% of the assessment base, in health insurance contributions paid by the state), helps increase the available resources in the health sector.

In evaluating the consolidation path it is necessary to bear in mind that the tax revenues and social contributions as a share of GDP will decrease by 0.5% of GDP in 2008-11. As regards tax revenues, indirect taxes are expected to post the highest decline. However, non-tax revenues should drop even more, by 2.4% of GDP. For the most part, this trend stems from the nominal reduction in expected dividend payments from state-owned companies and in capital income. This gap, however, is to a great extent covered by relatively high non-tax revenues in 2008 (when compared to the previous years) as a result of an increase in other non-tax revenues.

On the other hand, the funds from the European Union will play an increasingly important role in general government, rising by an amount equivalent to 1.9% of GDP during the same period. Nonetheless, this fact creates no additional room for deficit reduction, but quite the opposite. Mainly capital expenditures will rise equally; at the same time, however, there will be a higher demand for co-financing from the general government budget to accompany the EU funds.

V.3. Expenditure trends

The expenditure trend between 2009-11 will be marked by an effort to improve the quality of public finance, which entails more focused expenditures and implementation of institutional changes that will help increase Slovakia's potential economic growth.

One of Slovak government's priorities is to form a knowledge-based society, which will require more funding for the sectors of education, science and research from the general government budget for 2009-11. As regards the regional education system, the teachers will enjoy a faster salary increase in 2009 than the forecasted average wage growth and, to that effect, a 10.5% increase is envisaged in the budget. A considerable increase in the funding is also expected for universities and science, and these are the areas which represent a priority even in terms of EU Structural Funds drawdown. As a result, the public expenditures for universities will rise by 33% in 2009 against the level seen in 2006, and science will enjoy an increase in financing by 65%.

Another key priority is the construction and modernisation of Slovakia's transport infrastructure in order to connect it to the trans-European transport network and to improve access to all regions of the country, thus allowing the government to help prepare the ground for an improvement of the living standard in the individual regions and for

the reduction of regional disparities. Compared to 2006, the total budget for transport in 2009 increased by 33% while placing the greatest emphasis on the construction of motorway and express way infrastructure. According to the general government budget for 2009–11, the funding for the construction of motorway infrastructure should predominantly consist of state budget expenditures and the EU funds. Also, the preparations for allowing private funding to join through PPP projects are underway. A contract with a private partner for the 2nd package (R1 express way construction) has already been signed and the payments expected from the state for the availability of the motorway were already incorporated in the General Government Budget Framework for 2010-12, which is being prepared. The first payment from the state budget is expected in 2011. Railroad infrastructure is no less important than roads; the funding for the development and modernisation of railroads will be significantly increased as well (up by 22% compared to 2006).

The measures under the government-approved document entitled "Modernisation Programme – Slovakia 21" should considerably contribute to a higher quality of public finance (Box 10). The proposed short- and medium-term measures have, at the same time, become the cornerstone of the National Reform Programme for Slovakia for 2008-10. These measures are primarily aimed at improving the quality of the institutional environment in the key structural areas of Slovakia's economy.

BOX 10 – The Modernisation Programme Slovakia 21 and the National Reform Programme of the Slovak Republic for 2008-2010

In connection with Slovakia's entry into the Eurozone and the new cycle of the Lisbon strategy, the Slovak government approved the "Modernisation programme Slovakia 21" in June 2008. The modernisation programme is a set of specific short- and medium-term measures in four structural areas: (a) research, development and innovation, (b) education, (c) employment, (d) business environment, better regulation and higher transparency. It underlines the reform of the institutional environment as a means for improving the effectiveness of public expenditures.

The most ambitious measures of the programme include unified collection of taxes, customs duties, as well as health insurance and social contributions. It aims to change administration of taxes, customs duties, as well as health insurance and social contributions in order to improve the efficiency of the administration by reducing cost, to increase effectiveness of public sector's income collection and also to establish a pro-client orientation. The aim is to simplify and increase transparency of tax and social contribution processes, to abolish the excessive burden and to increase comfort for citizens and businesses. Similar objectives have been set for a wider use of information technologies in the general government sector to improve the effectiveness of its operations. To implement this goal, a legal framework should established along with the definition of conditions for general electronic access to the basic public services of interlinked general government registers, thus enabling comprehensive and real-time electronic data exchange among the citizens, public and private sector, while simultaneously preserving information security and personal data protection. For the unemployed and low-income groups, an employment premium has been designed to encourage employment of long-term unemployed persons and improve the social situation of low-income groups (Box 8).

In terms of research, development and innovation, the science funding reform and support for the exchange of knowledge between the academic sector and businesses should be predominantly addressed. In the education sector, the top grammar schools should be supported, along with more flexible forms of university management and support for the development of business skills at the secondary schools. As regards employment, preparations are underway in the modernisation of social services, preparation of a comprehensive monitoring system for the existing programmes of active labour market policy, as well as housing support with focus on the improvement of workforce mobility. In addition to the above measures, the business environment will see the development of one stop shops for businesses, more transparency in highly regulated markets, and establishment of a functional system for an interim and subsequent regulatory impact assessment.

The measures in the Modernisation Programme Slovakia 21, coupled with other measures, took the shape of specific action plans and were incorporated in the National Reform Programme for 2008-2010 approved by the government in October 2008. The intention behind the preparation of detailed action plans was to underline the focus on the implementation of the set tasks. The action plans include detailed timetable and information about funding. The measures in the National Reform Programme of the Slovak Republic for 2008-2010 are fully aligned with the medium-term fiscal framework of the general government.

Social affairs underwent changes as well; the measures primarily focus on the support for families and reconciliation of work and family life (for instance, one-off child birth allowance is extended to the birth of the second and the third child, introduction of a new and targeted instrument to support care for minors), and further changes will apply to the system of compensation benefits for severely disabled people (new benefit structure, setting of the automatic indexation, increase in lump sum benefits). Another important change affects the date of regular pension indexation, which moved from 1 July to 1 January. This also compensates for the expected increase in expenditures of sensitive population groups in connection with euro changeover. The expenditures budgeted in 2009 for the above social package stand at almost EUR 362 million (0.5% of GDP).

BOX 11 – The most important welfare measures in 2009

In 2009, several welfare measures will become effective, with total impact on the budget quantified at 0.5% of GDP. The measures vary in character, most of them represent measures which must be taken to preserve the real value of social benefits and the provision of adequate services for socially disadvantaged citizens.

For the most part, the changes were made in the structure of benefits for severely disabled persons, and their annual indexation by approximately the inflation rate is enshrined in the legislation. Insufficient indexation of child benefits continuously since 2004 necessitated a one-off increase of their amount; regular indexation of these benefits in an amount equal to subsistence minimum level growth had to be set as well. Another key measure comes in the form of an amendment to the Social Services Act, which commits the local governments to provide certain types of services. In terms of impact, the most important measure is the change of pension indexation date, which follows an overall trend of moving the dates of regular valorisation to 1 January.

