

**Draft Budgetary Plan
of the Slovak Republic for 2014**

October 2013



Table of Contents

SUMMARY	3
I. Macroeconomic assumptions of the budget proposal	5
I.1. External assumptions – gradual recovery in the external environment.....	5
I.2. Macroeconomic forecast - growth to be driven by household consumption.....	6
I.3. Consolidation effects.....	8
I.4. Forecast assessment by the Macroeconomic and Tax Revenue Forecasting Committees.....	10
II. Budgetary objectives	12
II.1. Recent development in public finances.....	13
II.2. Structural balance and expenditure benchmark.....	15
II.2.1. Structural balance	15
II.2.2. Expenditure benchmark	19
II.3. General government gross debt forecast.....	20
III. Revenue and expenditure targets of the general government budget	23
III.1. Revenue targets of the general government budget.....	23
III.2. Expenditure targets of the general government budget by function	23
III.3. General government balance under the no-policy-change scenario.....	25
III.4. Description of measures	26
IV. Linking the budgetary plan with the objectives of the Growth and Employment Strategy and Country-specific Recommendations of the European Commission	34
V. Divergence from the Stability Programme	35
ANNEXES	36

SUMMARY

The key objective of Slovakia's fiscal policy is to safeguard **effective and sustainable public finances that support sustainable economic growth and improve the quality of life**, while taking into account population ageing and contingent liabilities. This objective is also enshrined in the constitutional Fiscal Responsibility Act. The draft budgetary plan takes into account both the national and European legislation, and creates conditions for Slovakia to attain its medium-term budgetary objective (MTO).

Under the ongoing excessive deficit procedure, Slovakia's short-term fiscal objective is to bring its general government deficit below 3% of GDP in 2013 on a sustainable basis. The general government deficit stood at 4.3% of GDP in 2012, an improvement against the original budgetary target of 4.6% of GDP. The general government deficit was planned to reach 2.94% of GDP in 2013. Based on the most recent information on the positive factors and risks in the 2013 general government budget development, the deficit is likely to reach 2.98% of GDP, which means a consolidation effort of 1.3% of GDP. **This result meets the most important condition for Slovakia's exit from excessive deficit procedure.**

In the medium term, the draft budgetary plan is based on the proposal of the general government budget for 2014-2016, approved by the Slovak Government on 10 October 2013. General government deficit targets have been set at 2.83% of GDP in 2014, 2.57% of GDP in 2015 and 1.50% of GDP in 2016. The meeting of these targets will bring the rise in the ratio of public debt to GDP to a halt and enable its gradual reduction from 2015 onward.

Compared to the no-policy-change scenario, the measures necessary to meet the 2014 target represent 1.8% of GDP. The most important revenue measures in the total amount of 1.5% of GDP include higher dividends from state corporations, extraordinary revenue from the Telecommunications Regulatory Authority, and capital revenues from the ESO public administration reform. Public revenues will decrease due to a reduction in the corporate income tax rate. On the expenditure side, the largest savings of 0.3% of GDP will come from the ESO reform.

The public deficit will continue to decline in 2014. A moderate structural expansion at 0.2% of GDP will occur against the backdrop of the continuing adverse macroeconomic situation and the need to take measures to revive economic growth. **As a consequence, Slovakia has applied for the so-called investment clause in 2014 in order to be able to comply with the rules defined by the preventive arm of the Stability and Growth Pact.** This relief will be offset by faster structural restriction once the economic situation has improved.

The draft budgetary plan is prepared under the new requirements introduced through Regulation (EU) No 473/2013 of the European Parliament and of the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (part of the so-called Two-Pack), approved in May 2013.

The aim of the Regulation is to improve the coordination of fiscal and structural policies while taking into account the rules of the Stability and Growth Pact and the Europe 2020 strategy. One of the specific instruments employed to achieve this objective are the 'draft budgetary plans' that present developments in fiscal position, expected economic development and descriptions of the fiscal policy measures needed to achieve medium-term objectives.

Under Regulation (EU) No 473/2013, the Member States in the euro area are required to publish their draft budgetary plans by 15 October. The European Commission will subsequently publish its opinion on each draft budgetary plan; if a serious breach of the Stability and Growth Pact is identified, the Commission may request that the Member State concerned redraft its budgetary plan.



The content and the format of the document are in full compliance with the guiding principles of the European Commission. Similarly to the stability programme, the budgetary plan has been prepared in accordance with the documents specifying the minimum requirements for budgetary plans - *“Specifications on the implementation of the Two Pack”* and *“Guidelines on the format and content of draft budgetary plans, economic partnership programmes and debt issuance reports”*.

I. Macroeconomic assumptions of the budget proposal

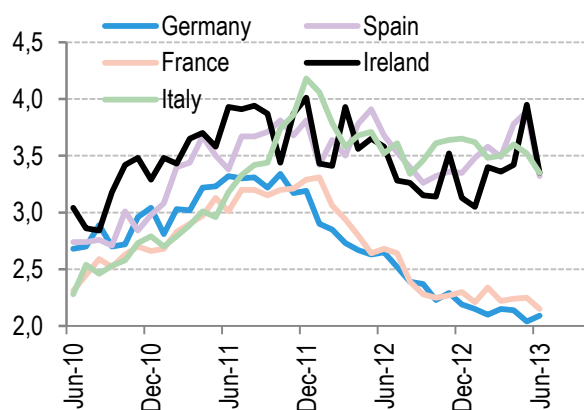
I.1. External assumptions – gradual recovery in the external environment

The developments in the external environment will have a positive impact on Slovak economy. However, the economic recovery of our trading partners will be slow and gradual. Germany's 2014 economic growth, a key driving force in the euro area, is unlikely to exceed the level of 2%. The euro area's high unemployment, coupled with prevailing imbalances, will tone down any considerable recovery of economic activity abroad.

The conditions on financial markets remain positive. Developed capital markets continue to show surplus liquidity, with share prices oscillating around their all-time-highs. Nevertheless, their volatility has moderately increased from a short-term perspective. The main reason has been concerns about the earlier-than-desirable relaxation of the Fed's expansive monetary policy, which are now gradually subsiding. With corrections made to the excessively low bond yields, the yields on German and US bonds have begun to rise slightly.

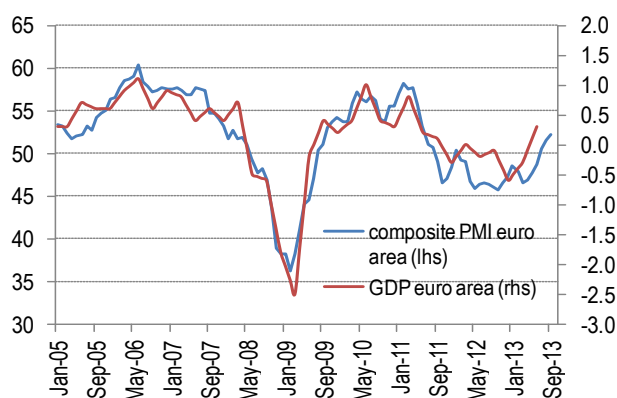
The financial markets in the euro area remained stable and the bonds of the euro area's periphery countries stayed at safe levels (Chart 1). The surplus liquidity has also already started to be felt in the real economy. The corporate lending activity in the euro area has bounced off the bottom, hinting at a change in trends. However, the euro area's small and medium-sized enterprises are still struggling with unfavourable conditions. Their profits decline and bankruptcies increase. Oil price (BRENT) stayed within the 100-115 USD/bl. range for most of 2013. Its movement within this range was mainly driven by geo-political developments in the Middle East, mainly the situation in Egypt and, later, by the risk of a military conflict in Syria. At the moment, a slight appreciation of the euro, with its exchange rate above the 1.35 USD/EUR level, has a positive impact on oil prices denominated in euro, as well as on inflation.

Chart 1: Interest rates for corporate lending in selected euro area countries



Source: Bloomberg

Chart 2: PMI and GDP growth in the euro area



Source: Eurostat, European Commission

The recession in the euro area ended after a year and a half. Its GDP grew in the second quarter, primarily driven by positive developments in Germany and France. The growth in the euro area's economies was no longer driven solely by net exports, but also by an increase in household consumption. **Forward-looking indicators suggest that the euro area will continue to grow in the second half of the year** (Chart 2). German economic sentiment indices (IFO and ZEW) indicate that Germany, an important trading partner of Slovakia, will continue its economic growth in the second half of 2013.

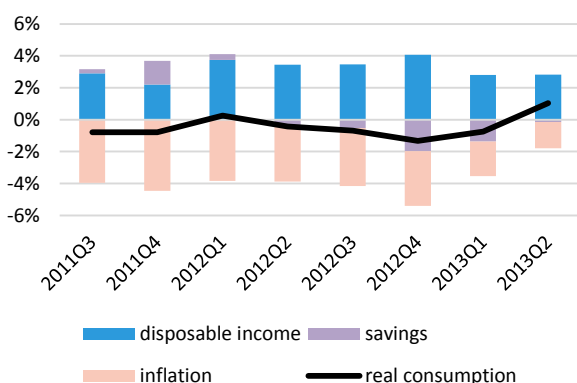
The 2014 outlook is more favourable, with the economies of our trading partners expected to recover gradually. The euro area's GDP growth is expected to increase to 0.9% in 2014 (compared to -0.5% in 2013). A stronger growth in the euro area economies will be hampered in the following years by several factors - high unemployment, persisting imbalances, and slower growth in developing countries.

I.2. Macroeconomic forecast - growth to be driven also by household consumption

A more favourable development across the euro area helps the Slovak economy to maintain its export performance and improves its prospects. In addition to growing exports, domestic consumption is showing signs of recovery due to rebounding consumer confidence and slower price growth. The Slovak economy will gradually pick up speed and its growth is likely to exceed 3% at the end of the forecast period.

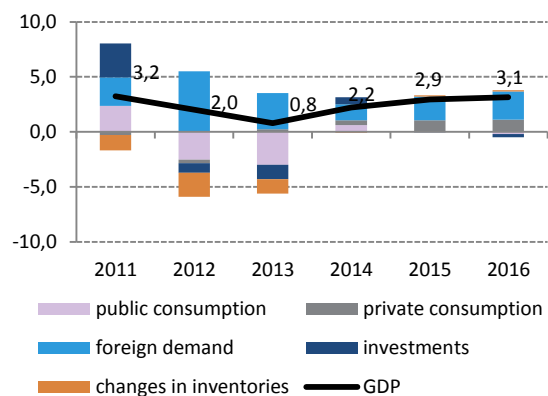
The positive development in the second quarter confirms that the Slovak economy is gradually recovering. The economy grew by 0.3% compared to the previous quarter. Foreign trade remains the key driver of Slovakia's economic growth, fuelled by higher exports and lower imports. However, household consumption increased as well for the first time since the 2009 crisis. The increase is mainly due to lower inflation and stronger confidence in future economic development (Chart 3). Nominal wages are pushed upwards by a higher growth in labour productivity. Moreover, a gradual decline in prices is having a positive impact on real wages and purchasing power. However, the overall economic growth has so far been insufficient to boost employment. General government consumption remains curbed by the ongoing consolidation of public finances. No signs of recovery have yet been seen in fixed investments and inventory re-stocking; therefore, domestic demand continued to shrink despite improved household consumption (Chart 4).

Chart 3: Development in household consumption (p.p.)



Source: MoF SR

Chart 4: Contributions to GDP growth (p.p.)



Source: MoF SR

The Slovak economy will grow by 0.8% this year. In 2014, Slovakia's GDP is expected to grow at a rate of 2.2%. Exports will remain the key driver of economic growth (Chart 4). In addition, household consumption will also make a positive contribution to GDP growth, which will be driven mainly by gradual improvements in the labour market and a moderate price growth. Investments already announced in the automotive sector, along with planned motorway construction projects, will contribute towards the 2014 investment growth despite the continued decline in corporate lending and adverse developments in profitability. The ongoing fiscal consolidation effort will curb general government consumption. A gradual increase in both domestic and foreign demand in the following years will speed up economic growth towards the 3-percent level in the medium term.

The unemployment rate is expected to peak this year. Despite gradual economic recovery, a more considerable increase in employment can only be expected in subsequent years. As far as the market structure is concerned, positive impacts in the labour market can be felt from large companies operating in the sectors of market services and manufacturing. On the other hand, employment in the small-businesses sector develops unfavourably.

After two years of decline, real wages will increase by 0.9%, with additional **moderate acceleration** expected in the years to come. The growth in real wages is mainly due to the fact that inflation shocks in the energy sector are ebbing. This trend is likely to continue in the following years, having a positive effect on the growth in real wages and purchasing power. The upward pressure on nominal wages will step up mainly due to increasing labour productivity in the private sector, and in industry in particular. The growth in public-sector wages will be stifled by the consolidation of public finances. The gradual pick-up in the eurozone's aggregate demand will also have a positive impact on wages.

The 2013 inflation will slow down considerably, to 1.6%, and remain at approximately the same level in 2014. The price growth deceleration is mainly due to considerably slower growth in regulated prices and the low net-inflation values. The recovery of economic activity next year will push net inflation up slightly; however, its increase will be curbed by lower food-price growth due to high announced harvest yields. The growth in regulated prices will remain at the 2013 low levels, primarily due to the cuts in electricity prices for households as of January 2014. In subsequent years, inflation will gradually rise above 2%.

Box 1: Estimate of the output gap for 2013 and 2014

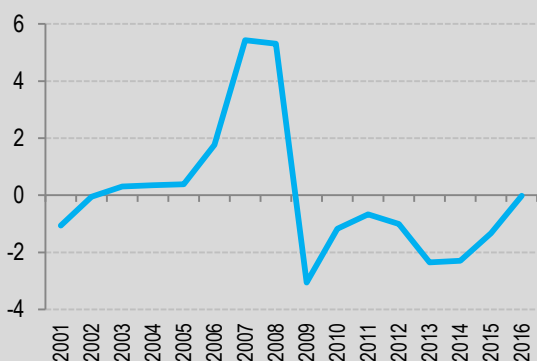
According to the Ministry of Finance's forecast, prepared in accordance with the Commission's methodology, Slovakia's output gap for 2013 and 2014 is estimated to reach -2.4% and -2.3% respectively. Therefore, no major reduction in the cyclical component is expected in 2014 and the economy will remain under its potential. The cyclical component should have only a moderate impact on the structural deficit's estimate.

The aim of the presented output gap forecast is to converge, in terms of methodology, to the Commission's estimate to be used to assess Slovakia's structural balance. Hence the Ministry of Finance applied the Commission's uniform methodology to the output gap estimate. The data on the 2013 and 2014 economic situations are based on the ministry's September forecast. The goal is to replicate the output gap based on the latest forecasts of the Ministry of Finance using the Commission's uniform methodology.

The Commission's methodology consists of two steps. Firstly, the estimates and projections are made for the trend unemployment rate which is consistent with a stable growth in wages in the economy (so-called NAWRU) and for the trend component of total factor productivity (so-called trend TFP). For this purpose, the Commission uses the publicly available GAP programme which disaggregates, using the Phillips curve and Kalman filter, the unemployment rate and total factor productivity into a trend and cyclical component. Since the most recent settings of the Commission's model are not yet available, the Ministry of Finance used the NAWRU and trend TFP contained in the Commission's spring forecast.

In the next step, the estimated trend components of unemployment (NAWRU) and total factor productivity (trend TFP) are used as inputs to forecast the actual output gap in the CONV programme (Chart A). The CONV output gap estimate model is based on the decomposition of the production function of the economy into labour, capital and total productivity factor contributions (Tab A).

