

Stability Programme of the Slovak Republic for 2014 - 2017

April 2014

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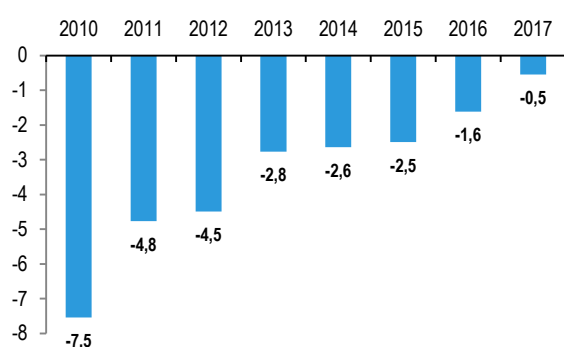
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SUMMARY

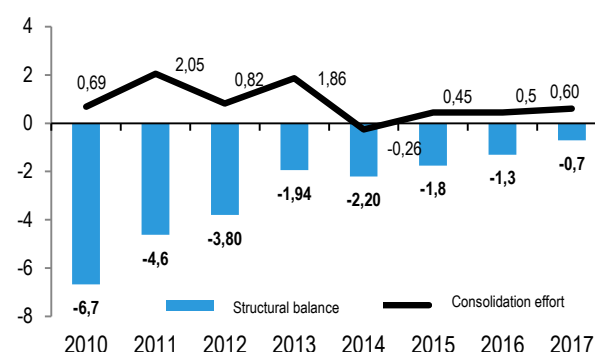
Healthy public finances are the basic requirement of a sustainable economic development and long-term well-being. The biggest challenge of the Slovak economic policy is to find an economic policy mix which will ensure consistency of the consolidation objectives resulting from the European and national fiscal rules with targets related to growth, employment and quality of life. The medium-term outlook of the fiscal policy contained in this Programme presents the fiscal strategy of the Slovak Government and the related policies for the next three years in a transparent and comprehensible manner.

Since the crisis year of 2009 Slovakia as well as other 17 EU Member States are in the Excessive Deficit Procedure. The basic requirement for its abrogation was to reduce the general government deficit below 3% of GDP by 2013 in a sustainable manner. **In 2013, the general government deficit amounted to 2.77% of GDP, below the budgetary target of 2.94% of GDP. The consolidation effort reached 1.9% of GDP and was one of the highest since joining the EU.** The size of measures, compared to the no-policy-change (NPC) scenario, amounted to 2.2% of GDP.

Nominal balance of GG (in % of GDP)



Structural balance of GG and consolidation effort (in % of GDP)

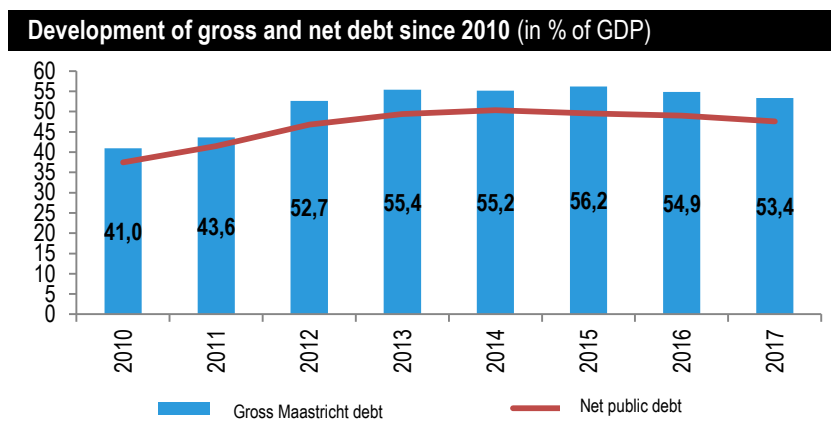


Source: SO SR, MoF SR

This result was achieved particularly due to successful consolidation of public finance in line with the Government plan outlined in the previous Stability Programmes. **Public debt amounted to 55.4% of GDP at the end of 2013**, which will lead to activation of additional corrective sanctions resulting from the provisions of the Fiscal Responsibility Act.

The strategy of the fiscal policy for the next years is focused on further improvement of the budgetary position of the general government in order to ensure a durable correction of the deficit below 3% of GDP also in 2014 and 2015. The Government will continue consolidating public finances so that **Slovakia proceeds towards its medium-term budgetary objective, the structural deficit of close to 0.5% of GDP in 2017.**

In the following years, the deficit is expected to decline gradually in line with the provisions of the Stability and Growth Pact and the Fiscal Compact, while respecting the constraints of the national fiscal rules (in particular the constitutional Fiscal Responsibility Act). **The deficit target has been set at 2.49% of GDP in 2015, 1.61% of GDP in 2016 and 0.54% of GDP in 2017.** Achievement of these objectives will stop the post-crisis increase in the share of the public debt on GDP with the aim not to exceed the limit of 57% of GDP, and it will enable its gradual decrease from 2016. A primary surplus is planned from 2016 for the first time, which means that the public budget balance net of costs for old debt should reduce the debt.



Source: MoF SR

The size of consolidation measures necessary to meet the objectives compared to the NPC scenario amounts to 1.2% of GDP in 2015, 1.7% of GDP in 2016 and 2.5% of GDP in 2017. A part of the measures has been included in the draft General Government Budget Framework for 2015 to 2017. Other measures will be specified in the course of preparation of the budget.

The revenue-related measures presented in this Programme, which are included also the draft General government budget framework, will improve the general government balances in the years 2015 to 2017 by 0.4% to 0.5% of GDP. The draft general government budget framework also included savings compared to the NPC scenario in the total volume of 0.5% of GDP in 2015 to 1.3% of GDP in 2017, including additional savings of expenditures which are part of the ESO reform. Other measures amounting to 0.3% of GDP in 2015 to 0.7% of GDP in 2017 will be necessary to achieve the deficit targets for 2015 – 17 and will be specified during the budget preparation. The obligation not to increase expenditures of the general government above the previously approved budget (due to the application of the constitutional act and gross debt above 55% of GDP) indicates that additional measures beyond those already included in the draft budget framework will be on the public expenditure side. Hence, consolidation in 2015 – 2017 compared to NPC will be carried out mainly on the expenditures side of the budget.

Assuming that the target deficits are achieved, consolidation would weight negatively on growth of GDP by 0.4 p.p. in 2015, 0.2 p.p. in 2016 and 0.3 p.p. in 2017. The fiscal multiplier in 2015 is estimated at 0.3 and in the following years equally at 0.4; that corresponds to the consolidation structure with prevailing expenditure measures. Hence, growth friendly expenditure supporting employment will be prioritized in the budget, and the Government will lay an emphasis on increasing efficiency of public expenditure. Some of the immediate expenditure priorities include in particular remuneration of teachers and employees of the offices of labour, social affairs and family and building capacities of pre-school education.

The Stability Programme is based on the General government budget for 2014 – 2016 as approved by the National Council of SR in December 2013, as well as on the latest available estimates of the fiscal position in 2014. For the years 2015 – 2017, it is based on the draft general government budget framework. The Stability Programme, once approved by the Government, is submitted to the National Council of SR.

Preparation of the Stability Programme is a requirement of the Stability and Growth Pact. The Stability Programme presents the development of the fiscal position, expected economic development, and a description of the fiscal policy to achieve the set targets in the medium term. It is submitted to the European Commission within the European semester, the aim of which is a better coordination of the fiscal policy and structural policies, taking into account to the Stability and Growth Pact and the Europe 2020 strategy. This-year's process started by publishing the Annual Growth Survey for 2014 in which the European Commission outlined five main priorities. The first of them is differentiated growth-friendly fiscal consolidation. When preparing their stability programmes and national reform programmes, Member States should follow the recommendations made under individual priority areas.



The content and the format of the document are in full compliance with the Commission's guiding principles. These guiding principles are described in the "*Specifications on the Implementation of the Stability and Growth Pact*" and the "*Guidelines on the Format and Content of Stability and Convergence Programmes*". The Stability Programme takes into consideration the latest review of these documents from September 2012.

The objective of the Government's economic policy is to react flexibly to the current economic situation, while the priority is to ensure a long term sustainability of the economy in order to accelerate growth in the standard of living and the process of catching up with the advanced EU Member States. Membership in the Eurozone and monetary policy integration have underscored the importance of pursuing a responsible fiscal policy aimed at making public finances sound and sustainable and structural policies designed to foster potential economic growth.

I. OVERALL POLICY FRAMEWORK AND OBJECTIVES

I.1. Fiscal policy

After accession to the Eurozone and monetary policy integration, the fiscal and structural policies became the main instruments available to counter the impacts of internal and external shocks on the economy. The global economic crisis in 2008 – 2009 led to a sharp worsening of the fiscal position of Slovakia, therefore it was necessary to proceed to an extensive budgetary consolidation. A credible medium-term consolidation plan was and still is the basic precondition for stabilization of the general government debt and a permanent reduction of deficits.

The objective of Slovakia's fiscal policy is to attain a budgetary position that creates conditions for long-term sustainability of public finance. An essential step in order to meet this target is to maintain the general government deficit below 3% of GDP also in 2014 – 2015, which is also the condition for abrogating the Excessive Deficit Procedure.

In the next period, the Government will consolidate public finance so as to ensure that Slovakia meets its medium term (budgetary) objective, defined as reaching a structural deficit of 0.5% of GDP by 2017, respecting the provisions of the Stability and Growth Pact (hereinafter referred to as the "Pact") and at the same time taking into account national budgetary rules. In addition to adhering to fiscal rules, the priority is to minimize risks of a negative impact of consolidation of the general government budget on economic growth.

With regard to the necessarily restrictive nature of the fiscal policy in the last years, it will be important to harmonize the need to adopt steps to ensure a decreasing general government deficit, and at the same time to continue in structural growth-promoting reforms. An important incentive for the economy is the drawing of finances from EU funds which should be higher in view of the closing second and the starting third programming period. After the first success in 2013, the tax policy will focus on increasing the effectiveness of tax collection and on eliminating tax fraud. As for expenditures, the priority will be higher efficiency of budget expenditures thanks to the focus on outcomes of policies and the quality of public services. Also, negative impacts of consolidation of public finance on the standards of living of the population could be offset by preferring expenditures promoting economic growth and employment.

Given the future demographic development, apart from improving fiscal discipline, it is necessary to reform also the sectors that are sensitive to population ageing, in particular the pension system and healthcare. Bearing this in mind, a pension system reform was adopted in 2012 as well as a reform of pensions of armed forces in 2013, considerably strengthening the long-term sustainability of public finance.

I.2. Monetary policy

After Slovakia's accession to the Eurozone, price stability remains the main monetary policy objective. The European Central Bank defines price stability as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the Eurozone below or close to 2%. Currently the inflation is significantly lower. In spite of the considerably weakened inflation pressures, in the short run it is obvious that if real and nominal convergence continues in Slovakia, a slightly higher rate of inflation should be expected given the absence of the exchange-rate channel. From a long-term perspective, responsible fiscal policy and implementation of structural policies focusing on improvements in the functioning of the labour market and the markets of goods and services, particularly their high competitiveness and flexibility, intelligent regulation and low information asymmetries, will be essential to ensuring price stability in Slovakia.

The difficult situation which has been present at financial markets for several years puts the Central Bank into a new position. Combating low inflation and with the aim to deliver the necessary liquidity in the markets, the ECB has decreased interest rates to historical lows. The ECB has also had to orally intervene several times and for months it was buying state bonds in the secondary market. As for the monetary policy, after decreasing the basic rate to 0.25%, ECB still has several possibilities how to loosen the monetary policy, including less orthodox ones.

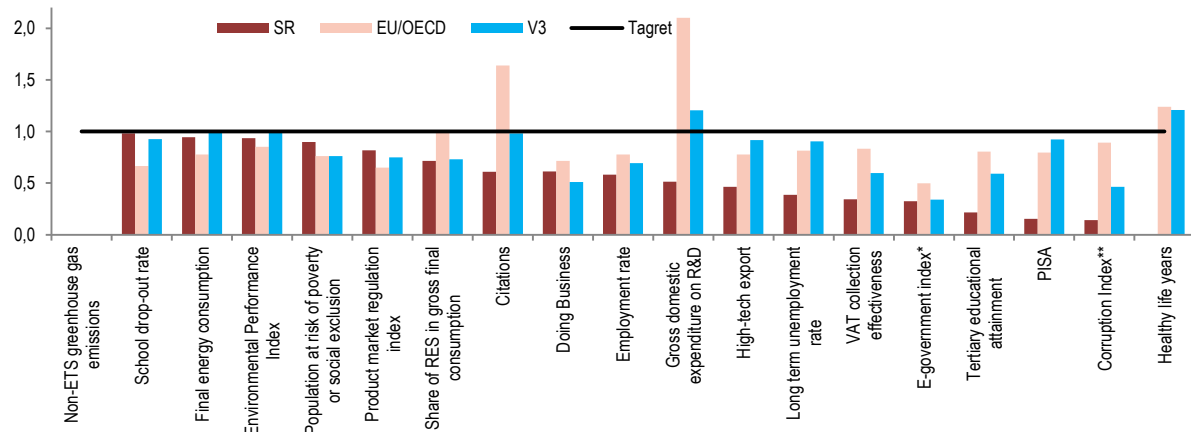


ECB may consider a further decrease in the deposit rate to negative values or to perform quantitative easing through the purchase of bonds, as the American FED has been doing for several years.

I.3. Structural policies

Changes in structural policies will focus on achieving a sustainable economic growth, creation of new work positions and improving the quality of life. This will create conditions to facilitate Slovakia's progress in the long term, and its convergence to advanced Western European economies.

CHART 1 – Comparison of achieving different objectives in the main National Reform Programme areas (1= SK objective for 2020)



Note: most indicators are updated for the last available year (2013, 2012) except for *(2010) and **(2011)

Source: MoF SR

After the current successful consolidation, our biggest challenge is to deal with employment issues. Main changes in the labour market will focus on active policies for promoting employment and improving labour offices. The remission of social insurance contributions and their subsidizing on the side of expenditures through tools of active labour market policies will decrease the price of labour, and hence increase the motivation of the long-term unemployed and inactive population to work. After the assessment of their efficiency, their continuation and potential extension for the future will be considered, similarly to the introduction of the concurrence of benefits in material need and wage.

In healthcare efforts are focused on stopping the indebtedness of hospitals and introducing a payment for a diagnostic group (DRG). The Government will continue increasing the efficiency of allocation of expenditures. Expenditure priorities include in particular wages of teachers and employees of the offices of labour, social affairs and family, and building capacities of pre-school education.

Measures in science and research are focused on stabilizing public resources and promoting private funding of science and research. The third stage of the ESO reform will bring further integration of local authorities and opening of new client centres for interaction between citizens and the general government. The National Reform Programme of the SR details the reforms in structural policies.

I.4. The list of implementation of recommendations of the Council of the EU for the Excessive Deficit Procedure

Pursuant to Article 126(6) of the Treaty on the functioning of the European Union (TFEU), in December 2009 the Council of EU adopted Council Decision on the existence of an excessive deficit in Slovakia, placing Slovakia under the excessive deficit procedure. At the same time, the EU Council approved, under Article 126(7) of the TFEU, recommendations for Slovakia, which are together with Government's reactions included in the following table:



TAB 1 – Reaction of the Government to recommendations of the Council of EU for the Excessive Deficit Procedure

Recommendation	Reaction
Excessive deficit should be corrected by 2013 in a sustainable manner.	Slovakia decreased the general government deficit in 2013 to 2.77% of GDP. The deficit should remain below the 3% of GDP reference threshold in the whole period of 2014 – 2017.
The deficit-reducing measures should be implemented in 2010, as planned in the general government budget for 2010 – 2012.	The first package of consolidation measures was adopted, effective from 2011. Further consolidation was carried out in 2012, and markedly in 2013, when the consolidation effort amounted to 1.9% of GDP.
The annual average consolidation effort in 2010 to 2013 should amount to 1% of GDP.	In 2010 – 2013, the average annual consolidation effort amounted to 1.4% of GDP, significantly higher than the 1% of GDP recommended by the Council of EU when opening the Excessive Deficit Procedure. The Government achieved one of the highest consolidation efforts since joining the EU in 2013, amounting to 1.9% of GDP.
The Slovak Government should specify the measures needed to achieve correction of the excessive deficit by 2013 and accelerate the reduction of the deficit if the macroeconomic developments turn out better than currently expected.	The measures designed to correct the excessive deficit have been specified in the approved General Government Budget for 2013 – 2015 and repeatedly in the Stability Programme 2013 – 2016. The Government adopted additional measures to achieve the budgetary objective and in 2013 it reached a deficit lower than the target by 0.2% of GDP. The level of macroeconomic bases is currently considerably lower than the expectations in 2009.
To limit risks to the adjustment, enforceability of the medium-term budgetary framework should be strengthened and monitoring of the budget execution throughout the year should be improved, in particular to avoid expenditure overruns.	The constitutional Fiscal Responsibility Act was adopted in 2011 with a broad Parliamentary consensus. In 2013, the SR transposed into the national legislation the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the so-called Fiscal Compact), including the rule of a balanced structural budget and the corrective mechanism (more details to be found in the part VII). In 2014, provisions implementing the Directive of the Council No. 2011/85/EU on Requirements for Budgetary Frameworks of the Member States became effective.

According to the data notified by Eurostat for 2010 – 2013, Slovakia met the recommendation of the Council for the Excessive Deficit Procedure. Deficit dropped from 8.0% of GDP in 2009 to 2.8% of GDP in 2013. Providing that targets are met, the structural deficit should further drop from 1.9% of GDP in 2013 to 0.7% of GDP in 2017 and thus ensure achievement of the medium term objective (MTO)¹ for Slovakia. The average annual consolidation effort for 2010 – 2013 amounted to 1.4% of GDP, and it considerably exceeded the 1% of GDP according to the recommendation of the Council of EU. The European Commission (EC) and the Council of EU will assess implementation of the recommendation based on notified deficit and debt figures by Eurostat in April 2014 and the spring economic forecast by the EC which will be disclosed in May 2014.

In June 2013, based on the evaluation of the Stability Programme of SR for 2013–2016 and the National Reform Programme of SR 2013, the Council of EU approved a set of country-specific recommendations. Their wording and a detailed account of compliance is included in the National Reform Programme of SR 2014.

¹ According to the Treaty, if the deviation of the structural balance from the medium-term objective is smaller than 0.25 p.p. of GDP, the MTO is considered to be achieved.



II. ECONOMIC OUTLOOK AND PROJECTIONS

In 2013, Slovak economy saw a slow-down of economic growth just below 1%, from 1.8% in 2012. The slow-down was mainly caused by the recession in the Eurozone as well as a long-term downturn of the domestic demand. The insufficient demand leads to a decrease in employment and investments; the households' consumption continued declining. The year-end saw a recovery of the economic growth, which should also continue in 2014 as a result of growth of our trading partners and a slight temporary loosening of consolidation. The economy is recovering, although it has been below its potential for a long time, and even with faster growth it should achieve its potential only in 2017..

External environment

The performance of the Slovak economy was affected by problems in the Eurozone countries. Imports of our trading partners were growing only slightly. In spite of a gradual recovery in the second half-year, the Eurozone economy saw a decrease in the economic activity last year. Generally speaking, the performance of individual Member States was uneven. The German economy grew when it benefited from the recovery of the domestic demand, particularly from the second quarter. On the other hand, in 2013 the peripheral countries of the Eurozone saw a significant drop in the economic activity (e.g. economies of Greece and Portugal dropped by 3.7% or 1.6% respectively). However, the second half of the last year indicates that the crisis is gradually leaving also the peripheral countries which saw a quarter-to-quarter growth in the last quarter. In 2013, the economy of the USA was growing slightly more slowly than in the previous year, namely by 1.9% (compared to the growth by 2.8% in 2012). Concerns about a significantly negative impact of a Federal Government shutdown in autumn 2013 on the GDP growth and the threat of a debt ceiling were kept off and thus the US economy was growing at a faster pace than the Eurozone economy in the second part of the year.

The overall positive development from the end of the last year was also reflected in the first months of 2014. Based on the Purchasing Manager Index (PMI) and economic sentiment indicators, a slight acceleration of economic growth in the Eurozone countries is expected in the first quarter of 2014. Moreover, the impact of fiscal consolidation in the Eurozone countries should not significantly hamper the economic growth anymore. Yet a high unemployment and a threat of deflation in the Eurozone, as well as a slower growth of the developing countries, are acting against a faster recovery of our trading partners.

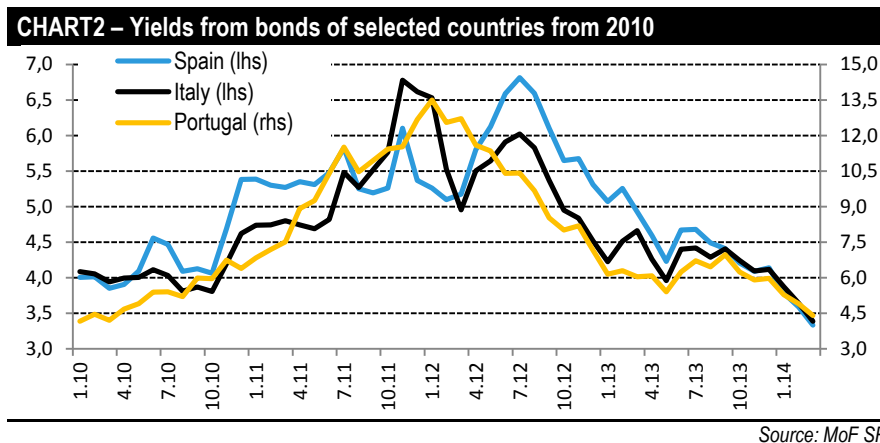
In its winter forecast from February 2014, the EC slightly improved the expected growth of the Eurozone countries and also EU for 2014. According to the forecast in 2014, the Eurozone should achieve significant growth (1.2%). The improved estimate applied also to Germany where the expected growth was increased to 1.8%. In spite of a certain upward revision, the assumptions used in the Commission's Winter Forecast are in line with the assumptions used in the present MoF SR forecast for the external environment, only with minor deviations. However, the escalating conflict in Ukraine brings further risks in the form of a potential reduction of export or, in extreme cases, a stoppage of gas supplies coming from Russia.

	MoF SR			EC		
	2013	2014	2015	2013*	2014*	2015*
<i>Economic growth</i>						
EU	0.1	1.4	1.8	0.1	1.5	2.0
Eurozone	-0.5	1.0	1.3	-0.5	1.2	1.8
Germany	0.4	1.6	1.8	0.4	1.8	2.0
USA	1.9	2.9	3.2	1.9	2.9	3.2
China	7.7	7.4	7.4	7.7	7.4	7.4
<i>Imports of Slovakia's trading partners</i>	1.1	3.7	4.5	1.1	4.4	6.0
<i>Long-term interest rates (10Y)</i>						
Eurozone	1.6	2.1	2.5	1.6	1.8	2.1
<i>ECB key interest rate</i>	0.5	0.3	0.3	-	-	-
Exchange rate (USD/EUR)	1.33	1.29	1.23	1.33	1.36	1.36
Oil prices (Brent, USD/barrel)	108.8	109.6	112.0	108.8	104.1	99.6
Oil price (Brent, EUR/bl)	81.9	85.1	90.8	81.9	76.5	73.2

Source: MoF SR February 2014 *EC Winter Forecast February 2014



The situation in financial markets was calm in 2013. The liquidity surplus, supplied mainly by two 3-year repo tenders by ECB already from 2011/2012 (LTRO), and in particular reassurance by verbal interventions of the ECB from the second half-year of 2012 could be felt in the market. The ECB declared that, if necessary, it would launch a programme of purchase of state bonds in the secondary market (the so-called OMT). The readiness to launch OMT if necessary was a clear signal for the markets; bond yields have considerably dropped and the demand of investors in the primary markets has sharply increased. Several stock indices exceeded their historical maxima in 2013. The EUR was appreciating relatively steadily towards the dollar as well as towards most other currencies. The EUR/USD exchange rate got from 1.3 at the start of 2013 almost to 1.4 in December. The yields of bonds of Spain and Italy which, with regard to their amounts, represented major risks for the fate of the Eurozone, continued decreasing sharply, with the exception of short-term fluctuations, and got below 4%. In April 2014, Greece managed to return to the financial markets by selling 5-year bonds, lowering the risk of the need of the third rescue package from the European partners and IMF.

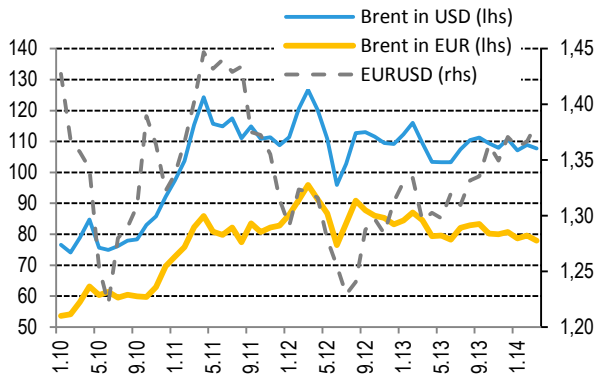


Oil prices in 2013 remained relatively stable, between 100 and 120 USD/bl (Brent), with some short-term fluctuations. The oil price increased in February 2013 to 117 USD/bl, which was followed by a steep drop, temporarily even below 100 USD/bl in April 2013. Then oil returned to the 110 USD/bl level where it remained for the second half-year without any major fluctuations. Its impact on inflation in 2013 was more-or-less neutral. However, apart from oil price increases in dollar terms, the Eurozone is also susceptible to EUR/USD fluctuations. Contrary to 2011, when dollar strengthened towards EUR more permanently, the situation in 2013 was different. EUR was strengthening, making oil cheaper in the EUR terms.

In 2013 we observed a general slow-down in the growth of prices. The inflation was slowing down in all countries and some states even saw a negative growth of prices - deflation. The slow-down in the growth of prices was caused by the development in energy and commodity markets together with the fading effect of fiscal consolidation from the past years. The average rate of growth of prices in the Eurozone was 1.4% last year. In January this year we only saw an increase of 0.8%. The current growth as well as short-term projections show that inflation will be well below the currency-political target of the ECB in this and in the future year. The zero lower bound of interest rates restricts the possibilities of the ECB to influence the dynamics of the price level through decreasing interests. It is therefore possible that the ECB will proceed to certain non-standard steps in order to stimulate economic growth and increase the expected rise in prices. The ECB may consider a further decrease in the deposit rate to negative values, as Denmark did in the past, or to perform quantitative easing through the purchase of bonds, as the American FED has been doing for several years.

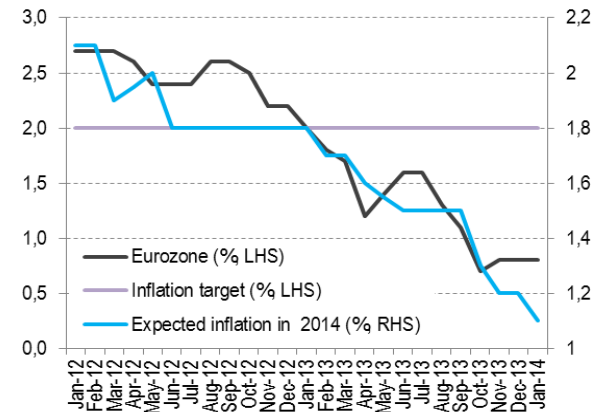


CHART 3 – BRENT oil (USD/bl) and EUR/USD



Source: MoF SR, ECB

CHART 4 – YoY growths of prices in the Eurozone, ECB target (in %, right axis) and the expected average inflation in 2014 (in %, left axis)



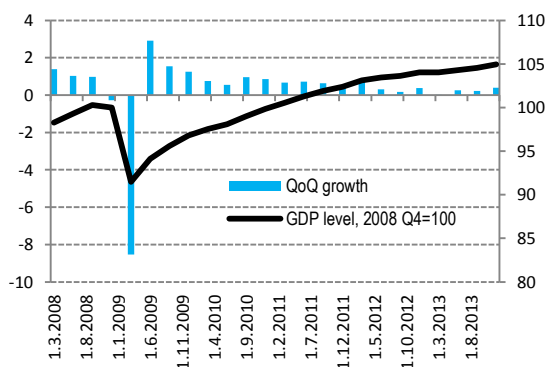
Source: MoF SR, ECB

The monetary policy pursued by most major central banks remained strongly expansionary in 2013, with rates kept at record lows. The crucial central bank, American FED, left the interests rates unchanged at record-low levels throughout 2013. The basic FED interest rate has not changed since December 2008 and has remained at 0.25%. In autumn 2013 a gradual decrease in the intensity of quantitative easing was expected (QE3²), which FED reported and started to implement in late 2012. Contrary to FED, the basic rate of which is practically zero, the ECB had a marginal room for decreasing the rates. The ECB decided to use this margin in 2013, reducing the rate to the current 0.25%, representing its all-time-low. ECB has considered decreasing the deposit rate which is currently at 0% to a negative value. It could substantially support the credit activity of banks. However, the ECB did not take such step in 2013.

II.1. Economic development in Slovakia in 2013

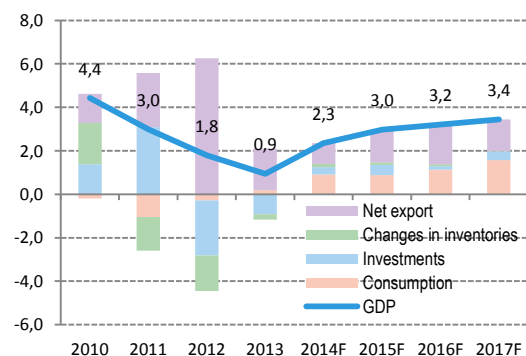
In 2013, the economic growth slowed down to 0.9%, in particular as a result of a worse performance of the external environment. The recession in the Eurozone in the first half of 2013 meant a slower growth of exports and a worsening situation in the labour market. A slight drop in employment in the first half-year lead to a further decrease of households' consumption, while surplus capacities and insufficient demand decreased the investments. Weak demand pressures along with a fall in the prices of commodities slowed down the growth of prices which started to approach zero at the beginning of the year, and in early 2014 there was even a short-term deflation. However, signs of a turn in the labour market appeared already at the end of the last year when employment started increasing, and consumption and investments increased as well.

CHART 5 – GDP, adjusted for seasonal and one-off effects*



*GDP adjusted for cigarettes stockpiling and one-off VAT payments after final inspection of R1 highway Source: SO SR, calculated by MoF SR

CHART 6 – Contributions to GDP growth in 2012 – 2017

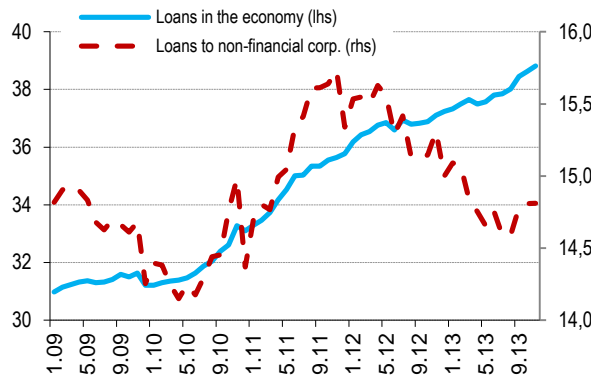


Source: SO SR

² FED is expected to every month decrease the overall value of purchased bonds in the secondary market by USD 10bn a month. This slows down the pace of supplying the financial market with dollar liquidity.