List of social measures in 2009	Amount in EUR mill.	As % of GDP
1. Indexation date for pensions and injury benefits – moved from 1 July to 1 January	165.2	0.2
2. Child birth allowance extended to the birth of the second and third child, thus ensuring equal support to families in the amount of EUR 830 per child	16.4	0.0
3. Change in the indexation mechanism and increased child benefits as of 1 January 2009 by EUR 40 every year	49.8	0.1
4. Improved system of compensations to severely disabled persons, containing a new structure of benefits, automatic indexation in the amount of subsistence minimum level growth, increase of lump-sum benefits	36.5	0.0
5. Pool of recipients entitled to receive Christmas bonus was extended by the recipients of widow's, widower's and orphan's pension	4.9	0.0
6. Social Services Act – promoting the social inclusion of citizens and satisfying the social needs of people in adverse social situation, introduction of new social services (e.g. interpreting services, monitoring and signalling of the need to provide assistance, crisis assistance by means of communication signalling, relief services)	71.3	0.1
7. Introduction of a new and targeted instrument to support care for minors aimed at the reconciliation of work and family life	0.9	0.0
8. Introduction of a new benefit for children in material need, amounting to EUR 16.60 per month	7.3	0.0
9. Extended period for the payment of social contributions on behalf of maternity benefit recipients	7.6	0.0
10. Assistants included in the pool of state's insurees	1.5	0.0
Total	361.5	0.5

In agriculture, the government's goal is to continue to provide direct payments in the maximum possible amount. According to the 2009-11 general government budget, direct payments in 2009 should account for 90% of the EU average. The level of subsidies in 2010 and 2011 will depend on the real budgetary possibilities in the respective years. So far, subsidies sufficient for maintaining the 90% level of the EU average are contemplated.

In the years to come, capital expenditures should be stable, hovering slightly above 4% of GDP. This is because of the expected drawing of the Structural Funds and the Cohesion Fund, of which a significant amount should be directed to regional development projects, particularly in the areas of infrastructure, education and the

environment. However, the actual development is conditional on the ability and the speed in spending the EU funds.

As regards its anti-crisis measures, the Slovak government froze and reallocated EUR 332 million (0.5% of GDP) for their funding. The objective of this measure was to identify those expenditures that are not inevitable during the crisis and may be allocated through effective tools of the fiscal policy to foster aggregate demand. This amount is made up, to a varying extent, of funds from the individual state budget chapters (with the Ministry of Defence and the Ministry of Economy being the key contributors) and the method used for the freeze of funds was based on an analysis assessing the specific aspects of the individual ministries, which means that the expenditures were not cut across-the-board by a fixed percentage.

The freeze of funds applies to expenditures for goods and services and to capital expenditures, both accounting for an approximately equal share. As regards the capital expenditures, more than a half of the respective amount comprises unspent funds that were carried over from the previous years.

General government revenue and expenditure in years 2002 and 2011 (ESA 95, % of GDP)

	2002	2007	2008B	2008E	2009B	2010B	2011B	2011B-2008E
TOTAL REVENUES	37.5	34.7	33.5	35.1	34.5	34.1	33.8	-1.3
Tax revenues	18.1	17.1	16.8	16.6	16.1	16.0	16.1	-0.5
Personal income tax	3.3	2.6	2.6	2.7	2.6	2.5	2.8	0.1
from dependent activity	2.8	2.3	2.3	2.4	2.3	2.2	2.5	0.1
from self-employment	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.0
Corporate income tax	2.5	3.0	3.0	3.0	2.9	2.9	2.9	-0.1
Withholding income tax	0.8	0.3	0.3	0.3	0.3	0.3	0.2	-0.1
Property taxes	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.0
Value added tax	7.0	6.7	7.1	6.9	6.7	6.6	6.5	-0.4
Excise taxes	2.9	3.5	3.1	2.7	2.7	2.9	2.8	0.1
Road tax	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0
Taxes from international trade and transactions	0.4	0.1	0.0	0.1	0.1	0.1	0.0	0.0
Taxes on specific services (municipalities)	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.0
Television and radio licence fees	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social contributions	14.3	11.6	11.4	12.0	12.2	12.0	11.8	-0.1
Social Insurance Agency	8.4	6.8	6.6	7.1	7.1	6.9	6.8	-0.3
Health insurance companies	5.0	4.8	4.9	4.9	5.1	5.1	5.1	0.2
National labour office	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-tax revenues	4.8	4.4	3.3	4.8	3.5	2.6	2.4	-2.4
of which: Dividends	0.1	1.0	1.0	0.7	0.9	0.5	0.5	-0.2
Capital income	0.4	0.6	0.4	0.6	0.5	0.3	0.3	-0.3
Interest	0.7	0.3	0.3	0.3	0.2	0.3	0.2	-0.1
Grants and transfers	0.2	1.6	1.8	1.6	2.7	3.5	3.4	1.8
of which from the European Union	0.0	1.4	1.8	1.4	2.6	3.3	3.3	1.9
TOTAL EXPENDITURES	45.7	36.7	35.8	37.3	37.5	37.0	36.0	-1.3
Current expenditure	38.1	33.0	32.7	33.1	33.2	32.6	31.9	-1.2
Compensation of employees	7.6	6.3	6.2	6.4	6.4	6.1	6.0	-0.4
- Wages and salaries	5.6	4.7	4.6	4.8	4.8	4.5	4.5	-0.4
- Employers´ social contributions	1.9	1.6	1.6	1.6	1.6	1.6	1.5	0.0
Goods and other services	10.0	9.9	9.9	10.3	9.7	9.8	9.6	-0.7
- Health insurance companies	4.9	4.5	4.6	4.7	4.9	4.9	4.9	0.2
- Other	5.1	5.4	5.3	5.6	4.8	4.9	4.8	-0.8
Subsidies and transfers	17.1	15.3	15.2	15.1	15.8	15.5	15.0	-0.1
- Agricultural subsidies	0.7	0.7	1.2	0.9	0.9	0.9	0.8	-0.1
- Transport subsidies	0.4	0.8	0.7	0.9	0.7	0.6	0.6	-0.3
- Housing subsidies	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- Active labour market policy	0.3	0.2	0.2	0.2	0.2	0.1	0.1	-0.1
- Sickness benefits	0.8	0.3	0.3	0.4	0.4	0.4	0.4	0.0
- Old-age and disability pensions	7.2	6.8	6.7	6.7	7.0	7.2	7.0	0.3
- Unemployment benefits	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- State benefits and social assistance	3.0	1.8	1.8	1.6	1.8	1.7	1.7	0.0
- Social contributions on behalf of certain groups	2.2	2.1	1.9	1.8	2.0	2.0	2.0	0.2
- Transfers to the EU budget	0.0	0.8	0.9	0.8	0.9	0.8	0.7	0.0
- Transfer of 2% of income tax to the third sector	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
- Other subsidies and transfers	1.8	1.6	1.3	1.6	1.6	1.6	1.5	-0.1
Interest	3.6	1.4	1.4	1.2	1.4	1.2	1.3	0.0
Capital expenditures	7.6	3.7	3.0	4.2	4.3	4.3	4.1	-0.1
Capital assets	3.2	2.3	1.9	2.3	2.0	1.7	1.7	-0.6
Capital transfers	4.4	1.4	1.2	1.8	2.3	2.6	2.4	0.6
General Government balance	-8.2	-1.9	-2.3	-2.2	-3.0	-2.9	-2.2	0.0
Impact of the 2nd pillar	*0.0*	*-1.3*	*-1.3*	*-1.3*	*-1.1*	*-1.1*	*-1.1*	0.1
GG balance excluding the impact of 2nd pillar	-8.2	-0.7	-1.0	-0.9	-1.9	-1.8	-1.1	-0.2