Chart A: Output gap development (as % of potential GDP) – Commission approach



Source: MoF SR

Table A: Contributions of productivity factors to the growth in potential GDP – Commission approach

	Pot. GDP (growth, %)	TFP*	Stock of capital	Labour
2008	5.9	3.1	1.5	1.2
2009	3.3	2.7	0.3	0.2
2010	2.4	2.6	0.4	-0.6
2011	2.7	2.4	0.8	-0.5
2012	2.3	2.2	0.4	-0.3
2013F	2.2	2.1	0.1	-0.1
2014F	2.1	2.0	0.2	-0.1
2015F	1.9	1.9	0.2	-0.2
2016F	1.7	1.9	0.1	-0.3

*Total factor productivity

Source: MoF SR

I.3. Consolidation effects

The 2014 consolidation will reduce GDP growth by 0.2 p.p. Under the no-policy-change scenario (NPC), the general government deficit should amount to 4.6% of GDP in 2014. In contrast to the no-policy-change scenario, the general government budget proposal contains **measures amounting to 1.8% of GDP, or EUR 1,351 million**, which should ensure that Slovakia's general government deficit meets the target of 2.8% of GDP in 2014. Of that, measures worth **EUR 428 million, or 0.6% of GDP**, have a direct effect on GDP. This section quantifies the overall consolidation effect on the key macroeconomic values of the Slovak economy.

Table 1: Size of consolidation measures (ESA 95, as % of GDP)

	2014
1. General government balance under the NPC scenario*	-4.6
2. General government balance - budget	-2.8
3. Size of consolidation measures (2-1)	1.8
- in EUR million	1,351
4. Size of measures with a direct effect on GDP	0.6
- in EUR million	428

* NPC includes the effect of changes in interest costs due to impaired general government balance, but does not factor in possible changes in debt risk premiums.

The consolidation measures without a direct effect on GDP have been included in the calculation of the consolidation package's impact on GDP. This category of measures includes extraordinary (windfall) revenues of the Telecommunications Regulatory Authority; the carryover of dividend payments from 2013 to 2014; the components whose revenues and expenditures mutually offset, resulting in a neutral impact on the budget (the reserve for better-than-expected collection of VAT and the change in public health insurance payments by the state); capital revenues from the sale of assets; and higher revenues from social contributions due to increased wage expenditures in the public sector. These components total **EUR 923 million**.

The expenditure measures with a direct effect on GDP, which are included in the 2014 consolidation package, represent a **reduction in expenditures by EUR 265 million (0.3% of GDP)**. They primarily involve cuts in intermediate consumption (EUR 137 million), changes in healthcare expenditures (EUR 175 million), and in other expenditures that mainly include current transfers and wage expenditures (EUR 16 million). Higher investments by local governments (EUR 63 million) have a counter-effect. The expenditure measures will affect the economy

through lower final government consumption and reduced compensations paid to public servants, which will be partially offset by higher public investments. The 2014 general government budget proposal contains additional **revenue measures** with a direct effect on GDP in the amount of **EUR 163 million** (0.2% of GDP). The revenue measures should impact the economy through a moderate increase in prices and a decline in compensations and profits.

Table 2: Fiscal measures with effect on GDP (in EUR million, ESA 95, differences against NPC)			
	Category	Macroeconomic effects	2014
Increase in revenues with a direct effect on GDP, total (1-3)	R	compensations, I, CPI	163
<i>(as % of GDP)</i>			0.2
1. Permanent levy on business operations in regulated industries	R	compensations, I	79
2. Reduction of the corporate income tax rate to 22%	R	compensations, I, CPI	-37
3. Introduction of the minimum tax liability with respect to corporate income tax	R	compensations, I, CPI	121
Decrease in expenditures with a direct effect on GDP, total (4-8)	E	compensations, G, I	265
<i>(as % of GDP)</i>			0.3
4. Cuts in public sector's payroll expenditures ¹	E	compensations, G	5
5. Cuts in expenditures on central government intermediate consumption	E	G	137
6. Changes in healthcare expenditures	E	G	175
7. Increased general government investments	E	I	-63
8. Other changes in expenditures	E	G	11
A. Total changes with a direct effect on GDP	R+E		428
<i>(as % of GDP)</i>			0.6
B. Measures with no direct effect on GDP	R+E		923
<i>(as % of GDP)</i>			1.2
C. Total changes (revenues + expenditures)	R+E		1,351
<i>(as % of GDP)</i>			1.8

Note: This describes the effect on general government balance, i.e., (+) means an improvement and (-) a deterioration in balance. abbreviations: R – revenues, E – expenditures, I –fixed investments, G –general government consumption, compensations – effects on employment and wages

The impact of these measures, along with their secondary effects, has been calculated using the IFP macroeconomic model (see methodology Annex 1). **The consolidation measures with a direct effect on GDP in the amount of 0.6% of GDP will reduce GDP growth by 0.2 p.p., approximately.** It means that the fiscal multiplier of the consolidation package is somewhere near 0.3. For comparison's sake, the 2011 package multiplier was 0.4 and the 2013 multiplier was 0.3². Government consumption will be most affected by the consolidation package, while it will only have a moderate negative effect on wages, employment and household consumption. In view of the stifled economic activities, the growth in investments and demand for imported goods will also slacken. The effect on consumer prices will be negligible.

¹ It represent a cumulative sum of two effects: savings from the ESO reform and an increase in wages of civil servants and teachers. More details in section IV.2.

² The estimates for 2011 and 2013 are based on the average values of multipliers according to the Institute for Financial Policy (IFP) macroeconomic model, SVAR analysis in the "Estimate of fiscal consolidation effects on the GDP growth in Slovakia" (*Odhad vplyvu fiškálnej konsolidácie na rast HDP v SR*) and the Ministry of Finance's DSGE model. The 2011 estimates were based on real figures, while public finance development forecasts were used to make estimates for 2013 and 2014.

Table 3: Effects of measures on GDP (p.p.) according to the IFP macro-model

	2014
Measures with a direct effect on GDP	-0.6
Contribution to the change in CPI	0.0
employment	-0.1
wages	-0.1
household consumption	-0.1
government consumption	-2.6
investments	-0.1
imports	-0.2
Contribution to a year-on-year change in GDP	-0.2

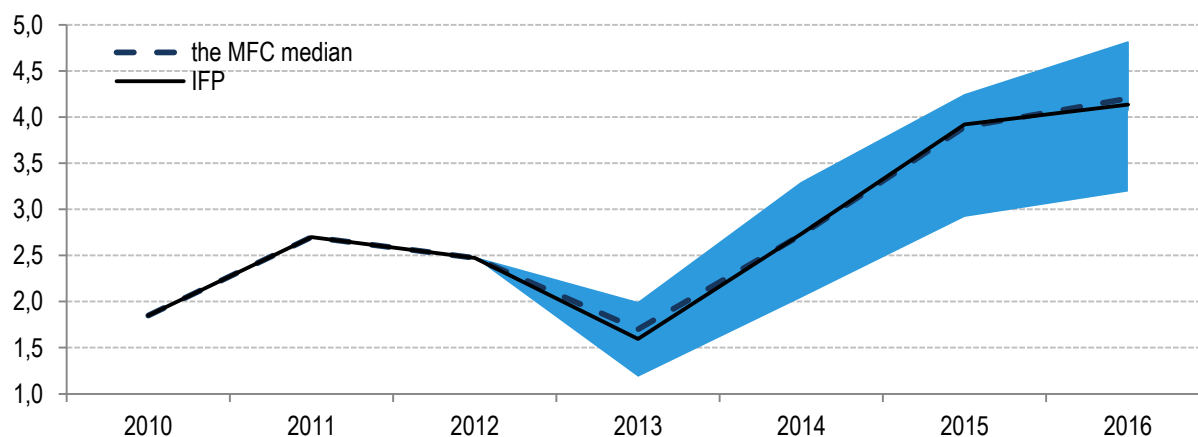
Source: MoF SR

I.4. Forecast assessment by the Macroeconomic and Tax Revenue Forecasting Committees

The majority of members of the Macroeconomic Forecasting Committee (NBS, Infostat, Tatra banka, UniCredit, SLSP, VÚB and Sberbank) described the current medium-term macroeconomic development forecast, prepared by the Ministry of Finance, as **realistic**; ČSOB was the only Committee member to assess the forecast as optimistic.

The Ministry's forecast is very close to the median of the Macroeconomic Forecasting Committee members in terms of effects on budget revenues. The effect is expressed as a weighted average of individual relevant bases for budget revenues, where weights are given by the share of individual taxes in total budgetary revenues.¹

Chart 2: Comparison of forecasts of macroeconomic bases³ for budget revenues with MFC members



Source: MoF SR

The updated tax revenue forecast, prepared by the Ministry of Finance and included in the budget proposal, is a follow-up to the macroeconomic forecast; **all members** of the Tax Revenue Forecasting Committee (NBS, Infostat, ČSOB, SLSP, Tatra banka a UniCredit Bank) considered the tax revenue forecast as **realistic**.

³ Macroeconomic bases for budgetary revenues (the weight of indicators depends on the share of individual taxes in the total tax and social contribution revenues); Wage base (employment + nominal wage) – 51.1%, Nominal private consumption – 25.7%, Real private consumption – 6.6%, Nominal GDP growth – 9.9%, Real GDP growth – 6.7%



The Macroeconomic Forecasting Committee (MFC) and the Tax Revenue Forecasting Committee (TRFC) were established under constitutional Fiscal Responsibility Act (Act No. 493/2011) as advisory bodies to the Minister of Finance. The role of the committees is to ensure greater transparency, objectiveness and quality of macroeconomic and tax revenue forecasts. Both committees prepare their forecasts at least twice a year, by 15 January and 30 June of the current fiscal year. In exceptional cases, the committees may be convoked either by the Minister of Finance or by committee members subject to approval by a simple majority. General government entities must take into account the forecasts prepared by the committees when drafting their budgets.

In addition to the Ministry of Finance officials, the committees consist of representatives of independent institutions (NBS, Slovak Academy of Sciences, Infostat and private banks). The Macroeconomic Forecasting Committee members assess the Ministry's macroeconomic forecasts using the terms *conservative*, *optimistic* or *realistic*. The Ministry's tax revenue forecasts are assessed by the Tax Revenue Forecasting Committee members by submitting their own forecasts; the final assessment is calculated automatically, based on a deviation between the two. **An MFSR forecast is accepted by the MFC or the TRFC if graded as 'conservative' or 'realistic' by a simple majority of its members.** In the absence of such grading, the Ministry is required to redraft its forecast and submit it to the Committee for re-assessment. The procedure is repeated until the MFSR forecast is accepted by the MFC or the TRFC as its own forecast.



II. Budgetary objectives

The main objective of Slovakia's fiscal policy is **to reduce the general government deficit in a sustainable manner for Slovakia to meet the requirements under the excessive deficit procedure**. In order to achieve this objective, the general government deficit target was set at 2.94% of GDP for 2013. The most recent deficit estimate is slightly higher (2.98% of GDP), mainly due to worse-than-expected macroeconomic performance, but still sufficient to meet the most important of the conditions for the abrogation of the excessive deficit procedure.

The general government budget proposal assumes that reduction in general government deficit will continue, with **the 2014 deficit target set at 2.83% of GDP**. Nevertheless, moderate structural expansion of 0.2% of GDP will occur, reflecting the continuing deteriorated macroeconomic situation and the need to take measures to boost economic growth. **As a consequence, Slovakia will apply for the so-called investment clause in 2014 in order to be able to comply with the rules defined by the preventive arm of the Stability and Growth Pact**. It also means that this relief will be offset by faster structural restriction once the economic situation has improved.

Under the set budgetary objectives, the general government gross debt is expected to increase from 52.1% of GDP at the end of 2012 to **56.8% of GDP at the end of 2014** (of which international commitments account for 3.5 p.p. in particular, Slovakia's commitments to the aid to Greece, Portugal and Ireland under the European Fiscal Stability Facility represent 2.7 p.p., while payments to the European Stability Mechanism represent 0.9 p.p.). **It means that the general government debt will remain below the reference value set under the Pact, as well as below the upper limit of the debt brake throughout the entire period**. Such a development will, however, trigger certain sanction mechanisms under the constitutional Fiscal Responsibility Act, which implies additional fiscal policy restrictions in the medium term (described in more detail in Box 2).

Box 2: Application of the Fiscal Responsibility Act provisions under the current debt forecast

The general government gross debt increased to 52.1% of GDP at the end of 2012. It exceeded the first threshold (set at 50% of GDP) defined under the constitutional Fiscal Responsibility Act, a situation in which the Minister of Finance must deliver to the Parliament an explanatory letter setting out the reasons for such debt development and proposing a set of measures designed to reduce the debt.

The 2013 and 2014 debt forecasts imply the activation of additional two sanction mechanisms under the Fiscal Responsibility Act.

Slovakia's gross debt is expected to reach 54.3% of GDP at the end of 2013, thus **exceeding the 53-percent debt threshold**. Once this figure is officially published, most likely in April 2013, the Government will submit to the Parliament a proposal for debt-reduction measures and reduce the salaries of the cabinet members to the previous fiscal year's level.

The 55-percent threshold is to be exceeded at the end of 2014, with the gross debt estimated to reach 56.8% of GDP; the figure will most likely be officially published in April 2015. It means that, in addition to the steps taken under the previous procedure (when the debt exceeds the 53% threshold), the Ministry of Finance will block, within a month following the publication of the debt data, 3% of total state budget expenditures, except for expenditures on the state debt service, EU funds and national co-financing, transfers to EU budget, transfers to the Social Insurance Agency, and expenditures to remedy damages caused by natural disasters. At the same time, the Government is not allowed to submit to the Parliament a budget proposal for 2016 that would entail a year-on-year nominal growth in total government expenditures (except for expenditures on the state debt service, EU funds and national co-financing, contributions to EU budget, and expenditures to remedy damages caused by natural disasters) and local governments will be obliged to approve their budget expenditures at a level no higher than in the previous year (except for EU funds and national co-financing and expenditures to remedy damages caused by natural disasters). At the same time, no funds may be released from the Prime Minister's and Government's reserves.

II.1. Recent development in public finances

The general government budget proposal for 2014 takes into account the most recent development in public finances, estimated using the macroeconomic and tax revenue forecasts of September 2013 and based on the development in all components of the general government budget. **The estimated deficit will reach 2.98% of GDP (the original deficit target was set at 2.94% of GDP), which is still in compliance with the most important condition for the abrogation of the excessive deficit procedure.**

Tab 4: Current estimate of general government balance in 2013 (ESA 95)

	EUR million	% GDP
General government balance - budget	-2 187	-2.94
A. Change in general government revenues	-618	-0.85
1. Tax and social contribution revenues of general government	-521	-0.71
2. Non-tax revenues	-97	-0.13
- Sale of emergency oil stocks	371	0.51
- Fee for the emergency oil stock management	-28	-0.04
- Dividends from corporations with government's equity participation	-377	-0.52
- Extraordinary revenues of the Telecommunications Regulatory Authority	-130	-0.18
- Revenues from the sale of CO2 allowances	-46	-0.06
- Grants accepted (state budget, public tertiary schools, National Nuclear Fund)	62	0.08
- Other non-tax revenues (administrative fees)	51	0.07
B. Change in general government expenditures	630	0.86
3. Expenditures on national co-funding to EU funds	403	0.55
4. Reserve for the opening of the fully-funded pension system pillar	229	0.31
5. Savings in state budget expenditures	251	0.35
6. General government interest expenditure	54	0.07
7. Debt of healthcare facilities	-100	-0.14
8. Expenditures of other general government entities	-207	-0.28
- Local governments (risk)	-152	-0.21
- Public health insurance	83	0.11
- Other entities	-138	-0.19
General government balance - estimate	-2 175	-2.98

(+) indicates a positive impact on government balance (higher revenues, savings in expenditures)

The lower-than-budgeted tax revenues, by EUR 521 million (0.7% of GDP), are mainly attributable to the worse economic development. Updates to the macroeconomic forecast account nearly for three quarters⁴ of the total shortfall in tax revenues, compared to what was expected in the 2013 budget:

- A considerable economic slowdown reduced **the revenues from social and health contributions, by EUR 105 million (0.1% of GDP).**
- **The shortfall of EUR 272 million (0.4% of GDP) in revenues from corporate income tax** was mainly caused, in addition to the sluggish economic growth, by declining corporate profits.