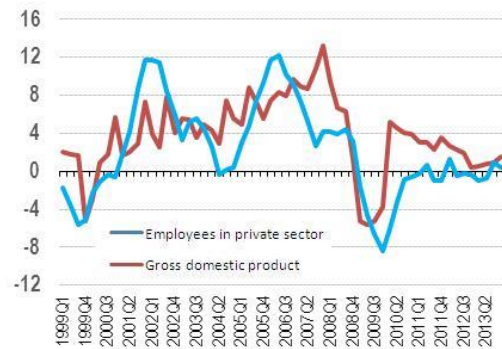


CHART 7 – Loans in the economy and loans to non-financial corporations (stock at the end of month, EUR bln.)



Source: NBS

CHART 8 – YoY growth of private sector employment and GDP growth (in %)

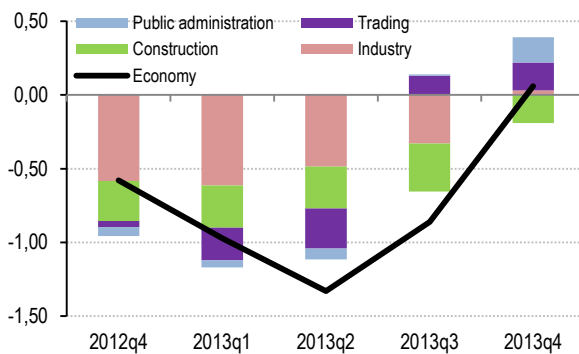


Source: MoF SR

In 2013, the slow-down of the economic growth had an impact in the labour market as well. According to the ESA95 methodology, the average employment in 2013 was approximately 2.19 million persons, i.e. by 0.8% less than in 2012. Although the employment decreased by 17,000 persons for the whole 2013, the labour market gradually stabilized in the course of the year and the employment increased at the end of the year. However, the growth of the economic output is considerably higher than the increase of employment in the whole post-crisis period.

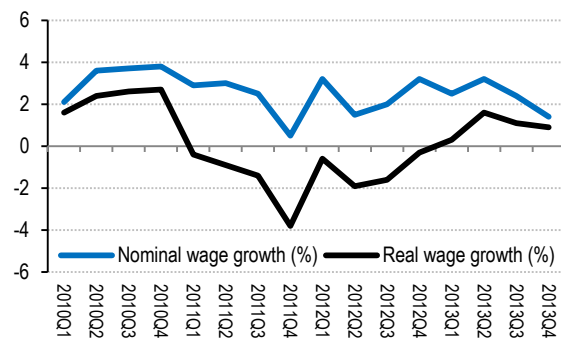
In 2013, the decreasing employment and the demographic development caused a growth of the unemployment rate (according to the LFS methodology) to 14.2%. The issue of long-term unemployment continued, when approximately two out of three jobless have been unemployed for longer than one year.

CHART 9 – Contributions of selected sectors to unemployment change (YoY changes in p.p.)



Source: SO SR

CHART 10 – YoY average wage growth (%)



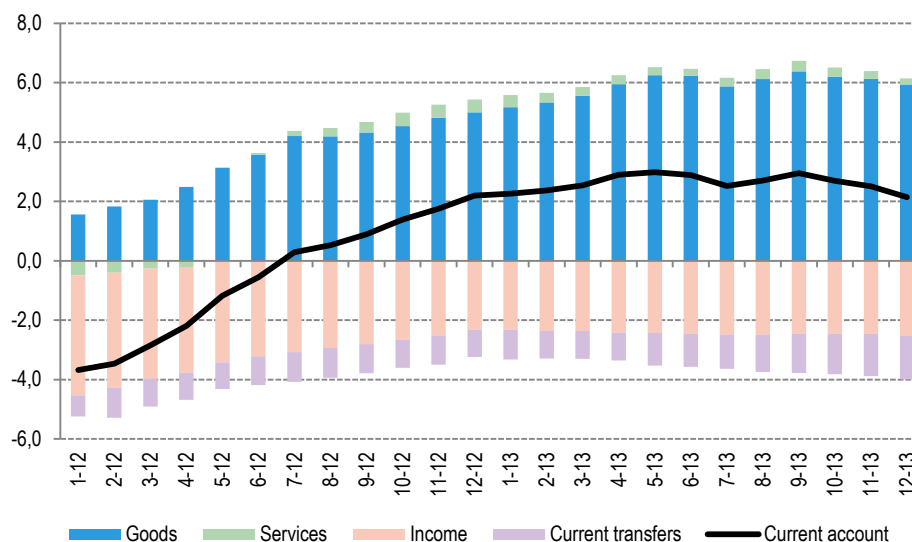
Source: SO SR

The average nominal monthly wage of an employee in economy amounted to EUR 824 in 2013. It increased by 2.4% year-on-year, representing the same growth as in the previous year. Wages were growing the fastest in education, industry and healthcare. The real wage increased by 1%.

Even though the slow-down of external demand lead to a lower growth of exports, the drop of investments and consumption of households meant that the import of goods dropped more significantly, and the trade balance reached the all-times highest surplus (5.9% of GDP). The higher surplus of the trade balance was compensated

by worsening of other items of the current account. Thus the current account balance remained unchanged in comparison with 2012 (2.2% of GDP), even though its structure changed.

CHART 11 – External imbalances – components of the CAB (in % of GDP for the last 12 months)



Source: NBS, MoF SR

In 2013, the inflation considerably slowed down in Slovakia, and currently it is lower than the average of the Eurozone countries. The average YoY price growth rate dropped from 3.7% in 2012 to 1.5% in 2013. The slower growth of prices was caused by both domestic and foreign factors. The stabilization of prices of energy commodities in global markets was reflected in a low growth of regulated prices. The above-average domestic and foreign crops gradually decreased the dynamically rising prices of food. Therefore, the YoY growths of food prices were continually decreasing last year. Some of the domestic factors which have an effect on slowing-down the inflation are mainly the continuing weak domestic demand and a low level of consumer confidence. These factors limit the potential transfer of demand factors to the growth of domestic prices. Weak demand pressures resulted in the drop of net inflation, by 1.7 p.p.

II.2. Medium-term economic forecast

The updated official MoF SR forecast from February 2014 assumes an economic growth of 2.3% in 2014. A gradual recovery of economy of the Eurozone and of other trading partners will lead to a faster growth of exports and to creation of new jobs. Private consumption, also supported by a low growth of prices, will rise along with a higher employment. The domestic demand will thus again start contributing to the growth of GDP. Even though investments will rise thanks to construction of highways and the announced projects in the automotive industry, the surplus of production capacities means private investments will start rising more significantly only in the following years. After a temporary slight loosening in 2014, the consolidation of public finance will again lead to a drop in public consumption from 2015; nonetheless, this should not hamper the economic growth from the medium term point of view. The economy will start approaching its potential which it should achieve by 2017.



TAB 3 – Forecast of selected indicators of the Slovak economy for the budgetary framework for 2015 – 2017

No.	Indicator	Unit	Actual			Forecast		
			2012	2013	2014	2015	2016	2017
1	GDP, current prices	EUR bn.	71.1	72.1	74.5	77.8	81.7	86.2
2	GDP, constant prices	%	1.8	0.9	2.3	3.0	3.2	3.4
3	Final consumption of households and NPISH ³	%	-0.2	-0.1	1.2	2.2	2.4	2.9
4	Final general government consumption	%	-1.1	1.4	1.9	-1.4	-0.4	0.9
5	Gross fixed capital formation	%	-10.5	-4.3	1.8	2.4	0.8	2.1
6	Export of goods and services	%	9.9	4.5	4.0	4.5	4.8	4.8
7	Import of goods and services	%	3.3	2.9	3.6	3.6	3.7	4.1
8	Output gap (share of the potential output)	%	-0.5	-1.3	-1.0	-0.7	-0.4	0.2
9	Average monthly wage in the economy (nominal growth)	%	2.4	2.4	2.5	3.5	4.1	4.5
10	Average employment growth, LFS	%	0.6	0.0	0.3	0.9	1.0	1.1
11	Average employment growth, ESA95	%	0.1	-0.8	0.3	0.6	0.7	0.9
12	Average unemployment rate, LFS	%	14.0	14.2	14.0	13.2	12.3	11.3
13	Average registered unemployment rate	%	13.6	14.1	13.7	13.0	12.0	11.0
14	Harmonized index of consumer price (HICP)	%	3.7	1.5	2.4	2.5	2.5	2.3
15	Current account balance (share of GDP)	%	2.2	2.2	4.5	5.3	6.1	6.9

Source: MoF SR

A gradual recovery of the national demand will have a positive impact on the labour market as well. The employment growth of 0.3% is expected for the whole 2014, while it should gradually accelerate towards 0.9% in the years to come, and thus to bring the employment to pre-crisis levels. The number of employed will increase in particular in services; a slight employment growth is expected in the construction industry after a long time. The recovery of the labour market will also be reflected in a drop of the unemployment rate which, according to the LFS methodology, should decrease to the average of 14% in 2014 and drop to 11.3% by 2017.

The expected rise in nominal wages in 2014 should be similar to the previous year, i.e. 2.5%. The relatively low increase of wages in the post-crisis period is caused by the continuing weak growth of aggregate demand in the Eurozone and a very low inflation. However, a gradual recovery of economy of the Eurozone should bring the growth of wages to around 4% in the following years. Thanks to a considerably slower growth of prices, the real wage should increase by 1.7% in 2014. In the following years, the growth of labour productivity should more strongly result in a higher growth of wages in the private sector, and the real wage should be increasing faster.

Prices will grow even more slowly this year than the last year. The YoY growth of consumer prices is expected to rise by 0.8%. We observed the lowest growth of prices around zero in the Q1. The price growth will gradually increase in the course of the year. The synergic effect of domestic and foreign factors, which was decreasing the pace of inflation last year, will also have an impact on the growth of prices this year. This year prices of energy will drop, households will save particularly in the expenditures on electricity the price of which has significantly dropped. The ongoing favourable situation in the market with agricultural commodities will be reflected in low increases in prices of food this year as well. The drop in energy prices and low prices of other inputs expressed in the dynamics of the producer price index eliminate the risk of price increase due to higher production costs. Net inflation will continue to be low in the first half-year. The risk of demand inflation is low, in view of the ongoing slow growth of private consumption and nominal wages. In 2015 – 2017, the inflation dynamics should gradually accelerate to around 2%.

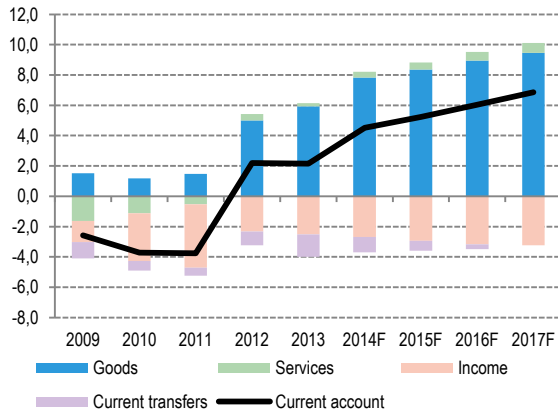
The exports of goods will continue increasing, following the recovery of the foreign demand. The lower investments and public consumption, as well as a gradually recovering consumption of households, will lead to a slighter increase in imports. Thus the trade balance surplus should continue increasing. The decrease of other

³ In the following text the households' consumption denotes consumption of households and non-profit institutions serving households (NPISH).



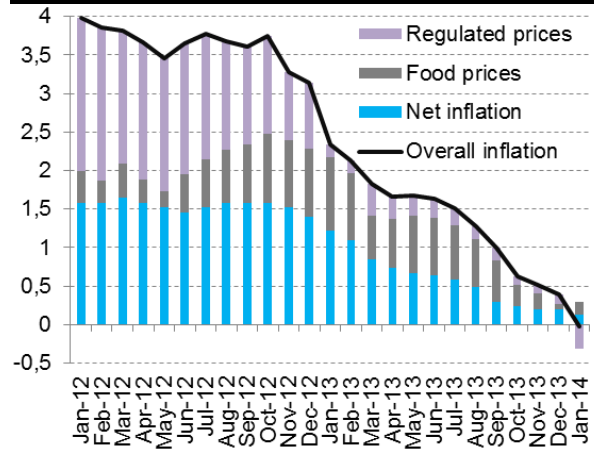
items of the current account of balance of payments will not be sufficient to compensate this development, and the current account balance will rise together with trade balance.

CHART 12 – External imbalances – components of the CAB (in % of GDP)



Source: NBS, MoF SR

CHART 13 – Consumer inflation structure – YoY contributions of CPI items (p.p.)



Source: SO SR, MoF SR

Main risks associated with the forecast⁴

The risks of the forecast are balanced on both sides and depend on the performance of external environment. Positive risks are associated with a potential of the monetary policy by the ECB and with a faster growth abroad which the leading indicators point out to. On the negative side there is a risk of deflation in the Eurozone countries and a slower growth of developing countries which would lead to a lower growth of our trading partners and thus also of Slovakia. The escalating conflict in Ukraine brings further risks in the form of a potential reduction of exports or, in an extreme case, stoppage of gas supplies coming from Russia.

⁴ Certain risk scenarios are contained in part IV.

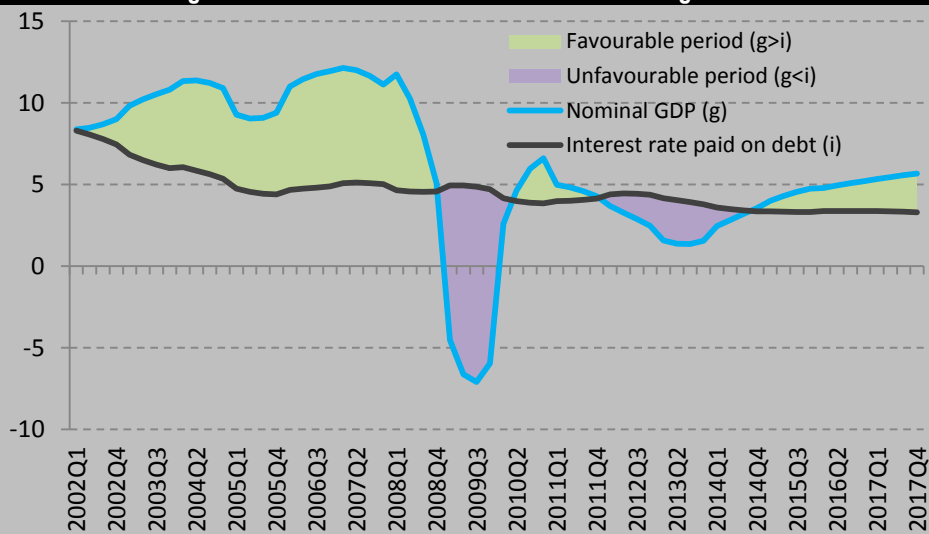


BOX 1 – Low growths of nominal values are unfavourable for decreasing public debt

The current low rise in consumer prices has an unfavourable impact on public finance. Indeed, the nominal growth of economy decreases as a result of a low price rise. Problems are more striking in the case of a decrease in nominal growth below the interest rate paid for administration of public debt. If the nominal growth of economy is lower than this rate, the proportion of the public debt to GDP would rise even with the currently balanced budget (zero primary deficit)^a. In the case of a positive difference between the growth of GDP and interest rates, revenues may be lower than expenditures and the share of the debt in GDP may still be decreased. In the opposite case the proportion of the debt to GDP will rise also with a balanced primary deficit.

The Chart shows that from 2012 on, we are still in the "unfavourable period" for decreasing public debt. A turn should come in early 2015 when the expected nominal growth of economy should be higher than the interest rate of the public debt.

CHART 14 – YoY growth of nominal GDP and the interest rate of gross debt^b



Source: IFP

a) Balanced proportion of revenues and expenditures of the state budget, excluding the costs of the public debt financing. The difference between revenues and expenditures, excluding interest costs, is called 'primary deficit'.

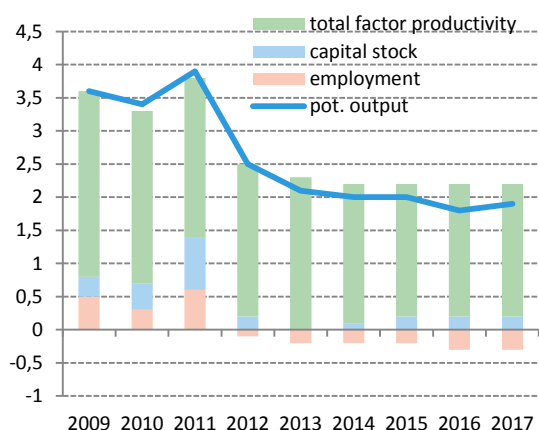
b) It is an implicit interest rate which is defined by a proportion of interest costs to the last year's gross debt.

II.3. Cyclical development of the economy

According to the EC methodology and based on the data forecast by MoF SR, the growth of potential output in 2013 amounted to 2.1% and in the following years it will be slightly slowing down. The labour contribution will be decreasing the potential growth; on the contrary capital formation will have a positive impact on it. Total factor productivity (TFP) will be stagnating during the projected period.



CHART 15 – Contributions of production factors to potential output growth (p. p.) – COM approach



TAB 4 – Contributions of production factors to potential output growth – COM approach

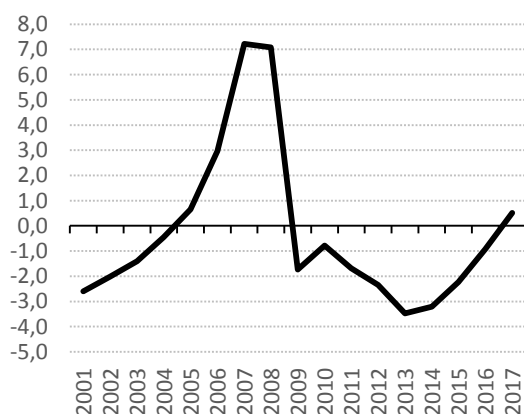
	Pot. GDP (growth, %)	TFP*	Capital stock	Labour
2009	3.6	2.8	0.3	0.5
2010	3.4	2.6	0.4	0.3
2011	3.9	2.4	0.8	0.6
2012	2.5	2.3	0.2	-0.1
2013	2.1	2.3	0.0	-0.2
2014F	2.0	2.1	0.1	-0.2
2015F	2.0	2.0	0.2	-0.2
2016F	1.8	2.0	0.2	-0.3
2017F	1.9	2.0	0.2	-0.3

* total factor productivity

Source: MoF SR

According to the EC methodology, the output gap amounted to -3.5% of the potential output in 2013. With regard to the slow growth of the potential, the output gap will close in late 2016, similarly to the MoF SR estimate. However, the speed of closing the output gap will be uneven. In 2014, the estimate is still at -3.2% of the potential output and only the following recovery of the GDP growth will significantly shrink the output gap.

CHART 16 – Output gap (% of potential GDP) – COM approach



TAB 5 Output gap – COM approach

	GDP* (real growth, %)	Potential GDP (growth, %)	Output gap (% pot. GDP)
2009	-4.9	3.6	-1.7
2010	4.4	3.0	-0.8
2011	3.0	3.9	-1.7
2012	1.8	2.5	-2.3
2013	0.9	2.1	-3.5
2014F	2.3	2.0	-3.2
2015F	3.0	2.0	-2.2
2016F	3.2	1.8	-0.9
2017F	3.4	1.9	0.5

Note: * Output gap is calculated based on GDP adjusted for cigarette stockpiling and other one-off effects.

Source: MoF



BOX 2 – Methodological differences in the calculation of potential output, EC vs. MoF SR

The estimate of the potential of the economy and the output gap made by MoF SR is different in methodology from EC estimates. The EC estimate is decisive in assessing the structural balance for the purposes of Economic fiscal rules. MoF SR discloses its own methodology within the Macroeconomic Forecasts Committee.

According to MoF SR estimates, the growth of the potential of the economy in 2013 slightly slowed down to 1.8% in 2013 compared to 2012, mainly as a result of decreasing investments in economy which have led to a slow-down in the accumulation of capital. However, already last year we observed a change in this trend and in the future we expect an acceleration of the potential of the economy.

CHART 17 – Contributions of production factors to potential output growth (p. p.) – MoF SR approach



TAB 6 – Contributions of production factors to potential output growth – MF approach

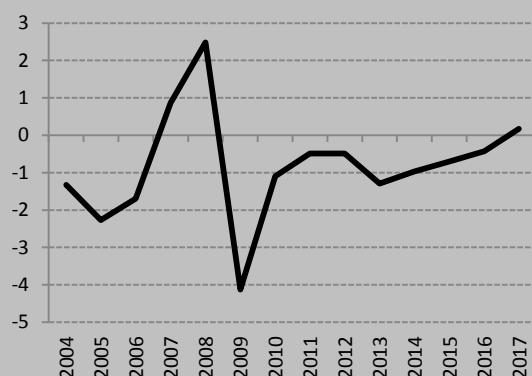
	Pot. GDP (growth, %)	TFP*	Capital stock	Equilibrium employment
2009	1.6	0.7	0.8	0.1
2010	1.2	0.7	0.6	-0.2
2011	2.3	1.2	0.8	0.4
2012	2.0	1.1	0.6	0.3
2013	1.8	1.1	0.4	0.3
2014F	2.1	1.3	0.3	0.5
2015F	2.6	1.6	0.4	0.7
2016F	2.7	1.8	0.4	0.6
2017F	2.8	1.9	0.4	0.5

* total factor productivity

Source: MoF SR

The growth of the real GDP in 2013 slowed down to 0.9% and this led to a further deepening of the output gap to -1.3% of the potential output. However, in the following years we expect the growth of GDP to be faster than the growth of the potential of the economy and the output gap will gradually close by the end of 2016.

CHART 18 – Output gap (% of potential GDP) – MoF approach



TAB 7 – Output gap – MoF approach

	GDP*) (real growth, %)	Potential GDP (growth, %)	Output gap (% pot. GDP)
2009	-4.9	1.6	-4.1
2010	4.4	1.2	-1.1
2011	3.0	2.3	-0.5
2012	1.8	2.0	-0.5
2013	0.9	1.8	-1.3
2014F	2.3	2.1	-1.0
2015F	3.0	2.6	-0.7
2016F	3.2	2.7	-0.4
2017F	3.4	2.8	0.2

*) Output gap is calculated based on GDP adjusted for cigarette stockpiling and other one-off effects.

Source: MoF SR

The differences in MoF SR and EC methodologies apply to almost all items of the calculation, even though the basic methodology is equal. Both institutions calculate the potential output using the Cobb-Douglas production function. But while the MoF SR calculates the potential output from quarterly data, the EC uses yearly data.

Another difference results from different shares of production factors. The EC uses common shares for all new Member States – 0.63 for labour elasticity and 0.37 for capital elasticity. On the other hand, the MoF SR derives

the shares of factors from national accounts - labour as a share of compensations of employees (excluding self-employed) in GDP at 0.43 and capital analogically at 0.57 (average values for 1995 – 2010).

As for the capital stock, the main difference is in the original value and in the rate of depreciation. For all new Member States (with the exception of CR), the EC estimated the capital stock in 1995 as a double of the GDP, and uses a common depreciation rate of 5%. The MoF SR uses the actual estimate of the capital stock of 1999 from the Statistical Office and the depreciation rate is obtained from annual national accounts.

Both institutions obtain the equilibrium employment estimate from the working-age population using the participation rate trend, NAIRU and the worked-hours trend. Yet there is a difference in input - the MoF uses the population aged 15+, while the EC population aged 15 to 64.

The difference in TFP consists mainly in historical data. The MoF SR increases the potential output in 2005 – 2008 so that it reflects structural changes in the economy which the EC's common method cannot reflect. Other imbalance indicators do not confirm any excessive output gap in 2007 – 2008 which results from the EC method. If the EC's methodology corresponded to reality in these years, it would also be demonstrated in observable economic development indicators. E.g. in the the current account of balance of payments, net inflation or in unit labour costs.

II.4. Impact of consolidation of public finance in 2013 – 2017 on the economy⁵

The consolidation in 2013 decreased the growth of GDP only by 0.2 p.p. The package contained measures in the amount of 2.2% of GDP, but only its part in the amount of 0.7% of GDP had a direct impact on the economy. Revenue measures focused on increasing the progressiveness of income taxes and increasing social contributions with a direct impact on growth. On the expenditures side of the budget, expenditures in intermediate consumption, investments as well as wage costs of the public sector increased⁶.

In 2014 we expect the impact of consolidation on the GDP growth in the amount of 0.4 p.p. The overall amount of measures necessary to achieve the fiscal target is 1.0% of GDP, while its direct impact on the economy is 1.1% of GDP⁷. Slightly prevailing expenditure measures in the amount of EUR 445m include savings in the intermediate consumption of general government, as well as in wage costs of the public sector. We expect the revenue consolidation measures to amount to EUR 342m. Continued levy from regulated industries has the biggest impact in 2014 as well as the implementation of tax licences.

Two scenarios for 2015 – 2017 are estimated. The first scenario includes consolidation measures contained in the draft general government budget framework (GGB) as well as expenditure measures beyond the GGB framework which take into consideration meeting the budgetary objectives. The overall size of necessary measures gradually increases from 1.2% of GDP in 2015, 1.7% of GDP in 2016 up to 2.5% of GDP in 2017. **The expected consolidation will decrease the growth of GDP by 0.4 p.p. in 2015, 0.2 p.p. in 2016 and 0.3 p.p. in 2017.** The second scenario assumes only implementation of consolidation measures according to the GGB framework. The overall size of consolidation measures in the second scenario amounts to 0.9% of GDP in 2015, 1.3% of GDP in 2016 and 1.7% of GDP in 2017. **Consolidation based on the GGB framework will have an impact on GDP by 0.2 p.p. in each year during 2015 to 2017.** In comparison, the amount of consolidation measured by the NPC scenario in 2011, including assumed obligations of hospitals for the last years, amounted to 2.5% of GDP.⁸

The fiscal multiplier in 2013 is estimated at 0.2. This result is in line with the economic literature according to which consolidation through revenue measures has a smaller short-term impact on the GDP growth compared

⁵ More details regarding the impact of consolidation in 2013 – 2017 may be found in the Annex 2.

⁶ More detailed information about the development of wage expenditures of the general government in 2013 can be found in the chapter III 2.2, p. 32.

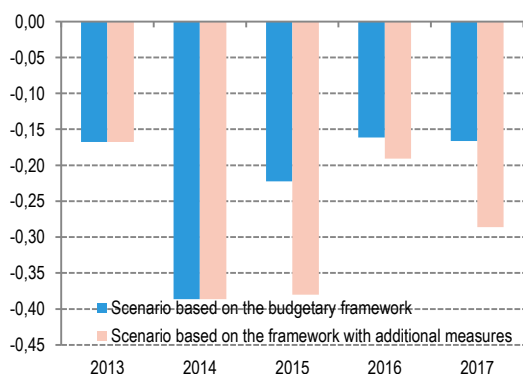
⁷ Mainly a decrease in grants and transfers is one of the measures with no impact on GDP in the amount of 0.1%, as it is expected that they are mainly revenues from abroad.

⁸ More detailed information is disclosed in the commentary of IFP 2012/22 on <http://www.finance.gov.sk/Default.aspx?CatID=8748>. Comparison of the amount of consolidation based on NPC 2011 is not comparable with the later data for 2013 to 2017, because a) the data for the last years has been revised; b) the Railways of the Slovak Republic were reclassified into GG and c) 2011 was based on the previous year, while 2015 – 2017 have 2014 as the baseline year.



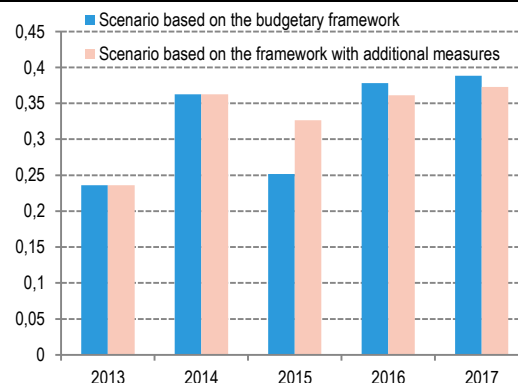
with consolidation focused on the expenditure side⁹. The estimated multiplier of the package in 2014 at 0.4 corresponds to the structure of consolidation with slightly prevailing expenditure measures. For 2015 – 2017, multipliers in both scenarios amount to values in the interval 0.3 – 0.4 and are only marginally higher in the first scenario.

CHART 19 – Impact of consolidation on GDP (in % of GDP)



Source: IFP

CHART 20 – Fiscal multipliers



Source: IFP

II.5. Comparison of forecasts of the MoF SR and of other institutions

Compared to the forecast published in the Q4 2013 (OECD), the forecasts published this year (IFP, EC, NBS, IMF) predict a slightly faster growth of the GDP of SR in 2014 – 2015. The main reason is a slightly more positive view of the development of external environment (compared to forecasts from autumn 2013) which should have a positive impact on investments and export performance of the Slovak economy. The MoF SR forecast is in line with the Commission's Winter Forecast from February 2014.

TAB 8 – Comparison of MoF's and other institutions' forecasts

	Year 2014	Year 2015	Year 2016
Real GDP growth (%)			
MoF SR	2.3	3.0	3.2
Macro committee (median)	2.2	3	3.2
NBS	2.3	3.3	-
EC	2.3	3.2	-
OECD	1.9	2.9	-
IMF	2.3	3.0	-
HICP (%)			
MoF SR	0.8	2.1	2.3
Macro committee (median)	0.7	2.1	2.3
NBS	0.6	1.9	-
EC	0.7	1.6	-
OECD	2.0	2.1	-
IMF	0.7	1.6	-
Current account (% HDP)			
MoF SR	4.5	5.3	6.1
Macro committee (median)	3.1	3.2	2.8
NBS	2.7	3.5	-
EC	1.9	2.3	-
OECD	4.5	5.5	-
IMF	2.7	2.9	-

Source: MoF SR (February 2014), Macroeconomic Forecasts Committee (February 2014), NBS (January 2014), EC (February 2014), OECD (November 2013) and IMF (April 2014)

⁹ OECD Economic Outlook (2009): Interim Report March

III. PUBLIC FINANCE POSITION

The main objective of the fiscal policy strategy is to ensure efficient and long-term sustainable public finances which support sustainable economic development and a higher quality of life in the context of population ageing, and with due account of contingent liabilities. This objective is also laid down in the constitutional Fiscal Responsibility Act¹⁰.

After a better-than-planned deficit amounting to 2.77% of GDP and the achieved significant consolidation effort amounting to 1.9% of GDP in 2013, which was one of the highest ones since Slovakia joined EU¹¹, the **main short-term objective** is to achieve a deficit of 2.64% of GDP in 2014 and thus to keep the deficit below 3% of GDP. In 2014, structural consolidation is temporarily slightly loosened. Even without making use of the investment clause, there should be no significant deviation as defined by the rules of the preventive arm of the Pact which would require activation of the corrective mechanism of the Fiscal Compact.