Source: Ministry of Finance

V.4. Linkage with the National Reform Programme

As the new three-year cycle of the Lisbon Strategy began, the Slovak government prepared and submitted to the European Commission (in October 2008) the National Reform Programme for 2008-2010 which includes measures in five priority areas – 1) research, development and innovation, 2) education, 3) employment, 4) business environment, and 5) climate change and energy.

The linkage between the Stability Programme of the Slovak Republic for 2008-2012 and the National Reform Programme of the Slovak Republic for 2008-2010 is ensured in a manner that the measures implemented under the National Reform Programme are financed from the public funds allocated in the general government budget, which is in line with the medium-term fiscal consolidation plan. Some of the measures require more detailed parameters, therefore the budgetary impact estimate is only indicative in such cases.

Estimate of the direct budgetary impact of the NRP measures (EUR mill.)

	2008	2009	2010
Research, development and innovations	4	141	156
Education	0.2	9	59
Employment	40	149	164
Business environment	366	585	803
- of which highways construction	*342*	*398*	*535*
Total (EUR mill.)	410	885	1 181
Total (% of GDP)	0.6	1.2	1.5

Source: Ministry of Finance

Based on preliminary estimates, the total expenditures of the general government budget for measures under the National Reform Programme will reach some EUR 2.5 billion between 2008 and 2010. This estimate also includes highway construction costs that account for more than 50% of the total cost. The EU Structural and Cohesion funds are an additional source of funding for Slovakia's structural policies and cover almost 40% of the overall financial cost of measures under the National Reform Programme.

A year-on-year change of the direct budgetary impact of the main structural reforms is provided in the table below. In terms of an increase in expenditures, the dominant measures are those aimed at transport infrastructure and the use of information technologies, including several measures addressing employment and the funding of science. The importance of the individual measures is not necessarily proportionate to the allocated amount, because some measures under the National Reform Programme alter the existing environment only through legislative changes, rather than requiring additional financial resources. In the future, even more attention should be paid to the issue of public finance quality as regards the effectiveness of expenditure policies, and a more robust reallocation of funds to promote the Lisbon Strategy goals will be necessary.

Estimate of the direct budgetary impact of the main structural reforms (EUR mill., year-on-year change)

Main structural reform measures	Expenditure/revenue category	2007	2008	2009	2010	2011
Science and technology financing reform	Total expenditure	-	14.9	18.3	3.3	1.3
Building of regional innovation centres	Total expenditure	-	0	17.9	16.3	16.4
Informatization of education. design of innovative study materials and aids	Total expenditure	-	76.3	20.9	1.7	-9.1
Support of demographic transition (exchange of generations) in higher education institutions	Total expenditure	-	0	0.1	16.5	0
Introduction of employee tax credit	Current taxes on income, wealth, etc.	-	0	8.7	-4	-2.4
Inclusion of the long term unemployed into the labour market	Total expenditure	-	2	4	13.3	1.3
Improvement of human capital in the labour market	Total expenditure	-	74.1	58.8	7.8	5.9

Informatization of public administration	Total expenditure	-	7.1	107.5	72.4	46.9
Increasing the availability and support for broadband internet access infrastructure	Total expenditure	-	0.2	36.8	8.8	9.5
Reform of tax and customs administration, unification of tax, customs and social security contributions	Total expenditure	-	8.3	13.1	2.4	3.6
Intensive building of motorways and high speed transit	Total expenditure	-	N/A	56.4	136.4	N/A
Total year-on-year change of direct budgetary impact (EUR mill.)			**178.4**	**342.6**	**274.7**	**73.3**
Total year-on-year change of direct budgetary impact (% of GDP)			**0.0026**	**0.0046**	**0.0034**	**0.0008**

Footnote: Data from NRP SR 2008 - 2010

Source: Ministry of Finance

VI. SUSTAINABILITY OF PUBLIC FINANCE

The sustainability of Slovak public finance was first set out in the Convergence Programme in May 2004. Since that time the question of long-term sustainability has been covered also in other major government documents, most significantly in the general government budget. The draft 2005-07 general government budget contained a separate addendum which defined long-term sustainability of the general government as the basic goal for fiscal policy. This brought the issues of sustainability of public finance, as well as the measures necessary to ensure sustainability, to the attention of the professional and general public; more importantly, they became a guiding framework for political decision-making.

VI.1. Policy strategy

The long-term sustainability of the public finance has an economic and a moral dimension. From the economic point of view, sound public finance is an essential precondition for high and sustainable economic growth. The moral dimension lies in ensuring intergenerational fairness. This is because general government budgets do not just reallocate resources between different groups of the population (solidarity) but also between generations. Carrying out a policy of high deficits and debts automatically means requiring future generations to pay the cost – usually through higher taxes.

From this perspective Slovakia belongs among responsible countries. This is above all due to the pursuit of ambitious goals in the consolidation of general government budgets, which automatically contribute to reductions in general government debt. This has been confirmed by the European Commission, which lists Slovakia among the medium-risk countries in its assessment of the sustainability of public finance. Reforms in the pension system had a positive effect on Slovakia's rating, since they reduced pressure for increased expenditures linked to the future ageing of the population. However, the general government deficit is still relatively high, indicating a need for further consolidation effort. A positive initial fiscal position is the basic precondition for the ability of public finance to absorb the future negative impacts of demographic developments. Reducing the general government deficit is therefore a central medium-term goal of fiscal policy.

The Ministry of Finance defined the long-term sustainability of public finance in the first Convergence Programme in May 2004. **The general government deficit must not exceed 3% of GDP and general government debt 60% of GDP by 2080.** This definition takes into account the demographic conditions in Slovakia and the basic principles of the Stability and Growth Pact. It is also sufficiently concrete and measurable to enable the setting of political objectives.

The main fiscal-policy objective in the area of public finance is to gradually attain a balanced general government budget. However, the Slovak government, having considered an update of macroeconomic developments which takes account of the financial crisis impacts on Slovakia's economy, put off the deadline for this goal from 2011 to a period not covered by the present Stability Programme.