⁴ Under the applicable [methodology for the assessment of the development in tax revenues](#), approved by the Tax Revenue Forecasting Committee, a portion of this effect comes from the updated estimate of positive effects of the adopted consolidation measures included in the tax revenues based on a more negative macroeconomic development.



- **The shortfall of EUR 87 million (0.1% of GDP) in excise taxes** was primarily caused by lower collection of taxes on mineral oils and tobacco products.
- On the other hand, **additional one-off revenue from the levy on business operations in regulated industries is expected to yield EUR 50 million (0.1% of GDP).**

Non-tax revenues have a negative impact on the general government balance in the amount of EUR 97 million (0.1% of GDP) compared to the budget. The key factors include:

- **The sale of emergency oil stocks** and oil products to the newly-established oil reserve management agency **has had a positive effect** amounting to EUR 371 million (0.5% of GDP). In contrast to the budget, which assumed the sale of these stocks to span over three years, all stocks are expected to be sold in 2013. A partial shortfall of EUR 28 million in the fee for the emergency oil reserves management is also attributable to the establishment of a management agency.
- **Lower revenues from dividends, by EUR 377 million (0.5% of GDP).** This development is mainly attributable to the shifting of regular dividend payments from two corporations with government's equity participation (SPP and SEPS) to 2014, with an overall negative effect of EUR 326 million (0.4% of GDP) compared to the budget. At the same time, super dividend payments are expected (they are cash-based, not accrual public revenues, therefore they do not reduce deficit). Even though they do not constitute revenues under the ESA95 methodology, these super dividend payments are important with respect to debt and liquidity management as they will contribute to the reduction of Maastricht debt.
- **The extraordinary revenues of the Telecommunications Regulatory Authority** will take place next year, resulting in a **shortfall of EUR 130 million (0.2% of GDP) compared to the budget.**
- **A shortfall of EUR 46 million (0.1% of GDP) in revenues from trading in emission allowances** is expected due to current price developments on the European exchange.
- A more positive development in revenues compared to the budget comes from **grants, in the amount of EUR 62 million (0.1% of GDP)**, and better-than-expected development in other non-tax revenues, administrative fees in particular. Higher revenues from grants will also be reflected in higher spending by the entities concerned.

The savings on the expenditure side total EUR 630 million (0.9% of GDP):

- **The main positive impact is attributable to the lower drawing of EU funds**, which will translate into savings on the national co-financing in the amount of EUR 403 million (0.6% of GDP). The drawing of EU funds, originally estimated at EUR 3.6 billion, was revised downwards (to EUR 1.8 billion) in the course of the year.
- At the same time, **the reserve for the opening of the fully-funded pension pillar, in the amount of EUR 229 million (0.3% of GDP)**, was dissolved to offset the adverse development in tax revenues. The reserve was originally intended to cover shortfalls related to the opening of the fully-funded pillar given the uncertainty as to the number of those who would decide to exit and switch for the pay-as-you-go pension pillar only, and how their numbers would spread over 2012 and 2013. Even though the estimate was slightly exceeded, the reserve was ultimately used to offset the worse-than-expected economic development.
- **The cuts in the state budget expenditures are estimated to reach EUR 251 million (0.3% of GDP)**, split 60:40 between capital and current expenditures.
- Another positive factor, a **saving of EUR 54 million (0.1% of GDP) is due to lower interest payments** caused by a drop in interest rates on multi-year bonds.
- The expected **assumption of debt from healthcare providers, amounting to EUR 100 million (0.1% of GDP)**, will have a negative impact on government expenditures.

With respect to **other general government entities, expenditures are expected to increase by EUR 207 million (0.3% of GDP) compared to the budget target. The largest share of this increase is attributable to local governments** with respect to which there is a risk that their budgeted expenditures will be overrun by EUR 152 million (0.2% of GDP). On the other hand, **expenditures on public health insurance are expected decline by EUR 83 million (0.1% of GDP)**, mainly in connection with the lower collection of premiums from the economically active population. **An increase in expenditures by EUR 138 million (0.2% of GDP) is expected for other public entities**, mainly public universities, the National Nuclear Fund and contributory organisations.

II.2. Structural balance and expenditure benchmark

Government's fiscal objectives are monitored by means of two analytical indicators. The first indicator is the **consolidation effort** which describes the way in which the government plans to achieve its medium-term objective. The second is the **expenditure benchmark** that serves to assess the pace of growth in general government expenditures.

II.2.1. Structural balance

The first step in calculating the consolidation effort is to adjust the general government balance for the effects of economic cycle (boom or recession), i.e., the cyclical component. The Ministry of Finance uses the estimate of the general government balance sensitivity to changes in the output gap (based on the OECD methodology⁵) fully from the European Commission. **In the second step, the general government balance is adjusted for one-off and temporary measures.** A one-off effect means a revenue or expenditure that is not permanent or recurrent and has only a temporary impact on the general government balance.

These adjustments result in obtaining the structural balance which reflects the conditions of public budgets assuming that the economy performs at its potential level of output net of one-off effects. **A change in the structural balance on the previous year describes the consolidation effort in the given year.** The estimated development in the structural balance of general government is defined in the preventive arm of the Stability and Growth Pact and serves as a basis for determining fiscal policy targets.

For 2012 to 2014, the following one-off measures with an effect on the general government balance have been identified:

- a. **A special levy in the banking sector** represents an additional one-off measure imposed on financial institutions in the 4th quarter of 2012 in the total amount of EUR 40 million (0.06% of GDP). The figure includes the negative impact on the corporate income tax.
- b. The existing official tax and social contribution revenue forecast **does not include the continuation of the special levy on business operations in regulated industries** in the general government budget proposal for 2014. Only the increase by EUR 50 million (0.07% of GDP) in revenues of the state financial assets from the special levy in regulated industries that is above the September forecast prepared by the Tax Revenue Forecasting Committee is deemed to have a one-off effect.
- c. When **the fully-funded pillar of the pension was temporarily open**, a part of the pension savers decided to opt out. This resulted in the transfer of funds from the old-age savings scheme to the pay-as-you-go scheme. The transfer involved all assets accumulated in the system since the savers' entry into the fully-funded pillar; the portion of these assets attributable to previous years meets the definition of a

⁵ Girouard, N., André, Ch.: Measuring cyclically-adjusted budget balances for OECD countries. OECD Economics department working papers, no. 434, 2005



one-off component. The one-off transfer from the savers exiting the fully-funded pillar represented EUR 44 million (0.06% of GDP) in 2012 and EUR 240 million (0.3% of GDP) in 2013.

- d. **One-off taxation of retained profits from before 2004** by a withholding income tax. The expected positive effect of this measure is EUR 8 million (0.01% of GDP) in 2013.
- e. **Extraordinary revenues from the Telecommunications Regulatory Authority** are revenues from the electronic auction of frequency bands under the Act on Electronic Communications. Contrary to the original plans in the budget, the auctions will take place in 2014.
- f. In order to bring the new method of managing the emergency oil and oil product stocks in compliance with the EU directives that prohibit dual management of reserves, a decision was taken to establish a new system of financing the emergency oil stocks and **sell the entire volume of oil stocks in 2013**. The new system of emergency oil stock financing is expected to have a positive effect on the general government balance in the amount of EUR 471 million (0.6% of GDP).
- g. **A loan was granted to the Cargo Railway Company from the state financial assets in 2009**. The transaction had a negative impact on the general government deficit and debt in 2009 (due to the assumption that the loan would not be paid back). In 2012, the company began repaying the loan, which had positive effect on the general government balance during the repayment period according to the ESA95 methodology. The 2014 loan instalment (in the amount of EUR 19.5 million) has been increased by additional EUR 78 million (by a Government resolution), translating into a total one-off positive effect in the amount of EUR 98 million (0.1% of GDP).
- h. **Vodohospodárska výstavba (VHV)** (Waterworks Construction Company) has currently two loan agreements for government guarantees materialised in 2002 and 2006. Similarly to the case of Cargo Railway Company, VHV is also repaying the loan which had a negative impact on the deficit and debt in the past. VHV is expected to repay the remaining principal of EUR 48 million (0.06% of GDP) in 2014 through a single payment.
- i. **The cancelled “bearer deposits”** were transferred to the management of state financial assets in 2006. The time limit for claims will expire at the end of 2013, which is expected to translate into EUR 26 million (0.03% of GDP) in revenues in 2014.
- j. **No dividends from the 2012 profit were paid in 2013** by the Slovenský plynárenský priemysel (SPP) (EUR 365 million) and by the Slovenská elektrizačná prenosová sústava (SEPS) (EUR 72 million). They will be paid in 2014, along with dividends from the 2013 profit. Shifting the one-off dividend will reduce revenues by 0.6% of GDP in 2013; however, revenues will increase by the same amount in 2014 .
- k. On the expenditure side, the 2014 budget proposal contains a **reserve for achieving the fiscal target**, in the amount of EUR 65 million (0.09% of GDP). The expenditure reserve will serve to mitigate the risk of a possible failure to meet the deficit target.
- l. Compared to both the average levels from the past years and the level expected in 2014, **the national co-financing fell considerably in 2013**. This one-off decline is primarily caused by temporary delays in the implementation of projects resulting from an amendment to the Public Procurement Act and the extension of the period for the drawing of EU funds from the finishing programming period by one more year. Its positive effect on the 2013 government balance is estimated at EUR 142 million (0.2% of GDP).

Tab 5: Consolidation effort (ESA 95, as % of GDP)			
	2012	2013	2014
1. Net lending/borrowings	-4.3	-3.0	-2.8
2. Cyclical component	-0.3	-0.8	-0.8
3. One-off effects	0.2	0.7	1.0
a. Special levy in the banking sector (including corporate income tax)	0.1	-	-
b. Temporary levy on business operations in regulated industries (including corporate income tax)	-	0.1	-
c. Possibility to leave the fully-funded pension pillar	0.1	0.3	-
d. Taxation of retained profits from before 2004	-	0.0	-
e. Extraordinary revenue of the Telecommunications Regulatory Authority	-	-	*6
f. Sale of oil stocks outside the public sector	-	0.6	-
g. Repayment of loan by Cargo Railway Company	0.0	0.0	0.1
h. Repayment of loan by the VHV	0.0	0.0	0.1
i. Transfer of funds resulting from the cancellation of bearer deposits	-	-	0.0
j. Dividend shifting	-	-0.6	0.6
k. Reserve for achieving the fiscal target	-	-	-0.1
l. Savings on national co-financing	-	0.2	-
4. Structural balance – cyclically-adjusted balance net of one-off effects (1-2-3)	-4.2	-2.9	-3.1
Consolidation effort according to the Commission (year-on-year change 4)	0.1	1.3	-0.2
- Investment clause – national co-funding			-0.6
Consolidation effort adjusted for the amount of national co-funding	0.1	1.3	0.4
<i>Output gap</i>	-1.0	-2.4	-2.3

Source: MoF SR

If the current estimate of the general government balance for 2013 is achieved and given the estimated effect of the economic cycle and one-off effects, the consolidation effort is projected to reach 1.3% of GDP. The average consolidation effort is 1.1% of GDP⁷ for the duration of the excessive deficit procedure (1.0% of GDP required). **According to the budget proposal, a moderate structural expansion of 0.2% of GDP will occur while nominal deficit will continue to decline, reflecting the continuing worse-than-expected macroeconomic situation and the need to take measures to boost economic growth.**

The European Commission has prepared a proposal of the so-called investment clause that allows Member States to temporarily deviate from the consolidation effort required under the preventive arm of the Stability and Growth Pact, provided they meet certain conditions. Once the investment clause is triggered, the consolidation effort in the first year will be adjusted for the sum of expenditures on national co-financing and expenditures on the Common Agricultural Policy and Common Fisheries Policy. In the subsequent years, adjustments are only made for a year-on-year change in these funds.

The following criteria must be met if a member state wants to apply for investment clause under the preventive arm of the Stability and Growth Pact:

- **Negative GDP growth** or growth far below the potential growth level,
- **Deficit below 3% of GDP and debt below 60% of GDP** (or, in case of countries with debt above 60% of GDP, debt is decreasing at a sufficient speed),

⁶ Yields will only be known after the auction is over.

⁷ One-off measures representing more than 0.1% of GDP included.



- the maximum deviation from **the required consolidation effort will be directly linked to the amount of expenditures spend on co-financing EU projects** implemented under the Structural and Cohesion Policies, TEN and CEF,
- Once the member state is forecasted to return to positive growth, **any deviation under the investment clause are assumed to be compensated for** so that the time path towards the MTO is not affected,
- In addition to meeting these conditions, a member state should also **demonstrate direct positive effects of co-financed projects** on the long-term sustainability of public finances, including their effects on the potential economic growth, as well as evidence that national investments are not replaced by investments co-financed from EU funds, i.e., that the overall share of capital expenditures is increasing.

The Commission will assess whether the conditions for the application of investment clause for 2014 have been met based on its autumn forecast. For the countries that apply for the exemption for 2014 and are currently under the excessive deficit procedure the Commission will make the assessment conditional upon exiting the excessive deficit procedure.

Slovakia meets the criteria for the granting of the investment clause and will apply for it for 2014. A negative output gap at the level of 2.3% of potential GDP is estimated for 2014, indicating a considerable 'undercooling' of the economy and a below- potential growth. The deficit target set for 2013 is below the level of 3% of GDP and the debt is projected to stay below the reference value of 60% of GDP. Given the fact the budgetary funds earmarked for the co-financing EU funded projects represent EUR 460 million (0.6% of GDP), **the adjusted consolidation effort will reach 0.4% of GDP, which is in principle in compliance with the requirements of the preventive arm of the Stability and Growth Pact.** The change in co-financing between 2013 and 2014 is 0.4% of GDP. The investments supported by co-financing contribute towards economic growth and have a positive effect on fiscal policy in the long term horizon (Box 3).

Box 3: National co-financing

The drawing of the EU Structural and Cohesion Funds in Slovakia focuses on investments designed to boost economic growth and enhance public welfare. Horizontal priorities include the elimination of regional disparities and social inclusion of marginalised communities and individuals. Both priorities ultimately contribute to economic growth. The current setting of EU funds defines the key objectives under the current programming period – convergence and regional competitiveness and employment.

The funding (and co-financing) of the operational programmes (OP) reflects the purpose and goals of the use of Structural and Cohesion Funds in Slovakia. Investments in research and development create basic knowledge and encourage its application in practice, thus facilitating technological progress. Financial resources from the Education and Employment and Social Inclusion OPs produce qualified labour and enhance labour market participation, including that of the marginalised individuals and communities. The Information Society operational programme is designed to implement new information and communication technologies in the public sector. In view of the need to develop new application solutions, the funds are allocated for the purchase of services, not capital.

Other operational programmes also contribute towards meeting the convergence and competitiveness objectives. As much as 97 percent of funds under these OPs are allocated for the purchase of capital assets which represent investments in the future growth.