In order to achieve a long-term sustainability of public finances, the Government will **continue consolidating public finances also after 2013** in line with provisions of the Pact and respecting the constraints of national budgetary rules. **The deficit target values have therefore been set at 2.49% of GDP in 2015, 1.61% of GDP in 2016 and 0.54 in % of GDP in 2017.**

The proposed targets for 2015 – 2017 respect the national budgetary rules and the limits of the general government debt defined by the constitutional act. Achieving the fiscal targets will lead to public debt peaking at 56.2 in % of GDP in 2015 and its subsequent decrease from 2016. Thus the level of 57% of GDP should not be breached; that would mean the obligation to prepare a balanced budget proposal in 2017, which would be linked to further significant fiscal restriction.

If Slovakia continues reducing its deficit, it will move towards its **medium-term budgetary objective of a structural deficit amounting to 0.5% of GDP** which should be achieved in 2017¹² assuming fiscal targets are met. Structural balance should improve by approximately 0.5% of GDP in 2015 and 2016 and by 0.6% of GDP in 2017. At the same time, the Government expects an increase in public expenditure in 2013 – 2017 in line with the reference value of the expenditure benchmark.

In comparison with the previous Stability Programme, the 2015 and 2016 targets for general government balance have been slightly revised. According to a new interpretation of rules of the Pact, the requested consolidation effort of countries in a similar economic and budgetary situations like Slovakia will be in 2015 could be lower than 0.5% of GDP, due to a significant negative output gap, relatively low deficit and debt, medium risk of long term sustainability (more details in the Box 4). Due to loosening of the fiscal policy in 2014, **in order to achieve the medium-term budgetary objective in line with the recommendations of the Council of EU from June 2013 and the requirements of the Fiscal Compact, it will be necessary to achieve higher consolidation effort in 2015 than allow for by the new interpretation of rules .**

¹⁰ Constitutional Act No. 493/2011 on Fiscal Responsibility

¹¹ In 2013, the consolidation effort amounted to 1.86% of GDP, and in 2011 to 2.05% of GDP. Slovakia achieved the highest consolidation effort in the amount of 3.3% of GDP in 2003.

¹² According to the Treaty, if the deviation of the structural balance from the medium-term budgetary objective is smaller than 0.25 p.p. of GDP, the MTO is considered to be achieved.



TAB 9 – Main fiscal indicators in 2013 – 2017 (ESA95, in % of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017
1 General government balance	-7.54	-4.76	-4.48	-2.77	-2.64	-2.49	-1.61	-0.54
2 Cyclical component	-0.3	-0.6	-0.8	-1.2	-1.1	-0.7	-0.3	0.2
3 One-off measures	-0.6	0.4	0.1	0.3	0.6	0.0	0.0	0.0
4 Cyclically adjusted budget balance without one-off measures (1-2-3)	-6.7	-4.6	-3.8	-1.9	-2.2	-1.8	-1.3	-0.7
5 Consolidation effort (y-o-y change 4)*	-	2.0	0.8	1.9	-0.3	0.4	0.5	0.6
6 Expenditure aggregate growth rate net of discretionary revenue measures (%)	-	-	-	-2.9	-3.6	-0.9	-0.5	-0.6
7 Reference rate of expenditure growth for SR (%)	-	-	-	1.8	2.4	2.4	1.3	1.3
8 Deviation from the expenditure benchmark (6-7) *	-	-	-	-4.8	-6.0	-3.3	-1.8	-1.9
9 Gross general government debt	41.0	43.6	52.7	55.4	55.2	56.2	54.9	53.4

* A negative figure represents an expenditure aggregate fulfilment; (+) restriction, (-) expansion;

The EC evaluates compliance with the expenditure rule for Slovakia only after the application of the preventive part of the Pact after 2013.

Source: MoF SR

The consolidation of public finances progresses in line with the plans of the Government. The 2013 general government deficit reached 2.77% of GDP, which is an improvement by 0.17 p.p. compared to the budgeted deficit target of 2.94% of GDP. Main negative factors, in particular the shortfall of several tax and non-tax revenues, were compensated for by savings on the expenditure side, better fiscal performance of local governments and other entities of the general government. The lower need for co-financing connected to a lower drawing of EU funds had a positive impact on the public finance balance. The general government gross debt reached 55.4 % of GDP at the end of 2013.

According to the latest estimate, the general government deficit should amount to 2.84% of GDP in 2014. The current estimate indicates risks of 0.2% of GDP in comparison with the deficit target of 2.64% of GDP, which will be covered by additional measures if they persist. The risks in the current development compared to the fiscal target may be attributed to several factors, the most important ones of which are a shortfall of expected revenues from dividends and lower revenues from the sale of frequency licences to telecommunication operators. A positive risk still represents the effort to combat tax evasion.

If the government had not taken any additional measures and only the macroeconomic development (NPC assumption) would impact the general government balance, the general government deficit would amount to 3.7% of GDP in 2015. In the next years, a slight drop in the deficit under the NPC assumptions is expected due to more favourable macroeconomic assumptions; as it amounts to 3.0% of GDP in 2017.

Based on that it will be necessary to adopt measures to improve the general government primary balance in total by EUR 904m (1.2% of GDP) in 2015, by EUR 1,385m (1.7% of GDP) in 2016 and by EUR 2,134m (2.5%) in 2017. This illustrates a cumulative amount of measures compared to the NPC scenario; this means that in the event of adoption of permanent (structural) measures, the need for additional measures decreases in the following periods by the volume of already adopted measures. **Assuming only adoption of permanent measures, the overall need for measures amounts to EUR 904m (1.2% of GDP) in 2015, EUR 482m (0.5% of GDP) in 2016 and EUR 748m (0.8% of GDP) in 2017.**

TAB 10 - Overall consolidation need to achieve fiscal targets compared to NPC (ESA95, % of GDP)

	2015	2016	2017
1 Primary GG balance – fiscal targets	-0.7	0.2	1.2
2 Primary GG balance – GG framework draft including measures	-1.0	-0.2	0.5
3 Primary GG balance – no-policy-change scenario (NPC)	-1.9	-1.5	-1.3
4 Overall consolidation need (1-3)	1.2	1.7	2.5
- y-o-y change (consolidation need for additional measures)	1.2	0.5	0.8
- overall consolidation need (1-3) in EUR million	904	1,385	2,134
- y-o-y change (consolidation need for additional measures)	904	482	748
The volume of measures beyond the framework need to achieve the target (1-2)	218	313	626
- in % of GDP	0.3	0.4	0.7
<i>p.m.: GG balance – fiscal targets</i>	-2.5	-1.6	-0.5

Source: MoF SR

A part of the required measures has been included in the draft general Government Budget Framework for 2015 – 2017. The main measures are maintaining revenue levels and improving the effectiveness of VAT collection, savings attributed to the ESO reform and measures related to combating tax evasion (e.g. obligatory cash registers for doctors, hotels and professional, scientific and technical services, documenting payments in official confirmations and withholding taxes for benefits from pharmaceutical companies for doctors and for iron scrap). The overall package of measures amounts to 0.5% of GDP in 2015 with a gradual increase to 0.6% of GDP in the following years (Table 21).

At the same time, the draft general government budget framework compared to the NPC scenario contains changes mainly on the expenditure side in the total volume of 0.4% of GDP in 2015 to 1.2% in 2017. Measures in the volume of 0.3% of GDP in 2015 to 0.7% in 2017 are needed to achieve the target deficits on top of the measures contained in the draft budget framework. The provisions of the constitutional act related to breaching of the 55% of GDP debt level already indicate that these measures will be on the expenditures side.

The attainment of the budgetary objectives is a prerequisite for stabilising the debt-to-GDP ratio. The general government gross debt reached 55.4% of GDP at the end of 2013. After attainment of the budgetary objective and changes in the Emergency Oil Stocks Agency (oil agency), in order to avoid increasing public debt, the share of debt on GDP will decrease to 55.2% of GDP in 2014. In the forecasted period, the debt will culminate at 56.2% of GDP in 2015, also thanks to the sale of the minority share of state in the Slovak Telekom. Subsequently the debt will fall below 55% of GDP. In spite of a subsiding slight increase of debt in the aftermath of the crisis, **the general government debt will remain below the reference benchmark set by the Pact throughout the whole period, as well as below the sanction limit of 57% of GDP resulting from the national debt brake. Such development will trigger certain mechanisms under the constitutional Fiscal Responsibility Act** (described in detail in Box 3).

The Stability Programme is based on macroeconomic and tax forecasts until year 2017 from February 2014. The macroeconomic scenario as well as the forecasted tax revenues are subject to preliminary discussion, approval and expert scrutiny by committees composed of national experts from both the public and private sector. The dates for disclosing forecasts as well as the guiding principles of the committees are laid down in the Fiscal Responsibility Act.

BOX 3 – Application of provisions of the Fiscal Responsibility Act

The general government gross debt reached 55.4% of GDP at the end of 2013. After confirming and publishing the actual debt by Eurostat on 23 April 2014, several corrective measures result from the fiscal responsibility act:

- From 16 May¹³, the Ministry of Finance cuts 3% of total expenditures of the state budget net of expenditures for the state debt service, EU funds and co-financing, contributions to the EU budget, transfers to the Social Insurance Agency and expenditures on the settlement of damage caused by natural disasters. The amount of expenditures which will need to be cut and which cannot be used as a result represents EUR 305m (calculations are included in the Table 11). Budget funds are cut only once, namely in the first year when the debt amount exceeded 55% (if the debt exceeds 55% of GDP for several subsequent years, funds are cut only in the first year when this limit was exceeded).

TAB 11 – Committing expenditures of the state budget in 2014 (ESA95)

	EUR mill.	% of GDP
1 Approved expenditures of the state budget for 2014	17,392	23.3
2 Expenditures on state debt service	1,398	1.9
3 EU funds	3,173	4.3

¹³ The transitory provisions (Article 12 (9)) lays down a transitory period in which sanctions resulting from breaching the 55% limit of the general government debt are not applied for the period of 24 months, starting from the first day following after the day when the Government Manifesto was approved and the confidence in the Government expressed. The Government Manifesto and the confidence in the Government was expressed on 15 May 2012, i.e. the transitory period lasts until 15 May 2014.



4 State budget funds for financing common projects of SR and EU	640	0.9
5 Contributions to the EU	727	1.0
6 Transfers to the Social Insurance Company	1,280	1.7
7 Expenditures on the settlement of damage caused by natural disasters	11	0.0
8 Aggregate for 3% cuts (1-2-3-4-5-6-7)	10,163	13.6
9 Volume of expenditures to be cut	305	0.41

Source: MoF SR (GGB 2014 – 2016)

- At the same time, the Government cannot submit to the National Council of SR a draft budget for 2015 – 2017 which contains a YoY nominal increase of general government expenditures (with the exception of expenditures on the state debt service, EU funds and co-financing, contributions to the EU budget and expenditures on the settlement of damage caused by natural disasters) until the debt has dropped below the above-stated limit. According to preliminary estimates, it will be necessary to decrease the draft of general government expenditures for 2015 in comparison with the budget framework for 2015 – 2017 by EUR 274m.
- Individual municipalities and higher territorial units are obliged to approve the budget for the following year with the expenditures not exceeding the expenditures of the budget of the previous year (excluding the EU funds, co-financing and expenditures on the settlement of damage caused by natural disasters). It means that in their budgets for 2015, municipalities and higher territorial units cannot approve higher expenditures than in the original budgets for 2014, approved at the end of 2013. According to the preliminary estimates of the MoF SR, based on the GGB balance for 2014 – 16 approved by the Government, it will be necessary to adjust the draft of the volume of budgeted expenditures of municipalities and higher territorial units by EUR 249m for 2015, by EUR 366m for 2016 and by EUR 409m for 2017.

TAB 12 – Maintaining expenditures of GG and of local governments at the level of the approved budget for 2014 (EUR mill.)

	2014*	2015	2016	2017
1 Nominal consolidated expenditures of GG	28,050	28,404	28,537	29,347
2 Expenditures on state debt service	1,411	1,404	1,528	1,593
3 EU funds (within GG)	1,198	1,365	1,090	1,390
4 State budget funds for financing common projects of SR and EU	640	586	426	480
5 Contributions to EU (excluding the EU resource based on VAT)	683	658	731	690
6 Expenditures on the settlement of damage caused by natural disasters	11	11	11	11
7 Adjusted GG expenditures (1 - 2 - 3 - 4 - 5 - 6)	24,107	24,380	24,752	25,183
8 Decreasing GG expenditures to the GGB level 2014 (7(t) - 7(2014))		-274	-645	-1,076
in % of GDP		-0.4	-0.8	-1.2

* approved GGB 2014 – 2016

Source: MoF SR

- The Government will send a written justification of the debt stock to the National Council, including proposed measures to decrease it.
- No funds from the reserve of the Prime Minister and the reserve of the Government may be disbursed.

Exceeding the limit of 57% of GDP would mean that the Government cannot submit a draft General government budget with a budgeted deficit to the National Council. Local governments would have the obligation to approve only a balanced or surplus budget for the following budget year. The current medium-term debt forecast does not project exceeding the debt limit of 57% of GDP with a sufficient buffer.

A special provision for local governments will start to be applicable according to the constitutional act from January 2015. If the overall debt of a municipality or a higher territorial units reaches 60% or more of actual current revenues of the previous year, the local governments are obliged to pay a fine of 5% from the difference between the overall debt and 60% of actual current revenues of the previous year.

III.1. General government balance development in 2013 and its impact on the budget in 2014

A thorough assessment of the state of play in public finances is a key prerequisite for setting realistic targets in the general government budget. This sub-chapter summarized basic information about the outcome of the general government balance in 2013.

III.1.1. General government balance in 2013

Under the General government budget for 2013 – 2015, the Government's fiscal target for 2013 was defined as reaching the general government deficit of 2.94% of GDP. This target reflects the recommendations of the Council of EU and it is a necessary condition for abrogating the Excessive Deficit Procedure. The actual deficit reached 2.77% of GDP, which means an improvement by 0.17% of GDP compared to the budget. The consolidation effort of 1.9% of GDP was one of the highest ones since joining the EU. Compared to the NPC scenario, the amount of consolidation measures reached 2.2% of GDP.

In autumn 2014, a new ESA2010 national accounts methodology will enter into force, which will be used to notify GG balance and gross debt also retrospectively for 2013. According to this methodology, there is substantial risk of excluding revenues stemming from a transfer of accumulated assets from the fully-funded pillar (second pillar) to the first pillar in the amount of 0.33% of GDP. A decision on abrogating the Excessive Deficit Procedure in June 2014 will be based on the ESA95 methodology.

Compared to the budget, **state budget revenues from taxes**¹⁴ were EUR 100m lower (0.14% of GDP) due to the deteriorated macroeconomic development. Higher VAT collection effectiveness measured by an effective tax rate and better developments of the macroeconomic base resulted in higher VAT revenues. The revenue from the tax on mineral oils was negatively affected by a decreased diesel consumption as well as due to the long-term trend of falling demand for gasoline. Lower profitability of companies as well as smaller growth of nominal GDP led to a lower estimate of corporate tax revenues. Personal income tax revenues were affected by a worse-than-expected development on the labour market in 2013, when the growth of wages and employment was lagging behind original expectations. Moreover, a higher-than-expected positive impact from increasing contributions was partly offset by lower personal income tax revenues, as contributions represent a tax allowance from the base of this tax.

TAB 13 – Change in tax revenues of the state budget compared to the budget in 2013

	EUR mill.	in % of GDP
Value added tax	244	0.3
Corporate income tax	-231	-0.3
Personal income tax (from self-employment)	-44	-0.1
Excise taxes	-43	-0.1
Other (incl. sanctions)	-26	0
Total	-100	-0.14

Non-tax revenues were lower than budgeted for the following reasons:

- **The shortfall from the sale of frequency licences** (the so-called digital dividend) amounting to EUR 130m (0.2% of GDP). The revenues from this auction positively influenced the budget only in 2014, amounting to EUR 164m.
- The approved budget for 2013 expected revenues **from the sale of emergency oil stocks** to the oil agency in the amount of EUR 100m in 2013. The sale worth 465m was realised, but according to a

¹⁴ Only contributions from the economically active population and insurance arrears are compared because only these have an impact on the general government balance.



Eurostat decision, the sale was classified as a financial operation with no impact on revenues of general government due to the continuing state control over the oil stocks.

- Payment of **dividends was lower** by EUR 94m than budgeted. The plan from October 2013 to pay out dividends of Slovenský plynárenský priemysel (SPP), amounting to EUR 365m, and Slovenská elektrizačná prenosová sústava (SEPS), amounting to EUR 78m, from the operation profit of the year 2012 only in 2014 was not carried out. A Eurostat mission concluded that only dividends paid from the profit/loss of the previous year can be considered as revenues.¹⁵ In 2013, the General Assembly of SPP decided on paying out these dividends with accrual impact already in 2013. Furthermore in 2013, the Ministry of Finance, in the competence of the General Assembly of SEPS, decided on paying out dividends from 2012 profits with an accrual impact in 2013. Compared to the approved budget, the accrual revenue from SEPS was higher by EUR 52m. Due to the postponed sale of SPP, i.e. retaining the 51% share by the state, the accrual revenue from SPP dividends was lower by EUR 115m.
- With regard to the decrease of prices of **emission permits on the stock exchange** compared to budget assumptions, the revenues from their sales were lower by EUR 43m.

TAB 14 – General government balance in 2013

	EUR mill.	% of GDP
1 General government balance – budget (ESA95)	-2,187	-2.94
Tax revenues of the state budget	-100	-0.14
Non-tax revenues	-269	-0.37
- shortfall of revenues from the digital dividend (income in 2014)	-130	-0.18
- shortfall of revenues from oil sale	-100	-0.14
- payment of dividends in 2013 (in particular SPP and SEPS)	-94	-0.13
- shortfall of revenues from emission permits (state budget + EF)	-43	-0.06
- changes of other than tax revenues of the state budget	98	0.14
Other effect of the state budget	-30	-0.04
Creation of reserves for the debt of healthcare providers	-18	-0.03
Savings of other expenditures of the state budget and other effects	183	0.25
Transfers related to EU	152	0.21
- savings of co-financing funds	261	0.36
- EU corrections	-125	-0.17
- contributions to the EU budget and other effects	16	0.02
Extra-budgetary accounts of the state budget	70	0.10
Savings in expenditures on state debt service	61	0.08
The Railways of the Slovak Republic	58	0.08
Improved fiscal performance of public universities	49	0.07
Improved fiscal performance of local governments	24	0.03
Other general government entities	12	0.02
2 General government balance – current estimate (ESA95)	-1,995	-2.77
<i>p.m. change in budget balance due to downward revision of nominal GDP estimate (2-1)</i>		<i>-0.09</i>
<i>Note: (+) means a positive effect and (-) negative effect on GG balance</i>		<i>Source: MoF SR</i>

Other effects of the state budget represent a negative impact of EUR 30m. The increase in receivables (claims) has a positive impact of EUR 83m, while the increase of liabilities has a negative impact of EUR 161m and a lower transfer to the Social Insurance Agency due to lower insurance expenditures has a positive impact of EUR 48m.

¹⁵ According to ESA95, dividends (company's profit/loss from the previous year) may be postponed for not more than two years only if such operation serves to smoothen the dividend payment profile.

Another factor which worsened the fiscal performance of the state was **the creation of a reserve for liabilities of healthcare providers** in the amount of EUR 18m which were not a part of the approved budget. Compared to the previous year when the state assumed liabilities in the amount of EUR 130m, this represents a **significantly lower need for reserves formation for liabilities of hospitals**. The amount of EUR 18m aligns the amount of assumed liabilities so that the total is in line with the data of the Ministry of Health of the Slovak Republic.

Transactions related to the EU budget have had a positive impact on the balance in the amount of EUR 152m (0.2% of GDP). Due to lower use of EU funds at the level of 57% compared to budgetary expectations, the amount of expenditures on co-financing fell by EUR 261m. Based on the decision by the European Commission on a higher rate of irregularities in drawing of EU funds, Slovakia will not be reimbursed EUR 125m from already used resources for the programming period of 2007 – 2013. The EC's decision has also an impact on the higher share of co-financing of ongoing projects for the following years.

Other impacts on the state budget balance include:

- **Savings in other expenditures of the state budget**, due to decisions at the level of line ministries as well as several changes in state financial assets in the amount of EUR 183m, out of which approximately EUR 95m are savings on capital expenditures;
- Cheaper refinancing of the state debt led to **savings on debt service** in the amount of EUR 61m;
- **Increase of other non-tax revenues**, in particular higher grants and transfers and administrative fees with a total positive impact of EUR 98m;
- **Savings in extra-budgetary accounts** of state budget entities in the amount of EUR 70m. The main factor behind this development is the payment of December wages in 2012 already in December 2012 in the process of abolishing autonomous budgetary organizations (Regional Police Directorate, Regional Directorate of Fire and Rescue Services and District Offices) with an impact of EUR 57m.

Regarding other GG entities, the highest impacts compared to the budget were observed in:

- **Local governments achieved better fiscal results** by EUR 24m. Of which higher territorial units improved their fiscal performance by EUR 38m due to higher non-tax revenues. On the contrary, municipalities had worsened their fiscal development by EUR 14m.
- **Fiscal performance of public universities** improved by EUR 49m, particularly due to higher non-tax revenues and administrative fees;
- **The Railways of the Slovak Republic were reclassified** into the general government sector, with a retroactive effect from 2011. The positive impact on the GG balance in 2013 represented EUR 58m.

III.1.2. Measures adopted in 2013

The 2013 general government budget set the fiscal target of general government deficit at 2.94% of GDP. The deficit figures notified by Eurostat for 2013 are better-than-budgeted, amounting to 2.77% of GDP. The quantification of consolidation measures were assessed under the NPC assumptions, with the baseline year 2012. Under the NPC scenario, the general government deficit would have reached 4.9% of GDP in 2013. By comparing this NPC scenario with the general government balance outcome, the magnitude of the necessary consolidation measures can be quantified, which represents 2.2% of GDP in 2013.

TAB 15 – List of measures in 2013 (difference against the NPC scenario)

	EUR mill.	% of GDP
1 Increase and unification of the maximum assessment bases of social security contributions	160	0.2
2 Increase in social security contributions for self-employed and other related changes	27	0.0
3 Health and social insurance contributions for workers by agreement	134	0.2
4 Changes in the fully-funded pillar	695	1.0
5 Extension of a special levy in the banking sector	92	0.1



6 Levy on enterprises in regulated industries	79	0.1
7 Changes in income tax rates	283	0.4
8 Re-introduction of television/radio licence fee	74	0.1
9 Limitation of lump-sum allowance for the self-employed	18	0.0
10 Other tax and SSC measures	24	0.0
11 Increased receivables of the state budget	107	0.1
12 Increasing the vehicle registration fee	27	0.0
13 Higher balances in extra-budgetary accounts	94	0.1
14 Higher non-tax revenues of local governments and other GG entities	63	0.1
15 Grants and transfers	70	0.1
16 Higher wage expenditures of the state budget	-40	-0.1
17 Higher wage expenditures of local governments	-65	-0.1
18 Higher expenditures on goods and services of the general government	-195	-0.3
19 Lower expenditures in healthcare	74	0.1
20 Higher current transfers	-187	-0.3
21 Higher capital expenditures of the state budget	46	0.1
22 Higher capital expenditures of the Railways of SR	-90	-0.1
23 Lower expenditures of other GG entities	44	0.1
Total	1,557	2.2

Note: these are impacts on the GG balance, (+) means improvement and (-) worsening of the balance

1. Increase and unification of the maximum assessment base of SSC

As of January 2013, the maximum assessment bases for the calculation of social and health insurance contributions (except for accident insurance which is not capped) have been unified to five times the average wage.

2. Increase in social contributions for self-employed plus other related changes

As of January 2013, the minimum assessment base for the self-employed has been increased from the original 44.2% to 50% of the average monthly wage. The assessment base for those paying health insurance voluntarily has also increased.

3. Health and social insurance contributions for workers by agreement

Since January 2013, temporary agreement workers are no longer exempted from social security contributions. However, some exceptions apply for secondary and tertiary students earning less than the specified monthly income threshold (EUR 66 or EUR 155 respectively) and for certain groups of pensioners, particularly those entitled to old-age and disability pension. The contribution rates for these categories of workers by agreement are reduced.

4. Changes in the fully-funded pillar

Significant changes occurred in the fully-funded pillar where, as of September 2012, the rate of contributions has been cut from 9% to 4%. From 2017, the rate of contributions to the fully-funded pillar will be increasing by 0.25 p.p. annually, until the contributions rate reaches 6% in 2024. Moreover, from September 2012 to the end of January 2013 the fully-funded pillar was opened to opt-out from the scheme. In order to compensate for the reduced rate, voluntarily contribute to this pillar were allowed. These private contributions are subject to a more favourable tax regime up to 2% of the individual's tax base, with a cap set at 2% of the maximum assessment base. The pension reform also included a major reform of the first-pillar, which significantly improved its long-term sustainability (further information in part V).

5. Extension of a special levy in the banking sector

As of September 2012, the base for the calculation of the special banking levy was extended to also include the value of protected deposits (exempt before). The rate of the levy will be gradually reduced depending on the



amount of the accumulated levy payments and the total assets in the banking sector. In the first step (when the total amount of the levy collected exceeds EUR 500m), the levy rate will be reduced from 0.4% to 0.2% and, in the second step (when the total amount of the levy collected exceeds EUR 750m), to 0.1%. The rate may be also be reduced to zero provided that the total amount of the levy collected exceeds EUR 750m and, at the same time, it reaches 1.45% of total assets in the Slovak banking sector. The law also envisages a situation where the total amount of the levy collected subsequently falls below 1.45% of total assets in the Slovak banking sector – in such a case, the levy rate will be raised from 0% to 0.05%.

6. Introduction of a levy on business in regulated industries

In October 2012, a levy on business in regulated industries has been introduced. It applies to companies whose revenues from regulated activities amount to at least 50% of their total revenues and whose profit exceeds EUR 3m.

7. Changes in income tax rates

A second tax rate (25%) for personal income tax has been introduced in 2013. This tax rate applies on gross monthly income at the level of approximately EUR 3.311 (equal to 4-times of the average wage). The corporate income tax rate has been raised from 19% to 23%.

8. Retaining licence fees for public-service broadcasting of Slovak Radio and Television (television/radio licence fee)

The Slovak Radio and Television will continue to be financed through licence fees payable for public-service broadcasting. The change adopted in 2011 envisaged full funding of the public radio and television from the state budget. However, the original system of licence fees has been maintained as part of the consolidation package.

9. Limitation of the lump-sum allowance for self-employed

As of 2013, a maximum monthly threshold for lump-sum allowance (40% of incomes) for self-employed has been introduced (in the amount of EUR 420 per month). Furthermore, since 2013 lump sum allowances can no longer be applied on income from renting property.

10. Other tax and levy changes

The other changes include, in particular, an increase in the minimum rate of excise tax on cigarettes and adjustments of other tax rates applicable to tobacco products. The measure also includes increased levies on lotteries and changes in the taxation of gambling. Other changes include the introduction of a special income tax rate for selected constitutional officials at 5% on top of the standard rate, restrictions concerning the basic tax allowance for the spouse, exemptions of certain types of in-kind income, and exemption of income from the sale of assets by municipalities and self-governing regions.

11. Increased receivables of the state budget

In 2013, we saw higher other receivables (claims) of individual chapters of the state budget compared to outcome in 2012

12. Increasing the vehicle registration fee

Administrative fees have been increased for vehicle registrations.

13. Higher balances in extra-budgetary accounts

The difference in extra-budgetary accounts (EBA) compared to the end of 2012 was partly caused by the fact that wages for December were paid already in 2012, so they did not increase the EBA. On the contrary, in 2013 wages were paid only in 2014, increasing the EBA in the amount of EUR 57m.

14. Higher non-tax revenues of local governments and other GG entities

Local governments had higher revenues from administrative fees and other non-tax revenues. The increase in non-tax revenues can also be seen in the Railways of SR which were included in general government.

15. Grants to municipalities and self-governing regions



The general government's revenues also include grants received by municipalities and self-governing regions (from foreign sources other than EU funds), but they are not taken into account in the budgeting process. In case of grants are actually received, they contribute positively to revenues.

16. – 17. Higher wage expenditures of the state budget and of local governments

Wage expenditures of contributory organisations and budgetary organizations decreased, except for the regional education. Employees in civil and public service, police and armed forces saw a significant wage decrease. On the contrary, wage expenditures of regional-education employees from the state budget in 2013 increased by 5% (EUR 45m). Wages of constitutional officials, judges and prosecutors slightly increased. The total wage expenditures of general government have thus increased compared to the previous year.

18. Higher expenditures on goods and services of general government

Expenditure of the general government on goods and services increased.

19. Lower expenditures in healthcare

The expenditure in healthcare decreased mainly as a result of a lower assumption of overdue liabilities.

20. – 23. Higher current and capital transfers (except for the state budget)

Higher capital expenditures were affected mainly by inclusion of the Railways of SR in the GG sector. Savings were achieved in the state budget compared to the NPC. Current expenditures increased compared to the NPC scenario.

III.1.3. Developments in 2014

The expected development in 2014 is based on the updated macroeconomic and tax forecast and the development of other items of the general government budget. The current GG balance estimate in 2014 is 2.84% of GDP, indicating risks in the amount of 0.2 in % of GDP compared to the approved GG budget with the projected deficit of 2.64% of GDP. The impact on the balance was positive on the side of the state budget, outweighed by a negative impact on the side of other GG entities. The negative impact on the estimate may be attributed to several factors, in particular to lower revenues from dividends and a lower revenue from the sale of frequency licences to telecommunication operators.

TAB 16 – Development in 2014 (ESA 95)

	EUR mill.	% of GDP
1 General government balance – budget	-2,000	-2.64
State budget	293	0.39
Tax and levy revenues	-51	-0.07
- cancelled reserve for VAT	-250	-0.34
- revised tax-SSC forecasts, including changes in estimates of local taxes	199	0.27
Non-tax revenues	-41	-0.06
- shortfall of revenues from the digital dividend	-86	-0.12
- fine related to a cartel agreement in construction (Antimonopoly Office of SR)	45	0.06
Abolition of the reserve for better tax collection (on the side of expenditures)	250	0.34
Special revenue from a levy on enterprises in regulated industries	176	0.24
SEPS dividends	-78	-0.10
Lower transfer to the Social Insurance Company	31	0.04
Other	6	0.01
Other general government entities	-408	-0.55
Municipalities and Higher territorial units	-26	-0.03
NPF	-381	-0.51
of which: SPP dividends	-365	-0.49
Other entities	-2	0.00
2 General government balance – current estimate	-2,115	-2.84
<i>p.m. change in budget balance due to downward revision of nominal GDP estimate (2-1)</i>		<i>-0.05</i>

Note: (+) means a positive effect and (-) negative effect on GG balance

Source: MoF SR



The most significant negative impact compared to the budget is the shortfall of the NPF revenues from **SPP dividends** in the amount of EUR 365m from the 2012 operational profit, which were supposed to be paid out in 2014 according to the approved budget, but the SPP General Assembly decided to pay them out already in 2013 with an accrual impact in 2013. At the same time there was a **shortfall of revenues from SEPS dividends** from the 2012 operating profit in the amount of **EUR 78m** which were paid already in 2013.