Notwithstanding the additional consolidation measures, the negative implications of the ageing population must be dealt with by further structural reforms. Higher employment, productivity and economic growth are not just the only sustainable sources of growth in the standard of living of the population; they can also make a significant contribution to the sustainability of the pension system, and the general consolidation of public finance. The prerequisites for higher employment and productivity include the relatively low and effective tax burden, flexible labour market, and flexible markets for goods and services.

VI.2. Long-term budget projections with a view to population ageing

Population ageing is a global phenomenon, which currently affects mainly the industrially advanced economies. Slovakia is no exception. This question has received special attention within the European Union in recent years. An Ageing Working Group (AWG) has been established to cooperate with the European Commission in analysing those expenditures that are sensitive to demographic trends, and identifying implications for the overall

development of public finance. The purpose is to obtain comparable information, as complete as possible, concerning the risks associated with the expected demographic change. In February 2006 new forecasts were approved and published for the public.[6].

According to the Code of Conduct, Member States are obliged to present the projections produced by AWG in their Convergence Programmes. Slovakia endorsed these projections at an expert level within the AWG and the Ministry of Finance therefore fully accepts them and uses them for its own analyses. The European Commission assesses the long-term sustainability of fiscal position and fiscal goals against these projections. Since the joint projections prepared by AWG will not be updated before 2009, Member States have a possibility to provide in their Convergence Programmes and Stability Programmes information about developments which may have a significant impact on the long-term sustainability of the public finance. This particularly concerns projections for pension systems, which each country produces separately for the AWG. If a country embarks on pension system reform which has a significant impact on long-term sustainability, the country may ask for the revision of the projections also before 2009. This ensures that the projections are up-to-date and so are the ensuing recommendations for economic policy.

The current situation in the pension system and the government's specific measures to ensure sustainability of the system were described in the most recent Convergence Programme prepared in 2007. In year 2008, the government approved a change of the pension indexation date as of 1 January 2009 (in order to unify the indexation dates for the minimum wage and the wages in the public sector) and reopening of the second pillar from 15 November 2008 to 30 June 2009. Given the three-year cycle for updates of projections with respect to the effect of population ageing on the public finance, the impact of these legislative measures and the previous changes in the pension system as outlined in the previous Convergence Programmes will be published in the next year’s Stability Programme.

This section has two parts. The first quantifies the problem to be faced by the public finance in Slovakia in the future. The second part deals with sustainability indicators. This entails quantified measures in the area of fiscal policy, which will have to be adopted now in order to resolve the problem of the sustainability of public finance. Both parts present the calculations of the European Commission made within the process of evaluating the 2007 Convergence Programme. The Ministry of Finance fully accepts this calculation method and only adds its comments to the results.

Long-term projections of revenue and expenditures sensitive to population ageing

The AWG has identified those expenditures of the general government that may be positively or negatively influenced by demographic changes. These include expenditures on pensions, health care, long-term care, education and unemployment benefits. The first three types of expenditure will rise in the future, while expenditure on education and on the unemployed will fall (less children, falling unemployment, less people in the labour market).

In addition, changes in the revenue of the pension systems have been taken into account for a number of countries, including Slovakia. In the Slovak case, this entails a shortfall in the general government revenue associated with the launch of the fully-funded pillar of the pension system.

Interest on the general government debt represents the last item sensitive to the ageing of the population. The above factors influence the growth of the deficit, and thereby the general government debt. A higher debt automatically requires higher interest payments to service it.

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[6] Economic Policy Committee and European Commission-DG ECFIN (2006) ‘The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health-care, long-term care, education and unemployment transfers (2004-2050)’, European Economy, Special Reports No 1, 2006, („Ageing Report“)

Changes in general government revenues and expenditures induced by demographic changes (% of GDP)							
	2004	2010	2020	2030	2040	2050	Change 2004-2050
A. Revenue shortfall (loss due to 2nd pillar)	0.0	-1.3	-1.5	-1.7	-1.7	-1.9	-1.9
B. Expenditures sensitive to population ageing	16.2	15.4	15.3	16.5	17.7	19.1	2.9
- pension benefits	7.2	6.7	7.0	7.7	8.2	9.0	1.8
- health care	4.4	4.7	5.2	5.7	6.0	6.3	1.9
- long-term care	0.7	0.8	0.7	0.9	1.1	1.3	0.6
- education	3.7	3.0	2.2	2.2	2.3	2.4	-1.3
- unemployment benefits	0.3	0.2	0.1	0.1	0.1	0.1	-0.2
C. Interest expenditures	2.2	1.6	2.0	3.3	6.0	10.6	8.4
D. Property income**	2.0	1.7	1.6	1.5	1.4	1.4	-0.5
Impact on general government balance							-13.7
p.m. Gross debt	*41.6*	*31.5*	*40.6*	*66.0*	*120.3*	*212.3*	*170.7*

* *Current legislation status* : retirement age 62 years, indexation 50:50 (wages, inflation), 2nd pillar implemented
** in year 2008 the methodology for the calculation of sustainability indicators was changed, as the projections also included property revenues

Source: Ageing report (February 2006),
Source: SLOVAKIA: MACRO FISCAL ASSESSMENT - AN ANALYSIS OF THE NOVEMBER 2007 UPDATE OF THE CONVERGENCE PROGRAMME (February 2008)

Unless corrective measures are taken, negative demographic trends will inflate the general government deficit by an alarming 13.7% of GDP by the year 2050 and the general government debt by 170.7% of GDP. These calculations are based on an AWG projection using 2004 as a starting point. That year was taken because no more recent calculations are officially available as of yet. The above-mentioned projections for Slovakia take into account all major measures, including introduction of a fully-funded pillar, increase of the retirement age to 62, indexation of pensions using the Swiss method, and the like. In that sense, the calculations are based on the current situation. However, since these projections should above all serve as an aid to political decisions regarding the medium-term and long-term goals of government, they must be updated every year to reflect the actual fiscal position (size of the deficit and general government debt) which the country has reported in the most recent Convergence Programme.

These results have two basic implications for fiscal policy. The first implication may come as a surprise in that the most negative element will ultimately be the interest payments on the general government debt. This shows how important it is to use every opportunity to reduce general government debt. In the Slovak context these opportunities stem mostly from higher-than-expected tax revenues and receipts from privatisation. The second implication for fiscal policy relates to the fully-funded pillar of the pension system. The introduction of this pillar has indeed reduced revenues (immediately and prospectively), yet it will also reduce public expenditure on old-age pensions in the future. In other words, if the second pillar had not been introduced, then by 2050 the deficit of public finance would have increased not by 13.7% of GDP but by 17.6%.

Assessment of long term sustainability

In assessing the long-term sustainability of public finance, it is essential to establish mutual consistency of the short- or medium-term fiscal objectives with the long-term ones. In the European Union, the assessment process is based on indicators of sustainability. The assessment does not merely end with a judgement of whether or not public finance is sustainable, but, through the use of concrete indicators, quantifies the magnitude of the fiscal measures to be taken in order to ensure sustainability.