Tab A: National co-financing (in EUR million)

	2013 E	2014 B
OP Information Society (IS)	19.6	63.2
OP Environment	23.1	48.4
OP Education	15.4	21.5
OP Research and Development (R&D)	21.0	51.8

OP Health	6.6	2.9
OP Employment and Social Inclusion (E&SI)	21.5	16.5
OP Competitiveness and Economic Growth	7.7	45.8
Regional Operational Programme	16.2	18.5
OP Bratislava Region	1.3	2.0
OP Transport	53.6	137.7
OP Technical Assistance (TA)	1.3	4.3
Operational programmes, total	187.3	412.6
3 rd programming period –Structural and Cohesion Funds	0	47.6
Structural and Cohesion Funds, total	187.3	460.2
EAGF	3.9	0
EAFRD	27.1	49.1
EFF	0.6	0.7
3 rd programming period - agriculture		114.1
Agricultural funds, total	31.6	163.9
Other co-financing to EU funds	14.9	13.8
National co-financing, total	233.8	637.9

II.2.2. Expenditure benchmark

The revised **Stability and Growth Pact** introduced the **expenditure benchmark** as a supplementary instrument for analysing the fiscal position. It shows the growth of the expenditure aggregate net of the revenue measures which, when compared against the expenditure growth reference rate, makes it possible to assess the progress achieved in fiscal consolidation.

The expenditure benchmark is applied differently depending on whether the country concerned has accomplished its medium-term objective. Slovakia has not been meeting its individual medium-term objective⁸ since 2005, the year of its inclusion in the revised Stability and Growth Pact. This means that the adjusted primary general government expenditures, net of the revenue measures, should be growing in real terms at a slower pace than the average potential growth of the economy in order to ensure that the structural balance improves annually by 0.5% of GDP. The reference rate of expenditure benchmark is taken from the documents of the Commission⁹.

The reference rate of the expenditure benchmark is compared with the expenditure aggregate analytically adjusted for factors beyond the Government's reach and those not affecting the general government balance. These include interest expenditures, changes in cyclical unemployment benefit expenditures unrelated to government policies, expenditures on EU programmes fully matched by EU funds revenue and revenue increases mandated by law. At the same time, considering a high year-on-year volatility of government investments (which is, in particular, the case of small EU member states), the average amount of investments for the past three years and the current year is taken into account. The nominal growth of expenditures adjusted in this manner is converted to real growth using the GDP deflator so that it could be compared against the expenditure benchmark.

⁸ Based on EU Council recommendations, Slovakia should meet the medium-term objective (structural general government deficit in the amount of 0.5% of GDP) until 2017.

⁹ [Vade Mecum on Stability and Growth Pact](#), pg. 30



Table 6: Expenditure benchmark (ESA 95, EUR million)

	2012	2013	2014
1. Total expenditure	26 758	26 187	27 875
2. Interest expenditure	1 322	1 363	1 375
3. Gross fixed capital formation	1 366	1 167	986
4. Gross fixed capital formation (average for t-3 through t)	1 533	1 459	1 276
5. Expenditure on EU programmes fully matched by EU funds revenue	807	1 013	1 198
6. Cyclical unemployment benefit expenditure	17	41	41
7. Expenditures fully matched by revenue increases mandated by law	0	0	0
8. Primary expenditure aggregate (1-2-3+4-5-6-7)	24 779	24 063	25 552
9. Year-on-year change in the primary expenditure aggregate ($8_t - 8_{t-1}$)	946	-715	1 489
10. Change in revenues related to measures	299	1 383	763
11. Nominal year-on-year growth of the expenditure aggregate net of revenue measures ($(9_t - 10_t) / 8_{t-1}$)	2.7	-8.5	3.0
12. Real year-on-year growth of the expenditure aggregate net of revenue measures	0.8	-10.2	1.4
13. Expenditure benchmark – expenditure growth reference rate	1.8	1.8	1.5
14. Compliance with the expenditure benchmark (12<13)	yes	yes	yes
<i>p. m. GDP deflator *</i>	1.9	1.9	1.6

* Until 2013, the deflator is taken from EC's forecasts and for 2014, it reflects the MF SR forecast

Source: MoF SR

When taking into account the current estimate of the general government expenditures and the adopted revenue measures, 2013 should see a considerable decline in expenditures in real terms. **In 2014, the growth of expenditures is estimated to be slightly below the benchmark (by 0.1 p. p.).**

II.3. General government gross debt forecast

The general government gross debt¹⁰ reached 52.1% of GDP at the end of 2012. Assuming that the budgetary objectives are met, the debt (as % of GDP) growth should gradually slow down, **peaking at 56.8 % of GDP in 2014.**

Table 7: General government debt developments between 2012 and 2014

	2012	2013	2014
Gross debt (EUR million)	37 245	39 600	43 024
Gross debt (% of GDP)	52.1	54.3	56.8
- Sovereign debt (net of international commitments)	48.1	49.6	51.9
- Slovakia's share in the EFSF facility	2.1	2.6	2.7
- Contribution to the ESM	0.4	0.7	0.9
- Debt of other general government sub-sectors	1.5	1.3	1.3
Change in gross debt ratio (p. p.):	8.8	2.1	2.5
- Nominal GDP growth	-1.4	-1.1	-2.0
- Primary balance	2.5	1.1	1.0
- Interest expenditure	1.9	1.9	1.8
- Stock-flow adjustment	5.9	0.3	1.7
Liquid financial assets (% of GDP)	5.6	5.3	5.8
Net financial debt (% of GDP)*	46.5	48.9	50.9
<i>p.m. The impact of the ESM and EFSF on gross debt</i>	2.5	3.4	3.5

* General government gross debt minus liquid financial assets

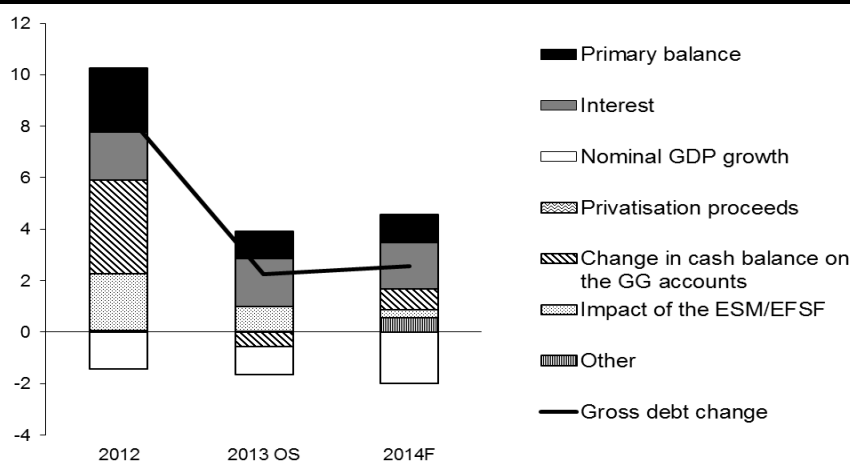
Source: MoF SR

¹⁰ All indicated values are calculated based on the methodology applied in the assessment of compliance with the Maastricht criterion for the amount of the general government gross debt, the so-called Maastricht general government gross debt

The nominal GDP growth is the only contributor to debt reduction during the entire reporting period. To a large extent, it is the general government deficit which is contributing to the change in gross debt between 2012 and 2014 based on ESA 95 methodology. With interest expenditure annually contributing some 1.9 p. p. to the debt growth, the contribution of the primary balance amidst the continuing fiscal consolidation is gradually decreasing.

Stock-flow adjustment is also contributing to the debt growth in every year. In 2012, it was above-average due to an increase in the government's cash reserve (3.7 p. p.) and in international commitments towards the EFSF and ESM (2.2 p. p.). In 2014, gross debt should be growing due to cash increases in the general government accounts (0.9 p. p.) and more significant differences between the cash and accrual balance of the general government (0.6 p. p.).

Chart 3: Contributors to the change in the general government's gross debt (p. p.)



*The items listed constitute the stock-flow adjustment

Source: MoF SR

In cash-flow terms, the growth of the general government gross debt in the forecast period will be mostly fuelled by the **cash-based deficit of the state budget**.

The second important factor is the **State Treasury system**. The development of the State Treasury funds used for the financing of government operations in 2012 has been influenced by an increase in the available resources of the system¹¹. In 2013, a portion of such accrued funds is expected to be used for debt reduction. The 2013 developments in the State Treasury funds will also be influenced by windfall revenues from super dividends¹² in the amount of EUR 0.4 billion.

Slovakia's international commitments with respect to the European Fiscal Stability Facility (EFSF) and the European Stability Mechanism (ESM) represent the third factor that comes into play.

The **commitments under the EFSF** are due to the provision of financial assistance to Ireland, Portugal and Greece. The EFSF will no longer participate in the new financial programmes; however, it will continue to administer the assistance provided to these countries until it is repaid in full. Until then, the EFSF commitments will be directly rerouted into the debt level based on Slovakia's share in the EFSF debt.

¹¹ Relatively favourable situation on the financial markets, coupled with lower interest rates, facilitated the creation of the "cash reserve" deposited with commercial banks and the National Bank of Slovakia.

¹² The revenues from super dividends are related to the distribution of a particular company's assets (for instance, revenues from the revaluation of the company's assets, dissolution of reserve funds). Unlike dividends, which are paid from business operations of a company, they are not treated as general government revenue under ESA 95 methodology.

The gross debt level is also affected by **Slovakia's contributions to the ESM**. Based on Eurostat decision¹³, the ESM commitments – unlike those under the EFSF – will not be directly routed to the general government debt of member states. However, Slovakia's contributions to the ESM remain a debt-increasing factor. These contributions are reducing the financial resources of the State Treasury available for the financing of the government's operations, thus contributing to an increase in the gross debt.

The fiscal performance of other general government entities (municipalities and self-governing regions in particular) represents the fourth factor affecting the gross debt. Local governments influence the total debt level in particular through loans from banks. On the other hand, the repayments of bank loans reduce the debt. **The fiscal performance of local governments is expected to continue to increase the general government debt in 2014. No assumption of hospitals' debts (bailout) is expected to take place in 2014.**

The other changes in the debt forecast are related to the impact of discount on the issue and repayment of debt instruments and the exchange rate differences.

	2012	2013	2014
A. General government gross debt (as at 1 January)	43.3	52.1	54.3
B. Total year-on-year change in the general government gross debt	8.8	2.1	2.5
- Cash-based state budget deficit	5.3	3.1	4.5
- State Treasury funds used for the financing of government operations	2.9	-0.8	-0.2
- Slovakia's share in the EFSF facility	1.8	0.6	0.1
- Slovakia's contributions to the ESM	0.4	0.4	0.2
- Balance between loans taken and repaid (municipalities and self-governing regions)	-0.1	-0.1	0.0
- Assumed debt from health care providers	0.2	0.1	0.0
- Other changes	-0.3	0.0	-0.1
- Impact of nominal GDP growth	-1.4	-1.1	-2.0
C. General government gross debt (as at 31 December)	52.1	54.3	56.8

Note.: Positive amounts increase the general government debt as at 31 December of the relevant year, negative amounts decrease the debt.

Source: MoF SR

¹³ In its Decision No. 2013-117666 of 31 January 2013, Eurostat confirmed that the ESM meets the criteria of an institutional financial unit and, therefore, can enter into contracts on its own behalf. Based on this decision, the ESM liabilities will not be routed to the member states, but directly to the ESM.



III. Revenue and expenditure targets of the general government budget

III.1. Revenue targets of the general government budget

Combating value-added tax evasion remains the most important priority of the Slovak Government in its effort aimed at improving tax collection. In 2011, according to the most recent EC study¹⁴, the Slovak Republic had the fourth highest tax gap relative to the theoretical tax liability of all EU countries. VAT evasion in Slovakia accounted for as much as 37% of the theoretical tax liability in 2011, whereas the EU average was about 20%.

Chart 4: VAT gap
(% of the theoretical tax liability)

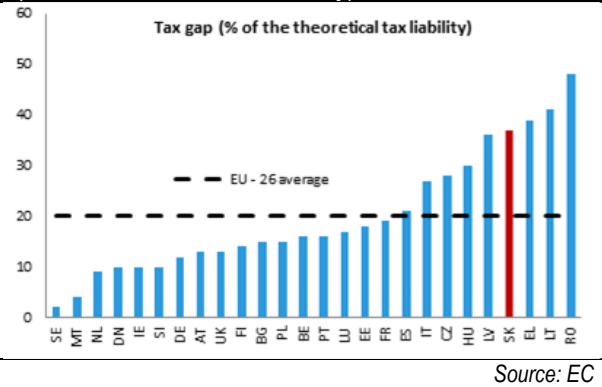
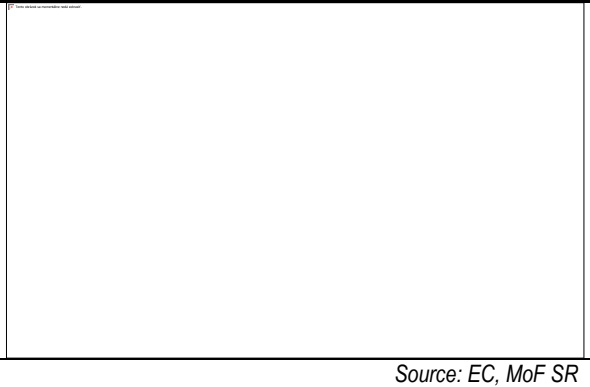
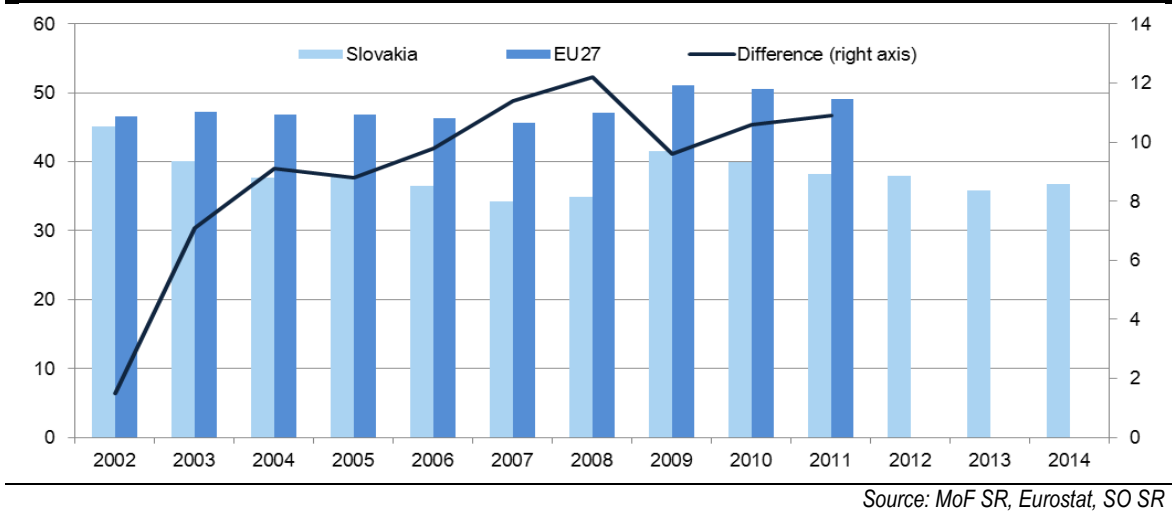


Chart 5: Tax gap developments in Slovakia and ETR



III.2. Expenditure targets of the general government budget by function

Chart 6: Total public expenditure (% of GDP)



Slovakia's public sector has been traditionally smaller in size than the EU average. The difference became more significant between 2002 and 2008. To get a better overall picture, lower public expenditures are one of the reasons why it is advisable to compare expenditures not only as a percentage of GDP, but also as a percentage of the total general government expenditure¹⁵.