As for **non-tax revenues**, a **negative impact of EUR 41m** is expected. It was caused by a lower revenue from auctions of frequency licences (digital dividend). Additional revenues from the fine imposed by the Antimonopoly Office of SR (PMU) for a cartel agreement in construction industry, which became effective in March 2014, were supposed to have a positive impact on the budget. In 2006, PMU imposed a fine of EUR 45m on six construction companies for having concluded a cartel agreement. The construction companies challenged the decision in court. In March 2014, the ruling of the Supreme Court became effective which dismissed the objections of the construction companies and confirmed the PMU fine in the matter of the cartel agreement. The fine will increase the non-tax revenues by 0.06% of GDP in 2014.

As for other GG entities, **local governments** contributed to worsening the general government balance by the amount of EUR 26m, particularly as a result of a lower collection of proportional taxes.

Update of the macroeconomic and tax forecast lead to a higher estimate of tax revenues for 2014 compared to the previous tax forecast. **Although the tax and levy revenues are lower by EUR 51m compared to the budget**, it is a result of dissolving the reserve of EUR 250m allocated for improvement of tax collection. The reserve was both on the revenues and expenditures side, it had no impact on the GG deficit as a result. Thanks to the **cancellation of the reserve on the expenditures side as well, the total impact on the GG balance is positive, amounting to EUR 200m.**

In 2014, there is a **one-off increase in a special Levy on enterprises in regulated industries by EUR 176m** (0.25% of GDP) in the context of significant changes in the ownership structure of SPP.

Other state budget savings are related to the expenditures side of the budget. Transfer to the Social Insurance Company is reduced, mainly due to higher estimated revenues from social insurance in the amount of EUR 31m. Update of the macroeconomic forecast has also an impact on the budget. As a result of decreasing the estimate of the nominal GDP, it is necessary to adopt additional measures amounting to 0.05% of GDP in order to meet the deficit target of the general government (expressed as a share on GDP).

As the estimate of the expected reality is only based on cash data for the first few months of the year, there are still risks of achieving the budgetary objectives connected to a different macroeconomic development and to a related impact on revenues of general government. Another risk is the financial management of municipalities and self-governing regions and potential indebtedness of hospitals.

III.2. Medium-term budgetary outlook

The Ministry of Finance of the Slovak Republic has prepared a draft of the General Government Budget Framework for 2015 –2017 with minimum modifications of budgetary objectives compared to the approved GG budget. The general government deficit for 2015 is set at 2.49% of GDP and in the following years the deficit is expected to fall to 1.61% of GDP in 2016 and 0.54% of GDP in 2017.

TAB 17 – Changes in fiscal targets of general government (in % HDP)					
	2013	2014	2015	2016	2017
1 GG budget for 2013 – 2015	-2.9	-2.4	-1.9		
2 Draft GG budget framework for 2014 – 2016	-2.9	-2.6	-2.0	-1.3	
3 GG budget for 2014 – 2016	-3.0	-2.6	-2.6	-1.5	
4 Draft GG budget framework draft for 2015 – 2017	-2.8	-2.6	-2.5	-1.6	-0.5
Change compared to the GG budget 2013 – 2015 (4-1)	0.2	-0.2	-0.6		
Change compared to the GG budget 2014 – 2016 (4-3)	0.2	0.0	0.1	-0.1	

Source: MoF SR

III.2.1. The scenario is based on the NPC assumption

This section aims to quantify the impact of the measures incorporated in the draft budgetary framework and to define the size of additional measures necessary to meet the fiscal targets. The so-called NPC scenario is used to quantify the measures, while it is based on the currently expected deficit for 2014 in the amount of 2.84% of GDP¹⁶. Then the general government balance can be estimated in the medium-term perspective. By comparing this scenario with the general government balance targets, the size of the necessary additional measures can be quantified.

The estimation of the no-policy-change scenario was based on the **updated estimate of general government deficit in 2014 at 2.84 in % of GDP**. Assuming no changes in economic policies, the general government deficit would amount to 3.7% of GDP in 2015, fall to 3.3% of GDP in 2016 and decrease to 3.0% of GDP at the end of the forecast period.

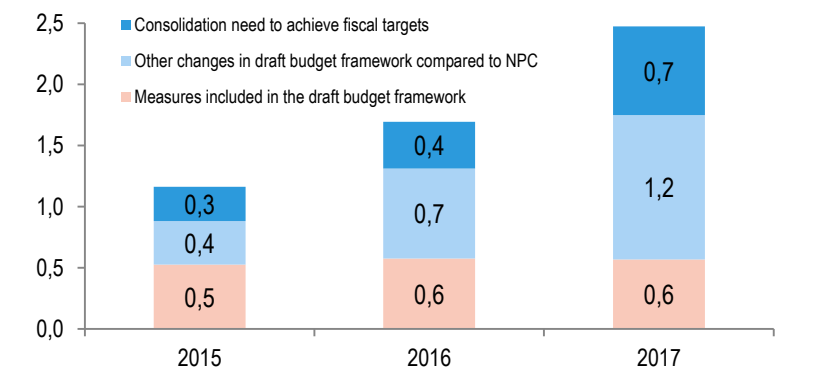
TAB 18 – Balance of revenues and expenditures of general government – NCP scenario (ESA95, % of GDP)					
	ESA code	2014	2015	2016	2017
1 Total revenues	TR	35.2	33.4	32.5	32.3
Tax revenues		16.3	15.5	15.3	15.1
Taxes on production and imports	D.2	10.1	9.6	9.4	9.2
- of which: VAT (excluding VAT – EU resource)	D.211 S.13	6.3	5.9	5.9	5.9
- of which: Excise taxes	D.214A	2.7	2.6	2.5	2.4
Current taxes on income, wealth	D.5	6.1	5.9	5.9	5.9
- of which: Personal tax income	D.51A	2.6	2.7	2.7	2.7
- of which: Corporate income tax	D.51B	2.6	2.6	2.6	2.6
- of which: Withholding income tax collected by deduction – budgetary classification	D.51E	0.2	0.2	0.2	0.2
Social security contributions	D.61	13.3	13.2	13.1	13.0
Non-tax revenues		2.4	2.2	2.0	2.0
Grants and transfers	D.39+D.7R+D.9R	3.2	2.6	2.1	2.3
2 Total expenditures	TE	38.0	37.1	35.8	35.4
Current expenditures		35.5	34.0	33.2	32.5
Compensations of employees	D.1P	7.0	6.8	6.7	6.6
Intermediate consumption	P.2	4.6	4.3	4.0	4.0
Subsidies	D.3P	1.0	0.9	0.8	0.8
Interest payments	D.41P	1.8	1.8	1.8	1.7
Total social transfers	D.6P	18.4	18.0	17.8	17.5
- Social transfers other than in kind	D.62P	13.4	13.1	12.9	12.6
- Social transfers in kind(health care providers)	D.631P	5.0	4.9	4.9	4.9
Other	D.7P+D.2+D.5	2.7	2.3	2.1	2.0
Capital expenditures		2.5	3.0	2.6	2.7
Capital investments	P.5+K.2	1.9	2.3	2.2	2.4
- Gross fixed capital formation	P.51	2.1	2.4	2.3	2.5
Capital transfers	D.9P	0.6	0.7	0.4	0.3
3 Net lending/borrowing (1-2)	B.9	-2.8	-3.7	-3.3	-3.0
4 Primary GG balance	B.9+D.41P	-1.0	-1.9	-1.5	-1.3

Source: MoF SR

¹⁶ Supposing that the target deficit of 2.64% of GDP is achieved in 2014, the permanent measures will also include the consolidation need in 2015 – 2017, lower compared to the values presented in this part.

Comparison of this scenario with fiscal targets identifies the size of measures which need to be implemented. The general government balance indicator may provide a somewhat distorted picture, because the meeting of the target values will simultaneously reduce interest payments in comparison with the no-policy-change scenario. For this reason, it is more appropriate to compare primary balances, i.e., general government balance net of debt interest payments. Under the no-policy-change scenario, the primary balance would amount to -1.9% of GDP in 2015 with a gradual improvement to -1.3% of GDP in 2017.

CHART 21 – Need for measures compared to the no-policy-change scenario (p.p.)



Source: MoF SR

In order to achieve the targets, it will be necessary to adopt measures to improve the primary general government balance in total by EUR 904m (1.2% of GDP) in 2015, by EUR 1 385m (1.7% of GDP) in 2016 and by EUR 2 134m (2.5% of GDP) in 2017. The figures represent the cumulative amount of measures compared to the NPC scenario; this means that in the event of adoption of permanent (structural) measures, the need for additional measures decreases in the following periods by the volume of already adopted measures. **With the assumption of permanent measures, the overall need for measures amounted to EUR 904m (1.2% of GDP) in 2015, EUR 482m (0.5% of GDP) in 2016 and EUR 748m (0.8% of GDP) in 2017.**

TAB 19 - Overall consolidation need to achieve fiscal targets compared to NPC (ESA95, % of GDP)

	2015	2016	2017
1 Primary GG balance – fiscal targets	-0.7	0.2	1.2
2 Primary GG balance – GG framework draft including measures	-1.0	-0.2	0.5
3 Primary GG balance – no policy change scenario (NPC)	-1.9	-1.5	-1.3
4 Overall consolidation need (1-3)	1.2	1.7	2.5
- y-o-y change (consolidation need for additional measures)	1.2	0.5	0.8
- overall consolidation need (1-3) in EUR million	904	1,385	2,134
- y-o-y change (consolidation need for additional measures)	904	482	748
<i>p.m.: GG balance – fiscal targets</i>	-2.5	-1.6	-0.5

Source: MoF SR

A comparison of the draft budgetary framework excluding the measures specified below with the NPC scenario shows differences mainly in public expenditures where savings are expected compared to the NPC scenario.

- **Savings in capital expenditures;** higher capital expenditures result from the no-policy-change scenario assumptions compared to the draft budgetary framework, in the amount of 0.3% of GDP in 2015 and 0.4% of GDP in 2016 and 2017.
- **Savings in wages;** the draft budgetary framework assumes lower wage expenditures compared to the NPC scenario in 2016 and 2017.
- **Savings in social transfers;** the draft budgetary framework expects lower expenditures on social transfers in the amount of 0.1% of GDP in each year compared to the NPC scenario.



- **Changes in revenues;** the draft budgetary framework expects lower revenues from contributions and grants and transfers, compensated for by higher non-tax revenues compared to the NPC scenario with an impact on total revenues in 2015 and 2016.

TAB 20 – General government balance – GG Budget Framework 2015 – 2017 and NPC (ESA95, in % of GDP)							
	2014 OS	GG budgetary framework excluding measures			Difference compared to NPC		
		2015	2016	2017	2015	2016	2017
Total revenues	35.2	33.4	32.5	32.3	-0.1	-0.1	0.0
Tax revenues	16.3	15.5	15.3	15.1	0.0	0.0	0.0
Taxes on production and imports	10.1	9.6	9.4	9.2	0.0	0.0	0.0
- of which: Value added tax	6.3	5.9	5.9	5.9	0.0	0.0	0.0
- of which: Excise taxes	2.7	2.6	2.5	2.4	0.0	0.0	0.0
Current taxes on income, wealth	6.1	5.9	5.9	5.9	0.0	0.0	0.0
- of which: Personal tax income	2.6	2.7	2.7	2.7	0.0	0.0	0.0
- of which: Corporate income tax	2.6	2.6	2.6	2.6	0.0	0.0	0.0
- of which: Withholding tax on capital income	0.2	0.2	0.2	0.2	0.0	0.0	0.0
Social security contributions	13.3	13.1	13.0	12.9	-0.1	-0.1	-0.1
Non-tax revenues	2.4	2.3	2.1	2.1	0.1	0.1	0.1
Grants and transfers	3.2	2.5	2.0	2.2	-0.1	-0.1	-0.1
Total expenditures	38.0	36.7	35.0	34.2	-0.4	-0.8	-1.2
Current expenditures	35.5	33.9	32.9	31.9	-0.1	-0.4	-0.7
Compensations of employees	7.0	6.8	6.5	6.2	0.0	-0.2	-0.4
Intermediate consumption	4.6	4.4	4.1	3.9	0.0	0.0	0.0
Subsidies	1.0	0.9	0.8	0.8	0.0	0.0	0.0
Interest expenditure	1.8	1.8	1.8	1.7	0.0	0.0	0.0
Total social transfers	18.4	17.9	17.7	17.4	-0.1	-0.1	-0.1
- Social transfers other than in kind	13.4	13.0	12.8	12.5	-0.1	-0.1	-0.1
- Social transfers in kind(health care providers)	5.0	4.9	4.9	4.8	-0.1	-0.1	-0.1
Other	2.7	2.3	2.0	1.9	0.0	-0.1	-0.1
Capital expenditures	2.5	2.7	2.1	2.3	-0.3	-0.4	-0.5
Capital investments	1.9	2.0	1.8	2.0	-0.3	-0.4	-0.4
- Gross fixed capital formation	2.1	2.1	1.9	2.1	-0.3	-0.4	-0.4
Capital transfers	0.6	0.7	0.3	0.3	0.0	-0.1	-0.1
Net lending/borrowing	-2.84	-3.3	-2.6	-1.8	0.4	0.7	1.2

Source: MoF SR

III.2.2. Description and quantification of the measures necessary to achieve fiscal targets

The previous part described the size of overall consolidation measures. This part deals with measures included in the draft GG framework for 2015 – 2017, submitted to the Government of the SR. The overall impact of quantified measures on the general government balance amounts to 0.5% of GDP in 2015, 0.6% of GDP in 2016 and 2017

TAB 21 – Measures included in the draft General government budget framework 2015 – 2017 (ESA95)*						
	EUR mill.			% of GDP		
	2015	2016	2017	2015	2016	2017
Revenue measures	303	368	383	0.39	0.45	0.44
1 Maintaining the VAT revenue and increasing the effectiveness of VAT collection	227	236	248	0.29	0.29	0.29



2 Broadening of obligations to use cash registers for doctors and other professions	71	71	71	0.09	0.09	0.08
3 Withholding income tax on financial and non-financial benefits from pharmaceutical companies for doctors	5	5	5	0.01	0.01	0.01
4 Annual clearing of social insurance contributions	0	56	59	0.00	0.07	0.07
Expenditure measures	106	102	107	0.14	0.12	0.12
5 Savings on wages (ESO)	66	66	66	0.08	0.08	0.08
6 Savings in intermediate consumption (ESO)	40	36	41	0.05	0.04	0.05
TOTAL	409	470	489	0.53	0.57	0.57

Note: (+) indicates positive and (-) negative effects on the budget balance in ESA 95 methodology

Source: MoF SR

1. Keeping VAT revenue and increasing the effectiveness in VAT collection

Maintaining the VAT revenue and increasing the effectiveness of VAT collection will raise an additional annual revenue of EUR 227 – 248 million in 2015 – 2017.

2. Broadening the obligation to use electronic cash registers for doctors and other professions

The Government will broaden the obligation to use electronic cash registers (ECR) to record the revenues to outpatient general practitioners, specialists, dentists, in the area of expert, scientific and technical activities and accommodation services. It also assumes introducing the obligation to attach a payment confirmation (receipt or electronic transfer confirmation) to official documents issued by private entities (e.g. public notaries, lawyers, doctors, experts). The measure will support the effort to combat tax evasion. For medical services only, the difference between the expenditures of households (according to the SO SR) and the reported revenues of relevant doctors' offices (according to the data of the Ministry of Health) was approximately EUR 214m in 2011. As for expert, scientific and technical activities and accommodation services, the estimated gap in VAT represents more than the half of the potential level. The expected revenue from this measure is EUR 71m as of 2015. The resulting impact of the measure is based mainly on estimates of the sector VAT gap in Box 7.

3. Implementation of the withholding income tax on cash and in-kind benefits from pharmaceutical companies and revenues from the sale of iron scrap

Revenues of doctors and healthcare providers from cash and in-kind benefits from pharmaceutical companies and revenues from the sale of iron scrap will be subject to direct taxation upon a payment in the form of a withholding income tax (19%). This change will increase the efficiency of tax collection. In the case of revenues from pharmaceutical companies, there has been identified a significant difference between official reporting of these companies based on the legislative obligation from 2011 (approximately EUR 40m annually), reports of individual natural persons in their tax returns. The data concerning cash and in-kind benefits of pharmaceutical companies to individual doctors and healthcare providers will be published on the internet. With regard to the overall volume of funds for marketing, promotion and in-kind benefits in the amount of EUR 40m and the current level of personal income taxation of these revenues, we expect a positive impact of EUR 5m annually. Revenues from the sale of iron scrap will be taxed similarly.

4. Introduction of annual clearing in SSC

Introduction of annual clearing of social contributions (clearing of the SSC advances at the end of the calendar year) will remove the possibility to optimize SSC in the form of accumulation of high one-off monthly remunerations in order to exceed the maximum assessment base in the particular month. Social contributions will thus reflect the incomes of individuals for the whole year in a more faithful way. Currently there are several alternatives, while the above-stated positive impact corresponds to the most preferred one of them. A positive budgetary impact of the measure is expected as late as in 2016.

5. Additional measures within the ESO reform

Other savings in public expenditures will be achieved since 2015 within the ESO reform in the amount of EUR 106m annually. Out of that EUR 40m will be saved in goods and services and EUR 66m in wage expenditures. Savings will be achieved mainly through optimization of the number of budgetary and contributory state organizations. Implementation of limits based on efficiency of the organizations, will be



considered in order to rationalize expenditures on performance of their activities. Moreover, steps to unify and reorganize the communication infrastructure with the aim to achieve particular savings in the following years are currently being prepared. Expenditures on air tickets and travel expenditures will also be included in the savings.

Compared to the draft budget framework, achievement of the budget target for 2015 requires adoption of additional measures in the amount of 0.3% of GDP, 0.4% of GDP for 2016 and 0.7% of GDP for 2017. These measures will be specified in the course of preparation of the budget for 2015 – 2017 during 2014. The obligation not to increase expenditures of the general government above the previous approved budget resulting from breaching the 55% debt threshold of the constitutional act – indicates that also additional measures beyond the budget framework draft will be on the expenditure side.

In the next period the Slovak Government will focus on measures in the following areas:

- Regarding the taxation of real estate, the possibilities to introduce a minimum tax rate (depending on the location and other relevant characteristics of the real estate) will be considered, in line with recommendations of the EC and OECD. Increase of the property tax would create room for a decrease in other more distortionary taxes with regards to economic growth.
- A set of measures is being prepared, related to cancellation or modification of the existing tax expenditures in direct taxation.

III.3. Structural balance and fiscal position of public finance

Due to the assumption of abrogation of the Excessive Deficit Procedure (part I.4) at the time of the EC assessment in 2014, fiscal policy of SR from 2014 will be subject of the rules of the preventive arm of the Pact. The basis for setting targets of the fiscal policy is to achieve the required structural consolidation effort, defined as a year-on-year change of the structural general government balance. The second pillar of the preventive arm of the Pact is compliance with the expenditure benchmark which requires limiting the growth of general government expenditures in line with the consolidation effort requirements to achieve the medium-term budgetary objective. As the EC assessment is decisive for implementation of the Pact rules, the analytical indicators presented in this part of the Stability Programme reflect the EC methodology as closely as possible.

TAB 22 – Consolidation effort (ESA95, in % of GDP)¹⁷					
	2013	2014	2015	2016	2017
1 Net lending/borrowing	-2.77	-2.64	-2.49	-1.61	-0.54
2 Cyclical component	-1.2	-1.1	-0.7	-0.3	0.2
3 One-off effects	0.3	0.6	0.0	0.0	0.0
- temporary special levy on enterprises in regulated industries from SPP		0.24			
- opt-out from the fully-funded pillar	0.33				
- digital dividend		0.22			
- repayment of the non-returnable financial assistance to Cargo		0.11			
- fine of the Antimonopoly Office		0.06			
4 Structural balance (1-2-3)	-1.9	-2.2	-1.8	-1.3	-0.7
Consolidation effort according to EC	1.9	-0.26	0.45	0.5	0.6
Investment clause: co-funding of EU projects		0.7			
Consolidation effort adjusted by the investment clause		0.4			

Source: MoF SR

The first step in the calculation of the **general government structural balance** is the adjustment of the real (officially notified) general government balance for the **cyclical component**. The cyclical component expresses

¹⁷ Differences in totals are caused by rounding effects.

the response of public finance revenues and expenditures and of the GDP as such to changes in the output gap. The size of the cyclical component depends on the size of the output gap and on the elasticity of selected revenue and expenditure categories responding to fluctuations in economic activity. The output gap was estimated in line with the EC methodology and based on the data of the MoF SR forecast (part II.3). In its estimation of elasticity of the general government balance to the changes in the output gap, the MoF SR fully relied on the EC's estimates based on the OECD methodology.¹⁸

The second item the general government balance must be adjusted for is **one-off and temporary effects**. Principles defined by the EC and described more closely in the IFP manual were taken into consideration in their identification¹⁹. Based on the available information, the following one-off effects may be identified in the period of 2013 and 2014 (no one-off measures have been envisaged for the remaining projection years):

- As a part of changes in the fully-funded pillar, the second pillar was temporarily opened in 2012 and 2013 to enable savers to either opt in or out from the pillar. The opt-outs of savers generated one-off revenues for the Social Insurance Agency in the amount corresponding to the amount of assets accumulated by the savers. The positive impact of a one-off legislative change on the balance²⁰ in 2013 represents 0.3% of GDP.
- The Regulatory Authority for Electronic Communications and Postal Services made an auction to sell frequency licences for operation of mobile networks of the fourth generation. In 2014, the non-tax revenues thus increased by 0.2% of GDP. Due to an exceptional amount and to its non-repetition in other years, we consider this impact to be a one-off.
- At the beginning of 2014 the lawsuit of the Antimonopoly Office with construction companies suspected of a cartel agreement was lawfully completed. The fine will increase the non-tax revenues by 0.06% of GDP. Due to the amount of the fine exceeding 0.05% of GDP and to its non-repetition in other years, we consider this impact to be one-off.
- In 2014, there is a one-off increase in the levy on enterprises in regulated industries by EUR 176m (0.25% of GDP). Due to the amount exceeding 0.05% of GDP and to its non-repetition in other years, we consider this impact to be one-off.
- An exceptional increase in repayment of the returnable financial subsidy to Cargo is considered to have a one-off impact as well. Compared to payments in the previous period, there is an increase by 0.1% of GDP in 2014. The measure is classified as one-off based on the Government decision and the impact above 0.05% of GDP.
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¹⁸ Girouard, N., André, Ch.: Measuring cyclically-adjusted budget balances for OECD countries. OECD Economics Department Working Papers, No. 434, 2005.

¹⁹ IFP (2014) Manual: One-off measures, <http://www.finance.gov.sk/Default.aspx?CatID=9595>

²⁰ After a transfer to the ESA2010 methodology from autumn 2014, the one-off transfer of savers' assets will have no impact on the GG balance.



BOX 4 – Consolidation effort according to the preventive arm of the Stability and Growth Pact

According to the preventive arm of the Pact, Eurozone countries²¹ which have not yet achieved their medium-term (budgetary) objective have to ensure the consolidation effort as a rule in the amount of 0.5% of GDP annually. According to the circulated new interpretation in line with the Regulation 1466/97 EC²², the required consolidation effort should be differentiated as per the cyclic position of the country, the amount of its debt and fiscal sustainability risks.

- If the economic growth is negative or a negative output gap exceeds -4% of GDP, no consolidation is required in the particular year.
- With a debt exceeding 60% of GDP or with a significant risk for sustainability of the debt measured by the sustainability indicator S1, the consolidation effort should exceed 0.5% of GDP annually, while at least 0.6% of GDP is to be understood thereunder.
- In good economic times, i.e. with the output gap exceeding 1.5% of GDP, the consolidation effort should also exceed 0.5% of GDP annually. On the contrary, with a negative output gap, higher than -1.5% of GDP, the consolidation effort may be lower than 0.5% of GDP annually, but at least 0.1% of GDP.

The table below provides a summary of the consolidation effort for the Eurozone countries which have not met the medium-term budgetary objective. The consolidation effort required by the Pact for a country like Slovakia amounts to at least 0.1% of GDP in 2014 and 2015 due to the debt below 60% of GDP, the medium-term sustainability risk according to the S1 indicator (more details to be found in the chapter V) and a negative output gap exceeding 1.5% of GDP (more details to be found in the chapter II.3). With regard to the lower-than-required consolidation effort in 2014, it is necessary to have higher consolidation effort in 2015 in order to achieve the medium-term budgetary objective in line with the recommendations of the Council of EU of June 2013 and the requirements of the Fiscal Compact.

	The required consolidation effort for countries which have not met the medium-term budgetary objective according to the Pact (in % of GDP)	
	Gross debt < 60% and a low or medium sustainability risk (indicator S1)	Gross debt > 60% or high sustainability risk (indicator S1)
Waiver: real growth < 0% or an output gap below -4 % of the potential GDP	No consolidation necessary	
'Bad' economic times: Output gap between -4% and -1.5% of the potential GDP	> 0	≥ 0.5
'Neither good nor bad' economic times: Output gap between -1.5% and 1.5% of the potential GDP	0.5	> 0.5
'Good' economic times: Output gap > 1.5% or slightly lower than 1.5% but quickly approaching a value above 1.5% of the potential GDP	> 0.5	

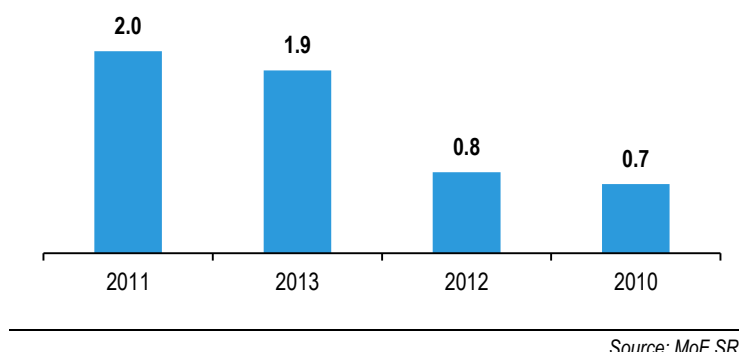
After an extensive post-2009 consolidation, in which the Excessive Deficit Procedure was opened for Slovakia, fiscal policy is slightly temporarily loosened in 2014. In 2010 – 2013, the average annual consolidation effort amounted to 1.4% of GDP, significantly higher than 1% of GDP recommended by the Council upon opening the Excessive Deficit Procedure. Slovakia achieved one of the highest consolidation efforts since joining the EU in the amount 1.9% of GDP in 2013. Due to a deteriorated macroeconomic situation, expressed by a significantly negative output gap in 2013 and 2014, a temporarily mild structural expansion by 0.26% of GDP is planned in 2014. In this year, the aim is also to further reduce the nominal deficit compared to the previous year, also thanks to a slight contribution of one-off measures, and to remain well below 3% of GDP. Structural expansion is slight

²¹ The Regulation 1466/97 does not specify the required consolidation effort for countries beyond ERMII and the Eurozone with a debt under 60% of GDP and without a high sustainability risk, but according to the EC's interpretation it should be 0.5% of GDP annually unless there is a different reason.

²² The Significant Deviation Procedure In The Preventive Arm of the SGP, Note for the Alternates of the Economic and Financial Committee, Ares(2014)1051386 – 03/04/2014

and limited for one year, while it will not pose a threat to the sustainability of the correction required as a precondition for abrogation of the Excessive Deficit Procedure. In 2015, consolidation in a higher-than-required size is renewed.

CHART 22 – Structural consolidation since joining the EU (% of GDP)



In the next years, the fiscal targets require an annual consolidation effort of approximately 0.5% of GDP in 2015 and 2016, and 0.6% of GDP in 2017. Slovakia should thus continue meeting specific recommendations of the Council of EU and to achieve the medium-term budgetary objective in 2017. When setting the targets for the next years, national fiscal rules defined by the Fiscal Responsibility Act along with the European rules were taken into consideration. Meeting lower nominal balance targets will ensure a decrease in the public debt already from 2016.

In an effort to take into account the growth-promoting investments of Member States, the EC prepared a draft of the so-called investment clause which enables the Member States to temporarily deviate from the consolidation path required by the preventive arm of the Pact while fulfilling certain conditions. In the first year, the activation of the investment clause will lead to adjustment of the consolidation effort by the amount of expenditures on co-financing EU funds adjusted by expenditures on the Common Agricultural Policy and Fisheries Policy. In the following years, it will only be adjusted by a year-on-year change in these funds.

In order to activate the clause, it is necessary to meet five criteria based on which the Member States in the preventive arm of the Pact may ask for application of the investment clause. The table below provides a summary of criteria and their fulfilment for Slovakia. According to the current estimates, **Slovakia meets the criteria necessary for granting the investment clause and requested its application in the Budget Plan Draft for 2014.** The spring forecast of the EC published in May 2014 will be crucial for the granting of the investments clause. **Including the investment clause, the consolidation effort would amount up to 0.4% of GDP in 2014.** Even if the investment clause is not granted, there is no significant deviation from the required consolidation effort in 2014 according to the rules of the preventive part of the Pact.

TAB 23 – Fulfilment of the criteria of the investment clause of the Stability and Growth Pact for SR

Investment clause criteria	Fulfilment for SR
A negative GDP growth or growth well below the potential growth.	A negative output gap is expected in 2014 in the amount of 3.2% of potential GDP, representing a significant cooling of the economy and a below-potential growth. According to the preliminary assessment by the EC ²³ , according to the 2013 autumn forecast, Slovakia met the condition of 'bad' economic times. According to the winter forecast 2014, the estimated negative output gap has further deepened.