The European Commission uses the following quantitative indicators:[7] *S1 indicator, S2 indicator, RPB – Required Primary Balance, Costs of delay.* A brief description of the individual indicators was provided in the previous Convergence Programmes.

[7] European Commission-DG ECFIN (2006) 'Long-term sustainability of public finances in the European Union, European Economy, No 4, 2006, („Sustainability Report")

The Ministry of Finance accepts the methodology used by the European Commission in calculating the sustainability indicators, and therefore fully incorporates these into the Stability Programme. In this case, the calculations are based on the 2007 data contained in the 2007 Update of the Convergence Programme (apart from the cyclical budget position, for which the European Commission uses its own calculations). The important parameters of calculation include the current deficit level, current debt, and the level of future public expenditure sensitive to demographic changes, which are assumed to develop in accordance with the previously-mentioned AWG projection. An important assumption is that the Commission takes into account only the actual legislation (year 2007) and its effects on the future growth of these expenditures. The planned changes and reforms are thus not taken into account in the calculations. Demography-unrelated revenues and expenditures are constant as a percentage of GDP over the entire period, except for property revenues incorporated into the long-term projections in the last round of the Convergence Programme evaluation. In other words, only those revenues and expenditures which are influenced by the ageing of the population are considered to have an impact on the deficit level.

Quantitative indicators of long-term sustainability of public finance (2007 scenario)

	Value	Initial fiscal position	Requirement for debt in 2050 (60% of GDP)	Change of the primary balance within a long-term horizon
S1 Indicator	2.6 (2.4)* (1.3)**	2.0 (1.9) (0.7)	-0.5 (-0.5) (-0.5)	1.1 (1.0) (1.1)
S2 Indicator	4.4 (4.1) (3.0)	2.2 (2.2) (0.9)	-	2.1 (2.0) (2.1)
RPB	3.2 (2.8) (2.9)			

** values from the 2007 CP update are displayed in parentheses (2006 scenario)*
***values from the 2006 CP update are displayed in parentheses (2005 scenario)*

Source: SLOVAKIA: MACRO FISCAL ASSESSMENT - AN ANALYSIS OF THE NOVEMBER 2007 UPDATE OF THE CONVERGENCE PROGRAMME (February 2008)

The indicators contained in the table are interpreted as follows: For Slovakia's general government debt in 2050 to be 60% of GDP, the government (in 2008) should increase taxes and/or reduce expenditures by an amount equal to 2.6% of GDP (Indicator S1). This necessary fiscal consolidation of 2.6% of GDP can be divided into three components. Consolidation equivalent to 2.0% of GDP is necessary because of the high current deficit.[8]. However, because Slovakia's general government debt is relatively low today, this would make it possible to loosen fiscal policy (reduce taxes and/or increase expenditures) by an amount equal to 0.5% of GDP. The third factor is the demographic trends themselves, which call for a consolidation equivalent to 1.1% of GDP already now.

The interpretation of Indicator S2 is similar. Unlike S1, the goal is not a specific level of debt in a given year, but the overall sustainability of that debt In the light of the fact that Slovakia's general government debt is much lower than 60% of GDP, it comes as no surprise that the necessity for consolidation is considerably higher compared to S1 and was quantified at 4.4% of GDP in 2008.

Unlike long-term fiscal forecasts, these indicators are updated every year. Their main role is to remind us that the country will face a fundamental fiscal problem in the relatively distant future, in the Slovak case in some 40 to 50 years. However, the solution to that problem is in the hands of today's politicians. If the governments reduce the deficit and debt today, the size of fiscal consolidation necessary in the future will be much smaller. On the other hand, the longer it is before corrective measures are adopted, the more serious (more fiscally severe) they will have to be. The greater the necessity for fiscal consolidation, the greater the negative effect on living standards in a given period, since in such a situation consolidation always means above all paying off old debts, at the cost of future development.

[8] Despite fiscal consolidation at 0.2% of GDP, the year 2007 saw an unexpected negative trend in year-on-year results of sustainability indicators. The reason lies in the changed methodology for the calculation of these indicators, as the projections also included property revenues. Considering the projected decline (the revenues were originally expected to retain a constant share of GDP), sustainability worsens automatically. Another reason is that actual data on general government balance for 2007 was not available during the preparation of the Convergence Programme for 2007-2010. The Convergence Programme rated the deficit at 2.5% of GDP in 2007, whereas the actual general government deficit in that year stood at 1.9% of GDP.

ANNEXES

Annex 1 – Required Tables

Table 1a. Macroeconomic prospects (ESA95, EUR bn.)

	ESA code	2008 Level	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. Real GDP	B1*g	50.5	6.4	2.4	3.6	4.5	5.1
2. Nominal GDP	B1*g	67.3	9.5	4.1	7.0	8.6	9.1
Components of real GDP							
3. Private consumption expenditure	P.3	26.6	6.1	3.1	3.5	4.4	5.0
4. Government consumption expenditure	P.3	8.2	4.3	4.0	2.4	2.3	1.9
5. Gross fixed capital formation	P.51	13.8	6.8	2.2	3.6	5.1	5.7
6. Exports of goods and services	P.6	48.1	3.2	-2.7	3.1	6.2	8.1
7. Imports of goods and services	P.7	46.6	3.3	-2.2	2.5	5.5	7.1
Contributions to real GDP growth							
8. Final domestic demand		-	6.4	3.0	3.0	3.7	4.0
9. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.5	0.0	-0.3	-0.5	-0.3
10. External balance of goods and services	B.11	-	0.0	-0.6	0.6	0.8	1.1

Source: Statistical Office, Ministry of Finance

Table 1b. Price developments (ESA95)

	ESA code	2008 Level	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. GDP deflator		1.3	2.9	1.7	3.3	4.0	3.8
2. Private consumption deflator		1.4	4.4	2.4	3.6	4.0	3.9
3. HICP		-	3.9	2.2	3.6	4.1	4.2
4. Public consumption deflator		1.4	4.1	3.3	4.3	4.6	4.5
5. Investment deflator		1.3	1.9	1.9	2.8	2.4	2.3
6. Export price deflator (goods and services)		1.2	1.4	0.4	1.2	1.6	1.5
7. Import price deflator (goods and services)		1.2	3.0	0.2	0.8	1.3	1.2

Source: Ministry of Finance

Table 1c: Labour market developments (ESA95)

	ESA code	2007 Level	2007 Rate of change	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change
1. Employment, persons (thousands) [1]		2 177	2.1	2.8	0.1	0.4	1.0
2. Employment, hours worked (thousands)[2]		3 866.7	2.3	2.2	1.6	1.9	1.9
3. Unemployment rate (%) [3]		11.0	-1.5	0.9	-0.1	-0.3	-0.3
4. Labour productivity per persons (EUR) [4]		21 819	8.1	4.3	2.3	3.2	3.5
5. Labour productivity per hours worked (EUR) [5]		12 284	6.4	4.7	3.0	3.3	4.1
6. Compensation of employees (EUR mill.)	D.1	22 404	10.1	11.7	8.2	8.9	9.9
7. Compensation per employee (EUR)		10 292	8.6	7.4	-	-	-

[1] Occupied population, domestic concept national accounts definition.
[2] National accounts definition.
[3] Harmonised definition, Eurostat; levels.
[4 Real GDP per person employed.
[5] Real GDP per hour worked.