¹⁴ Study to quantify and analyse the VAT Gap in the EU-27 Member States (July 2013)

¹⁵ The methodology for recording expenditures based on the classification of the functions of government may vary between individual countries. As a result, the same item may contain different data for different countries (for instance, taxable and non-taxable pensions). Furthermore, expenditure made through the tax system (such as tax bonuses) is not taken into account in the COFOG classification.



The share of public expenditure on healthcare in the total general government expenditure is higher than the EU average, even though this figure has been decreasing over the past few years. When compared against GDP, the situation is similar. In this case, however, healthcare expenditures have been below the international average since 2010. In the fiscal year of 2014, both figures will continue to be on a slight decline, and there is still enough room to improve their effectiveness¹⁶. The situation in education is quite different: expenditures (expressed as a share of GDP and of the total expenditures) are among the lowest in the entire EU and are spent quite effectively, as shown by international studies¹⁷. In the fiscal year of 2014, both figures will be slightly decreasing. Private funding plays an important role in both the healthcare and the education sector. However, they are not reflected in the COFOG classification. As regards the education sector, household expenditures account for 11% and the total private expenditures for 16% (roughly the OECD average) of all expenditures. In healthcare, household expenditures are at 23% and the total private funding at 30%, which is slightly above the OECD average (20% or, respectively, 28%). In both sectors, the share of public funding in the total expenditure of the sector has increased approximately three times since 2000.

Table 9: Total expenditure on education, healthcare and employment

	2013		2014		EU-27 2011	
	% GDP	% TE	% GDP	% TE	% GDP	% TE
Education	3.80	10.60	3.60	9.90	5.3	10.9
Health	5.60	15.50	5.30	14.30	7.3	14.9
Employment*	0.23	0.63	0.19	0.51	-	-

* The table shows an estimate for 2014, calculated as the average of EU funds for the period between 2011 and 2013. An international comparison is only available for a portion of employment expenditures – the active labour market policies. In 2011, the expenditures on active labour market policies accounting for 0.30% of GDP (0.77% of TE) were less than half of the EU-27 average (0.61% of GDP and 1.25% of TE). TE – total general government expenditure
Source: Eurostat

Slovakia's spending on employment policies as a share of GDP and of the total general government expenditures is approximately half of that seen in the EU. Employment-related expenditure includes the financing of active labour market policies and expenditures for investment incentives in the form of subsidies for newly created jobs and training.

Table 10: General government expenditures based on COFOG

Functions	COFOG Code	2013		2014		EU-27 2011	
		% GDP	% TE	% GDP	% TE	% GDP	% TE
1. General public services	1	5.06	14.10	6.20	16.86	6.60	13.46
2. Defence	2	0.92	2.56	0.93	2.52	1.50	3.06
3. Public order and safety	3	1.83	5.09	1.94	5.27	1.90	3.88
4. Economic affairs	4	2.34	6.53	3.19	8.67	4.00	8.16
5. Environmental protection	5	0.64	1.78	0.39	1.07	0.90	1.84
6. Housing and community amenities	6	0.71	1.97	0.55	1.49	0.90	1.84
7. Health	7	5.55	15.47	5.27	14.34	7.30	14.89
8. Recreation, culture and religion	8	1.08	3.01	0.94	2.55	1.10	2.24
9. Education	9	3.80	10.58	3.65	9.93	5.30	10.81
10. Social protection	10	13.96	38.90	13.71	37.30	19.60	39.98
Total expenditure	TE	35.88	100.00	36.75	100.00	49.02	100.00

Note: The methodology for recording expenditures based on the classification of the functions of government may vary between individual countries. As a result, the same item may contain different data for different countries (for instance, taxable and non-taxable pensions). Furthermore, expenditure made

¹⁶ See the "Less health for more money – An analysis of the Slovak healthcare system efficiency" publication of the Institute for Financial Policy (IFP) [Málo zdravia za veľa peňazí - Analýza efektívnosti slovenského zdravotníctva](#)

¹⁷ Sutherland, D. et al. (2007), Performance Indicators for Public Spending Efficiency in Primary and Secondary Education, Economics Department Working Papers, No. 546, OECD Publishing.

through the tax system (such as tax bonuses) is not taken into account in the COFOG classification. TE – total general government expenditure.

Source: MoF SR

III.3. General government balance under the no-policy-change scenario

The no-policy-change scenario¹⁸ is based on the current estimate of the general government deficit in 2013 of 2.98% of GDP. **Assuming that no changes are made in economic policies, the general government deficit would reach 4.6% of GDP in 2014.**

Table 11: Comparison between the balance of expenditures and revenues and the no-policy-change scenario in 2014 (% of GDP)					
	ESA Code	2013 E	2014 NPC	2014 GGB	GGB - NPC
1. Total revenue	TR	32.9	32.5	34.0	1.5
1.1. Taxes on production and imports	D.2	10.0	9.5	9.8	0.3
1.2. Current taxes on income, wealth, etc.	D.5	5.6	5.6	5.8	0.2
1.3. Capital taxes	D.91	0.0	0.0	0.0	0.0
1.4. Social contributions	D.61	13.6	13.1	13.0	-0.1
1.5. Property income	D.4	0.4	0.9	1.5	0.6
1.6. Other		3.3	3.4	3.9	0.5
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		29.2	28.2	28.6	0.4
2. Total expenditure	TE	35.9	37.1	36.8	-0.3
2.1. Compensation of employees	D.1	6.7	6.6	6.6	0.0
2.2. Intermediate consumption	P.2	4.2	4.5	4.7	0.1
2.3. Social payments	D.62, D.632	18.4	18.4	18.0	-0.4
of which: unemployment benefits		0.3	0.2	0.2	0.0
2.4. Interest expenditure	D.41	1.9	1.8	1.8	0.0
2.5. Subsidies	D.3	1.2	1.3	1.3	0.0
2.6. Gross fixed capital formation	P.51	1.6	1.3	1.3	0.0
2.7. Capital transfers	D.9	0.5	0.8	0.7	0.0
2.8. Other		1.4	2.3	2.4	0.0
General government balance	B.9	-3.0	-4.6	-2.8	1.8
- in EUR million		-2 175	-3 495	-2 144	1 351
<i>p.m. Primary general government balance</i>		<i>-1.1</i>	<i>-2.8</i>	<i>-1.0</i>	<i>1.8</i>
<i>- in EUR million</i>		<i>-812</i>	<i>-2 101</i>	<i>-769</i>	<i>1 332</i>

Note.: E - estimate; GGB – General Government Budget Proposal for 2014-2016; NPC - no-policy-change scenario

Source: MoF
SR

The difference in the general government balance between the no-policy-change scenario and the budget proposal for 2014 represents EUR 1 351 million (1.8% of GDP). Considering that the debt interest payments (EUR 19 million) will decline against the no-policy-change scenario when the target balance figures are reached, **the overall size of the measures incorporated in the budget proposal is EUR 1 332 million (1.8 % of GDP).**

The measures on the revenue side account for 1.5% of GDP, whereas the remaining 0.3% of GDP can be found on the expenditure side. The assumption behind these figures is that the reserve incorporated in the budget proposal will be depleted in order to meet the budgetary target regarding an increase in expenditure.

¹⁸ The no-policy-change scenario is prepared in line with the [Manual](#) published by the Ministry of Finance of the Slovak Republic. When compared to the Stability Programme of April 2013, the basic methodology remained unchanged. The only difference is that the final balance of general government revenue and expenditure is expressed in key items of ESA 95.

Without the reserve, i.e., assuming an improved general government balance, the revenue measures would account for 1.5% of GDP and the expenditure measures for 0.4% of GDP.

The measures can be broken down into three categories depending on their impact on the general government balance, if any, and whether they constitute one-off or permanent measures. The measures with neutral impact on the general government balance include the creation of a reserve for higher VAT collection and the reduction of health insurance payments for those insured by the state. The one-off measures are described in the chapter on structural balance. Their size in comparison with the no-policy-change scenario is slightly different because some of these measures are part of the no-policy-change scenario¹⁹. **Measures with permanent effects account for 0.8% of GDP, of which 0.3% of GDP can be found on the revenue side (in particular, changes in taxes) and 0.5% of GDP on the expenditure side (in particular the ESO reform).** The details of all measures are provided in Section IV.2.

Table 12: Structure of measures in the budget proposal (% of GDP, comparison with NPC)

	2014*
General government revenues	1,5
- Measures with neutral impact on general government balance	0,1
- One-off revenues	1,1
- Structural revenues	0,3
General government expenditure	0,3
- Measures with neutral impact on general government balance	-0,1
- One-off expenditures	-0,1
- Structural expenditures	0,5

* Impact on general government balance

Source: MoF
SR

III.4. Description of measures

This section quantifies and describes the impacts of measures incorporated in the budget proposal which will make it possible to meet the budgetary target for 2014. The description of selected measures also includes their distributional impacts.²⁰

Table 13: Measures included in the general government budget proposal (ESA 95, % of GDP, year-on-year changes)

Measures	Sub-sector	ESA 95 Code	Budgetary impact* (% of GDP)		
			2013	2014	2015
ESO	S.1311			0.54**	
- property income		D.4 rec		0.03	
- other income		other, rec		0.02	
- gross wages		D.1 pay		0.09	
- intermediate consumption		P.2		0.24	
- gross fixed capital formation		P.51		0.14	
- other expenditure		Other, pay		0.03	
Healthcare savings				0.23	
- payment for persons insured by the state, received	S.1311	D.61 rec		-0.19	
- payment for persons insured by the state, paid	S.1314	D.62 pay		0.19	

¹⁹ One-off revenue from the cancellation of bearer deposits based on a decision made in the past can serve as an example. This effect does not constitute a measure under the NPC scenario, however, it has an impact on balance (as detailed in the "Structural Balance" section).

²⁰ Given the consolidation structure, the estimate of distributional effects cannot be applied to all of the described measures.



- transfer for healthcare facilities	S.1314	D.631 pay	0.23		
Wages in public administration	S.13	D.1 pay	-0.09		
Introduction of the minimum tax liability with respect to corporate income tax	S.1311	D.5 rec	0.16		
Reduction in corporate income tax rate	S.1311	D.5 rec	-0.05		
Levy on profits generated by regulated companies	S.1311	D.5 rec	0.10		
Extraordinary revenue of the Telecommunications Regulatory Authority	S.1311	other, rec	.21		.*
Dividend shifting from 2013 to 2014 ***	S.1311	D.4 rec	-0.60	1.15	-0.55
- one-off decrease in dividends in 2013			-0.60	0.58	
- one-off increase in dividends in 2014				0.58	-0.55
Changes in rail transport	S.1311		0.07		-0.10
- one-off increase of the instalment of repayable financial assistance from the CARGO company		other, rec	0.10		-0.10
- compensation for the Slovak Railways (ŽSR) company		D.3 pay	-0.03		
Reserve for higher VAT collection	S.1311		0.00		0.00
- taxes on production and imports (VAT)		D.2 rec	0.33		-0.31
- intermediate consumption (General Treasury Administration chapter)		P.2	-0.33		0.31
Reserve for meeting the budgetary target	S.1311	P.2	-0.09		0.08
Other changes compared to NPC	S.13		-0.01		-0.03
Total			-0.60	2.36	-0.91

Note: All measures are at the proposal stage, the only exception are the changes in rail transport, which have been approved through a government resolution. The effects of the measures are expressed using ESA 95 methodology (accrual principle) and have no impact on other Euro Area Member States.

* impact on general government balance

** of which: public universities 0.06% of GDP (EUR 49 million)

*** In comparison with NPC, the measures are bigger in size compared to Section II.2.1 (one-off measures net of structural balance. The difference is due to EC methodology which quantifies the impact on general government balance – based on the principle of incremental change – in the first year only. In the subsequent year, the impact will be offset in order for the measure to be neutral over time. Such procedure subsequently leads to the recording of dividend shifting as two separate one-off measures.

Source: MoF SR

The Government will continue to **increase the effectiveness of central administration** and other general government entities (except for local governments) as an integral part of creating an effective, reliable and open public administration, i.e. ESO reform. The reform focuses on improving the management processes, reconsidering its functions, optimising the organisational structure and laying greater emphasis on the needs of citizens. This should bring savings in the operation of the general government and better results without the need for additional financing. Compared against the NPC, the budgeted impact of the measures focusing on public administration efficiency represents EUR 409 million in 2014. This figure consists of EUR 99 million from higher revenues and EUR 309 million from lower expenditures.

On the expenditure side, the largest portion of savings will be made in the **purchase of goods and services** which will be EUR 179 million below the NPC scenario. Further savings will also be achieved through **wages** (EUR 71 million), even though the overall wages in the public administration will rise due to an increase in wage tariffs. **Capital expenditure** will fall by EUR 39 million. Furthermore, EUR 20 million will be saved in a subsidy of the Ministry of Defence on a special account outside the general government sector.

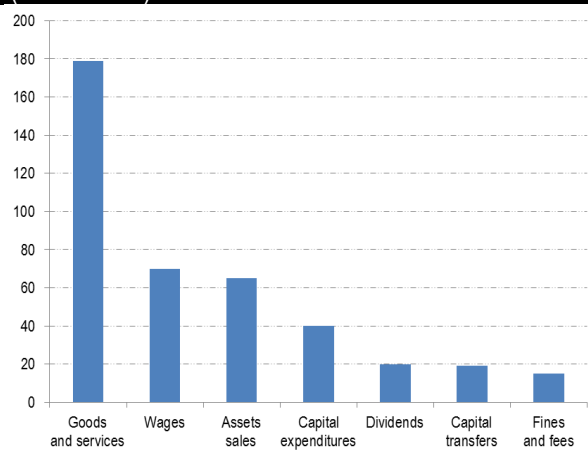
Increase in revenues is mostly attributable to the **sale of superfluous assets** (EUR 65 million), and the same amount is envisaged every year until 2016. The **dividends** from the SEPS (electricity grid operator), Transpetrol (pipeline operator), Lesy SR (state forests) companies and several other smaller enterprises should rise by EUR 20 million. **Revenues from fines and administrative fees** are projected to increase by EUR 14 million.

²¹ Yields will only be known after the auction is over.



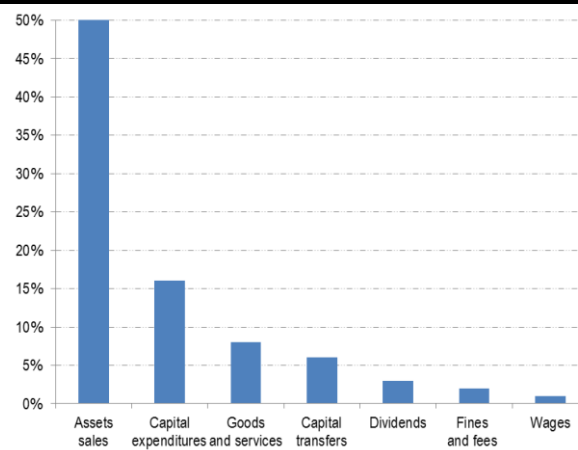
In percentage terms, the steepest rise will be registered in revenues from the sale of property, which will triple compared to the NPC scenario. Dividends will rise substantially (by 3.3 %), and so will the fines and fees (2.3 %). In relative terms, capital expenditures will be reduced the most (15.2 %). Costs of goods and services will decrease by 8.7%, capital transfers by 5.6% and wages by 1.5% against the NPC scenario.