²³ The investment clause in the preventive arm of the Stability And Growth Pact: preliminary assessment of eligibility, Note for the Economic and Financial Committee, Ares (2013) 3540113 – 22/11-2013



<p>A country outside the corrective arm of the Pact, i.e. the deficit is below 3% of GDP and the debt below 60% of GDP (or in the case of countries with debts above 60% of GDP with a sufficiently decreasing debt).</p>	<p>According to the current assumptions, we expect abrogation of the Excessive Deficit Procedure in the 2014 assessment (part I.4) and the following application of the preventive arm of the Pact. The fiscal objectives for 2014 and 2015 are below the deficit limit of 3% of GDP and similarly the debt forecast is below the reference value of 60% of GDP.</p>
<p>The maximum deviation from the required consolidation effort will be directly proportional to the amount of expenditures on co-funding of EU projects of the Structural and Cohesion Policy, TEN and CEF.</p>	<p>In 21014, the funds for co-funding the relevant EU projects according to latest estimates should amount to EUR 508m (0.7% of GDP).</p>
<p>In case economic growth is forecasted or closing of the negative output gap, the deviation granted based on the investment clause is expected to be compensated so that there is no delay in meeting the medium-term budgetary objective.</p>	<p>According to the latest data, the deviation for 2014 will be compensated by a higher consolidation effort in 2015. At the same time, in spite of an adverse macroeconomic environment and unexpected revenues losses, significant consolidation was achieved in 2013. In line with the recommendations of the Council of EU from June 2013, the year 2017 remains the deadline for meeting the medium-term budgetary objective.</p>
<p>Along with meeting these conditions, a Member State should prove direct positive impacts of co-financed projects on the long-term sustainability of the public finance, including impacts on the potential economic growth and also the fact that national investments are not being replaced by investments co-funded from EU funds, thus there is no decrease in the gross fixed capital formation of the general government.</p>	<p>Investments from co-financing contribute to the economic growth and have a positive impact on the fiscal policy from the medium-term perspective. Similarly, according to the current EC's 2014 Winter forecast, growth of public investments (gross fixed capital formation) is expected in 2014 by 11.6%. The current MoF estimate expects a growth in public investments by 5.5% in 2014.</p>

The reviewed Stability and Growth Pact from 2011 introduced an expenditure benchmark as another tool to analyze the fiscal position side the change in the structural balance. Comparing the growth of the expenditure aggregate, net of revenue measures with a reference rate for expenditures growth, adjusted by the required consolidation effort for Slovakia, enables to assess the progress in fiscal consolidation.

The expenditure benchmark is applied differently depending on if the particular country has achieved its medium-term budgetary objective or not. Slovakia is currently not meeting its medium-term objective. This means that the adjusted primary expenditures of the general government, net of discretionary revenue measures²⁴ should grow more slowly in real terms than the average potential growth of the economy so that the structural balance is improved by the required consolidation effort, in principle by 0.5% of GDP annually. In other words, a lower growth rate of expenditures than the reference rate means that the expenditure growth should contribute to achieving the medium-term budgetary objective. The reference rate of the expenditure benchmark for 2013 is based on EC's supporting materials²⁵ and for the next years it is based on the estimated potential growth by the MoF SR and the relevant minimum required consolidation effort according to the Pact rules (see Box 4).

²⁴ They are measures related to tax revenues, recorded according to the EC methodology. It assumes that revenue measures have an effect only in the first year after their implementation. In the first year, one-off measures have a positive impact and in the following year a negative impact, so that their overall impact is zero.

²⁵ [Vade Mecum on Stability and Growth Pact](#), p. 30



TAB 24 – Expenditure aggregate net of discretionary revenue measures (ESA95, EUR mill.)

	2013	2014 OS	2015	2016	2017
1 Total expenditures	27,918	28,310	28,404	28,537	29,347
2 Interest payments	1,413	1,367	1,366	1,476	1,494
3 Government expenditure on EU programmes which is fully matched by EU funds revenue	818	1,388	1,365	1,090	1,390
4 Gross fixed capital formation (year t) ²⁶	1,497	1,579	1,618	1,556	1,791
5 Gross fixed capital formation (average for t-3 to t)	1,668	1,634	1,570	1,562	1,636
6 Unemployment benefit expenditure at unchanged policies	60	57	41	18	-10
7 Primary expenditure aggregate (1-2-3-(4-5)-6)	25,799	25,553	25,584	25,960	26,318
8 YoY change of primary expenditure aggregate	735	-246	31	376	358
9 Revenue increases mandated by law	0	0	0	0	0
10 Discretionary revenue measures, change compared to the previous year	1,219	363	-103	59	3
11 Nominal YoY growth of expenditure aggregate net of discretionary revenue measures $((8_t - 9_t - 10_t) / 8_{t-1})$	-1.9	-2.4	0.5	1.2	1.4
12 Actual year-on-year expenditure aggregate growth net of discretionary revenue measures	-2.9	-3.6	-0.9	-0.5	-0.6
13 Expenditure benchmark – reference rate of expenditures growth applicable for SR	1.8	2.4	2.4	1.3	1.3
14 Deviation from the expenditure benchmark (12-13) *	-4.8	-6.0	-3.3	-1.8	-1.9
<i>p. m. GDP deflator**</i>	1.1	1.3	1.4	1.8	2.0

* A negative figure represents fulfilment of the expenditure aggregate

Source: MoF SR

** From 2015 the MoF SR forecast, for the previous years it is an average of two last EC forecasts

The expenditure benchmark is compared to expenditures which are analytically adjusted for factors which are outside the control of the Government and the factors which have no impact on the general government balance. These are interest payments, changes in expenditures on unemployment benefits not related to Government policies, expenditures financed from EU funds and expenditures covered by revenue side measures. At the same time, due to a high year-on-year volatility of Government investments (in particular in smaller EU Member States), the average level of investments for the last three years and for the current year are taken into consideration. The nominal growth of such adjusted expenditures will be recalculated to real growth using the GDP deflator, so that it is comparable to the expenditure benchmark.

According to the expected outcome for 2014 and the draft budgetary framework for 2015 – 2017 the level of expenditures of general government is in line with the expenditure benchmark of the preventive arm of the Pact. Total expenditures do not fully reflect the need for measures to comply with fiscal targets, as at this stage of budget preparation the proportion between the expenditure and revenue consolidation cannot be determined. It means that the positive risk of expenditure decrease prevails, which would further reduce the expenditure benchmark as well. Expenditure decrease may also be expected with regard to activation of corrective measures related to public debt levels over 55% of GDP (more details to be found in the Box 3). **Even if we take into account the conservative assumption, the expenditure benchmark should not be exceeded throughout the whole forecasted period.**

III.4. General government debt and its development

The general government²⁷ gross debt reached 55.4% of GDP at the end of 2013. Assuming that the budgetary objective and some other expectations are met²⁸, the debt share in GDP in 2014 will decrease to 55.2% of GDP. The debt will reach its maximum in the forecasted period in 2015 – amounting to 56.2% of GDP – and then it will start to decrease. Such development will lead to the activation of **corrective measures defined by the Fiscal**

²⁶ As a result of reclassification of the Railways of the Slovak Republic to the general government sector, the gross fixed capital formation increased in 2011 – 2013.

²⁷ All values are calculated with the methodology which is used in assessing the Maastricht criterion for the amount of gross debt of the general government – the so-called Maastricht gross debt of general government.

²⁸ Based on the reform of the Oil Agency, its debt will be a part of the debt of public finance. Sale of a minority share in Slovak Telekom is expected.



Responsibility Act upon exceeding the debt level of 55% of GDP. The debt forecast does not include any potential impacts from the new ESA2010 methodology, while the potential risks might result from adjusting the level of the nominal GDP and reclassification of entities to be included in the general government sector.

The debt of the general government will be below the reference level of the Maastricht criterion throughout the period. **The net financial debt, defined as a gross debt net of cash in general government accounts (liquid financial assets), will reach the level of 47.6% of GDP at the end of the forecasted period.** More details regarding the calculation are stated in the Box 5.

TAB 25 – General government debt evolution in 2012 – 2017 (in % of GDP)							
		2012	2013	2014	2015	2016	2017
Gross debt	(1)	52.7	55.4	55.2	56.2	54.9	53.4
Gross debt change (p.p.)		9.0	2.8	-0.2	1.0	-1.3	-1.5
- nominal GDP growth		-1.8	-0.8	-1.8	-2.3	-2.7	-2.9
- primary balance		2.7	0.8	0.9	0.7	-0.2	-1.2
- interests		1.8	2.0	1.8	1.8	1.8	1.7
- stock flow adjustment		5.8	0.8	-1.2	0.9	-0.2	0.8
Liquid financial assets (in % of GDP)	(2)	5.9	6.0	4.9	6.6	5.8	5.8
- cash on GG accounts		5.6	6.0	4.8	6.6	5.8	5.8
- securities*		0.3	0.0	0.0	0.0	0.0	0.0
- other items (quoted shares, monetary gold)		0.0	0.0	0.0	0.0	0.0	0.0
Net debt	(1-2)	46.8	49.4	50.3	49.6	49.0	47.6
<i>p.m.: Implicit interest rate (%)</i>		4.3	3.8	3.4	3.3	3.4	3.3
<i>p.m.: ESM and EFSF impact on gross debt</i>		2.5	3.4	3.6	3.4	3.3	3.1

* In 2013 there was a methodological change in the accounting principles for securities in GG.

Source: MoF SR



BOX 5 – Net debt

Methodologically speaking, there is no clear definition of net debt. Within the Stability Programme, the so-called concept of liquid financial assets (LFA) is being reported, defined in the Stability Programme manual (Code of Conduct). Eurostat has a different view, using a broader definition. Both approaches are based on gross debt net of more or less liquid assets.

The net financial debt (Stability Programme concept) is netted of the following consolidated items of the general government sector from financial accounts: 1. gold and SDR (nominal value); 2. currency and deposits (nominal value); 3. securities other than shares (market value), 4. quoted shares (market value)²⁹:

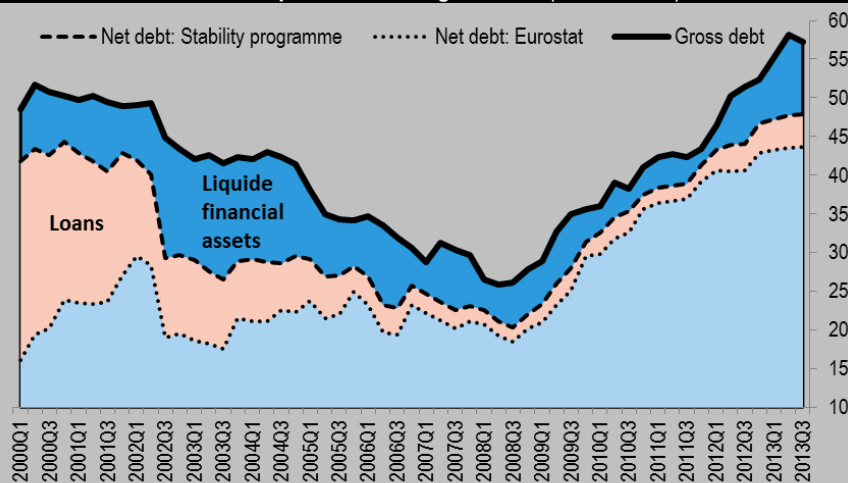
$$\text{Net financial debt} = \text{Maastricht debt} - \text{gold and SDR} - \text{currency and deposits} - \text{securities} - \text{quoted shares}$$

Net financial debt calculated in this way reflects currency and deposits on accounts also of those entities which do not have an account in the State Treasury (municipalities and some self-governing regions). Currently the general government has no quoted shares, gold or SDR on its accounts.

Eurostat introduced an alternative proposal of displaying net debt, which goes beyond the liquidity concept framework. The main change compared to the previous approach is netting gross debt also of loans. This would translate, among other, into directly considering loans within the EFSF which increase gross debt. Net debt defined in such a way should better account for assets, as the Maastricht debt concept is based on the gross principle of reporting, which does not take assets into account³⁰.

The chart displays the quarterly development of net debt according to both approaches. The growth of LFA from 2011 is mainly driven by higher deposits and cash on the GG accounts due to a more difficult access to financial markets. Loans in the sense of state assets had a more significant impact in the past, which was due to the restructuring the bank sector by the state. Since 2011, we may see an increase in loans mainly because of the EFSF. **Regardless of the methodology used, the net debt, expressed as a share in GDP, has been stable for over a year.**

CHART 23 – Different concepts of assessing net debt (in % of GDP)



Source: IFP

²⁹ In the case of Slovakia, securities and shares are reported in accounting in the nominal value (cost of acquisition). With regard to the unavailability of data about their market value, their nominal value is used for the purposes of forecasting.

³⁰ The disadvantage of netting of loans is often their low liquidity due to a non-existing secondary market. Inclusion of a nominal amount of loans also underestimates the risk of non-performing loans.



Development in 2013 according to financing resources

In 2013, the gross debt of general government in nominal terms increased by EUR 2,536m, with the cash deficit of the state budget having the biggest contribution. This was financed by bond issues and loans, on the contrary State Treasury bills were almost fully repaid without the need of additional issuing. Another factor contributing to debt increase was the increasing share of Slovakia within EFSF debt by EUR 401m. Gross debt was also influenced by the creation of a reserve for liabilities of healthcare providers in the amount of EUR 18m.

Based on a Eurostat decision, a significant part of the debt of the Emergency Oil Stocks Agency (EUR 465m) is re-routed into public debt until these loans have been repaid. SR should take this step in spite of the fact that the oil agency was not included in the general government sector, i.e. revenues from the sale of oil do not contribute to state revenues but the loan burden is increasing the public debt. The Government of SR will take the necessary steps including the reform of the Agency's so that the administration of emergency oil stocks does not increase the public debt. Restructuring of the oil agency will be carried out in 2014.

As for other entities of general government, the debt decreased by EUR 188m. The drop is caused mainly by decreasing existing loans of the Railways of SR, which have been reclassified to be a part of the general government sector since 2011, while the Railways repaid loans in the amount of EUR 131m in 2013. The indebtedness of local governments decreased approximately by EUR 57m compared to the previous year.

TAB 26 – Factors contributing to a debt change in 2013 (in EUR mill.)

1 Gross GG debt as of the start of the year	37,439
2 State debt	2,725
- State bonds	2,857
- State Treasury bills	-1,304
- Loans	281
- Change in deposits of ST clients not belonging to GG	17
- EFSF	401
- Assumed liabilities of hospitals	18
- Assumed loans of the Emergency Oil Stocks Agency	465
- Other	-12
3 Debt of other GG entities	-188
- Railways of SR	-131
- Local governments	-57
- Other general government entities	-1
4 Gross GG debt as of the year end (1+2+3)	39,975

Note: Based on the reclassification of the Railways of SR into the public sector, other GG entities were revised retroactively for 2011 and 2012.

Source: MoF SR

Forecast for 2014 – 2017

The change in the gross debt in the next years is driven mainly by the the state budget deficit, which will be gradually decreasing. The expected state deficit already accounts for the specified measures, including an additional decrease of the state budget deficit so that fiscal targets are met.³¹ Based on a Eurostat decision, a significant part of the debt of the **Emergency Oil Stocks Agency is re-routed in the public debt until loans have been repaid**. The Government of SR will take the necessary steps to ensure that the administration of emergency oil stocks will be transfered to private entities and hence does not increase the public debt. Restructuring of the oil agency will be carried out in 2014. In 2015, **reserves for a new debt of healthcare providers in the amount of EUR 50m** are included in the draft general government budgetary framework, which will also have an impact on the public debt.

³¹ For the purposes of the forecast it was assumed that half of the volume of additional measures (residual after including already specified measures) necessary to achieve the targets will be specified and included in the state budget balance.



In case of **of other general government entities, a better fiscal performance is expected** (in particular local government and the Railways of SR). **With the exception of 2014, other GG entities will contribute to decreasing the debt.** The reclassification of certain public transportation companies of local governments into GG is expected, for which a conservative level of loans based on available financial statements was assumed.

Another factor with an impact on the debt level is the **State Treasury (ST) system**. It is assumed that part of the accumulated funds will be used for debt decrease in the forecasted period. The forecast of ST funds in 2015 includes revenues from the privatization of Slovak Telekom in the amount of 1.3% of GDP.

Methodological adjustments, such as **discount on issuance and discount on redemption of bonds**, have to be taken into account for the debt calculation. Discounts on issuance of new debt instruments increase the debt to a lesser extent. Since, at the moment of issuing bonds, state liabilities increase by a nominal value of the bonds, but the state receives a lower amount in cash (decreased by the discount), the issuance discount is a factor contributing to debt increase. When the bonds reach maturity the amount of the paid discount is a part of cash expenditures from the state budget, although this amount does not contribute to debt increase. The discount on redemption of bonds has a positive impact on debt. This is due to the fact that the debt increase occurs already when bond are issued, at the level of the nominal value of the bond, rather than the at the time of their redemption. The total effect of both factors decreases debt in particular in 2014 and 2015.

Higher contributions of Slovakia to ESM has also an impact on the level of gross debt . Based on a Eurostat decision³², the ESM liabilities are not directly included in the debt of the general government of Member States, unlike EFSF. However, the Slovakia's contributions to ESM are a factor worsening the debt. The contributions decrease available funds of the ST, which could have been used for funding the state needs. Thus such contributions increase the need to issue additional debt instruments and contribute to a increase in gross debt.

The impact of **Slovakia's commitment under the in EFSF liabilities**, connected with providing financial assistance, is also taken into consideration in the debt forecast. EFSF will not enter into new financial programmes, but it will continue managing repayments of liabilities of debtor countries until their full settlement. Until that time, the EFSF liabilities will have a direct impact on the debt amount according to the Slovak share in EFSF.

TAB 27 – Impact on the general government gross debt change (EUR mill.)							
	2011	2012	2013	2014	2015	2016	2017
A. Gross debt of general government (as of 1 January)	26,998	30,106	37,439	39,975	41,110	43,711	44,824
B. Total YoY change of the GG gross debt	3,108	7,333	2,536	1,135	2,601	1,113	1,198
- state budget deficit (cash accounting)	3,276	3,811	2,023	3,032	2,637	2,107	1,535
- ST funds used to finance state needs	-684	2,051	-463	-1,697	59	-931	-263
- SR commitment under EFSF	173	1,321	401	122	0	0	0
- Slovak contributions to ESM	0	264	264	132	0	0	0
- issuance discount	146	151	51	9	18	72	63
- redemption of bonds (discount)	-103	-311	-68	-114	-83	-57	-63
- balance of received and repaid loans of other GG entities	161	-62	-188	115	-79	-76	-74
- of which: Railways of SR	195	-1	-131	-1	0	0	0
- assumed liabilities of hospitals	100	130	18	0	50	0	0
- deposits of clients of ST not belonging to GG *	30	-8	17	0	0	0	0
- debt of the Emergency Oil Stocks Agency	0	0	465	-465	0	0	0
- other	10	-15	17	2	0	-3	-1
C. Gross debt of general government (as of 31 December)	30,106	37,439	39,975	41,110	43,711	44,824	46,021
in % of GDP	43.6	52.7	55.4	55.2	56.2	54.9	53.4

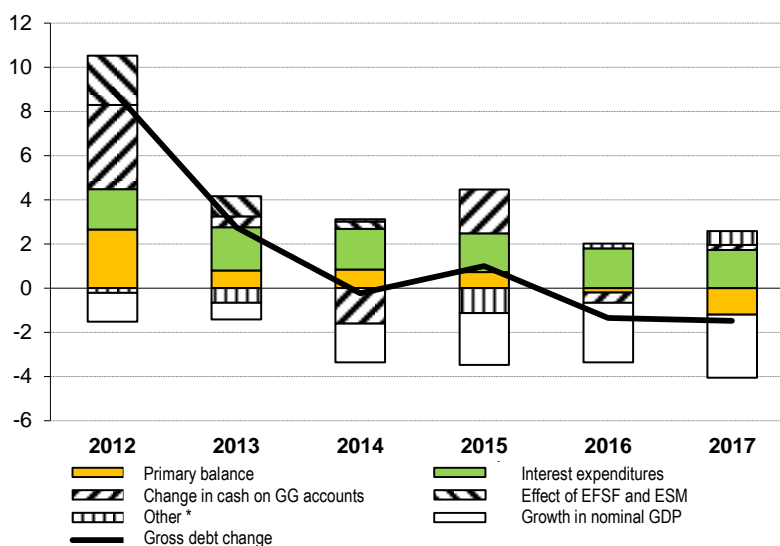
Note: Based on the reclassification of the Railways of SR into the public sector, other GG units were revised retroactively for 2011 and 2012.

* They are mainly contributory organizations which, according to ESA95, do not meet the criteria to be included in the general government sector, but they have voluntary deposits in the State Treasury.

³² In its opinion of 30 January 2013, Eurostat confirmed that ESM meets the criteria of an institutional financial unit and can thus establish contractual relationships independently. Based on this decision, the ESM liabilities will not be attributed to the Member States, but directly to the ESM.

The analytical view of individual factors, which contribute to the debt change shows that until 2015 the debt increase is conditioned by the amount of GG deficits and international liabilities of EFSF and ESM. **Since 2015 a primary surplus is expected for the first time, meaning that the GG balance net of interest payments will decrease debt.** A cash increase in 2015 corresponds to the planned sale of the minority share in Slovak Telekom. The main factor contributing to a decrease of debt as a share of GDP is the growth of the nominal GDP which, from 2016 onwards will exceed other negative factors and contribute to decreasing debt.

CHART 24 – Contributions of factors to the change in the gross debt of GG (p.p.)



* This item refers to stock-flow adjustment (SFA)

Source: MoF SR

The relation between a debt increase and deficit is captured through the stock-flow adjustment – SFA. SFA is rarely zero; which means that a change in the debt level correspond only seldom to the deficit in the particular year. The main causes are different methodologies: while general government balance uses the so-called net concept (revenues decreased by expenditures), then debt is a gross concept, not decreased by assets; at the same time, the general government balance is based on the accrual data, while the debt is calculated from cash data. In addition, a high SFA may also indicate statistical discrepancies.

A change in financial assets influenced mainly by the expected development of resources of the ST system and by the cash balance of other GG entities, has the biggest effect on the SFA. SFA increases the debt mainly in 2015 and 2017. In 2013, the value of the stock-flow adjustment was more significantly influenced by a net growth of financial assets, which was due to a drop in deposits, and increased EFSF commitments and contribution to ESM. The difference between cash and accrual recording in accounting has also contributed to the stock flow adjustment. The planned privatization has a considerable cash effect in the amount of 1.3% of GDP, increasing the GG deposits. Additionally, the transactions connected to the sale of emergency stocks have also an impact on increasing cash.

TAB 28 – Stock-flow adjustment (in % of GDP)

	2013	2014	2015	2016	2017
Stock-flow adjustment	0.8	-1.2	0.9	-0.2	0.8
1 Difference between cash and accrual data	-0.3	0.3	0.3	0.3	0.3
2 Change in financial assets	1.3	-1.3	0.7	-0.5	0.2
Change in GG currency and deposits	0.5	-1.6	2.0	-0.5	0.2
of which: loans of the oil agency	-	0.6	-0.6	-	-
ESM	0.4	0.2	-	-	-
EFSF	0.6	0.2	-	-	-
Change in other assets	-0.1	0.0	-1.3	0.0	0.0
of which: privatization	-	-	-1.3	-	-



3 Discount on issuance of bonds	0.1	0.0	0.0	0.1	0.1
4 Discount on redemption of bonds	-0.1	-0.2	-0.1	-0.1	-0.1
5 Other	-0.1	-0.1	-0.1	-0.1	0.3

Source: MoF SR

BOX 6 – Cash reserve of the state

Cash reserve of the state represents liquid resources, which the state can immediately use to settle its liabilities. In the past, the reserve covered state liabilities on average for the following four months. In June 2013 it achieved a historical top of over EUR 6,000m in nominal terms, covering the financial needs for the following nine months. In some periods of 2013 and 2014 the cash reserve was sufficient for state financing for 10 months. Such a buffer can protect us from problems with debt refunding in economic bad times and cause savings. However, after the stabilization of financing of Slovak public finance and after the situation in the European financial markets has calmed down (in particular thanks to the OMT programme), its future optimization is possible.

The cash reserve of the state is a significant element of managing state debt and liquidity, as it creates room for overcoming potential difficulties with state financing. It is worth thinking about it as about insurance – it decreases certain risks, but its creation and maintenance increases interest payments. Reserve creation has also an impact on the gross debt of the general government.³³ The needs for state financing are uneven and harder to predict, what has an effect on the process of obtaining resources for their coverage. The Government used favourable conditions of financing the Slovak state debt to extend its average maturity as well.

The cash reserve is formed by deposits deposited by the Debt and Liquidity Management Agency (ARDAL) in the money market in commercial banks and on the current accounts of the State Treasury (ST³⁴) in the National Bank of Slovakia. On the other hand, the reserve is decreased by loans which ARDAL obtains on behalf of the MoF in the money market for short-term coverage of liquidity mismatch or to settle liabilities in the situation when the reserve is zero.

CHART 25 – Cash reserve (number of months of state expenditures covered from the reserve)



Source: MoF SR

Since 2006, when ARDAL became operational as a debt management agency, the state cash reserve has been volatile. It is given by the nature of its use and formation, when it is incrementally influenced mainly by instalments or bond issues. In relative terms (as the number of months during which all state expenditures would be covered from the reserve) the reserve on average covered state expenditures in 2006 – 2012 for the following 4 months; it achieved its minimum – 2 months – at the turn of 2010 and 2011 and never exceeded 8 months. In 2012, its sharp increase in nominal terms started, also in the number of months covering the state expenditures, and in 2013 it covered 7 months of expenditures on average. In 2013 and 2014, the reserve covered even 10 months of the future state expenditures during several months.

³³ Simply said, the amount of reserves is influenced by the financial management of the state budget and ARDAL operations in the financial markets (which has a direct impact on gross debt), as well as by financial management of other entities of general government involved in the State Treasury system (it has no effect on gross debt). The amount of reserve for the purposes of debt forecasts does not directly take into consideration deposits in NBS or the collateral stemming from swap operations.

³⁴ The practical use of current accounts of the ST was renewed in late 2012 when ARDAL started to actively deposit temporarily loose funds instead of commercial banks on the ST current accounts. The ST then deposited them in the National Bank of Slovakia, mainly due to a higher credit risk of commercial banks.



The current reserve level may be high, mainly with regard to the current situation in financial markets. ECB has orally intervened several times and declared that if necessary, it would launch a programme to purchase state bonds in the secondary market (Outright monetary transactions, OMT). The readiness to launch OMT if necessary was a clear signal for the markets; revenues from bonds have considerably dropped and the demand of investors in the primary market has sharply increased. E.g. if the reserve covered only 4 months, as was the average of 2006 – 2012, instead of 7 months, it would mean annual savings in interest payments in the amount of almost EUR 60m.

IV. SENSITIVITY ANALYSES AND COMPARISON WITH THE PREVIOUS UPDATE

The Stability Programme of SR is based on the baseline macroeconomic forecast with exogenous assumptions concerning the external environment, as described in the Table 2. This section presents risk scenarios derived from the model simulations assuming negative shocks in foreign demand, foreign prices and public consumption.

IV.1. Risk scenarios

Scenario 1 Slowdown in foreign demand

The Scenario 1 assumes a slowdown in weighted imports of trading partners of SR which will be reflected in a slower export growth of SR. The simulation assumes an additional decrease in weighed foreign demand by 1 p.p. in 2014 compared to the baseline forecast.

A lower foreign demand will cause a fall of orders of export-oriented companies, and the growth of export of SR will immediately slow down. As a result of a slower growth in profitability, companies will reduce their investment activities compared to the baseline scenario. A lower capacity utilisation will also lead to lay-offs of employees. A worse situation on the labour market will have a negative impact on the household consumption. Overall, a slowdown in aggregate domestic demand will also decrease inflationary pressures in the economy. On the contrary, the impact on the external imbalance is minimal, since the slowdown in the export growth is almost entirely compensated by lower import caused by a slower growth of household consumption and fixed investment. A decrease in economic activity, lower price and wage growth as well as higher unemployment rate will lead to deepening the general government balance. Decrease in the nominal GDP growth and deepening of the government the balance in each year would increase the gross debt at the end of the monitored period compared to the baseline debt prognosis by 1.2 p.p.

TAB 29 – Scenario 1 – Slowdown in foreign demand growth by 1 p.p. in 2014

Cumulative change of variables compared to baseline scenario in p.p.

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (in % of GDP)	General government balance (in % of GDP)	General government debt (in % of GDP)
2014	-0.5	-0.4	-0.6	0.1	-0.1	0.0	-0.2	0.5
2015	-0.5	-0.4	-0.6	0.2	-0.3	0.0	-0.2	0.8
2016	-0.4	-0.4	-0.5	0.2	-0.5	0.0	-0.2	1.0
2017	-0.3	-0.3	-0.4	0.2	-0.6	0.1	-0.2	1.2

Source: MoF

Scenario 2 Lower growth of foreign prices

The second scenario is motivated by a significant slowdown in inflation in Eurozone countries and in Slovakia in late 2013, as well as by the perspective of low inflation for 2014. In this scenario we assume a drop in foreign price growth by 1 p.p. in 2014 compared with the baseline scenario, both on the export and import side.

A decrease in foreign export prices or competitive prices on the import side will be manifested in an immediate slowdown of the import deflator growth which will be then reflected in a slower growth of prices of investment and consumer goods through a decreased imported inflation. The government consumption deflator responses with a slight delay. Real export of SR is decreased through the real exchange rate channel. As a result of the worsening price competitiveness, the export-oriented companies will slow down their investment activities and there is even a slight increase of the unemployment rate. A decrease in domestic demand has secondary effects on domestic prices. Thanks to demand effects on the import side, the current account balance worsens. Similarly to the previous scenario, worsening the nominal tax bases leads to decreasing the general government balance by 0.1



p.p. in each year. The debt would increase less than in the first scenario, while it would increase by 0.7 p.p. as of late 2017.

TAB 30 – Scenario 2– Drop in the growth of foreign prices by 1 p.p. in 2014

Cumulative change of variables compared to baseline scenario in p.p.

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (in % of GDP)	General government balance (in % of GDP)	General government debt (% HDP)
2013	-0.3	-0.3	-0.3	0.1	-0.2	-0.2	-0.1	0.4
2014	-0.2	-0.2	-0.3	0.1	-0.3	-0.2	-0.1	0.5
2015	-0.2	-0.1	-0.2	0.1	-0.4	-0.2	-0.1	0.6
2016	-0.2	-0.1	-0.2	0.1	-0.4	-0.2	-0.1	0.7

Source: MoF SR

Scenario 3 Lower government consumption

The continuing consolidation effort, necessary to meet fiscal targets, is a motivation for the third scenario. The impact of an actual consolidation package on GDP growth, implemented in 2013, as well as an overview of fiscal multipliers estimated for Slovakia are stated in a separate chapter II. In the following scenario we assume a negative shock in nominal government consumption by 1 p.p. in 2013 in terms of government demand for finished products. An additional assumption of the scenario is that wage expenditures in the public sector remain unchanged compared to the baseline scenario. If the risks of not meeting the fiscal target are increasing, a drop consumption of general government can be efficiently and quickly implemented.

As a result of lower government consumption, there will be a slight slowdown of the GDP growth with a significant secondary impact only in the case of fixed investments. This drop will be reflected in the development of employment, though the negative impact on the labour market is negligible thanks to the export orientation of the Slovak economy. A decrease in demand pressures in the economy as a result of a slower domestic demand is also marginal as well as the overall positive impact on the balance of the current account as a result of only slightly lower import growth. The impact of consolidation through decreasing the final consumption of the general government has a negligible impact on the general government balance with regard to the secondary negative effects on the economic activity and price level, resulting only in negligibly worse revenues of the general government. The debt will increase only slightly in the first year; its impact in the following years will be negligible up to positive in 2017.

TAB 31 - Scenario 3 –Decrease in Nominal government consumption by 1 p.p. in 2014

Cumulative change of variables compared to baseline scenario in p.p.