Source: Statistical Office, Ministry of Finance

Table 1d. Sectoral balances (ESA95, % of GDP)

	ESA code	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-5.8	-4.2	-2.9	-2.6	-1.6
of which:						
- Balance on goods and services		-2.4	-2.0	-1.2	-0.5	0.4
- Balance of primary incomes and transfers		-4.4	-3.6	-3.4	-3.5	-3.4
- Capital account		1.0	1.4	1.7	1.4	1.4
2. Net lending/borrowing of the private sector	B.9	-3.6	-1.2	0.0	-0.4	0.1
3. Net lending/borrowing of general government	EDP B.9	-2.2	-3.0	-2.9	-2.2	-1.7
4. Statistical discrepancy						

Source: Ministry of Finance

Table 2. General government budgetary prospects							
	ESA code	2007	2007	2008	2009	2010	2011
		EUR mill	% GDP	% GDP	% GDP	% GDP	% GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-1 199	-1.9	-2.2	-3.0	-2.9	-2.2
2. Central government	S.1311	-1 164	-1.9	-2.6	-2.9	-2.8	-2.3
3. State government	S.1312	-	-	-	-	-	-
4. Local government	S.1313	-72	-0.1	-0.1	0.0	-0.1	0.0
5. Social security funds	S.1314	37	0.1	0.5	-0.1	-0.1	0.1
General government (S.13)							
6. Total revenue	TR	20 093	32.7	33.4	32.1	31.6	31.8
7. Total expenditure	TE [1]	21 292	34.6	35.6	35.1	34.5	34.1
8. Net lending/borrowing	EDP B.9	-1 199	-1.9	-2.2	-3.0	-2.9	-2.2
9. Interest expenditure	EDP D.41	852	1.4	1.2	1.4	1.2	1.3
10. Primary balance	[2]	-346	-0.6	-0.9	-1.7	-1.7	-1.0
11. One-off and other temporary measures	[3]	519	0.8	-0.3	0.4	0.1	0.1
Selected components of revenue							
12. Total taxes (11=11a+11b+11c)		10 756	17.5	17.1	16.4	16.3	16.4
12a. Taxes on production and imports	D.2	6 993	11.4	10.8	10.4	10.4	10.1
12b. Current taxes on income, wealth, etc.	D.5	3 763	6.1	6.4	6.1	5.9	6.3
12c. Capital taxes	D.91	0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	7 293	11.9	12.1	12.2	12.0	11.8
14. Property income	D.4	933	1.5	0.8	1.2	0.9	0.8
15. Other	[4]	1 111	1.8	3.4	2.2	2.4	2.8
16=6. Total revenue	TR	20 093	32.7	33.4	32.1	31.6	31.8
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)	[5]	18 049	29.3	29.2	28.6	28.3	28.3
Selected components of expenditure							
17. Compensation of employees + Intermediate consumption	D.1+P.2	7 010	11.4	11.5	10.8	10.5	10.2
17a. Compensation of employees	D.1	4 209	6.8	6.8	6.8	6.5	6.4
17b. Intermediate consumption	P.2	2 801	4.6	4.8	4.0	4.0	3.9
18. Social payments		9 879	16.1	15.7	16.5	16.6	16.3
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	2 750	4.5	4.7	4.9	4.9	4.9
18b. Social transfers other than in kind	D.62	7 129	11.6	11.0	11.7	11.7	11.5
19. = 9. Interest expenditure	EDP D.41	852	1.4	1.2	1.4	1.2	1.3
20. Subsidies	D.3	740	1.2	1.4	1.3	1.0	1.0
21. Gross fixed capital formation	P.51	1 153	1.9	1.5	1.5	1.4	1.5
22. Other	[6]	1 658	2.7	4.3	3.6	3.8	3.8
23=7. Total expenditure	TE [1]	21 292	34.6	35.6	35.1	34.5	34.1
p.m.: Government consumption (nominal)	P.3	10 783	17.5	17.7	17.4	17.1	16.9

Source: Ministry of Finance

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5] Including those collected by the EU

[6] D.29+D4 (other than D.41)+D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function (% of GDP)

	COFOG code	2007	2011
1. General public services	1	3.7	4.9
2. Defence	2	1.5	1.2
3. Public order and safety	3	2.0	1.4
4. Economic affairs	4	4.3	4.4
5. Environmental protection	5	0.6	0.9
6. Housing and community amenities	6	0.8	0.8
7. Health	7	6.5	6.5
8. Recreation, culture and religion	8	0.7	0.9
9. Education	9	4.0	3.1
10. Social protection	10	10.6	10.1
11. Total expenditure	**TE**	**34.6**	**34.1**

Source: Eurostat, Ministry of Finance

Table 4. General government debt developments (% of GDP)

	ESA code	2007	2008	2009	2010	2011
1. Gross debt		29.4	27.6	31.4	32.7	32.7
2. Change in gross debt ratio		-1.1	-1.7	3.7	1.3	0.0
Contributions to change in gross debt						
3. Primary balance		0.6	0.9	1.7	1.7	1.0
4. Interest expenditure	EDP D.41	1.4	1.2	1.4	1.2	1.3
5. Stock-flow adjustment		0.1	-1.4	2.2	0.5	0.4
Of which:						
- Differences between cash and accruals		-0.2	0.2	0.2	-0.2	0.2
- Net accumulation of financial assets		1.1	-0.9	1.8	0.6	0.3
- Valuation effects and others		-0.6	-0.7	0.2	0.1	-0.1
p.m. Implicit interest rate on debt		*5.1*	*4.7*	*5.3*	*3.9*	*4.2*
Other relevant variables						
6. Liquid financial assets		4.6	3.7	3.6	3.4	3.1
7. Net financial debt (7=1-6)		24.8	24.0	27.8	29.3	29.6

Source: Ministry of Finance

Table 5. Cyclical developments (% of GDP)