Chart 7: Savings by expenditure category (EUR million)



Source: MoF SR

Chart 8: Savings relative to NPC



Source: MoF SR

Compared to previous years, out of all central government organisations, the Ministry of Finance will record the highest nominal increase in own revenues²² in 2014 due to higher dividends (up EUR 192 million). A considerable rise in revenues can be seen in other budgetary envelopes as well. The revenues of the Ministry of the Environment will rise by EUR 93 million (due to the sale of emission allowances) and those of the Ministry of the Interior by EUR 36 million, with the Ministry of Culture and the Antimonopoly Office of the Slovak Republic coming next with a EUR 16 million increase each. A more significant decline in revenues will only be registered in the State Material Reserves of the Slovak Republic due to a one-off sale of diesel oil reserves worth EUR 471 million in 2013. Net of this amount, the own revenues of the central government organisations will increase by EUR 292 million (158%).

In nominal terms, **current expenditures²³ of government organisations are stagnating**. The highest total savings compared to 2013 will be made by the Ministry of Finance (EUR 55 million). The Ministry of Transport, Construction and Regional Development of the Slovak Republic, the Geodesy, Cartography and Cadastre Authority of Slovak Republic and the State Material Reserves of the Slovak Republic will save more than EUR 20 million as well. The highest rise in expenditures is that of the Ministry of the Interior and the Ministry of Education (due to increasing wages of teachers). In relative terms, the best savers are the Ministry of the Environment (39%), the Ministry of Finance (17%) and the Ministry of Transport (14%). However, the highest percentage savings will be materialise in smaller budgetary envelopes, such as the State Material Reserves of the Slovak Republic (69%) and the Geodesy, Cartography and Cadastre Office of the Slovak Republic (67%).

Table 14: Savings in central government organisations (EUR million)

Budget envelope	Revenues*			Expenditures**			
	2013 E	2014 B	Diff.	2013 E	2014 B	Diff.	Diff.(%)
Office of the National Council of the Slovak Republic	0.7	0.8	0.1	25.3	26.3	1	4%
Office of the President of the Slovak Republic	0	0	-	4.2	3.9	-0.3	-7%

²² From dividends, fees and fines, as well as from capital sales

²³ Gross wages, goods and services, as well as capital expenditures with the exception of the ESIF



Office of the Government of the Slovak Republic	0.8	0.8	-	13.2	12.4	-0.8	-6%
Office of the Constitutional Court	0	0	-	3.5	3.3	-0.3	-7%
Supreme Court of the Slovak Republic	0	0	-	8.7	8.7	0	-1%
General Prosecutor's Office of the Slovak Republic	0.4	0.4	-0.1	67	68.7	1.7	2%
Supreme Audit Office of the Slovak Republic	0	0	-	7.9	7.9	0	0%
Slovak Information Service	0.1	0	-0.1	44.7	42.9	-1.7	-4%
Ministry of Foreign Affairs	1.4	3.5	2	97.2	90.6	-6.6	-7%
Ministry of Defence	11.4	5.1	-6.4	597.4	597.6	0.2	0%
Ministry of the Interior	63.6	99.4	35.8	993.1	1 100.5	107.4	11%
Ministry of Justice	12.5	12.5	-	304.5	303.9	-0.6	0%
Ministry of Finance	10.5	139.7	129.2	331.5	276.6	-54.9	-17%
Ministry of the Environment of the Slovak Republic	0.1	93.4	93.3	29.3	17.8	-11.5	-39%
Ministry of Education, Science, Research and Sport	0.1	0.1	-	64.6	103.6	39	60%
Ministry of Health	2.8	2.4	-0.4	42.1	38.6	-3.5	-8%
Ministry of Labour, Social Affairs and Family	7.9	8.5	0.6	198	200.7	2.8	1%
Ministry of Culture of the Slovak Republic	0.9	17.1	16.2	30.7	28.2	-2.5	-8%
Ministry of Economy of the Slovak Republic	23.9	33.3	9.4	25.3	24.5	-0.8	-3%
Ministry of Agriculture and Rural Development	14.6	21.3	6.7	78.9	67	-11.9	-15%
Ministry of Transport, Construction and Regional Development	1.6	9.1	7.5	253.4	217.1	-36.3	-14%
Geodesy, Cartography and Cadastre Office	4.1	0.3	-3.8	43	14.4	-28.6	-67%
Statistical Office of the Slovak Republic	0	0.3	0.3	18.8	18.4	-0.4	-2%
Public Procurement Office	0.3	0.3	-	4.9	5.1	0.2	5%
Regulatory Office for Network Industries	0.5	0.7	0.3	2.7	2.9	0.2	8%
Nuclear Regulatory Authority of the Slovak Republic	4.3	8.9	4.6	4.1	8.3	4.2	101%
Industrial Property Office of the Slovak Republic	2.5	2.8	0.3	2.7	2.6	-0.1	-4%
Slovak Office of Standards, Metrology and Testing	0.2	1.1	0.9	2.9	3.7	0.8	29%
Antimonopoly Office of the Slovak Republic	16.1	0.2	-15.9	2.1	2	-0.1	-3%
National Security Authority	0	0	-	8	7.6	-0.4	-4%
State Material Reserves of the Slovak Republic	472.2	12.6	-459.5	33.7	10.3	-23.3	-69%
of which: sale of diesel oil reserves	471						
Slovak Academy of Sciences	1.6	1.1	-0.5	45.1	36.7	-8.4	-19%
Total	655.1	475.8		3 388.60	3 352.8		

* Dividends, fines and fees, capital revenues

** Gross wages, goods and services, capital expenditures with the exception of ESIF

Source: MoF SR

Sustainable savings in expenditure as part of the ESO reform, which are incorporated in the budget proposal for the period between 2014 and 2016, can be partially achieved by increasing the internal effectiveness of state organisations without significantly changing their current structure and functioning. As the sponsor of the reform, the Ministry of the Interior carried out an analysis of more than 400 quasi-government and government organisations, funds and special-purpose organisations established by law.

The purpose of the audit was to identify duplicate and unused functions. The savings can be achieved through the sharing of supporting activities and technical facilities, merging or winding up of organisations. For this reason, the Telecommunications Regulatory Authority of the Slovak Republic and the Postal Regulatory Office will be merged into the Regulatory Authority for Electronic Communications and Postal Services as of 2014. The

Railway Regulatory Authority, the Civil Aviation Authority of the Slovak Republic and the State Navigation Administration will be combined into the Transport Authority. Furthermore, the Centre for Chemical Substances and Preparations became part of the Ministry of Economy and the Slovak Standards Institute now falls under the Slovak Office of Standards, Metrology and Testing. The transformation and integration of government and quasi-government organisations will continue in the period between 2015 and 2016 as well.

Public expenditure in healthcare will reach 5.6% of GDP in 2014. Lower expenditures will be offset by savings measures, bringing the same results while using less resources. Effectiveness in this sector will be increased following the changes in the financial management and fiscal performance, better quality control and a new system of payments. There is also room for economisation in the procurement of utilities, medicines, materials and services, as well as in drug categorisation. Further operational savings should be achieved by removing duplicities in processes and staffing. Savings in administrative costs of health insurance companies and the Healthcare Surveillance Authority are anticipated as well. The financial management of hospitals will be configured in a way that will allow performance-based remuneration and increased effectiveness. In terms of healthcare provision, treatment procedures will be unified for all diagnoses, thus putting more pressure on the quality of healthcare and enabling a transition to DRG payments at a later time.

The wages of teachers and professional staff in regional and tertiary education will increase by 5%. Other public sector employees will enjoy a pay rise by two percent, which corresponds to some EUR 16 per month on average. At universities, the pay rise amounting to EUR 16 will be coupled with an additional increase by 3 %. The wage growth in education should ensure better employee performance and attract high-quality teachers. The overall impact of the pay rise is quantified at EUR 124 million. Compared to the NPC scenario, the overall impact on wages in the general government sector is lower by EUR 58 million due to a decrease in wages in municipalities and higher territorial units. The wages of civil servants will increase for the first time since 2010.

Legal entities will pay a **tax licence** differentiated for various types of companies. The purpose of this measure is to tackle corporate income tax evasion. Some 60% of legal entities do not pay corporate income tax in one year and almost 25% of all entities have not paid any corporate income tax for the last four years in a row. The tax licence will also apply to corporations which have been evading their tax liabilities by adopting tax optimisation measures, and will considerably attenuate the regressive effect of the measure. On the other hand, the licence can be deducted from the tax liability not only in the current year, but also in the subsequent year, and will not apply to newly established entities in the first year of their existence. The system will get rid of inactive legal entities, thus reducing the workload of tax inspection authorities, as well as the administrative costs of the financial administration. With this measure in place, the revenue from corporate income tax should increase by EUR 121 million.

At the same time, the **corporate income tax rate** will be reduced by one percentage point to 22%. The revenues will therefore drop by EUR 37 million. The reduction of the tax burden in the form of direct taxes is aimed at improving the business environment. The lower tax rate, coupled with the introduction of tax licences, will be a positive message for entities which take a responsible approach towards the payment of taxes. The Slovak Government will continue to work towards optimising the tax mix within the constraints set by the rules of the constitutional Act on fiscal responsibility and the commitments towards the EU formulated in the Stability and Growth Pact.

Table 14: Impact of changes in corporate income tax by sector (in %)

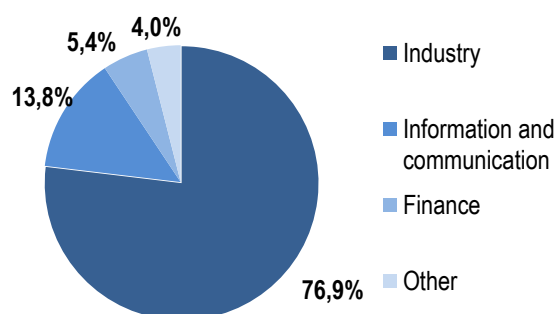
Sector	Share in tax revenues	Impact on tax liability
Agriculture	3.7	14.4
Industry	-4.5	-0.6

Civil engineering	10.7	10.0
Wholesale and retail	33.7	12.1
Transportation	2.6	2.6
Housing sector and catering services	6.3	106.2
Information and communication	2.0	1.1
Finance	-4.2	-1.5
Real estate	10.8	27.1
Professional services	16.4	15.5
Administrative and support services	6.5	21.9
Other	12.4	18.3
Not classified elsewhere	3.6	89.7
Total	100.0	5.2

Source: MoF SR

In relative terms, it is the housing and catering services sector whose profits will be most affected by the reduced tax rate combined with the basic tax licence; in this case, the tax liability could double, as suggested by calculations based on individual tax returns. On the contrary, the industrial sector envisages an overall positive impact of the combination of these measures.

Chart 9: Who will pay the special levy?
(the share of sectors in total revenues)



Source: MoF SR

The extension of the period of application of the special levy in regulated industries, which was originally effective until 2013, should improve the fiscal performance of general government by EUR 79 million. The liability to pay the special levy applies to entities with revenues from regulated activities reaching at least 50% of overall revenues in a given accounting period. The levy is calculated on the basis of economic performance, with the assessment base for the levy representing EUR 3 million as the threshold for the payment of this liability. The monthly amount of the levy for a regulated entity corresponds to 0.363%. The special levy is treated as expenditure and, therefore, has a negative impact on revenues from the corporate income tax.

When taking into account the current distribution of levies, the extension of the period of application of the special levy will mostly affect the **manufacturing sector** – more than three quarters of revenues from this levy are paid by companies active in the **energy sector**. Other industries with considerable contribution to revenues from the levy include the **telecoms and insurance sectors**. When structured by size, the levy almost exclusively applies to large companies (except for pharmaceutical distributors).

The revenues of the Telecommunications Regulatory Authority will be higher due to the sale of frequency bands released by the transition from analogue to digital television broadcasting. This part of the spectrum also lends itself to the provision of broadband mobile Internet through the fourth generation network (4G). With lower costs of coverage, sparsely populated areas can reap the benefits of fast Internet connection as well.

The Slovak Government approved²⁴ a **one-off increase of the instalment** (on top of previously agreed instalments) of repayable financial assistance from the **Cargo Slovakia company in the amount of EUR 78 million** (0.1% of GDP) in 2014. Based on ESA 95 methodology, this will have a positive impact on the balance, because it was recorded with a negative impact on the general government deficit and debt in 2009 due to expected non-repayment of this assistance. Simultaneously, a **compensation for financial impacts resulting from the reduced fee for access to railway infrastructure amounting to EUR 22.5 million a year** was provided to the **Slovak Railways (ŽSR)** company on the basis of the budget proposal.

A portion of dividends will be shifted from 2013 to 2014. The profits generated by the SPP and SEPS companies in 2012 will be paid to the state as a shareholder one year later, together with the dividends for 2013. The one-off dividend shift will reduce the revenues in 2013 by EUR 437 million (0.6% of GDP); however, the revenues in 2014 will increase by the same amount. This will improve the fiscal performance of general government by EUR 873 million (1.2 % of GDP) year-on-year.

In 2012, the **Action Plan to Combat Tax Evasion was approved, as a part of which** several measures aimed at reducing VAT evasion were adopted. The additional measures to combat tax evasion include the introduction of the VAT monitoring statement for enterprises, which will make it possible to perform tax inspections more effectively. At the same time, the “reverse charge” system should apply to risky commodities to limit carousel frauds. In addition, specialised tax courts will be established .

The **receipt lottery** was launched as one of the instruments designed to reduce VAT evasion. In just two weeks preceding the first draw, 253,000 people registered more than seven million cash receipts. The mass participation of the population should help identify “illegal” cash registers.

The current VAT developments indicate that the effective tax rate has stabilised after several years of decline. In 2013 it will reach slightly better figures than in 2012. More efficient tax collection is primarily indicated by VAT revenues based on tax returns for the first half of 2013 which increased more than the VAT base²⁵ in year-on-year comparison. Better tax collection this year is attributable to a decline in excess VAT and a gradual stabilisation of the tax liability itself. This structure of improved VAT collection is in line with the growth of final household consumption and helps prevent the spread of tax evasion.

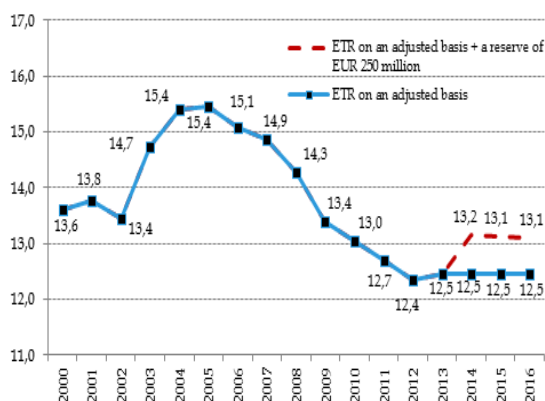
On top of the forecast figure, the budget proposal created a **reserve of EUR 250 million for higher VAT collection in 2014**. However, no expenditure is assigned to this reserve; therefore, it does not affect the general government balance calculation. **The reserve for attaining the fiscal objective amounting to EUR 65 million** is designed to reduce the risk of potential failure to reach the deficit target.

²⁴ Slovak Government Resolution No. 390/2013 of 10 July 2013 concerning the proposal of measures for the consolidation of railway transportation in the Slovak Republic

²⁵ VAT collection based on tax returns in the first half of 2013 rose 1.1% year-on-year, whereas the VAT base adjusted for analytical purposes rose by 0.7% year-on-year.