	Household consumption	Gross fixed investment	GDP	Unemployment rate	CPI	Current account balance (in % of GDP)	General government balance (in % of GDP)	General government debt (% HDP)
2013	0.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.1
2014	0.0	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0
2015	0.0	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0
2016	0.0	-0.1	-0.1	0.0	-0.1	0.0	0.0	-0.1

Source: MoF SR

IV.2. Comparison with the previous update

The Stability Programme of SR for 2014 – 2017 contains updated macroeconomic and budgetary objectives. Compared to the last-year update of April 2013, the forecast of the general government debt improved and the target values of the general government balance in 2015 and 2016 were slightly modified.



TAB 32 – Comparison of the previous and updated forecasts

	ESA code	2013	2014	2015	2016	2017
Real GDP growth (%)						
Previous update*		1.2	2.9	3.3	3.6	-
Reality and current update		0.9	2.3	3.0	3.2	3.4
Difference		-0.3	-0.6	-0.3	-0.4	-
General government balance (% of GDP)						
	EDP B.9					
Previous update*		-2.9	-2.6	-2.0	-1.3	-
Reality and current update		-2.8	-2.6	-2.5	-1.6	-0.5
Difference		0.1	0.0	-0.5	-0.3	-
Gross general government debt (% of GDP)						
Previous update*		54.8	56.3	56.7	55.9	-
Reality and current update		55.4	55.2	56.2	54.9	53.4
Difference		0.6	-1.1	-0.5	-1.0	-

Note: * Stability Programme of SR for 2013 – 2016

Source: MoF SR

V. SUSTAINABILITY OF PUBLIC FINANCES

Long-term sustainability of public finances has both an economic and ethical, inter-generational aspect. Healthy public finances is a necessary prerequisite of a sustainable economic growth and should also contribute to inter-generational fairness. Past deficits and the resulting levels of debt, if not used for productive investments, automatically imply debiting future generations who may not have benefited from previous policies. Therefore, the current generations should not transfer too heavy financial burdens on future generations.

V.1. Policy strategy

In order to ensure long-term sustainability of public finances it is necessary that the pension and healthcare system can flexibly respond to the changing needs of the population and to the **challenges related to ageing**. According to the EC report³⁵, in the next 30 to 50 years all EU Member States will face considerable demographic changes with a following impact on the pension and healthcare system. Slovakia belongs to the countries with the greatest demographic changes³⁶.

The need for a more flexible setting of the pension schemes was exacerbated by the economic crisis which considerably worsened fiscal positions of the EU countries and evolved into a debt crisis in the Eurozone periphery. Since 2009, economic policies of Member States have focused more on putting public finances on a sounder footing. Fiscal consolidation, required by the Pact, and in relation to adopting the Fiscal Compact (more details to be found in Chapter 7), is aimed at stabilizing and subsequently decreasing the general government debt. In spite of a successful consolidation, improved management of public finance may not suffice to ensure sustainability in the long-term. It is therefore necessary to appropriately set the pension and healthcare system in view of the fact that they represent the most significant share of public expenditures, sensitive to population ageing.

The Government of SR has adopted several significant amendments to the pension system which improve its long-term sustainability in a comprehensive way.

- In 2012, a major **pension system reform** was adopted. The key changes with a positive impact on public finance include automatic increase in the statutory retirement age depending on life expectancy, change in the indexation of pension benefits, strengthening solidarity in awarding new pensions and changes to the maximum assessment base for the payment of social insurance contributions. Changes in the fully-funded pillar increase revenues of the pension system on the one hand, but increase its future expenditures on the other. Over the relevant period until 2060, their cumulative impact on the general government balance is positive³⁷.
- In 2013, **changes in the social security scheme of police and armed forces** were adopted, with the aim to stabilize expenditures on seniority pensions of these units³⁸. The key measures include an increase in the number of years in service necessary to be awarded a seniority pension and changes in the indexation of retirement rents so that they reflect increases in pension benefits in the pay-as-you-go pillar of the pension system and years of seniority.

Adverse effects resulting from population ageing need to be dampened, in addition to parametric or systemic reforms, also by structural reforms promoting growth and employment. Higher employment rate, productivity and

³⁵ European Commission (DG ECFIN) and the Economic Policy Committee (AWG) (2012) 'The 2012 Ageing report: Economic and budgetary projections for the EU27 Member States (2010 – 2060), European Economy, No 2, 2012.

³⁶ According to the latest demographic projections by Eurostat (EUROPOP), Slovakia will be the country with the second biggest change in the age structure of the population within EU after Poland. The old-age dependency ratio (proportion of the population at post-productive age of 65+ and population at productive age of 20 – 64) will deteriorate from 17.0% in 2010 to 61.9% in 2060.

³⁷ The time horizon until 2060 is too short to objectively evaluate this measure, as its negative effects are manifested with a longer delay. More detailed information about the pension system reform in 2012 is contained in the "Stability Programme of the Slovak Republic for 2013 – 2016" (http://www.finance.gov.sk/Components/CategoryDocuments/s_LoadDocument.aspx?categoryId=120&documentId=9803) and the IFP Policy Brief "Ageing will increase expenditures, the pension system reform has helped", (http://www.finance.gov.sk/Components/CategoryDocuments/s_LoadDocument.aspx?categoryId=8886&documentId=9796, April 2013).

³⁸ The calculations presented in this chapter do not include the impact of changes in the pension scheme of police and armed forces. Quantification of these measures will be the subject of the next projection Ageing Report 2015, which is being prepared by IFP within the EC's Ageing Working Group.

a higher economic growth not only improve the living standard of the population, but they may considerably help sustainability of the pension system and a the overall consolidation of public finance. Adequate and efficient tax burden, intelligent labour market regulation and flexible markets of goods and services are a prerequisites for higher employment and productivity.

V.2. Long-term budgetary outlook in the context of population ageing

Long-term projection of revenues and expenditures sensitive to population ageing

The Ageing Working Group (AWG), which has a mandate, in cooperation with the Commission, to develop and to regularly update long-term projections of expenditures sensitive to demographic trends, and to examine their impact on the development of public finance, identified those general government expenditure items that may be positively or adversely affected by demographic changes. These include pension expenditures³⁹, health care⁴⁰, long-term care, education and unemployment benefits. In addition to the expenditure side, the revenue side reflects changes in property income⁴¹ and, in certain countries including Slovakia, changes resulting from pension system reforms. In the case of Slovakia, these include a shortfall in general government revenues brought about by the situation in the fully-funded pillar of the pension system

By 2060, the general government balance will be adversely influenced by pension expenditures, expenditures on health care and long-term care as well as by a decrease in property income. By contrast, the fully-funded pillar and expenditures on education and unemployment benefits will have a positive impact.

	2010	2020	2030	2040	2050	2060	Change 2010 – 2060
A. Revenue shortfall due to the fully-funded pillar	-1.1	-0.6	-0.6	-0.4	-0.2	-0.2	0.9
B. Age-related expenditures	17.8	18.0	18.7	19.8	21.6	23.3	5.5
- pension benefits	8.0	8.0	8.1	8.5	9.5	10.6	2.7
- health care	6.2	6.8	7.5	8.2	8.9	9.2	3.0
- long-term care	0.3	0.3	0.4	0.5	0.5	0.7	0.4
- education	3.1	2.8	2.7	2.5	2.6	2.7	-0.5
- unemployment benefits	0.2	0.1	0.1	0.1	0.1	0.1	-0.1
C. Property income	1.4	1.0	0.9	0.9	0.8	0.8	-0.6
Impact on general government balance							-5.2

Source: MoF SR, EC

Under policy change, the adverse demographic evolution along with a drop in general government revenues will deteriorate the general government balance by 5.2% of GDP by 2060.

Assessment of long term sustainability using sustainability indicators

The aim of the assessment of long-term sustainability is to evaluate the current situation of public finances from the perspective of the future growth of age-related public finance expenditures (and/or fall in revenues) described in the preceding section, i. e. to judge whether the current policy mix (fiscal discipline, pension system, health

³⁹ Pension benefits comprise – in addition to retirement pensions, early retirement pensions and survivor pensions – also social assistance. This is due to the fact that the current system does not explicitly guarantee a minimum pension which implies that the effects of ageing could be underestimated for those pensioners who will receive a supplementary social benefit on top of their pension. Pension expenditures do not include seniority pension expenditures of police and armed forces, amounting to approx. 0.3% of GDP. In accordance with the approved AWG methodology, also expenditures on Christmas benefits have been omitted.

⁴⁰ Expenditures on health care, long-term care, education and unemployment benefits are defined by the AWG to ensure international comparability and are described in the "2012 Ageing report".

⁴¹ The fall in property income in proportion to GDP in the AWG projections is not caused by demographic factors. It stems from the assumption that besides the impact of the mutual relationship of the average interest rate development and economic growth, the debt dynamics (as % of GDP) is exclusively determined by the general government primary balance. In the light of this assumption, it is implicitly assumed that the nominal sum of the general government assets will remain fixed over time and the asset income as a ratio to GDP will be falling.



care system) is sustainable in the long run (capable of preventing an uncontrolled growth of debt and maintaining its stable level) given the government debt at its present level. To this end,, the EC uses the so-called sustainability indicators⁴² S1 and S2.

BOX 7 – Sustainability indicators in the EC methodology

S1 indicator (medium term) – represents a value by which the primary structural balance must durably change for the gross debt to achieve 60% of GDP in 2030. Initially, the indicator represented a change in the primary balance by the year 2060. Another change compared with the past is that the consolidation needed to reach the target debt is spread over several years (in the Commission's report, over the years 2015 to 2020). On the basis of the value of the S1 indicator, countries are classified into several risk groups – if their S1 indicator is less than 0, they are classified as low risk. Indicator values between 0 and 3 place the countries in the medium risk group and values of more than 3 in the high-risk group.

S2 indicator (long term) – represents the value by which the primary structural balance must permanently change for the current value of future primary balances to equal to gross debt. The countries with the S2 indicator less than 2 are identified as low-risk countries. If the indicator value is between 2 and 6, the country is identified as a medium-risk country. If the value is above 6, the country is identified as a high-risk country.

In addition to the traditional sustainability indicators, the EC also uses the **S0 indicator**. It is an early warning indicator of fiscal risks which could materialize in the short-term based on the current fiscal and macroeconomic trends.

The Ministry of Finance evaluates the sustainability using the long-term sustainability indicator according to the Commission's methodology; however, in contrast to the Commission, the Ministry also includes in its calculation the impact of the fully-funded pillar not only on expenditures but also on revenues. In the opinion of the Ministry of Finance, this approach is economically more appropriate because changes in fully-funded pillar systems affect not only the expenditures of pension systems, but also their revenues.

The sustainability indicators in the following part are calculated according to the MoF SR approach for four scenarios.

- **2015 scenario** is based on the forecast of debt and of the primary structural balance for 2015, and reflects the positive impacts of the pension system reform adopted in 2012.
- **MTO scenario** is based on the assumption of achieving the medium-term budgetary objective in 2017 in line with the recommendation of the Council of EU for Slovakia as of June 2013 and the corresponding level of debt and of the primary structural balance.
- **MTO scenario with debt brake** is based on the assumption of achieving the medium-term budgetary objective in 2017, while it also takes into consideration the national fiscal rules on the debt brake. According to the constitutional provisions, if the debt level reaches 57% of GDP, the Government must submit a balanced budget to the Parliament. The above-mentioned limit will be annually decreased by 1 p.p. starting from 2018. Therefore, in this scenario the S1 indicator is calculated based on the assumption that the debt will amount to 47% of GDP in 2027.
- **Pessimistic scenario** assumes that in 2017, the primary structural balance will amount to 0.30% of GDP and the debt will amount to 54.7% of GDP (in other words, the Government would not meet its medium-term objective). This scenario as well reflects in its assumptions the national fiscal rules on the debt brake.



TAB 34 – Assumptions used in calculation of the indicators

	Base year (t ₀)	SPB in t ₀	Debt in t ₀	Fiscal adjustment	Debt in t ₂
Commission Report	2014	0.8	55.9	2015 – 2020	60
2015 scenario	2015	-0.9	58.4	2016 – 2020	60
MTO scenario	2017	1.0	53.4	2018 – 2020	60
MTO scenario with debt brake	2017	1.0	53.4	2018 – 2020	47
Pessimistic scenario	2017	0.3	54.7	2018 – 2020	47

SPB – Structural primary balance

The **long-term** sustainability gap based on the calculated values of the S2 indicator amounts to 3.2 to 5.1% of GDP. The need for an additional improvement of the primary structural balance is mainly due to the increasing expenditures on healthcare and long-term care (2.2-2.3 p.p.) and expenditures on pensions which will increase particularly after 2030 (1.4-1.6 p.p.).

In the medium term, the S1 indicator points out the presence of a low to medium risk. Negative values of this indicator in the MTO scenario and in the MTO scenario with debt brake express that if the Government meets its objective until 2017, no additional consolidation measures are required in the medium-term, there is even a buffer. Also, meeting the medium-term objective provides sufficient fiscal space for the debt levels to respect the national fiscal rules. On the other hand, a less favourable budgetary position and a higher level of debt in t₀, as we model in the pessimistic scenario, would require additional consolidation of 0.5% of GDP. A debt level at which the Government would be obliged to run a balanced budget would be achieved in 2024.

TAB 35 – Sustainability indicators S1 and S2 (% of GDP)

	S1	IBP	CDA	DR	LE	2P	S2	IBP	PE	HLC	EUB	2P
Commission Report	2.2	0.8	0.3	-0.2	1.3	-	6.9	1.8	3.5	1.7	-0.1	-
2015 scenario	1.0	0.5	0.1	-0.1	0.3	0.1	5.1	1.9	1.4	2.3	-0.3	-0.2
MTO scenario	-1.4	-1.3	-0.1	-0.5	0.4	0.1	3.2	-0.1	1.6	2.2	-0.3	-0.2
MTO scenario with debt brake	-0.4	-1.4	0.0	0.7	0.3	0.1	-	-	-	-	-	-
Pessimistic scenario	0.5	-0.7	0.1	0.8	0.3	0.1	-	-	-	-	-	-

Source: MoF SR, Fiscal sustainability report 2012

Contributions of the contributions (in p.p.):

IBP – initial budgetary position

CDA – costs of delaying adjustment

DR – debt requirement in the final year

LE – long-term expenditures (ageing costs)

2P – revenue shortfall due to second pillar

PE – pension expenditures

HLC – health and long-term care

EUB – education and unemployment benefits

VI. PUBLIC FINANCE QUALITY

In order to achieve economic recovery, in its Annual Growth Survey for 2013, the EC recommends to the EU countries to focus on these main priorities at the local and European-wide level:

- pursuing growth-friendly fiscal consolidation;
- restoring normal lending to the economy;
- promoting growth and competitiveness through implementing structural reforms;
- tackling unemployment and the social consequences of the crisis;
- and modernising public administration.

The emphasis is laid on fiscal consolidation as a necessary prerequisite for restoring of the macroeconomic and financial stability and trust in financial markets. The EC also recommends increasing the efficiency of public finance. In the case of decreasing the expenditures, it recommends to apply a selective approach. Expenditures on education, science, research and innovation, energy and active labour market policies should not be cut. In order to promote growth and employment, taxation of low-income work should not be increased. The Commission recommends focusing the additional tax burden on consumption, property and environmental taxes.

VI.1. Development in revenues

As for revenues, the priority remains to be the effort to combat tax evasion. In 2012, the **Action plan to combat tax fraud** was approved, in which 50 measures were adopted, focused mainly on decreasing VAT evasions. In **the first stage** of the Action plan, cancellation of registration for VAT purposes of non-communicating persons and persons who could not be contacted was enabled, and the institute of joint and several liability for tax was introduced. The amendment of the act introduced the obligation for risk persons to deposit a financial guarantee in VAT registration, obligatory monthly taxation period for new VAT payers for 12 months and the turnover threshold for the obligatory monthly taxation period was reduced. New criminal acts of tax fraud and obstruction of tax administration have been defined. In July 2012, the pilot project of "Tax Cobra" was launched, in which the Financial Office of SR in cooperation with the Police and prosecution deal with cases of major tax frauds.

In the second stage the regime of a stricter tax surveillance over risk entities was introduced, the obligation of the administrator to deposit monetary deposits of partners in Ltd companies on a bank account. An anti-corruption programme was launched within the Financial Authority of SR and with the intention to prevent issuing fictitious receipts, the obligation of cashless payment with the limit over EUR 5,000 has been introduced.

Implementation of a receipts lottery is an additional tool to promote fair payment of taxes and the effort to combat tax evasion in VAT. Since September 2013, consumers have a possibility to register their receipts from the purchase of goods and services to a lottery which is drawn regularly twice a month. The aim of the measure is to motivate customers to request a receipt when purchasing goods and services. Since its launching in September 2013 until the 13th drawing in March 2014, almost 59 million receipts from 450,000 players were registered in the receipts lottery. The potential positive impact of the lottery on the annual VAT revenue, based on the 2013 data, is EUR 7m to 8m in particular in small retail trade companies and restaurants. The lottery has brought a lot of motions from citizens which may be used in inspecting the electronic cash registers. The efficiency of inspections has considerably increased; the statistics of success rate of the motions from citizens is not available yet though.

Since January 2014, VAT payers have the obligation to send electronic monthly statements on national supplies of goods and services. The implementation of a **control statement** on particular business transactions of tax payers should help efficiently combat tax frauds. Selected data from the statement may be confronted with the data which the tax payers stated in their tax returns. An analytical software of the FA SR will enable to assess the data stated in statements in real time and to match VAT in input and output based on the VAT identification numbers, but mainly the justness of VAT on input. This will create an efficient option to cross-check this data with the data of individual trading partners and to identify frauds in VAT also in complicated networks of companies, what will help strengthen the revenues of public finance.

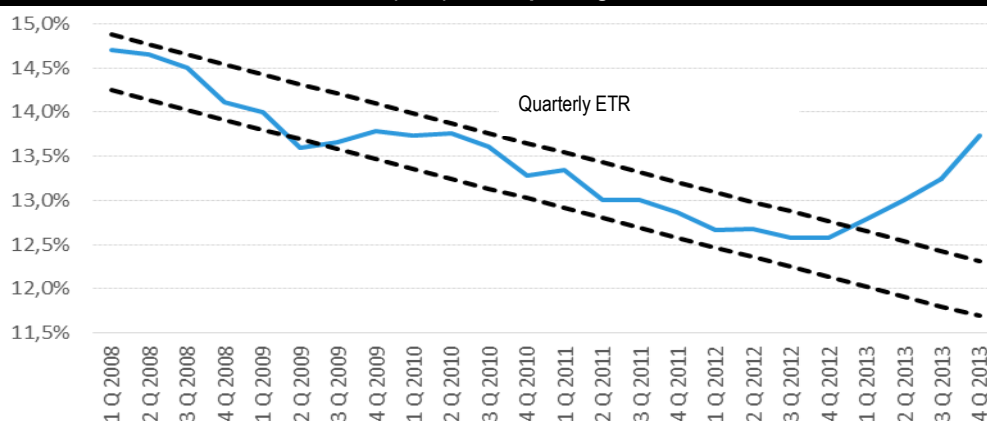
Since January 2014, the domestic transfer of tax liability for the payment of VAT to the recipient (the so-called **reverse charge**) has been extended to include risk commodities, limiting carousel trades with them. In addition, specialized senates at regional courts focused on taxes will be established.

Other measures adopted are the obligations of the deposit administrator to deposit monetary deposits of partners on establishing limited liability companies on bank accounts and modification of erasure of companies "ex offio". Financial investigation institute analysis has been prepared as an instrument to increase the efficiency of finding out financial circumstances of perpetrators in particular in relation to tax criminal acts.

Introduction of a tax licence, which will be differentiated according to the types of companies, is a new measure. The measure is focused on preventing a long-term evasion of corporate income taxes.

Measures intended to improve tax collection are manifested in the outcomes. After a several years of decreases, the negative trend of VAT collection effectiveness measured through an effective tax rate has been reversed. Since 4Q 2012, it has seen growth in four subsequent quarters and currently it is at the level of 2010. According to the current estimate, the improvement of effectiveness in the collection between 2012 and 2013 increased the VAT collection by EUR 289m(0.4% of GDP).

CHART 26 – Effectiveness in VAT collection (EDS) was improving also in the second half of 2013



Source: IFP

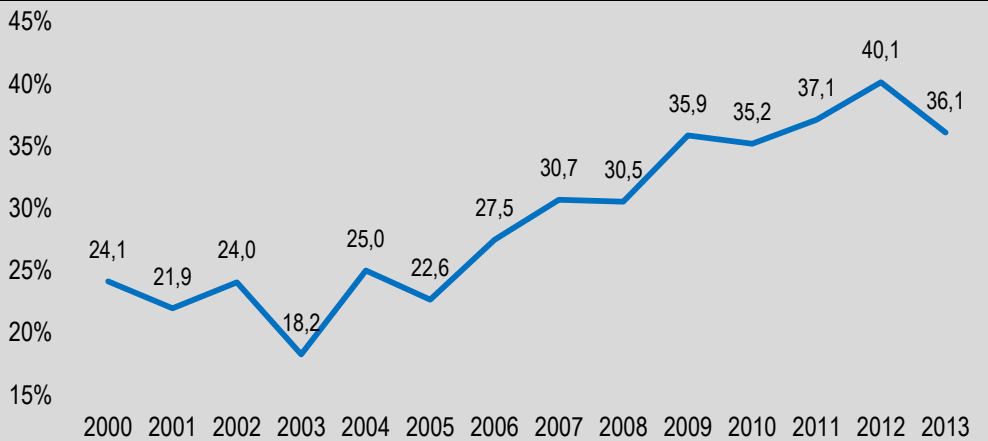
Consolidation measures for the upcoming years related to revenues (implementation of the obligation of cash registers, withholding income tax from iron scrap and for benefits from pharmaceutical companies) substantially reflect the priority to further increase the efficiency of tax collection..



BOX 8 – VAT gap

Slovakia is one of the EU countries with the highest VAT gap. According to a CASE study,⁴³ in 2011 SR saw the fourth highest VAT gap as % of potential among the EU countries. The IFP and CASE estimates coincide that the VAT gap in SR was growing since the SR joined EU from 20 – 25% from the potential collection to approximately 40% in 2012. The VAT collection effectiveness was lowest in the middle of 2012. Corresponding to implementation of measures of the Action plan to combat tax evasion, the collection effectiveness has been improving since then continuously for four subsequent quarters. In 2013, the VAT gap dropped approximately to 36%. This represents a similar level than in 2009 and corresponds to closing approximately 10% VAT gap of 2012.

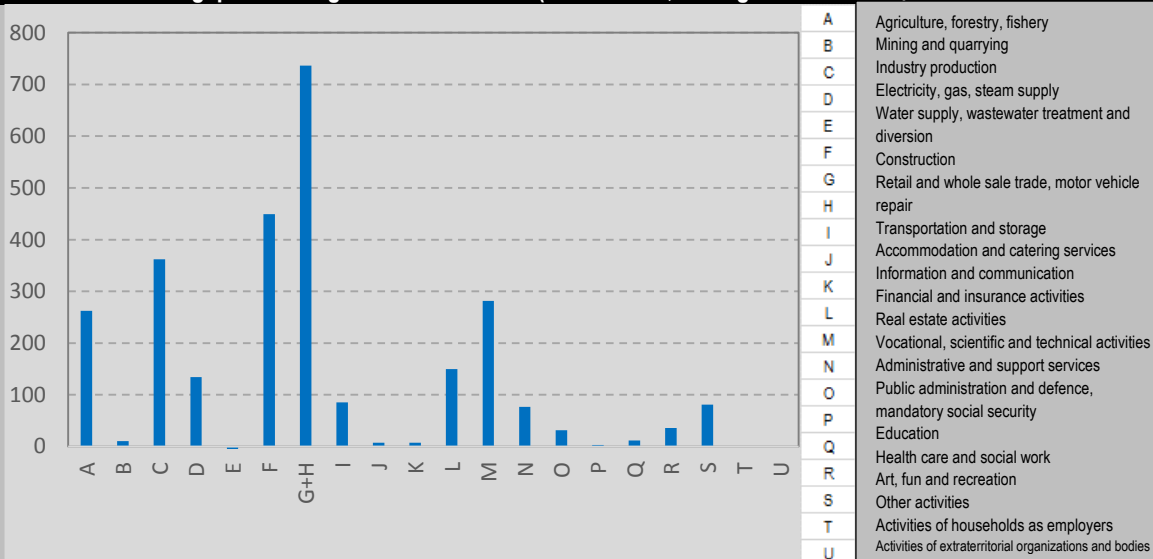
CHART 27 – VAT gap as % of the potential VAT



Source: SO SR, IFP

A big part of the VAT gap is present in several areas of the economy. Mainly retail trade and wholesale, construction, industrial production, professional, scientific and technical activities and agriculture are risky from the point of view of VAT evasion. The estimated outcomes are based on the methodology used in the Revenue Administration Gap (RA-GAP) programme of the International Monetary Fund. This methodology works with aggregated macroeconomic data from supply and use table of national accounts, which enables to estimate the VAT gap at the level of individual sectors. The disadvantage is that the supply and use tables are prepared with rather long delays. The latest ones available today are for 2010.

CHART 28 – VAT gap according to NACE2 sectors (EUR million, average for 2008 – 10)



Source: SO SR, IFP

⁴³ More detail in: "Study to quantify and analyse the VAT Gap in the EU-27 Member States"; http://ec.EURpa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf

The sector estimate of a VAT gap will enable to focus the inspection activities of the financial administration more efficiently, prepare better targeted measures to combat tax evasion and to estimate their potential impact on tax collection. An example is the introduction of cash registers which is being prepared, and the obligation to attach invoices to administrative documents used for official purposes for hotels and for professional, scientific and technical activities.

Compared to other OECD or EU countries, **property taxes** in Slovakia represent a less significant part of tax revenues of municipalities and self-governing regions. The current setting of the system (tax rate in EUR according to the floorage) is less efficient and fair because the tax base does not reflect the actual property value (defined by the size of the building, property location, age, facilities pertaining to the property and other characteristics), but only the size. This is then the basis of different efficient tax burden of individual properties (the share of paid tax compared to the property price) and the regressivity of the system. From the point of view of tax fairness and efficiency, the optimum solution is to set the system so that the tax base is linked to the estimated market value of the property. A system set-up in such a way would ensure that the tax base changes together with the market price of the property and that the efficient taxation conditional upon unchanged rate would be constant.

MoF SR has prepared a new property taxation proposal based on the estimated market value. Based on the data obtained about the prices of advertised residential properties a model was proposed which, after considering input characteristics, enables to estimate the market value of the property. The first steps in implementation of the new system will be carried out after 2015.

VI.2. Expenditures development

The ongoing consolidation of public finance is also reflected in decreasing expenditures of the general government. In addition to the ESO reform, which brings considerable savings in the operations of the state, local governments and other general government entities also significantly contribute to the decrease in expenditures. The Government's priority remains to protect the expenditures on education, science and research, and transport infrastructure which promote the long-term economic potential of the country. In 2014 they are increasing year-on-year by 21%. In the upcoming years, they will be supplemented by finances from the third programming period of the European funds.

In 2014, general government expenditures will amount to EUR 28.3 billion, representing a nominal increase by EUR 0.4 billion compared to 2013. According to the draft general government budget framework (GGB) for 2015 – 2017, in the budgeted period the share of general government expenditure to GDP will decrease from 38.7% in 2013 to 34.0% in 2017. In relation to GDP, wage expenditures are decreasing the most, as well as social transfers thanks to a better forecast of employment. Intermediate consumption, interest payments and capital transfers will see a slight decrease. Subsidies and investment (gross fixed capital formation, GFCF) will be comparable to the previous period. The Government is thus complying with the commitment from the Partnership Agreement to maintain the average level of GFCF above 2% of GDP during the third programming period for EU funding.

TAB 36 – General government expenditure (% of GDP)

	ESA code	2011	2012	2013	2014OS	2015V	2016V	2017V
Total expenditures	TE ^[1]	38.9	38.3	38.7	38.0	36.5	34.9	34.0
Compensation of employees	D.1	7.4	7.3	7.6	7.0	6.7	6.4	6.2
Intermediate consumption	P.2	4.8	4.7	4.6	4.6	4.3	4.0	3.9
Social transfers	^[2]	18.5	18.7	18.9	18.4	17.9	17.7	17.4
Interest payments	EDP D.41	1.6	1.9	2.0	1.8	1.8	1.8	1.7
Subsidies	D.3	0.9	1.0	1.1	1.0	0.9	0.8	0.8
Gross fixed capital formation	P.51	2.7	2.2	2.1	2.1	2.1	1.9	2.1

Capital transfers	D.9	1.2	0.9	0.6	0.6	0.7	0.3	0.3
Other	[3]	1.8	1.5	1.8	2.4	2.2	1.9	1.8

[1] Adjusted by net flows related to swaps so that TR-TE=EDP B.9

Source: SO SR, MoF SR

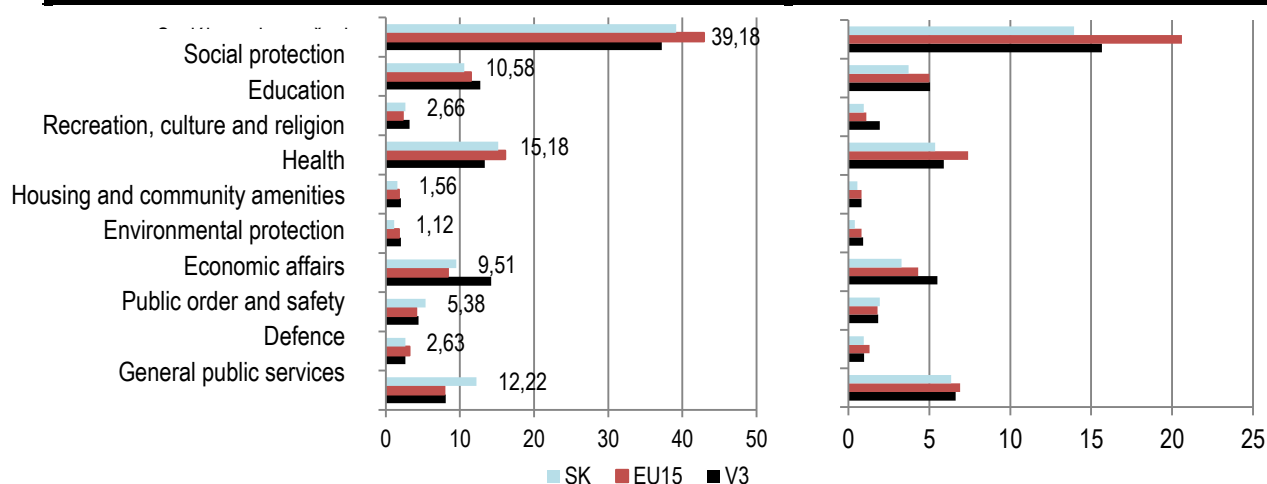
[2] D.6311+D.63121+D.63131+D.62

[3] D.29+D4 (except for D.41)+ D.5+D.7+P.52+P.53+K.2+D.8.