	ESA code	2008	2009	2010	2011	2012
1. Real GDP growth net of the impact of stockpiling (%)		7.5	2.4	3.3	4.5	5.1
2. Net lending of general government	EDP B.9	-2.2	-3.0	-2.9	-2.2	-1.7
3. Interest expenditure	EDP D.41	1.2	1.4	1.2	1.3	1.2
4. One-off and other temporary measures	[1]	-0.3	0.4	0.1	0.1	0.1
5. Potential GDP growth (%)		7.3	4.8	4.0	4.1	4.5
contributions:						
- labour		1.0	0.6	0.5	0.4	0.4
- capital		2.0	2.0	1.9	2.0	2.0
- total factor productivity		4.3	2.2	1.6	1.7	2.1
6. Output gap		1.7	-0.6	-1.2	-0.9	-0.3
7. Cyclical budgetary component		0.5	-0.2	-0.4	-0.2	-0.1
8. Cyclically-adjusted balance (2 - 7)		-2.7	-2.9	-2.5	-2.0	-1.7
9. Cyclically-adjusted primary balance (8 + 3)		-1.5	-1.5	-1.4	-0.7	-0.5
10. Structural balance (8 - 4)		-2.4	-3.3	-2.6	-2.1	-1.7

[1] A plus sign means deficit-reducing one-off measure

Source: Ministry of Finance

Table 6. Divergence from previous update

	ESA code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update*		8.8	6.8	5.8	5.0	-
Current update		10.4	6.4	2.4	3.6	4.5
Difference		1.6	-0.4	-3.4	-1.4	-
General government net lending (% of GDP)	EDP B.9					
Previous update*		-2.5	-2.3	-1.8	-0.8	-
Current update		-1.9	-2.2	-3.0	-2.9	-2.2
Difference		0.5	0.1	-1.2	-2.1	-
General government gross debt (% of GDP)						
Previous update*		30.6	30.8	30.5	29.5	-
Current update		29.4	27.6	31.4	32.7	32.7
Difference		-1.2	-3.2	0.9	3.2	-

*Note: * Convergence Programme of the Slovak Republic for 2007 - 2010*

Source: Ministry of Finance

Table 7. Long-term sustainability of public finances - AWG scenario (% of GDP)

	2004	2010	2020	2030	2040	2050
Total expenditure	38.0	36.4	36.2	38.0	40.9	45.3
Of which: age-related expenditure	16.2	15.4	15.3	16.5	17.7	19.1
A. Pension expenditure	7.2	6.7	7.0	7.7	8.2	9.0
1. Social security pension	7.2	6.7	7.0	7.7	8.2	9.0
a) Old-age and early pensions	5.4	4.8	4.6	5.0	5.5	6.3
b) Other pensions (disability, survivors)	1.8	1.9	2.3	2.7	2.7	2.7
2. Occupational pensions (if in general government)	-	-	-	-	-	-
B. Health care	4.4	4.7	5.2	5.7	6.0	6.3
C. Long-term care	0.7	0.8	0.7	0.9	1.1	1.3
D. Education expenditure	3.7	3.0	2.2	2.2	2.3	2.4
E. Other age-related expenditures	0.3	0.2	0.1	0.1	0.1	0.1
Interest expenditure	2.2	1.5	1.4	2.0	3.7	6.7
Total revenue	35.0	31.8	31.6	31.5	31.4	31.2
Of which: property income (D.4)	1.7	1.1	1.1	1.1	1.1	1.1
Of which: from pensions contributions	12.8	11.5	11.3	11.2	11.1	10.9
Pension reserve fund assets	0.0	7.0	18.9	31.5	45.7	58.0
Of which: consolidated public pension fund assets	0.0	0.0	0.0	0.0	0.0	0.0
Assumptions						
Labour productivity growth	5.5	4.9	3.3	2.7	1.9	1.7
Real GDP growth	5.5	5.3	3.3	2.0	0.4	0.3
Participation rate males (aged 15-64)	77.3	79.6	82.1	82.3	79.4	78.7
Participation rate females (aged 15-64)	64.1	67.1	73.5	73.8	70.0	69.1
Total participation rates (aged 15-64)	70.7	73.3	77.8	78.0	74.7	73.9
Unemployment rate	18.1	15.2	9.7	7.0	7.0	7.0
Population aged 65+ over total population (in %)	11.5	12.3	16.3	20.8	24.1	29.3

Source: Ministry of Finance

Table 8. Basic assumptions					
	2008	2009	2010	2011	2012
Short-term interest rate (annual average)	4.6	2.1	2.8	3.4	3.4
Long-term interest rate (annual average)	4.0	3.1	3.3	4.0	4.0
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.47	1.38	1.38	1.38	1.38
World excluding EU, GDP growth	3.9	1.2	3.3	3.5	3.6
EU GDP growth	1.0	-1.8	0.5	1.2	1.5
Growth of relevant foreign markets	2.0	-1.1	0.1	2.4	2.6
World import volumes, excluding EU	4.1	-1.3	3.6	4.9	5.0
Oil prices (Brent, USD/barrel)	98.5	52.1	61.7	76.0	87.0

Source: Common external assumptions, Ministry of Finance

Annex 2 - Indicative estimate up to 2012

Estimate up to 2012						
	unit	2008	2009F	2010F	2011F	2012F
GDP, constant prices 2000	%	6.4	2.4	3.6	4.5	5.1
Final consumption of households	%	6.1	3.1	3.5	4.4	5.0
Final consumption of government	%	4.3	4.0	2.4	2.3	1.9
Gross fixed capital formation	%	6.8	2.2	3.6	5.1	5.7
Exports of goods and services	%	3.2	-2.7	3.1	6.2	8.6
Imports of goods and services	%	3.3	-3.1	2.6	5.5	8.0
HICP (annual average)	%	4.0	2.2	3.6	4.1	4.2
Current account balance	% GDP	-6.1	-5.6	-4.6	-4.0	-3.0
Total employment LFS	%	3.2	-0.4	0.2	1.0	1.0
Unemployment rate LFS	%	9.6	10.5	10.4	10.1	9.8
Real wages per employee	%	3.3	3.3	3.3	3.5	4.1
GG revenues (ESA 95)	% GDP	33.4	32.1	31.6	31.8	-
GG expenditures (ESA 95)	% GDP	35.6	35.1	34.5	34.1	-
GG balance (ESA 95)	% GDP	-2.2	-3.0	-2.9	-2.2	-1.7

Source: Ministry of Finance

Annex 3 - Macroeconomic Forecasts Committee

With the aim to bring more transparency and objectiveness to macroeconomic forecasts, the Ministry of Finance addresses the members of the Macroeconomic Forecasts Committee on a regular basis. Following its extraordinary session in October 2008, the Committee members held another session on 2 February 2009 to tackle the issues connected with the financial crisis. To a great extent, the Committee members described the medium-term macroeconomic forecast by the Ministry of Finance as realistic:

Assessment of Ministry of Finance's forecast by Committee members

Member	Assessment
NBS	realistic
Infostat	realistic
VÚB	optimistic
ING Bank	realistic
Tatrabanka	realistic
SLSP	realistic
UNICREDIT Bank	optimistic
ČSOB	realistic
SAV	realistic