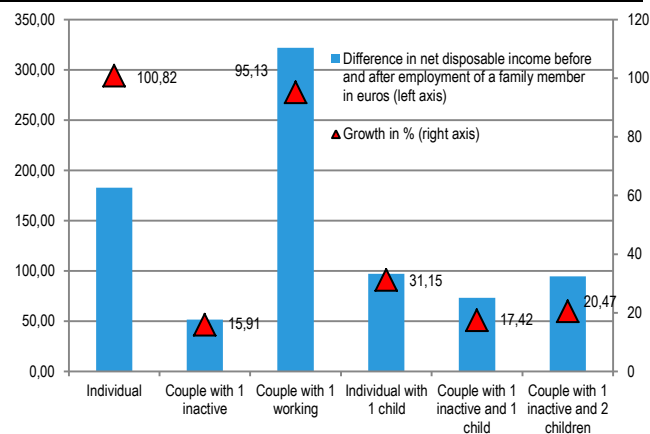


Chart 10: Stabilisation of net effective tax rate (ETR) following a period of decline in VAT



Source: MoF SR

Chart 11: Impact of payroll tax forgiveness on monthly disposable income of families in 2013



Note: including the entitlement for activation benefit (AB) for the period of 6 month after finding a job (average monthly increase in income in 2013); family members receive AB prior to finding a job; net family income includes a child allowance, a tax bonus and an employee tax credit (for couples with one working person)

In addition to the proposed consolidation, the Government will continue to adopt necessary **structural measures** with a positive impact on employment in the period between 2014 and 2016, although they will have a slightly negative impact on public finance.

Wages of the long-term unemployed will be exempt from social contributions in the first year of working in a new job. The measure will boost the supply of, and demand for such workforce. As regards the minimum wage, labour costs will drop by more than 25 % and the net income will increase. With the temporary exemption from the payment of social contributions in place, people will be less motivated to work illegally. The assumption is that roughly 15,000 long-term unemployed would find work due to being exempt from the payment of social contributions, and about one quarter of this number would leave the informal economy to get a regular job. The estimated cost of the measure stands at EUR 8 million.

The exemption from the obligation to pay social security contributions for the long-term unemployed will have a **positive impact especially in low-income households**. The net income of 20% poorest households will increase by 0.8% on average. The net income of individuals will increase by 101 % when compared against their income from the minimum subsistence allowance and other benefits attached. After finding a job, an individual with a child will also be entitled to a tax bonus, which will increase their income by additional 31%. For couples with one working person and two children, household income will increase by almost 25%. In other quintiles, no income changes are expected.

The **Slovak Government is currently assessing the benefits and public acceptance of the consolidation measures** which could be adopted in 2014 and 2015 to meet the medium-term budgetary objective until 2017. The measures were outlined in the most recent Stability Programme of the Slovak Republic and the National Reform Programme of the Slovak Republic, and additional measures will be detailed in updates to these documents in 2014.



IV. **Linking the budgetary plan with the objectives of the Growth and Employment Strategy and Country-specific Recommendations of the European Commission**

The **structural measures**, which do not significantly affect public finances, yet are important for the competitiveness of the Slovak economy and the quality of life of its population in the long term, will particularly focus on the **labour market, education and transport infrastructure**.

Following the legislative amendments to the **system of active labour market policies**, the Slovak Government will proceed with further changes at the offices of labour, social affairs and family to further improve the policies, while laying more emphasis on the provision of consulting services and tailored public services. This effort will also entail the monitoring of their effectiveness. In particular, the focus will be on increasing the employment of the long-term unemployed and young people.

The **reform of the education sector** will undergo essential changes. Regional schools must provide better access to education for marginalised groups while linking vocational training with practical training in companies, in particular by incorporating the components of the dual education system (theoretical education combined with practical training) in vocational education. The supervision over the quality of university studies will also change. Accreditation and guarantees will be simplified and the rigid rules for the selection of study sponsors will be modified as well.

Productive investments remain a priority. The Government will allocate funds for the construction and reconstruction of roads and railroads. Special attention will be given to Class A roads, many of which are in unsatisfactory condition. The Energy Efficiency Directive is being implemented, and a set of tools for improving energy efficiency in the public administration, companies and households will be created.

The measures described in Table 5.a (see Annex 3), as well as other reforms described in Section V, are implemented in response to Country-specific Recommendations (CSR) for the Slovak Republic and the objectives of the EU Growth and Employment Strategy (Europe 2020). In addition, there are also other measures which are to be adopted by the Government in line with its commitments under the National Reform Programme 2013 and which will address the problems identified by CSR and in Europe 2020. The most important measures are listed in Table 6.a and Table 6.b (see Annex 3).

V. Divergence from the Stability Programme

The Stability Programme was based on data from the official macroeconomic forecast of the Ministry of Finance of the Slovak Republic from January 2013, which expected the economy to grow by 1.2% in 2013. The most recent forecast prepared in September 2013, which served as a basis for the general government budget proposal, assumes that economic growth will be lower in 2013 and 2014.

No.	Indicator	Unit of measure	Forecast (Stability Programme)		Forecast (Budget Proposal)	
			2013	2014	2013	2014
1	GDP, at current prices	in EUR billion	73.8	77.5	73.0	75.8
2	GDP, at constant prices	%	1.2	2.9	0.8	2.2
3	Final consumption of households and non-profit institutions serving households (NPISH)	%	-0.1	1.5	0.5	0.8
4	Final general government consumption	%	-0.9	-1.4	-0.7	-1.2
5	Gross fixed capital formation	%	2.3	3.3	-5.8	2.9
6	Exports of goods and services	%	3.3	4.9	4.8	4.3
7	Imports of goods and services	%	3.5	4.1	1.7	3.3
8	Average monthly wage in the economy (nominal growth)	%	2.3	3.5	2.6	2.8
9	Average employment growth, Labour Force Sample Survey (LFSS)	%	-0.5	0.7	-0.2	0.2
10	Average employment growth, ESA 95	%	-0.5	0.5	-1.0	0.2
11	Average unemployment rate, LFSS	%	14.3	13.8	14.5	14.3
12	Average registered unemployment rate	%	14.1	13.5	14.4	14.2
13	Harmonised index of Consumer Prices (HICP)	%	2.4	2.5	1.7	1.7
14	Current Account Balance (as percentage of GDP)	%	1.2	1.7	3.2	3.5

Source: MoF SR

In comparison with the Stability Programme, the estimate of the general government balance in 2013 and the budgetary target for 2014 is slightly worse. The change is mainly attributed to a less favourable macroeconomic development. In the case of the no-policy-change scenario, the difference is even more pronounced²⁶. The 2014 general government deficit under this scenario is worse by almost 1 p.p. of GDP in particular due to the lower forecast of tax revenues. **The consolidation effort in 2014, as described in this draft budgetary plan, is therefore more ambitious than expected by the Stability Programme for 2013.**

	ESA Code	2012 % of GDP	2013 % of GDP	2014 % of GDP
Target general government net lending/net borrowing	B.9			
Stability Programme		-4.35	-2.94	-2.60
Draft Budgetary Plan		-4.35	-2.98	-2.83
Difference		0.00	-0.04	-0.23
General government net lending projection at unchanged policies	B.9			
Stability Programme		-4.35	-2.94	-3.65
Draft Budgetary Plan		-4.35	-2.98	-4.61
Difference		0.00	-0.04	-0.96

²⁶ The no-policy-change scenarios in both documents were prepared using the same method and approach for the inclusion of measures (the scenarios did not include the measures proposed/approved after 1 January 2013) which means that they are fully comparable.

ANNEXES

Annex 1: Forecasting tool of the MF SR

The MF SR uses a neo-Keynesian **structural** open-economy **model** for medium-term forecasting and for the construction of sensitivity scenarios. This is an econometric model with backward-looking expectations based on an error correction model. The model parameters were partly estimated and partly calibrated to ensure that the model has economically intuitive properties and responds to standard economic shocks. Within the error correction structure, long-term relationships are mostly based on economic theory, while short-term relationships are estimated so as to achieve a better explanation of historical data. The model uses more than 30 endogenous variables, more than 40 exogenous variables and contains 24 behavioural equations and 24 identities. It consists of three main blocks: supply, demand and price. A more detailed description of each block can be found in the paragraphs below.

The **supply block** is based on first-order conditions for the Cobb-Douglas single-sector production function. Long-term investment and employment equations are derived from optimisation conditions. Short-term fixed investment dynamics are a function of GDP growth and changes in the real interest rate. Short-term employment dynamics depend on potential employment, the total factor productivity trend and GDP growth. The supply block also defines simple long-term relationships and identities for potential output, the NAIRU, potential employment, output gaps and employment, total factor productivity, capital and wealth accumulation²⁷, labour force and population.

The **demand block** includes long-term and short-term equations for all expenditure components of GDP, together with the related identities. *Household consumption* is, in the long term, a function of disposable income and wealth. In the short term, consumption is also affected by interest rates, which are an exogenous variable within the model. The unemployment rate, which reflects uncertainty on the labour market from the standpoint of households, also has a short-term effect on consumption. Movements in household disposable income are also related to household consumption. It consists of individual components, such as the wage base and other components. The wage base is based on endogenous model relationships, while other components of household income are treated in the forecast as exogenous variables. In the long term, however, the model assumes a stable relationship between wage base growth and the growth of other components of gross disposable income.

Government consumption enters the model at the forecast horizon as an exogenous variable according to the current government budget outlook. Beyond the forecast horizon, the growth in government consumption gradually approaches that in potential output. The *fixed investment* equation was described above, in relation to the demand block.

Export is a function of the index of demand from Slovakia's major trade partners (the euro zone and V3 countries) and the real exchange rate. The differential in total factor productivity between Slovakia and Germany also has a short-term impact on export. *Import* is derived from the components of domestic demand and export, where import intensities of the individual components are fixed. Short-term import dynamics are further illustrated by the relative prices between domestic and foreign economies.

²⁷For the purposes of the model, wealth is defined as accumulated private capital less government debt and plus cumulative trade balance.



The **price block** describes real wages, the deflators of GDP expenditure components, energy prices and core CPI inflation. *Real wages* depend on labour productivity, while the unemployment gap also has an effect on the short-term developments in real wages.

The *GDP deflator* is a function of per-unit labour costs. In the short term, GDP deflator dynamics are also affected by the output gap, import prices and the Balassa-Samuelson effect. The *household consumption deflator* has dynamics identical to those of CPI inflation. CPI inflation accounts for the largest share of the *government consumption deflator*, which is also partially affected by the investment deflator. The investment deflator is derived from the GDP and import deflators, the former having a slightly greater weight. The *export deflator* is a function of the real exchange rate. In addition to the real exchange rate, oil prices and the USD/EUR exchange rate have an effect on the import deflator.

Given the significant share of the regulated component, domestic *energy prices* enter the model at the forecast horizon exogenously. Beyond this horizon, however, they are affected in particular by the GDP deflator and, to a lower extent, by world oil prices in euro. *Consumer prices excluding energy* are a function of the GDP deflator and, in the short term, energy prices, import prices and the output gap.

Annex 2: Assumptions for the quantification of revenue measures

Introduction of the tax licence and reduction of the corporate income tax rate to 22%

The quantification is based on the assumption that the proposal will enter into force on 01.01.2014, while taking into account the current forecast of the macroeconomic situation and developments in corporate income tax. Data from the tax returns of legal entities for 2011 (data for 2012 are not yet available) were used for the calculation, which were then indexed according to the expected macroeconomic developments. The quantification does not include dynamic effects, such as changes in legal form from a legal to natural entities or lower optimisation rate due to the reduced corporate income tax rate.

Extension of the period of application of the special levy in regulated industries

The quantification is based on the assumption that the proposal will enter into force on 01.01.2014, while taking into account the current forecast of the macroeconomic situation and developments in the special levy on businesses in regulated industries and corporate income tax. Data from the Slovak Financial Authority and the Tax Office for selected taxpayers on the number and structure of companies which paid the levy for 2013 were used for the calculation. The quantification assumes that the total number of companies with a profit in excess of EUR 3 million which pay the levy (in the current situation) will remain unchanged. The quantification does not include the dynamic effects of optimisation of profit by particular levy-paying companies compared to 2013.

Relief from social contributions for the long-term unemployed

For the purposes of quantifying the effects of the temporary exemption of the long-term unemployed from social contributions, an impact simulation through the Euromod tax-benefit model, which is based on and uses data from anonymous statistical surveys on income and living conditions of households - EU SILC 2011, was used. The forecast assumes, that **15 000 of long-term unemployed** are to be supported annually. This is based on experience with active labour market policies in the 2009-2012²⁸ and takes into account the specificities²⁹ of the policies, which will not exist in the case of exemption from social contributions. The quantification also takes the dynamic effects of substitution of existing employees into consideration.

²⁸ In the period specified above, 5 500 jobs were created on average per year, of which around 60% were jobs for the long-term unemployed

²⁹ The administratively intensive process, the testing of meeting the requirements for the above measures, the automatic requirement to retain the job for a certain period of time, non-existence of automatic eligibility, etc.



Appendix 3 - Required tables

Table 0i - Basic assumptions

	2012	2013	2014
Short-term interest rate (annual average)	0.6	0.2	0.4
Long-term interest rate (annual average)	3.4	2.7	3.4
USD/€ exchange rate (average)	1.286	1.313	1.261
Nominal effective exchange rate (change in %)	-0.9	-0.2	1.4
EU GDP growth	-0.7	-0.5	0.9
Growth of relevant foreign markets	-0.2	-0.1	1.3
Oil prices (Brent, USD/barrel)	112.0	110.2	115.5

Source: MoF SR

Table 0ii - Main assumptions

	2012	2013	2014
1. External environment			
Oil prices (€)	87.0	83.9	91.6
2. Fiscal policy			
Net lending/net borrowing of the general government	-4.3	-3.0	-2.8
Gross debt of the general government	52.1	54.3	56.8
3. Monetary policy, financial sector			
Interest rates:			
3M Euribor (average)	0.6	0.2	0.4
Deposit rates	1.2	1.0	1.0
Yield to maturity of 10-year Slovak government bonds (average)	3.4	2.7	3.4
Evolution of deposits	4.7	3.3	5.4
4. Demographic trends			
Evolution of working-age population	1.0	0.4	0.0
Total dependency ratio	39.8	39.8	40.4

Source: MoF SR



Table 1.a - Macroeconomic overview

	ESA Code	2012 Level	2012 rate of change	2013 rate of change	2014 rate of change
1. Real GDP	B1*g	65.2	2.0	0.8	2.2
of which					
1.1 Attributed to the estimated impact of aggregated budgetary measures on economic growth		-	-	0	0.2
2. Potential GDP		65.9	2.3	2.2	2.1
contributions:					
- labour		-	-0.3	-0.1	-0.1
- capital		-	0.4	0.1	0.2
- total factor productivity		-	2.2	2.1	2.0
3. Nominal GDP	B1*g	71.5	3.4	2.1	3.8
Components of real GDP					
3. Private final consumption expenditure	P.3	33.5	-0.6	0.5	0.8
4. Government final consumption expenditure	P.3	10.6	-0.6	-0.7	-1.2
5. Gross fixed capital formation	P.51	14.8	-3.7	-5.8	2.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	-1.1	-2.8	-2.7
7. Exports of goods and services	P.6	63.7	8.6	4.8	4.3
8. Imports of goods and services	P.7	55.8	2.8	1.7	3.3
Contributions to real GDP growth					
9. Final domestic demand		-	-1.3	-1.2	0.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-2.2	-1.3	-0.1
11. External balance of goods and services	B.11	-	5.5	3.3	1.5

Source: MoF SR

Table 1.b - Price developments

	ESA Code	2012 Level	2012 rate of change	2013 rate of change	2014 rate of change
1. GDP deflator		1.10	1.4	1.3	1.6
2. Private consumption deflator		1.22	3.7	1.5	1.6
3. HICP		121.16	3.7	1.7	1.7
4. Public consumption deflator		1.19	1.9	1.5	1.8
5. Investment deflator		1.04	0.2	0.6	2.1
6. Export price deflator (goods and services)		1.07	1.4	-1.6	1.1
7. Import price deflator (goods and services)		1.16	2.3	-0.9	2.2

Source: MoF SR



Table 1.c - Labour market developments

		2012	2012	2013	2014
	ESA Code	Level	rate of change	rate of change	rate of change
1. Employment, persons (thousands) [1]		2 209	0.1	-1.0	0.2
2. Employment, hours worked (million)[2]		3 944	-0.4	-1.7	0.0
3. Unemployment rate (%) [3]			14.0	14.5	14.3
4. Labour productivity, persons (EUR) [4]		29 315	2.0	1.8	2.0
5. Labour productivity, hours worked (EUR) [5]		16.5	2.4	2.6	2.2
6. Compensation of employees (EUR million)	D.1	26 465	2.6	2.9	2.8
7. Compensation per employee (EUR)		14 197	2.0	2.2	2.8

[1] Occupied population, domestic concept national accounts definition.