OS – estimate; V – GG budget framework draft

In 2014 public expenditure in Slovakia will reach 38% of GDP, which will rank us among countries with the smallest government within the EU. The EU average is in fact 49% of GDP. Compared to the Western Europe, and according to the COFOG methodology, in 2014 Slovakia will give relatively smaller proportion of public expenditures to social protection in spite of a high increase in spending in this area, mainly on pensions. Financing of health, defence, environmental protection, education, and housing and community amenities will be relatively lower. **In 2014, a higher share of public expenditures than in EU15 will also flow to the economic area (e.g. transport, investment aid, agriculture) and to public order and safety (e.g. police and justice).** Expenditures of the public sector on general public services (e.g. administration and offices) will rise again, though when expressed in relation to GDP, they still do not achieve the EU15 level.

CHART 29 – General government expenditures (left chart – % of total expenditures, right chart – % of GDP)



Note: SK=2014; EU15, V3=2012

Source: MoF SR, Eurostat, SO SR

Efficiency of public expenditure

Even after a thorough consolidation there are public expenditures which do not fully contribute to meeting their targets. Inefficiently spent finances increase the expenditures of the state budget to the detriment of priorities. This can be felt mainly at the time of the ongoing consolidation. The Government's priority is to increase expenditure on areas which provide the necessary public services to citizens, and promote the long-term economic potential of the country. This is reflected in prioritization of public expenditures in areas promoting the economic growth which grow year-on-year by 21% in 2014 (including the EU funds and co-financing). Expenditure from the state budget will be raised particularly in education, R&D and the development of transport infrastructure.

TAB 37 – Growth enhancing expenditure (EUR mill. including EU and co-financing)

	2011	2012	2013	2014
Growth enhancing expenditure, of which	3,447	3,632	3,761	4,560
Education	1,776	1,833	1,868	1,916
Research and development	318	379	410	495
Road and rail infrastructure	1,353	1,420	1,482	2,149

Source: MoF SR, GGB 2014 – 2016, 2014 – budget

The increase in growth-enhancing expenditures in 2014 is a result of several measures. Wages of pedagogic and professional staff in regional education will increase by 5%. Tariffs of university employees will increase by EUR 16; moreover, the wage bill will increase by further 3%. The overall impact of the wage increase is EUR 124m compared to the NPC scenario. Wages of employees of labour offices providing consultancy services will increase to the average wage level in public administration in 2014. New capacities in kindergartens will enable to provide care for 95% of children aged 4+.

Consolidation measures in 2014

In 2014, the consolidation of public finance in expenditures will amount to EUR 445m, representing 0.6% of GDP. The Government will continue **increasing the efficiency of the central government**. Expenditure of the state budget and of contributory organisations of the state will therefore drop by EUR 117m (0.2% of GDP). ESO will generate further revenues from the sale of buildings in the amount of EUR 54m (0.1% of GDP).

Most significant savings will be achieved in wage expenditure, which will decrease by EUR 279m compared to NPC⁴⁴, of which by EUR 78m in the budgetary and contributory organisations of the state budget (SB). Savings will be also achieved in goods and services which will decline by EUR 184m in the general government. EUR 72m will be saved in the SB. EUR 89m less will be spent on capital expenditures; although the state and its contributory organisations will save up to EUR 171m. Compared to NPC, expenditures on healthcare will decrease by EUR 38m. The only growing category of expenditures will be current transfers, which will increase by EUR 146m in the whole public administration and by EUR 203m in the state budget.

CHART 30 – Savings in GG (EUR mill.)

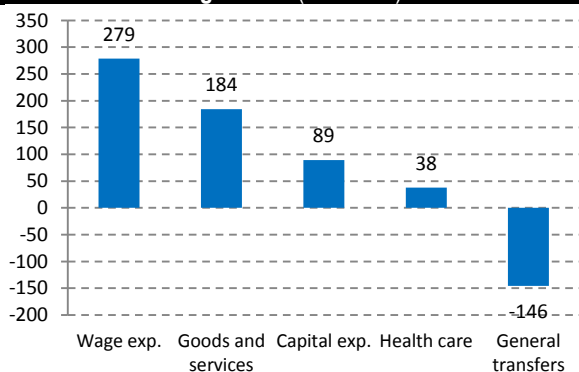
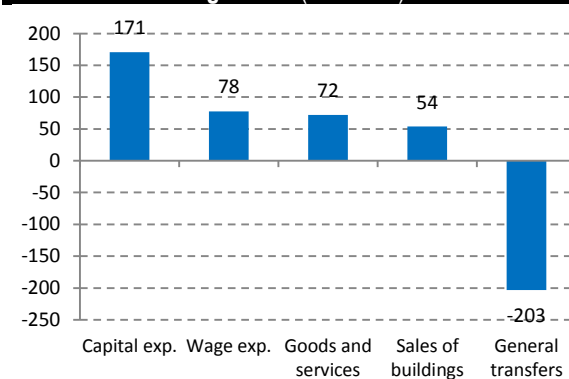


CHART 31 – Savings in SB (EUR mill.)



Most savings in the current expenditure of the state budget will be achieved thanks to planned changes in the structure and functioning of state organizations. The Ministry of Interior of the Slovak Republic as the sponsor of the ESO reform performed an analysis of over 400 contributory organisations and budgetary organizations, funds and special organizations established by law. The aim of the assessment was to identify duplicate and unused functions. In 2014, most organizations realizing for savings by increasing the efficiency of their activities internally. There is, however, increasingly more merging, closing down or sharing of supporting activities, operating costs and material equipment sharing of these subordinate organizations, which enables significant savings without decreasing the performance of the general government and its services for the citizens.

Table 38 shows nominal year-on-year savings in main categories of operating expenditures: wage expenditure and expenditure on goods and services. Decreasing expenditures at most ministries shows the extent of savings in 2014 and 2015. Major exceptions are only defence and education (regional education financed through the Ministry of Interior of the Slovak Republic and the Ministry of Education, Science, Research and Sport).

⁴⁴ Real revenues and expenditure for 2013 were used as the baseline year for the NPC for 2014.



TAB 38 – YoY nominal savings in operating expenditures of ministries (EUR mill.)

	Expenditures ⁴⁵			Savings	
	S2013 ⁴⁶	OS2014	R2015	2014	2015
Office of the National Council of SR	23.0	22.9	22.4	0.1	0.5
Office of the President of SR	4.0	3.9	3.8	0.1	0.1
Government Office of SR	12.2	11.5	11.8	0.7	-0.2
Office of the Supreme Court of SR	3.4	3.3	3.3	0.2	0.0
Supreme Court of SR	8.7	8.6	8.6	0.1	0.0
Prosecution Office of SR	67.8	68.1	68.6	-0.3	-0.5
Supreme Audit Office of SR	7.7	7.8	7.7	-0.1	0.0
Ministry of Foreign and European Affairs of SR	97.3	89.2	88.2	8.2	1.0
Ministry of Defence of SR	560.2	596.3	643.7	-36.2	-47.4
Ministry of Interior of SR	1,005.0	1,047.5	1,034.3	-42.5	13.2
Ministry of Justice of SR	299.3	287.0	286.3	12.3	0.6
Ministry of Finance of SR	302.7	261.0	256.9	41.7	4.1
Ministry of the Environment of SR	24.3	21.3	3.0	3.0	18.3
Ministry of Education, Science, Research and Sport of SR	61.9	73.2	45.7	-11.3	27.4
Ministry of Health of SR	42.0	38.1	38.4	4.0	-0.3
Ministry of Labour, Social Affairs and Family of SR	195.1	197.8	181.0	-2.6	16.7
Ministry of Culture of SR	27.0	28.2	18.3	-1.2	10.0
Ministry of Economy of SR	22.0	23.4	19.3	-1.4	4.1
Ministry of Agriculture and Rural Development of SR	76.7	64.7	52.0	12.0	12.7
Ministry of Transport, Construction and Regional Development of SR	206.5	203.0	189.3	3.5	13.6
Geodesy, Cartography and Cadastre Office of SR	35.2	14.2	14.2	21.0	-0.1
Statistical Office of SR	18.7	18.1	13.4	0.6	4.7
Office for Public Procurement	4.8	5.1	6.3	-0.3	-1.2
Regulatory Office for Network Industries	2.8	2.9	2.9	-0.1	0.0
Nuclear Regulatory Authority of SR	4.0	7.7	7.6	-3.7	0.1
Industrial Property Office of SR	2.5	2.5	2.5	0.0	0.1
Slovak Office of Standards, Meteorology and Testing of SR	2.5	3.6	2.8	-1.2	0.8
Antimonopoly Office of SR	2.0	2.0	1.3	0.1	0.6
State Material Reserves of SR	26.9	8.4 ⁴⁷	7.9	18.5	0.6
Slovak Academy of Sciences	43.4	36.2	28.7	7.2	7.5
Total	3189.7	3157.2	3070.3	32.4	87.0

Source: MoF SR

The integration in 2012 and 2013 most affected local state administration. As a part of its reorganization, 49 out of the original 50 district offices became county offices. Regional educational offices, regional construction offices and territorial military administration were incorporated into county offices in the regional capitals. In October 2013, county offices of environment, district offices of road transport, district forest service, district land offices and cadastre administration were integrated.

In addition to the local administration, the reorganization will this year affect 23 organizations subordinate to the state budget and the Slovak Academy of Sciences. Table 39 shows that this will bring significant savings already in the first year, almost 14% of their expenditures. In 2014, the Telecommunications Regulatory Authority and the Postal Regulatory Authority will merge into the Regulatory Authority for Electronic Communication and Postal Services. In addition, the Railway Regulatory Authority, Civil Aviation Authority and State Navigation Administration have merged into the Transport Authority. The Centre for chemical substances and preparations was integrated into the apparatus of the Ministry of Economy, and the Museum of Trade has been transformed into a contributory organisation. A merge of the State Energy Inspection with the Slovak Trade Inspection has

⁴⁵ Includes wage expenditures and expenditures on goods and services

⁴⁶ Figures for 2013 are preliminary ; OS – estimate; R – budget framework.

⁴⁷ Adjusted by one-time expenditure of EUR100m for VAT on the sales of oil reserves to be played



been prepared to take place in May 2014. Slovak Office of Standards has become a part of the Office of Standards, Meteorology and Testing and the Slovak Institute of Metrology has been transformed into a non-profit organization. In addition, the Ministry of Agriculture and Rural Development has prepared a merge of three state veterinary and food institutes and the State Veterinary Institute into one organization. It also merges its 7 scientific centres and institutes into the National Agricultural and Food Centre. The Institute of Information and Prognoses of Education has become a part of the Centre of Scientific and Technical Information. Organizations of the Slovak Academy of Sciences will be transformed into a new form of independent legal entities – public research institutions.

TAB 39 – The impact of reorganization of 23 subordinate organizations on their expenditures in 2014 (savings in state budget resources)

EUR mill.	2013 estimate	Transformation	2014 budget	Savings
Telecommunications Regulatory Authority	4.74	Regulatory Authority for Electronic Communication and Postal Services	4.59	0.78
Postal Regulatory Authority	0.64			
Regulatory Office for Railway Transport	1.46	Transport Authority	4.87	0.34
Civil Aviation Authority	2.31			
State Navigation Administration	1.44			
State Energy Inspection	0.81	Merge on 1 May 2014	0.57	0.24
Slovak Trade Inspection	4.51	Merge on 1 May 2014	4.51	0.00
Centre for Chemical Substances	0.37	Part of the ME SR	-	.48
Museum of Trade	0.23	Transformation into a CO	0.13	0.10
Slovak Institute of Metrology	2.18	Transformation into a NPO	0.90	1.28
Slovak Office of Standards	0.78	Part of OSMT	-	-
State Veterinary Institute Bratislava	1.30	State Veterinary and Food Institute in Dolný Kubín	3.73	0.45
State Veterinary Institute Zvolen	1.39			
State Veterinary and Food Institute Košice	0.42			
State Veterinary and Food Institute DK	1.06			
Plant Production Research Centre PN	2.30	National Agriculture and Food Centre	5.65	1.62
Animal Production Research Centre Nitra	1.92			
Soil Science and Protection Research Centre	0.98			
Food Research Institute	0.96			
Research Institute of Agricultural and Food Economics	0.85			
Technical and Testing Institute of Agriculture	0.26			
SAPV Agency	0.07			
Institute of Information and Prognoses of Education	11.09	SCSTI	4.23	-1.78
		Ministry of Education of SR	7.20	
Slovak Academy of Sciences	72.08	Transformation of 68 organizations into 10 public research institutions	60.80	11.28
Total	113.0		97.7	15.3

Source: MoF SR

Increasing the efficiency of state administration and the transformation and integration of budgetary and contributory organisations will continue in 2015 and 2016.

EU funds

Allocation of EU resources represents a crucial resource for investment and growth priorities of Slovakia. The general government budget for 2014 and the budget framework for 2015 – 2017 therefore assumes faster

⁴⁸ In case of incorporation under larger organization, the impact on expenditures can not be estimated.



drawdown of EU resources from the second programming period and a gradual start of the use of finances from the new multi-year framework. Furthermore, in December 2013 most regulations for European Structural and Investment Funds of 2014 – 2020 became effective. Altogether 11 thematic objectives have been set:

1. strengthening research, technological development and innovation;
2. enhancing access to, and use and quality of, information and communication technologies;
3. enhancing the competitiveness of small and medium-sized enterprises, the agricultural sector and the fisheries and aquaculture sector;
4. supporting the shift towards a low-carbon economy in all sectors;
5. promoting climate change adaptation, risk prevention and management;
6. protecting the environment and promoting resource efficiency;
7. promoting sustainable transport and removing bottlenecks in key network infrastructures;
8. promoting employment and supporting labour mobility;
9. promoting social inclusion and combating poverty;
10. investing in education, skills and lifelong learning;
11. enhancing institutional capacity and an efficient public administration.

In February 2014, the Government of SR approved the Partnership Agreement of SR⁴⁹ for 2014 – 2020 which it then submitted to the EC. The responsible sponsors started sending operational programme proposals. Within the 2014 – 2020 ESIF target "**Investing in growth and employment**", the following operational programme proposals are currently in the last stage of preparation in Slovakia:

- OP Research and Innovation (OP RaI)
- OP Integrated Infrastructure (OP II)
- Integrated Regional OP (IROP)
- OP Human Resources (OP HR)
- OP Quality of Environment (OP QE)
- OP Efficient Public Administration (OP EPA)
- OP Technical Support (OP TS)

Slovakia proposes allocations of EU resources to the individual operational programmes and within them to the thematic objectives as follows:

TAB 40 – Proposed allocation of EU resources for OPs and thematic objectives (EUR mill.)								
TO/OP	OP RaI	OP II	OP HR	OP QE	IROP	OP EPA	OP TS	TOTAL for TOs
1	1,704				324			2,028
2		841						841
3	455							455
4				891	111			1,002
5				749				749
6				1,442	88			1,530
7		3,111			421			3,532
8			929					929
9			634		595			1,229
10			326		263			589
11						267		267
TA	68	85	77	75	60	11	169	545
TOTAL for OPs	2,227	4,037	1,966	3,157	1,862	278	169	13,696

Source: GO SR

⁴⁹ Partnership Agreement for 2014 – 2020 was approved by the Resolution of the Government of SR No. 65/2014 of 12 February 2014



Within the 2014 – 2020 ESIF target "**European territorial cooperation**" there will be managing authorities for OP SK – CZ 2014 – 2020, OP INTERACT III 2014 – 2020 in Slovakia, while the option to manage also OP SK – AT 2014 – 2020 is being discussed. As for other OPs, SR is a participant with its own national authority. Slovakia is involved in five programmes of cross-border cooperation, two programmes of multinational cooperation and four programmes of inter-regional cooperation. Programmes for 2014 – 2020 are currently being prepared.

Compared to the previous period, the total number of OPs has decreased. On the other hand, a higher number of intermediate bodies was created as a result of reflecting all thematic objectives and new ESIF elements, which will create greater requirement for coordination within the system, among operational programmes and among managing authorities and intermediate bodies of individual programmes.

Crucial changes for the new period, leading to clearer rules, higher flexibility and more efficient implementation, include also expanding the possibility to use financial instruments. Their implementation will be possible through tailor-made tools (which will enable the application of specific national or local requirements) or instruments prepared by the EC (faster implementation thanks to prepared designs). The rules allow combining financial instruments with other forms of support such as grants, subsidies of interest rates or subsidies of loan guarantees. Financial contributions of the private sector in the financial instrument may also be included in the national co-financing.

VII. INSTITUTIONAL ASPECTS OF PUBLIC FINANCE

Institutional changes in public finance were carried out in 2013 in particular in relation to implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the so-called Fiscal Compact) and the resulting amendment of the Budgetary Rules Act. The Budgetary Rules Act for municipalities and self-governing regions was amended in 2013 as well.

Fiscal compact

Effective from January 2014, the amendment of the Budgetary Rules Act of the general government transposed provisions of the Fiscal Compact into the national legislation, in particular the provisions regarding a balanced budget of the general government and the automatic correction mechanism.

According to the Fiscal Compact, the balanced budget is defined in structural terms, i.e. net of the impact of the economic cycle and one-off measures. According to recommendations of the Council of EU from June 2013, the structural deficit of Slovakia of 0.5% of GDP should be achieved until 2017. If the general government debt is considerably lower than 60% of GDP and long term sustainability risks are low, the structural deficit may not be higher than 1% of GDP.

The act also lays down the procedure of an automatic correction mechanism, which will apply in the event of a significant deviation from the medium-term budgetary objective or the convergence path towards it (defined in the Regulation of the Council (EC) No. 1466/97). If the Ministry of Finance publishes that there has been a significant deviation, it will propose to the Government a public expenditure ceiling and measures to eliminate the deviation, while maintaining the original deadline for meeting the medium-term objective. The Government will then decide on the correction mechanism within which it will decide about the proposed public expenditure ceiling and approve measures to be implemented as part of the correction mechanism. Before the Government decision, the proposal will be assessed by an independent fiscal institution, the Council for Budget Responsibility. If the Government has not applied the correction mechanism, it must deliver to the National Council a written justification of the decision not to apply the correction mechanism. The assessment whether a significant deviation has occurred is made twice a year and it is also performed by the Council for Budget Responsibility which assesses and publishes an assessment of application or non-application of the correction mechanism and the beginning and end of the duration of exceptional circumstances.

Budgetary Rules Act for municipalities and self-governing regions

In November 2013, the Budgetary Rules Act for local governments was amended, effective from January 2014. From the point of view of fiscal rules, the possibilities of funding local governments through the so-called returnable financing resources have been modified (loans, credits and returnable financial assistance). According to the original legislation, municipalities and HTUs (higher territorial units) could receive returnable financial resources on condition that:

- the total amount of debt of municipalities and self-governing regions has not exceeded 60% of actual current revenues of the previous budget year;
- in the relevant budget year, the amount of instalments of returnable financing resources does not exceed 25% of collected current revenues of the previous budget year.

New rules impose stricter requirements on adoption of returnable financial resources. The definition of returnable instalments of financial resources is extended by investment supplier loans and excludes transfers from budgets of other general government entities, EU budget and from international subjects or according to a special regulation, from actual current revenues (base for calculation of the amount of instalments). Additionally, the amendment forbids any entities of municipalities and self-governing regions to directly assume liabilities from loans, credits or other debts from natural persons or legal entities.



A special provision for local governments will be applicable from 2015 according to the constitutional act. If the overall debt of a municipality or a higher territorial unit reaches 60% or more of actual current revenues from the previous year, the local governments are obliged to pay a fine of 5% from the difference between the overall debt and 60% of actual current revenues from the previous year. In connection with this act, the Budgetary Rules Act for municipalities imposes stricter rules of indebtedness of local governments. The amendment contains measures to decrease debt if it is higher than 50% and more of actual current revenues of the previous budget year:

- **50% – 58%**, the mayor of the municipality or a HTU chairperson is obliged to justify the total debt stock together with proposed measures to reduce it.
- **58% – 60%**, the municipality and HTU are obliged, until the end of the budget year, to make such changes in the budget which will ensure its balance and approve only a balanced or surplus budget for the following budget year with certain exceptions for purposefully intended resources.

Beyond these changes, the local governments will provide financial data through a specialized budgetary information system, which should increase the transparency of their budgetary processes.



ANNEXES

Annex 1 – Compulsory tables

Table 1a: Macroeconomic prospects (ESA95, EUR bn.)							
		2013	2013	2014	2015	2016	2017
	ESA code	Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Real GDP	B1*g	65.6	0.9	2.3	3.0	3.2	3.4
2. Nominal GDP	B1*g	72.1	1.5	3.2	4.4	5.0	5.5
Components of real GDP							
3. Private consumption expenditure	P.3	33.6	-0.1	1.2	2.2	2.4	2.9
4. Government consumption expenditure	P.3	10.7	1.4	1.9	-1.4	-0.4	0.9
5. Gross fixed capital formation	P.51	13.2	-4.3	1.8	2.4	0.8	2.1
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	-1.1	-0.9	-0.8	-0.7	0.5
7. Export of goods and services	P.6	67	4.5	4.0	4.5	4.8	4.8
8. Imports of goods and services	P.7	57.5	2.9	3.6	3.6	3.7	4.1
Contribution to real GDP growth							
9. Final domestic demand (total)		-	-0.7	1.3	1.3	1.3	2.0
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.3	0.1	0.1	0.1	0.0
11. External balance of goods and services	B.11	-	1.9	0.9	1.5	1.8	1.5

* Forecast of final government consumption is based on the February macroeconomic forecast of MoF SR Source: SO SR, MoF SR

Table 1b: Price developments (ESA95)							
		2013	2013	2014	2015	2016	2017
	ESA code	Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. GDP deflator		1.1	0.5	0.9	1.4	1.8	2.0
2. Private consumption deflator		1.2	1.3	0.8	2.1	2.3	2.4
3. HICP		1.5	1.5	0.8	2.1	2.3	2.4
4. Public consumption deflator		1.2	1.2	1.0	2.0	2.1	2.2
5. Investment deflator		1.1	0.6	-0.5	1.4	2.3	2.4
6. Export price deflator (goods and services)		1.1	-1.8	1.3	1.5	2.0	2.2
7. Import price deflator (goods and services)		1.2	-1.4	0.5	1.8	2.4	2.5

Source: MoF SR



Table 1c: Labour market development (ESA95)

	2013	2013	2014	2015	2016	2017
ESA code	Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Employment, persons (thousands) [1]	2 192	-0.8	0.7	0.62	0.74	0.93
2. Employment, hours worked (thousands) [2]	3 881	-1.8	0.4	0.62	0.74	0.93
3. Unemployment rate (%) [3]		14.2	14.0	13.2	12.3	11.3
4. Labour productivity per persons (EUR) [4]	29 917	1.7	1.6	2.3	2.4	2.5
5. Labour productivity per hours worked (EUR) [5]	16 900	2.8	1.9	2.3	2.4	2.5
6. Compensation of employees (EUR mill.)	D.1 27 695	2.9	2.5	3.5	4.1	4.5
7. Compensation per employee (EUR)	12 633	3.7	1.8	2.9	3.3	3.5

[1] Total occupied population, domestic concept – national accounts definition

Source: SO SR, MoF SR

[2] National accounts definition

[3] Harmonised definition according to Eurostat; levels

[4] Real GDP per person employed

[5] Real GDP per hour worked

Table 1d: Sectoral balance (ESA95, % of GDP)

	ESA code	2013	2014	2015	2016	2017
1. Net lending / borrowing vis-à-vis the rest of the world	B.9	4.2	6.0	6.7	7.7	8.4
of which:		0.0	0.0	0.0	0.0	0.0
- Balance on goods and services		6.8	8.0	8.6	9.4	10.0
- Balance of primary incomes and transfers		-4.0	-3.7	-3.6	-3.5	-3.2
- Capital account		1.4	1.6	1.7	1.7	1.7
2. Net lending / borrowing of the private sector	B.9	7.0	8.6	9.2	9.3	9.0
3. Net lending / borrowing of general government	EDP B.9	-2.8	-2.6	-2.5	-1.6	-0.5
4. Statistical discrepancy						

Source: MoF SR



Table 2a: General government budgetary prospects

	ESA code	2013 level	2013 % of GDP	2014 % of GDP	2015 % of GDP	2016 % of GDP	2017 % of GDP
Net lending (EDP B.9) by subsector							
1. General government	S.13	-1 994.9	-2.8	-2.8	-2.8	-2.0	-1.3
2. Central government	S.1311	-2 210.5	-3.1	-3.0	-2.9	-2.1	-1.5
3. State government	S.1312	-	-	-	-	-	-
4. Local government	S.1313	169.3	0.2	0.0	0.1	0.1	0.2
5. Social security funds	S.1314	46.2	0.1	0.1	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	25 925.8	35.9	35.2	33.7	32.9	32.8
7. Total expenditure	TE ^[1]	27 920.7	38.7	38.0	36.5	34.9	34.0
8. Net lending/ borrowing	EDP B.9	-1 994.9	-2.8	-2.8	-2.8	-2.0	-1.3
9. Interest expenditure	EDP D.41	1 413.4	2.0	1.8	1.8	1.8	1.7
10. Primary balance	^[2]	-581.6	-0.8	-1.0	-1.0	-0.2	0.5
11. One-off and other temporary measures	^[3]	239.7	0.3	0.6	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		11 739.2	16.3	16.3	15.9	15.7	15.4
12a. Taxes on production and imports	D.2	7 518.4	10.4	10.1	9.9	9.7	9.5
12b. Current taxes on income, wealth, etc	D.5	4 220.8	5.9	6.1	5.9	6.0	5.9
12c. Capital taxes	D.91	0.0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	9 931.5	13.8	13.3	13.1	13.1	13.0
14. Property income	D.4	662.3	0.9	0.9	0.7	0.7	0.7
15. Other	^[4]	3 592.7	5.0	4.7	4.0	3.5	3.6
16=6. Total revenue	TR	25 925.8	35.9	35.2	33.7	32.9	32.8
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)	^[5]	21 670.8	30.0	29.6	29.0	28.8	28.5
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	8 807.5	12.2	11.6	11.0	10.5	10.0
17a. Compensation of employees	D.1	5 488.1	7.6	7.0	6.7	6.4	6.2
17b. Intermediate consumption	P.2	3 319.4	4.6	4.6	4.3	4.0	3.9
18. Social payments (18=18a+18b)		13 660.8	18.9	18.4	17.9	17.7	17.4
of which Unemployment benefits	^[6]	174.3	0.2	0.2	0.2	0.2	0.2
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	3 664.5	5.1	5.0	4.9	4.9	4.8
18b. Social transfers other than in kind	D.62	9 996.3	13.9	13.4	13.0	12.8	12.5
19.=9. Interest expenditure	EDP D.41	1 413.4	2.0	1.8	1.8	1.8	1.7
20. Subsidies	D.3	812.0	1.1	1.0	0.9	0.8	0.8
21. Gross fixed capital formation	P.51	1 497.2	2.1	2.1	2.1	1.9	2.1
22. Capital transfers	D.9	457.0	0.6	0.6	0.7	0.3	0.3
23. Other	^[7]	1 272.8	1.8	2.4	2.2	1.9	1.8
24=7. Total expenditure	TE ^[1]	27 920.7	38.7	38.0	36.5	34.9	34.0
p.m.: Government consumption (nominal)	P.3	13 223.8	18.3	18.2	17.3	16.8	16.3

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

Source: MoF SR

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

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

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

[5] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] Includes cash benefit (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits

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

* Tables shows GG balance according to the draft budgetary guidelines for 2015-2017. The presented balance differs from the fiscal targets of the government. Additional measures will be specified to achieve the budgetary targets.



Table 2b: No-policy-change scenario

	2013	2013	2014	2015	2016	2017
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	25 926	35.9	35.2	33.4	32.5	32.3
2. Total expenditure at unchanged policie	27 918	38.7	38.0	37.1	35.8	35.4

Note: The base for the NPC purposes is the actual estimate for 2014 incl. EU funds and co-financing. Data for 2013 is the outcome for expenditures and revenues. Data for 2015 - 2017 exclude EU funds and co-financing. The 2014 figures are the latest expected outcome for the year.

Source: MoF SR

Table 2c: Amounts to be excluded from the expenditure benchmark

	2013	2013	2014	2015	2016	2017
	level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	817.7	1.1	1.9	1.8	1.3	1.6
2. Cyclical unemployment benefit expenditure	59.8	0.1	0.1	0.1	0.0	0.0
3. Effect of discretionary revenue measures	1218.8	1.7	0.5	-0.1	0.1	0.0
4. Revenue increases mandated by law	0.0	0.0	0.0	0.0	0.0	0.0

Source: MoF SR

Table 3: General government expenditures by function (% of GDP)

	COFOG code	2012	2017*
1. General public services	1	6.0	0.0
2. Defence	2	1.0	0.0
3. Public order and safety	3	2.4	0.0
4. Economic affairs	4	3.5	0.0
5. Environmental protection	5	0.9	0.0
6. Housing and community amenities	6	0.8	0.0
7. Health	7	6.2	0.0
8. Recreation, culture and religion	8	1.0	0.0
9. Education	9	3.8	0.0
10. Social protection	10	12.1	0.0
11. Total expenditures	TE	37.8	0.0

* Given the early stage of the budgetary process, data for 2017 in COFOG classification are not available.