Source: Committee for Macroeconomic Forecast

Average forecasts of the selected indicators of the Slovakia's economic development by the members of the Macroeconomic Forecasts Committee (excluding MoF) and MoF forecasts

Indicator	2007	2008		2009		2010		2011		2012	
		MFC	MoF	MFC	MoF	MFC	MoF	MFC	MoF	MFC	MoF
GDP; real growth	10.4	6.9	6.6	2.5	2.4	3.5	3.6	4.4	4.5	5.0	5.1
GDP; current prices; bn. EUR	61.469	67.7	68.3	71.4	71.1	76.1	76.1	82.3	82.7	89.3	90.2
Final consumption of households; real growth	7.0	6.2	6.1	2.7	3.1	3.3	3.5	4.5	4.4	4.8	5.0
Final consumption of households; nominal growth	9.8	11.0	10.8	5.7	5.6	6.6	7.2	8.4	8.6	8.7	9.0
Average monthly wages (real growth)	4.3	4.2	4.0	2.6	3.3	3.1	3.3	3.5	3.5	3.7	4.1
Average monthly wages (nominal growth)	7.2	8.9	8.8	5.8	6.0	6.7	7.4	7.5	8.2	7.7	8.7
Average employment growth, LFS	2.4	3.0	3.0	-0.6	-0.4	0.2	0.2	0.9	1.0	1.0	1.0
Consumer price index, (average growth)	2.8	4.6	4.6	3.0	2.7	3.4	4.0	3.9	4.5	4.0	4.4
Current account balance (share of GDP)	-5.3	-6.2	-6.1	-5.6	-5.6	-4.8	-4.6	-3.8	-4.0	-3.7	-3.0

Note: MFC - Macroeconomic Forecasts Committee *Source: Macroeconomic Forecasts Committee*

Annex 4 - Tax Revenue Forecasts Committee

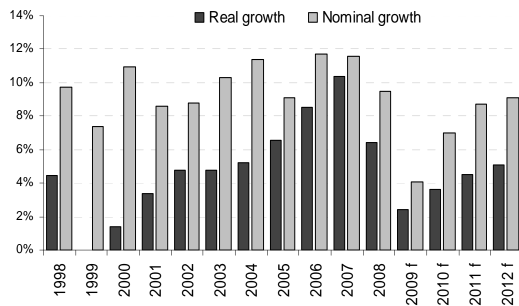
Following the session of the Macroeconomic Forecasts Committee, the Tax Revenue Forecasts Committee held its session on 11 February 2009. At this session, the Ministry of Finance presented its updated medium-term tax revenue forecast for 2009-12. The medium-term forecast for tax revenues and social contributions prepared by the Ministry of Finance was described as realistic by all Committee members except for the National Bank of Slovakia (NBS), which considered it optimistic.

Assessment of the tax revenues forecasts by the Committee	
Member of the Committee	Assessment
NBS	optimistic
Infostat	realistic
ING Bank	realistic
Tatra banka	realistic
ČSOB	realistic
SLSP	realistic
UniCredit Bank	realistic

Source: Tax Revenue Forecasts Committee

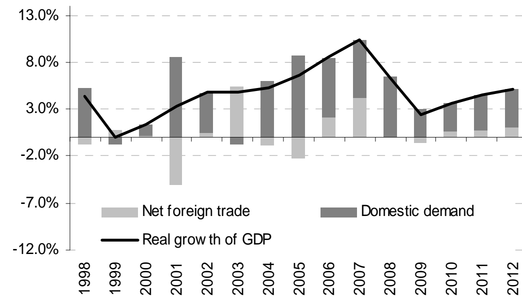
Annex 5 – Graphs

Growth of gross domestic product in %



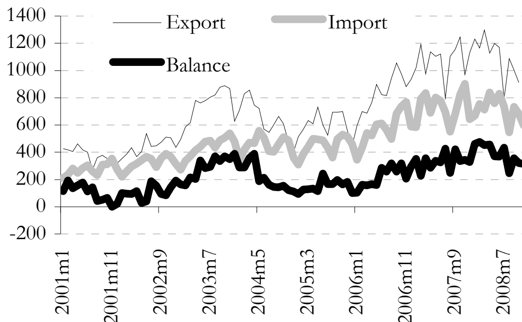
Source: Statistical Office, Ministry of Finance

Contributions to growth of GDP in p.p.



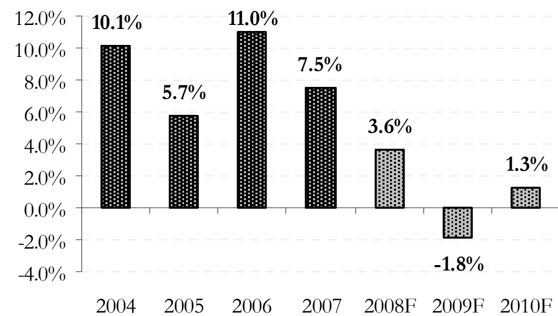
Source: Statistical Office, Ministry of Finance

Export, import and balance of motor vehicles and their parts and accessories (EUR mill.)



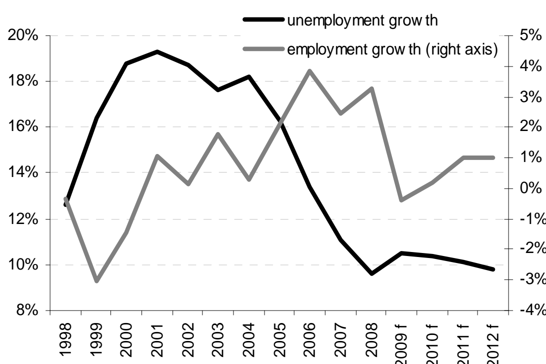
Source: Statistical Office, Ministry of Finance

Weighted GDP growth of Slovakia's trade partners (%) [9]



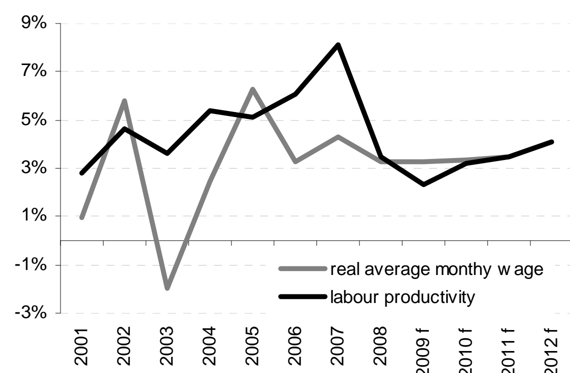
Source: European Commission, Ministry of Finance

Economic activity, LFS (%)



Source: Statistical Office, Ministry of Finance

Real wages and labour productivity growth (%)



Source: Statistical Office, Ministry of Finance

[9] The weighted average of the 10 most important trading partners was calculated based on the countries' share on the Slovakia's exports (Germany, Czech Republic, Italy, Austria, Hungary, Poland, Spain, the US, France, Great Britain, 75% of the total exports).