Source: SO SR



Table 4: General government debt development (% of GDP)

	ESA code	2013	2014	2015	2016	2017
1. Gross debt		55.4	55.2	56.2	54.9	53.4
2. Change in gross debt ratio		2.8	-0.2	1.0	-1.3	-1.5
Contributions to change in gross debt						
3. Primary balance		-0.8	-0.9	-0.7	0.2	1.2
4. Interest expenditure	EDP D.41	2.0	1.8	1.8	1.8	1.7
5. Stock-flow adjustment		0.8	-1.2	0.9	-0.2	0.8
of which:		0.0	0.0	0.0	0.0	0.0
- differences between cash and accruals		-0.3	0.3	0.2	0.3	0.3
- net accumulation of financial assets		1.3	-1.3	0.7	-0.5	0.2
of which: revenues from privatisation		0.0	0.0	-1.3	0.0	0.0
- valuation effects and others		-0.3	-0.2	-0.1	-0.1	0.3
p.m. implicit interest rate on debt		3.8	3.4	3.3	3.4	3.3
Other relevant variables						
6. Liquid financial assets		6.0	4.9	6.6	5.8	5.8
7. Net financial debt (7=1-6)		49.4	50.3	49.6	49.0	47.6
8. Debt repayment (existing debts) from previous year		3.6	5.1	4.8	5.8	6.2
9. Share of debt denominated in foreign currency		3.9	4.2	3.4	2.9	2.8
10. Average maturity (years)*		6.5	6.7	-	-	-

Note: * maturity of state debt

Source: MoF SR

** the 2014 primary balance is based on the adopted 2014 budget.

Table 5: Cyclical developments

(% of GDP)	ESA code	2013	2014	2015	2016	2017
1. Real GDP growth (%)		0.9	2.3	3.0	3.2	3.4
2. Net lending of general government	EDP B.9	-2.8	-2.6	-2.5	-1.6	-0.5
3. Interest expenditure	EDP D.41	2.0	1.8	1.8	1.8	1.7
4. One-off and other temporary measures	[1]	0.3	0.6	0.0	0.0	0.0
5. Potential GDP growth (%)		2.1	2.0	2.0	1.8	1.9
contributions:		0.0	0.0	0.0	0.0	0.0
- labour		-0.2	-0.2	-0.2	-0.3	-0.3
- capital		0.0	0.1	0.2	0.2	0.2
- total factor productivity		2.3	2.1	2.0	2.0	2.0
6. Output gap		-3.5	-3.2	-2.2	-0.9	0.5
7. Cyclical budgetary component		-1.2	-1.1	-0.7	-0.3	0.2
8. Cyclically-adjusted balance (2 - 7)		-1.6	-1.6	-1.8	-1.3	-0.7
9. Cyclically-adjusted primary balance (8 + 3)		0.4	0.3	0.0	0.5	1.0
10. Structural balance (8 - 4)		-1.9	-2.2	-1.8	-1.3	-0.7

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

Source: MoF SR



Table 6: Comparison between the previous forecast and the updated forecast

ESA code	Year	Year	Year	Year	Year
	2013	2014	2015	2016	2017
Real GDP growth (%)					
Previous update*	1.2	2.9	3.3	3.6	-
Current update	0.9	2.3	3	3.2	3.4
Difference	-0.3	-0.6	-0.3	-0.4	-
General government balance (% of GDP) EDP B.9					
Previous update*	-2.9	-2.6	-2	-1.3	-
Current update	-2.8	-2.6	-2.5	-1.6	-0.5
Difference	0.1	0.0	-0.5	-0.3	-
General government gross debt (% of GDP)					
Previous update*	54.8	56.3	56.7	55.9	-
Current update	55.4	55.2	56.2	54.9	53.4
Difference	0.6	-1.1	-0.5	-1.0	-

Note: * Stability Programme for 2013 - 2016

Source: MoF SR

Table 7 - Long-term sustainability of public finances (% of GDP)*

	2010	2020	2030	2040	2050	2060
Total expenditure	42.9	44.1	46.1	49.1	54.0	60.5
Of which: Age-related expenditures	17.8	18.0	18.7	19.8	21.6	23.3
A. Pension expenditure	8.0	8.0	8.1	8.5	9.5	10.6
1. Social security pension	8.0	8.0	8.1	8.5	9.5	10.6
a) Old-age and early pensions	6.1	6.0	5.8	6.1	7.0	8.0
b) Other pensions (disability, survivors)	1.9	2.0	2.2	2.4	2.4	2.6
2. Occupational pensions (if in general government)	-	-	-	-	-	-
B. Health care	6.2	6.8	7.5	8.2	8.9	9.2
C. Long-term care	0.3	0.3	0.4	0.5	0.5	0.7
D. Education expenditure	3.1	2.8	2.7	2.5	2.6	2.7
E. Other age-related expenditures	0.2	0.1	0.1	0.1	0.1	0.1
Of which: Interest expenditure**	1.3	2.3	3.6	5.5	8.6	13.5
Total revenue	32.4	32.4	32.2	32.3	32.4	32.6
Of which: Property income (D.4)	1.4	1.0	0.9	0.9	0.8	0.8
Of which: Pensions contributions	12.6	13.0	12.9	13.0	13.2	13.4
Pension reserve fund assets	-	-	-	-	-	-
Of which: Consolidated public pension fund assets	-	-	-	-	-	-
Systematic pension reforms						
Social contributions diverted to voluntary private scheme	1.1	0.6	0.6	0.4	0.2	0.2
Pension expenditure paid by voluntary private scheme	-	-	-	-	-	-
Assumptions						
Labour productivity growth	5.5	2.7	2.0	2.0	1.8	1.5
Real GDP growth	4.0	3.1	1.9	1.3	0.9	1.0
Participation rate males (aged 15-64)	76.4	77.4	75.8	75.0	76.5	77.6
Participation rate females (aged 15-64)	61.4	65.0	65.5	64.1	65.1	66.5
Total participation rate (aged 15-64)	68.9	71.2	70.7	69.6	70.8	72.1
Unemployment rate (aged 15-64)	14.4	13.1	8.1	7.5	7.3	7.3
Population aged 65+ over total population	12.3	16.4	20.7	24.4	29.9	33.5

* Age-related expenditures as well as macroeconomic assumptions were updated after issuing Ageing report 2012

Source: MoF SR

** Baseline scenario 2015



Table 7a - Contingent liabilities

	2012	2013*
	% GDP	% GDP
Public guarantees	2.88	
of which: linked to the financial sector	0,0	

* Estimate for 2013 is currently not available.

Source: MoF SR

Table 8: Basic assumptions

	2013	2014	2015	2016	2017
Short-term interest rate (annual average)	0.22	0.27	0.37	0.99	1.99
Long-term interest rate (annual average)	2.58	2.83	3.46	4.03	4.39
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.33	1.29	1.23	1.22	1.22
World excluding EU, GDP growth	3.60	4.10	4.40	4.40	4.40
EU GDP growth	0.10	1.51	1.97	1.97	1.97
Growth of relevant foreign markets	-0.10	1.40	1.80	1.80	1.80
World import volumes, excluding EU	3.50	5.40	6.10	6.10	6.10
Oil prices (Brent, USD/barrel)	108.76	109.58	111.98	114.14	116.77

Source: Common external assumptions, MoF SR

Table 9 - Budgetary plan

% of GDP	ESA code	2013	2014	2015	2016	2017
1. General government balance	S.13 (EDP B.9)	-2.8	-2.6	-2.5	-1.6	-0.5
2. Structural balance		-1.9	-2.2	-1.8	-1.3	-0.7
3. Cyclical budgetary component		-1.2	-1.1	-0.7	-0.3	0.2
4. One-offs and other temporary measures		0.3	0.6	0.0	0.0	0.0
5. General government balance	S.13 (EDP B.9)	-2.8	-2.6	-2.5	-1.6	-0.5
6. Total revenues		35.9	35.2	33.7	32.9	32.8
6a. Total revenues at no-policy-change scenario from 2013		-	35.2	33.4	32.5	32.3
7. Total expenditure		38.7	38.0	36.5	34.9	34.0
Amounts to be excluded from the expenditure benchmark						
7a. Interest expenditure	EDP D.41	2.0	1.8	1.8	1.8	1.7
7b. Expenditure on EU programmes fully matched by EU funds revenue		1.1	1.9	1.8	1.3	1.6
7c. Cyclical unemployment benefit expenditure		0.2	0.2	0.2	0.2	0.2
7d. Effect of discretionary revenue measures (y-o-y change)		1.7	0.5	-0.1	0.1	0.0
7e. Revenue increases mandated by law		0.0	0.0	0.0	0.0	0.0
7f. Gross fixed capital formation (actual)		2.1	2.1	2.1	1.9	2.1
7g. Gross fixed capital formation (average for t-3 to t)		2.3	2.2	2.0	1.9	1.9
8. Tax burden		30.0	29.6	29.0	28.8	28.5
9. Gross debt		55.4	55.2	56.2	54.9	53.4

* Table shows fiscal targets of the government for 2014 - 2017. Total expenditure does not include additional measures to meet the targets.

Source: MoF SR



Annex 2 – Consolidation packages for 2013 – 2017

1.1 Consolidation package 2013

On the NPC assumption, the general government deficit amounted to 4.9% of GDP in 2013. The difference between the deficit level with the NPC assumption and the notified reality for 2013 represents 2.2% of GDP, i.e. EUR 1 557m. Thanks to these measures, the general government deficit of SR was lower than the set objective of 2.9% of GDP in 2013. Measures in the amount of **EUR 512m, representing 0.7% of GDP**, have a direct impact on GDP. Consolidation measures without direct impact on GDP were excluded in the calculations of the impact of the package on GDP. This category includes one-off revenues from a change in the pension system pillar and other non-tax revenues.

Based on the data notified for 2013, additional **revenue measures** with a direct impact on GDP **amounted to EUR 927m** (1.3% of GDP). Higher budget revenues were mainly driven by income taxes and social contributions from households and companies. The progressiveness of income taxes rates increased as well as social contributions of self-employed persons and workers by agreement. Collection of the enterprise levy for selected financial institutions (mainly banks) and regulated industries was enacted. As for other revenue measures, the highest additional revenue was brought by the tax on motor vehicle registration, increase in taxes and levies from gambling and a higher excise tax on tobacco products. The revenue measures had an effect on economy through a slight increase in prices and a decrease in compensations and corporate profits in the economy.

Expenditure measures with a direct impact on GDP amounted to an increase by **EUR 415m** (0.6% of GDP). They mainly included increase in current transfers (EUR 187m) and intermediate government consumption (EUR 121m). Expenditure measures had an effect on the economy through a higher public consumption, public investments and wage expenditures of general government. On the other hand, there was a decrease in expenditures in healthcare system (EUR 74m).

Table 1 – Budgetary measures with an impact on GDP (EUR mill., ESA 95, differences compared to NPC)

	Categories	Macroeconomic impact	2013
Increase in revenues with a direct impact on GDP – total (1-4) (% of GDP)	R	Compensations, prices	927 1.3
1. Increased contributions of self-employed persons and workers by agreement	R	Compensations	331
2. Increased progressiveness in tax rates	R	Compensations, prices	283
3. Special levy for financial institutions and regulated industries	R	Compensations, prices	171
4. Other non-tax revenue measures (e.g. fee for registration of motor vehicles and other items)	R	Prices	135
Increase in expenditures with a direct impact on GDP – total (5-8) (% of GDP)	E	Compensations, G, I	-415 -0.6
5. Higher expenditures on current transfers	E	Compensations	-187
6. Higher expenditures on intermediate consumption of general government	E	G	-121
7. Increase in wage expenditures of state budget	E	Compensations	-89
8. Higher investment of general government	E	I	-17
A. Total change with a direct impact on GDP (in % of GDP)	R+E		512 0.7
B. Measures without direct impact on GDP (in % of GDP)	R+E		1045 1.4
C. Total change (revenues + expenditures) (in % of GDP)	R+E		1557 2.2

Note: Impact on the GG balance, (+) means improvement and (-) worsening of the balance

Abbreviations: R – revenues, E – expenditures, I – fixed investments, G – general government consumption, compensations – impact on employment and wages



1.2 Consolidation package 2014

In the NPC scenario a general government balance of 3.8% of GDP is expected in 2014. The set fiscal objective should be reached through overall measures amounting to **1.0% of GDP, i.e. EUR 749m**. Measures in the amount of **EUR 787m**, have a direct impact on GDP, **representing 1.1% of GDP**. Mainly a decrease in grants and transfers are included in the measures with no impact on GDP in the amount of 0.1% of GDP, while it is expected that they are mainly revenues from abroad.

Revenue measures with a direct impact on GDP amount to **EUR 342m** (0.5% of GDP). Continued levies in regulated industries have the biggest impact (EUR 256m), followed by tax licences and other changes in income taxes (EUR 91m). Similarly to 2013, the revenue measures should have an effect on the economy through a slight increase in prices and a decrease in compensations and corporate profits in the economy.

Expenditure measures with a direct impact on GDP include **savings by EUR 445m** (0.6% of GDP). It contains mainly a decrease in wage expenditures (EUR 279m), intermediate government consumption (EUR 184m) and fixed investment (EUR 89m). Expenditure measures will have an effect on the economy through lower government consumption, public investment and compensation of employees.

Table 2 – Budgetary measures with an impact on GDP (EUR mill., ESA 95, differences compared to NPC)

	Categories	Macroeconomic impact	2014
Increase in revenues with a direct impact on GDP – total (1-2) (% of GDP)	R	Compensations, prices	342 0.5
1. Special levy in regulated industries	R	Compensations, prices	256
2. Tax licences and other changes in income taxes	R	Compensations, prices	91
3. Other changes in non-tax revenues	R	Compensations, prices	-5
Decrease in expenditures with a direct impact on GDP – total (5-8) (% of GDP)	E	Compensations, G, I	445 0.6
4. Decrease in wage expenditures of state budget	E	Compensations	279
5. Savings in the intermediate consumption of general government	E	G	184
6. Savings in investment of general government	E	I	89
7. Higher expenditures on current transfers	E	Compensations	-146
A. Total change with a direct impact on GDP (in % of GDP)	R+E		787 1.1
B. Measures without direct impact on GDP (in % of GDP)	R+E		-38 -0.1
C. Total change (revenues + expenditures) (in % of GDP)	R+E		749 1.0

Note: Impact on the GG balance, (+) means improvement and (-) worsening of the balance

Abbreviations: R – revenues, E – expenditures, I – fixed investments, G – general government consumption, compensations – impact on employment and wages

1.3 Consolidation packages for 2015 – 2017

In the first scenario for 2015 – 2017, which assumes achieving the targeted fiscal objectives, the need for consolidation measures is estimated at 1.2% of GDP in 2015, 1.7% of GDP in 2016 and 2.5% of GDP. It is a cumulative need for measures compared to the NPC scenario; this means that in the case of adoption of permanent measures, the need of additional measures decreases in the following years by the volume of already implemented measures. **With the assumption of permanent measures, the overall need for measures would amount to EUR 904m (1.2% of GDP) in 2015, EUR 482m (0.5% of GDP) in 2016 and EUR 748m (0.8% of GDP) in 2017.**

Table 3 – Amount of consolidation measures (ESA 95, % of GDP) – comparison of scenarios

	2015	2016	2017
1 Cumulative consolidation need – scenario 1	1.2	1.7	2.5
- need for additional consolidation measures (year-on-year change)	1.2	0.5	0.8
2 Cumulative consolidation need – scenario 2	0.9	1.3	1.7
- need for additional consolidation measures (year-on-year change)	0.9	0.4	0.4

¹ It takes into the consideration national budgetary rules and targets ² NPC includes the impact of the change in interest costs due to a worse GG balance, but does not take into account potential changes in risk premiums of the debt

In 2015 – 2017, consolidation in the scenario 1 contains three groups of measures:

- Measures specified in the GGB framework for 2015 – 2017, described and quantified in the part III.3.2.
- Other changes included in the GGB framework against NPC in the amount of 0.4% of GDP in 2015, 0.7% of GDP in 2016 and 1.2% of GDP in 2017, cumulatively compared to NPC.
- Measures beyond the GGB framework to achieve the fiscal objectives, rising from 0.3% of GDP up to 0.7% of GDP in 2017, cumulatively against NPC.

With regard to exceeding the level of 55% of GDP of gross debt and activation of sanctions of the constitutional act (more information to be found in the Box 3), the third group of measures includes mainly expenditure measures. As no detailed information is available regarding this group, proportional distribution of expenditure cuts is expected among intermediate government consumption, wage expenditures of general government and public investment.

Table 4 – Scenario 1: Consolidation measures according to the macroeconomic impact compared to NPC (EUR mill.)

	2015	2016	2017
TOTAL	904	482	748
(% of GDP)	1.2	0.5	0.8
Public consumption	359	157	374
Intermediate government consumption	139	59	149
Compensation of employees	220	99	224
Public Investment	96	88	142
Government	48	31	70
Other	48	57	73
Gross disposable income of households	48	113	75
CPI	324	123	157
Other	76	0	0

Source: MoF SR

The second scenario for 2015 – 2017 estimate the economic impact of meeting the fiscal objectives according to the GGB framework. The difference of general government balance compared to NPC is 0.9% of GDP in 2015, 1.3% of GDP in 2016 and 1.7% of GDP. On the assumption of permanent measures, **the overall need for measures would amount to EUR 686 m (0.9% of GDP) in 2015, EUR 387m (0.4% of GDP) in 2016 and EUR 435m (0.4% of GDP) in 2017.** Compared to the first scenario, it does not contain the third group of consolidation measures to achieve the target deficits.

Table 5 – Scenario 2: Consolidation measures according to the macroeconomic impact compared to NPC (EUR mill.)

	2015	2016	2017
TOTAL	686	387	435
(% of GDP)	0.9	0.4	0.4
Public consumption	176	78	110



Intermediate government consumption	68	28	46
Compensation of employees	108	50	64
Public investment	62	73	92
Government	13	16	20
Other	48	57	73
Gross disposable income of households	48	113	75
CPI	324	123	157
Other	76	0	0

Source: MoF SR

2. The impact of consolidation on GDP in 2013 – 2017

This part contains a calculation of the total impact of consolidation on main macroeconomic indicators of the Slovak economy. The impact of the measures was estimated using the IFP macroeconomic model for medium-term forecasts.

In 2013, the consolidation package in the size of 0.7% GDP **decreased GDP by 0.2 p.p.** The fiscal multiplier is estimated at 0.2 and it is lower compared to the multiplier in 2011, estimated at 0.3. When comparing several model approaches stated in the part 3 of this Annex, the outcome is at the upper boundary of the range of the estimated multipliers. In line with the expectations, it has the most significant impact on the public consumption due to higher expenditures. Mainly as a result of increasing the contributions of self-employed persons and introducing contributions for workers by contract, the disposable income of households decreased, while the impact on the average wage is marginal thanks to the increase of wage expenditures in public sector. Employment will remain unchanged. The impact on price development through revenue measures was not significant.

The consolidation package in the volume of 1.0% of GDP **in 2014 will decrease the GDP by 0.4% p.p.** The fiscal multiplier estimated at 0.4 is higher than in 2013 and reflects a higher share of expenditure consolidation measures. The multiplier is at the upper boundary of the range of estimated multipliers for Slovakia described in the part 3. The most significant impact is on the general government consumption, wages and fixed investment. On the other hand, the impact on employment is not significant.

In the first scenario for 2015 – 2017 containing the measures in the amount of 1.2% of GDP in 2015, 0.5% of GDP in 2016 up to 0.8% of GDP in 2017 **the impact on GDP is 0.4 p.p. in 2015, 0.2 p.p. in 2016 and 0.3 p.p. in 2017.** In line with the expectations, it has the most significant impact on investment through a decrease in the public gross fixed capital formation and the public intermediate consumption. The situation in the labour market worsens slightly, resulting in a decrease in household consumption. The negative impact on the household consumption is increasing on the modelling horizon. The impact on price development is low until 2015; however, it accelerates in the following years due to slowdown of the domestic demand. The implied fiscal multipliers are estimated at 0.3 in 2015 and 0.4 in the following in both 2016 and 2017. When taking into account the structure of the measures, the estimates of multipliers are at the upper boundary of estimates in the literature.

Table 6 – Impact of measures on GDP (in p.p.) according to the IFP macro model – scenario 1

	2013	2014	2015	2016	2017
measures with a direct impact on GDP	0.7	1.0	1.2	0.5	0.8
contribution to a CPI change	0.2	-0.1	-0.1	-0.3	-0.4
employment	0.0	-0.1	-0.2	-0.2	-0.2
nominal wage	0.3	-1.0	0.0	-0.4	-0.7
household consumption	-0.4	-0.5	-0.1	-0.4	-0.5
government consumption	0.7	-1.6	-0.9	-0.2	-0.6
fixed investment	0.3	-0.7	-1.3	-1.0	-1.5
import	0.0	-0.2	-0.2	-0.2	-0.3

contribution to the YoY GDP change	-0.2	-0.4	-0.4	-0.2	-0.3
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Source: MoF SR

Scenario 2 for 2015 – 2017 represents lower consolidation effort, without meeting the national budgetary objectives. **The consolidation measures** in the amount of 0.9% of GDP in 2015, 0.4% of GDP in 2016 and 0.4% of GDP in 2017 **have an impact on GDP of 0.2 p.p. in 2015, 0.2 p.p. in 2016 and 0.2 p.p. in 2017**. Within the GDP structure, the impact on the economy is similar to the first scenario, but the response of the labour market and household consumption is relatively smaller. The impact on the price development is also lower compared to the first scenario. On a whole horizon, the fiscal multipliers have the same values as in the first scenario.

Table 7 – Impact of measures on GDP (in p.p.) according to the IFP macro model – scenario 2

	2013	2014	2015	2016	2017
measures with a direct impact on GDP	0.7	1.0	0.9	0.4	0.4
contribution to a CPI change	0.2	-0.1	-0.1	-0.2	-0.3
employment	0.0	-0.1	-0.1	-0.1	-0.1
nominal wage	0.3	-1.0	0.2	-0.3	-0.3
household consumption	-0.4	-0.5	0.1	-0.3	-0.3
government consumption	0.7	-1.6	-0.5	0.0	-0.1
fixed investment	0.3	-0.7	-0.8	-0.8	-1.0
import	0.0	-0.2	-0.1	-0.2	-0.2
contribution to the YoY GDP change	-0.2	-0.4	-0.2	-0.2	-0.2

Source: MoF SR

3. Fiscal multipliers in Slovakia

We compared the multiplier of the consolidation package for 2013 also with **estimates of fiscal multipliers according to the existing analyses** on slovak economy. We summarize the main outcomes of the study by Pécsyová (2013)⁵⁰ based on the SVAR model, OECD analysis⁵¹ and IFP analysis through the DSGE QUEST model⁵².

The fiscal multiplier is a simple expression of **by how many EUR the GDP will change, if the government changes expenditures or revenues by 1 EUR**. The amount of the multiplier depends on a number of factors. It is generally expected that multipliers are smaller in small and open economies due to losses of a part of the fiscal impulse through import. On the contrary in the case of a recession or a higher propensity to consume, higher multipliers are expected. The impact of permanent consolidation measures on the economy is more striking compared to temporary measures, as with temporary measures the economic agents may absorb secondary impacts to the decrease of their savings or profits.

According to the theory, one EUR saved in expenditures causes higher secondary impacts on GDP compared to the additional EUR collected in revenues of the budget. It is because a part of the initial fiscal impulse in the case of tax measures is absorbed by private savings, while government expenditures represent an immediate impulse for GDP. Moreover, increased income taxes of households or companies limit the motivation of economic agents. For this reason the multiplier of these measures should be higher compared to changes in the excise tax or VAT. It results from the above-mentioned analyses that the **consolidation through expenditures has higher costs compared to revenue consolidation in the form of a lost GDP growth in the short term. On the other hand,**

⁵⁰ The author estimates the impact of several expenditure and revenue consolidation measures on the Slovak GDP using the SVAR model. More details are to be found in Pécsyová, M., (2013). "Estimated impact of fiscal consolidation on GDP growth in SR", [BIATEC 4/2013](#), National Bank of Slovakia.

⁵¹ See the OECD Economic Outlook 2012

⁵² QUEST III is a structural DSGE model developed by the European Commission which was calibrated also for the Slovak economy. The model is primarily used to quantify the impacts of structural reforms, but it may also be used to analyze the impact of the majority of consolidation measures. The consolidation analysis using the QUEST model will be published in a short time.

in the medium or long term it is less painful, as it has a positive impact on the potential growth of economy.

Estimates of fiscal multipliers for the Slovak economy are in line with the consensus in the foreign literature. The Table 8 summarizes estimates of the cumulative multiplier in the first year for different kinds of measures. Changes in public investments and in current expenditures of the general government have the most striking impact on the economy. Tax measures have a slightly lower impact on the GDP growth. According to these estimates, a change in indirect taxes has the smallest impact on the economy. **A weighted multiplier of the consolidation package of 2013**, calculated according to the Table 8, is in the range of **0.03 to 0.29**.

Table 8 – Estimates of annual multipliers for Slovakia

(based on the SVAR and DSGE models and the OECD study)

	min	max	SVAR	DSGE	OECD
Expenditure measures	0.25	0.70	0.39		
Current expenditures	0.25	0.30	0.29	0.25	0.30
Capital expenditures	0.46	0.70	0.46	0.58	0.70
Revenue measures	0.10	0.30	0.15		
Direct taxes	0.10	0.30		0.19	0.10-0.30
Indirect taxes	0.10	0.20		0.20	0.10

Annex 3 – Macroeconomic Forecasts Committee

In order to achieve higher transparency and impartiality of macroeconomic forecasts, the MoF SR regularly addresses members of the Macroeconomic Forecasts Committee. After a session of the Committee held in February 2014, most members assessed the medium-term macroeconomic forecast of MoF SR as **realistic to conservative**:

Assessment of the MoF SR's February forecast by the Macroeconomic Forecasts Committee	
Committee member	Forecast characteristics
NBS	realistic
Infostat	realistic
VÚB	realistic
Tatrabanka	realistic
SLSP	realistic
UNICREDIT Bank	conservative
ČSOB	realistic
Sberbank	realistic
SAS	-

Source: Macroeconomic Forecasts Committee

Average forecast of selected indicators of economic development in SR by members of the Macroeconomic Forecasts Committee (except for MoF SR) and MoF SR forecast									
in %, unless stated otherwise	2013	2014		2015		2016		2017	
		Committee	MoF SR	Committee	MoF SR	Committee	MoF SR	Committee	MoF SR
Gross domestic product, real growth	0.9	2.2	2.3	3.0	3.0	3.2	3.2	3.3	3.4
Gross domestic product in current prices; EUR billion	72.1	74.5	74.5	77.8	77.8	81.7	81.7	85.8	86.2
Final households consumption; real growth	-0.1	1.2	1.2	1.8	2.2	2.1	2.4	2.3	2.9
Final households consumption; nominal growth	1.2	2.3	2.0	3.9	4.3	4.4	4.7	4.5	5.4
Average monthly wage; real growth	1.0	1.7	1.7	1.4	1.5	1.6	1.8	1.7	2.1
Average monthly wage; nominal growth	2.4	2.6	2.5	3.5	3.5	4.0	4.1	4.2	4.5
Employment increase (statistical finding)	-0.7	0.2	0.3	0.4	0.6	0.5	0.7	0.6	0.9
Consumer price index; average growth; CPI	1.4	0.7	0.8	2.1	2.1	2.3	2.3	2.5	2.4
Current account balance (% of GDP)	2.2	3.1	4.5	3.2	5.3	2.8	6.1	2.9	6.9

Source: Macroeconomic Forecasts Committee



Annex 4 – Tax Revenue Forecasts Committee

After meeting of the Macroeconomic Forecasts Committee, a meeting of the Tax Revenue Forecasts Committee was held on 12 February 2013 as well. At this meeting, the MoF SR presented its updated medium-term forecast of tax revenues for 2013 – 2017. The medium-term forecast of tax revenues and social security contributions of the MoF SR was identified as realistic by all members of the Committee.

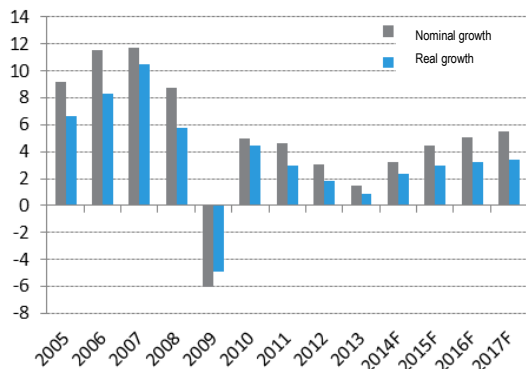
Assessment of the MoF SR forecast by the Tax Revenue Forecasts Committee	
Committee member	Forecast characteristics
NBS	realistic
Infostat	realistic
ING Bank	realistic
Tatra banka	realistic
ČSOB	realistic
SLSP	realistic
UniCredit Bank	realistic

Source: Tax Revenue Forecasts Committee



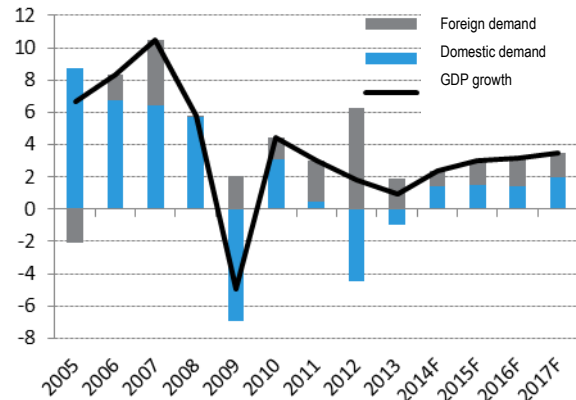
Annex 5 – Charts

GDP growth (in %)



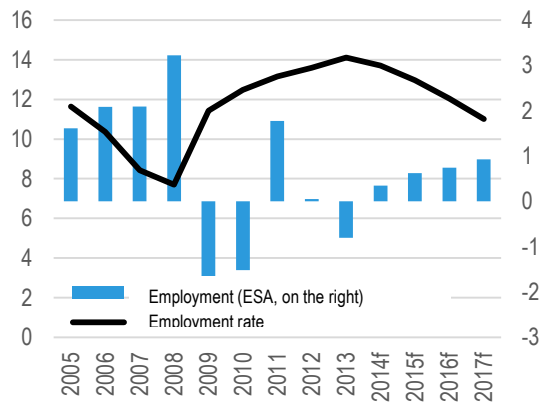
Source: SO SR, MoF SR

Contributions to the GDP growth (in p.p.)



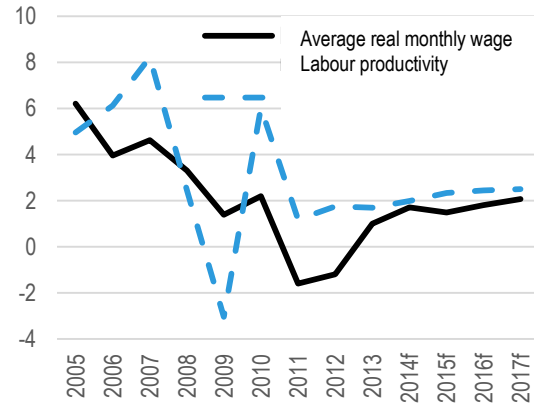
Source: SO SR, MoF SR

Economic activity according to LFS in %



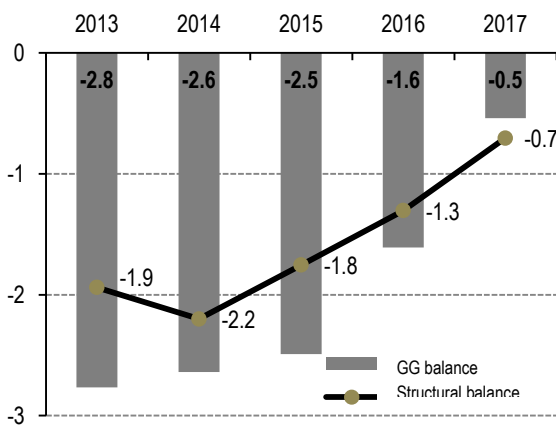
Source: SO SR, MoF SR

Growth of real wage and labour productivity in %



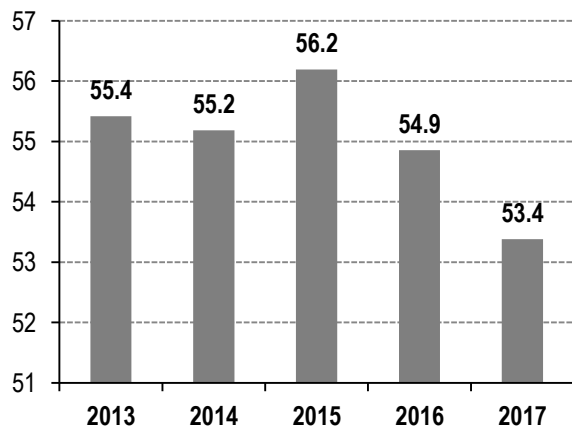
Source: SO SR, MoF SR

General government deficit (% of GDP)



Source: MoF SR

Gross general government debt (% of GDP)



Source: MoF SR