Source: MoF SR

[2] National accounts definition.

[3] Harmonised definition, Eurostat; levels.

[4] Real GDP per person employed.

[5] Real GDP per hour worked.

Table 1.d - Sectoral balances (ESA 95, % of GDP)

	ESA Code	2012	2013	2014
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	4.1	4.7	5.1
of which:				
- Balance of goods and services		5.4	7.6	7.6
- Balance of primary incomes and transfers		-3.2	-4.4	-4.1
- Capital Account		1.9	1.5	1.6
2. Net lending/net borrowing of the private sector	B.9	8.4	7.7	7.9
3. Net lending/net borrowing of the general government	EDP B.9	-4.3	-3.0	-2.8
4. Statistical discrepancy		0	0	0

Source: MoF SR

Table 2.a: General government budgetary targets (% of GDP)

	ESA Code	2013	2014
		% of GDP	% of GDP
Net lending (+)/net borrowing (-) (EDP B.9) by sub-sector			
1. General government	S.13	-2.98	-2.83
2. Central government	S.1311	-3.2	-3.0
3. State government	S.1312	-	-
4. Local government	S.1313	0.1	0.0
5. Social security funds	S.1314	0.0	0.1
6. Interest expenditure	D.41	1.9	1.8
7. Primary balance of the general government (1+6)		-1.1	-1.0
8. One-off and other temporary measures		0.7	1.0
9. Real GDP growth (%)		0.8	2.2
10. Potential GDP growth (%)		2.2	2.1
contributions:			
- labour		-0.1	-0.1
- capital		0.1	0.2
- total factor productivity		2.1	2.0
11. Output gap (% of potential GDP)		-2.4	-2.3



12. Cyclical component (% of potential GDP)	-0.8	-0.8
13. Cyclically-adjusted balance (1-12) (% of potential GDP)	-2.2	-2.1
14. Cyclically-adjusted primary balance (13+6) (% of potential GDP)	-0.3	-0.3
15. Structural balance (13-8) (% of potential GDP)	-2.9	-3.1

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

Source: MoF SR

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

[3] A plus sign means deficit-reducing one-off measures of the general government

[5] Including those collected by the EU

Table 2.b: General government debt developments (% of GDP)

	ESA Code	2013	2014
1. Gross debt		54.3	56.8
2. Change in gross debt ratio		2.1	2.5
Contributions to changes in gross debt			
3. Primary balance		-1.1	-1.0
4. Interest expenditure	D.41	1.9	1.8
5. Stock-flow adjustment		0.3	1.7
of which:			
- Differences between cash and accruals		-0.4	0.6
- Net accumulation of financial assets		0.8	1.0
of which: privatisation proceeds		0.0	0.0
- Valuation effects and other		-0.1	0.1
p.m. Implicit interest rate on debt		3.7	3.5
Other relevant factors			
6. Liquid financial assets		5.3	5.8
7. Net financial debt (1-6)		48.9	50.9
8. Debt amortisation (existing bonds) since the end of the previous year		6.0	3.4
9. Percentage of debt denominated in foreign currency		5.4	5.0
10. Average maturity*		5.9	6.0

Note: maturity of government debt at the end of the year

Source: MoF SR

Table 2.c: Contingent liabilities (% of GDP)

	2012	2013	2014
Public guarantees	2.88		
of which:			
financial sector	0		

Note: Estimate as of 31.12.2012. Compared to the figure provided in the Stability Programme, the quality of the underlying data has improved.



Table 3: General government expenditure and revenue projections at unchanged policies (broken down by components)

General government (S13)	ESA Code	2013 % of GDP	2014 % of GDP	2013 EUR million	2014 EUR million
1. Total revenue	TR	32.9	32.5	24 012	24 599
of which					
1.1. Taxes on production and imports	D.2	10.0	9.5	7 285	7 202
1.2. Current taxes on income, wealth etc.	D.5	5.6	5.6	4 109	4 226
1.3. Capital taxes	D.91	0.0	0.0	0	0
1.4. Social contributions	D.61	13.6	13.1	9 914	9 950
1.5. Property income	D.4	0.4	0.9	264	644
1.6. Other		3.3	3.4	2 441	2 577
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		29.2	28.2	21 307	21 378
2. Total expenditure	TE	35.9	37.1	26 187	28 094
of which					
2.1. Compensation of employees	D.1	6.7	6.6	4 894	4 990
2.2. Intermediate consumption	P.2	4.2	4.5	3 065	3 418
2.3. Social payments	D.62, D.632	18.4	18.4	13 454	13 943
of which: Unemployment benefits		0.3	0.2	186	179
2.4. Interest expenditure	D.41	1.9	1.8	1 363	1 394
2.5. Subsidies	D.3	1.2	1.3	894	1 003
2.6. Gross fixed capital formation	P.51	1.6	1.3	1 167	1 000
2.7. Capital transfers	D.9	0.5	0.8	350	576
2.8. Other		1.4	2.3	1 001	1 771

Table 4.a: General government expenditure and revenue targets (broken down by components)

General government (S13)	ESA Code	2013 % of GDP	2014 % of GDP	2013 EUR million	2014 EUR million
1. Total revenue	TR	32.9	34.0	24 012	25 731
of which					
1.1. Taxes on production and imports	D.2	10.0	9.8	7 285	7 452
1.2. Current taxes on income, wealth etc.	D.5	5.6	5.8	4 109	4 389
1.3. Capital taxes	D.91	-	-	-	-
1.4. Social contributions	D.61	13.6	13.0	9 914	9 845
1.5. Property income	D.4	0.4	1.5	264	1 101
1.6. Other ¹		3.3	3.9	2 441	2 943
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		29.2	28.6	21 307	21 686
2. Total expenditure	TE ³	35.9	36.8	26 187	27 875
of which					
2.1. Compensation of employees	D.1	6.7	6.6	4 894	4 985
2.2. Intermediate consumption	P.2	4.2	4.7	3 065	3 531
2.3. Social payments	D.62 ⁶ , D.632	18.4	18.0	13 454	13 652
of which: Unemployment benefits		0.3	0.2	186	179
2.4. Interest expenditure	D.41	1.9	1.8	1 363	1 375
2.5. Subsidies	D.3	1.2	1.3	894	989
2.6. Gross fixed capital formation	P.51	1.6	1.3	1 167	986
2.7. Capital transfers	D.9	0.5	0.7	350	564
2.8. Other ⁵		1.4	2.4	1 001	1 793

Note: Compared to the data presented in the general government budget proposal for the 2014-2016 period, changes have been made to the data on compensation of employees and other expenditure in 2014. Expenditure intended for increasing wages in general government has been transferred from



the other expenditure category the compensation of employees category.

Table 4.b: Amounts to be excluded from the expenditure benchmark

	ESA Code	2012	2012	2013	2014
		EUR million	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue		807	1.1	1.4	1.6
2. Cyclical unemployment benefit expenditure		17	0.0	0.1	0.1
3. Effect of discretionary revenue measures		299	0.4	1.9	1.0
4. Revenue increases mandated by law		0	0	0	0

Table 4.c.i): General government expenditure on education, healthcare and employment

	2013		2014		EU27 in 2011	
	% of GDP	% TE	% of GDP	% TE	% of GDP	% TE
Education	3.8	10.6	3.6	9.9	5.3	10.9
Health	5.6	15.5	5.3	14.3	7.3	14.9
Employment*	0.23	0.63	0.19	0.51	-	-

Note: TE - Total general government expenditure.

Source: Eurostat

For 2014, the table shows an estimate calculated as the average of EU funds for 2011 through to 2013. International comparison is available only for some of the expenditure on employment - active labour market policies. 2011 expenditure on active labour market policies amounting to 0.30% of GDP (0.77% of TE) was less than half of that of the EU27 average, which amounted to 0.61% of GDP (1.25% of TE).

Table 4.c.ii): General government expenditure according to the COFOG classification

Functions	COFOG Code	2013		2014		EU27 in 2011	
		% of GDP	% TE	% GDP	% TE	% GDP	% TE
1. General public services	1	5.06	14.1	6.2	16.86	6.6	13.46
2. Defence	2	0.92	2.56	0.93	2.52	1.5	3.06
3. Public order and safety	3	1.83	5.09	1.94	5.27	1.9	3.88
4. Economic affairs	4	2.34	6.53	3.19	8.67	4	8.16
5. Environmental protection	5	0.64	1.78	0.39	1.07	0.9	1.84
6. Housing and community amenities	6	0.71	1.97	0.55	1.49	0.9	1.84
7. Health	7	5.55	15.47	5.27	14.34	7.3	14.89
8. Recreation, culture and religion	8	1.08	3.01	0.94	2.55	1.1	2.24
9. Education	9	3.8	10.58	3.65	9.93	5.3	10.81
10. Social protection	10	13.96	38.9	13.71	37.3	19.6	39.98
Total expenditure	TE	35.88	100	36.75	100	49.02	100

Note: TE - Total general government expenditure



Table 5.a: Measures included in the general government budget proposal (ESA 95, % of GDP, comparison to NPC)

Measures	Sub-sector	ESA 95 Code	Budgetary impact* (% GDP)		
			2013	2014	2015
1. ESO	S.1311			0.54	
- property income		D.4 rec		0.03	
- other income		other, rec		0.02	
- gross wages		D.1 pay		0.09	
- intermediate consumption		P.2		0.24	
- gross fixed capital formation		P.51		0.14	
- other expenditure		other, pay		0.03	
2. Savings in the healthcare sector				0.23	
- payment for persons insured by the state, received	S.1311	D.61 rec		-0.19	
- payment for persons insured by the state, paid	S.1314	D.62 pay		0.19	
- transfer for healthcare facilities	S.1314	D.631 pay		0.23	
3. Wages in general government	S.13	D.1 pay		-0.09	
4. Introduction of the minimum tax liability with respect to corporate income tax	S.1311	D.5 rec		0.16	
5. Reduction in corporate income tax rate	S.1311	D.5 rec		-0.05	
6. Levy on profits generated by regulated undertakings	S.1311	D.5 rec		0.10	
7. Extraordinary revenues of the Telecommunications Regulatory Authority	S.1311	other, rec		*30	.*
8. Dividend carryover from 2013 to 2014	S.1311	D.4 rec	-0.60	1.15	-0.55
- one-off decrease in dividends in 2013			-0.60	0.58	
- one-off increase in dividend in 2014				0.58	-0.55
9. Changes in rail transport	S.1311			0.07	-0.10
- one-off increase of the instalment of repayable financial assistance from the CARGO company		other, rec		0.10	-0.10
- compensation for the Slovak Railways (ŽSR) company		D.3 pay		-0.03	
10. Reserve for higher VAT collection	S.1311			0.00	0.00
- taxes on production and imports (VAT)		D.2 rec		0.33	-0.31
- intermediate consumption (General Treasury Administration chapter)		P.2		-0.33	0.31
11. Reserve for meeting the budgetary target	S.1311	P.2		-0.09	0.08
12. Other changes against NPC	S.13			-0.01	-0.03
Total			-0.60	2.36	-0.91

Note: All measures are at the proposal stage, the only exception are the changes in rail transport, which have been approved through a Government Resolution. The effects of the measures are expressed using ESA 95 methodology (accrual principle) and have no impact on other Euro Area Member States.

* impact on general government balance

Source: MoF SR

³⁰ The proceeds will not be known until after the auction.



Table 6.a: NRP response to specific recommendations for Slovakia

CSR number	Measure	Objectives
1	Implement as envisaged the budget for the year 2013, so as to correct the excessive deficit in a sustainable manner and achieve the fiscal effort specified in the Council recommendations under the excessive deficit procedure. After the correction of the excessive deficit, pursue the structural adjustment effort that will enable Slovakia to reach the medium-term objective by 2017. Avoid cuts in growth enhancing expenditure and step up efforts to improve the efficiency of public spending. Building on the pension reform already adopted, further improve the long-term sustainability of public finance by reducing the financing gap in the public pension system and increasing the cost-effectiveness of the health-care sector.	
1	Consolidation of public finance	Under the ongoing excessive deficit procedure, Slovakia's short-term fiscal objective is to reduce the general government deficit in 2013 to below 3% of GDP in a sustainable manner. According to the up-to-date information on the positive aspects and risks of the developments in the general government budget in 2013, the general government budget deficit could reach the level of 2.98% of GDP. In the medium term, the Draft Budgetary Plan is based on the general government budget proposal for the 2014-2016 period presented to the Slovak Government in October 2013. The target general government budget deficit is at the level of 2.83% of GDP for 2014, 2.57% of GDP for 2015 and 1.50% of GDP for 2016. Achieving these targets will stop the public debt-to-GDP ratio from growing further and allow for its gradual reduction from 2015 onwards. Based on the recommendations from the Council of the EU, the Slovak Republic should meet the medium-term budgetary objective by achieving structural general government deficit of 0.5% of GDP in 2017.
1	Basic tax licence and reduction of the corporate income tax rate to 22%	Fiscal consolidation. Reduction of tax evasion. Reduction of administrative costs of financial administration. Improvement of the business environment.
1	Extension of the period of application of the special levy in regulated industries	Fiscal consolidation.
1	Adoption of rules on expenditure ceilings	Better management of public finances. Expenditure ceilings will serve as an operational tool to meet all fiscal rules that govern fiscal policy (the fiscal compact and the Fiscal Responsibility Act).
1	Reallocation of inefficient expenditure	Improvement of efficiency of general government expenditure. Identification of expenditure items that fail to meet the objectives of government policies. Transfer of some of these expenditures to productive programmes or creation of room for further structural consolidation on the expenditure side.
1	Tightening of the rules for local governments	Better management of public finances. This will allow for better control of the fiscal performance of local governments, which account for 14% of public expenditure.
1	Efficiency in healthcare	Better efficiency and long-term sustainability of expenditure in healthcare. Savings will be achieved through changes in financial management and performance-based remuneration, better quality control, new system of payments and purchasing of medicines, materials and services.
2	Speed up the implementation of the action plan to combat tax fraud and continue efforts to improve VAT collection, in particular by strengthening the analytical and audit capacity of the tax administration. Improve tax compliance. Link real-estate taxation to the market value of property.	
2	Action plan to combat tax evasion	Reduction of tax evasion. The concept for increasing the efficiency of tax collection consists of three phases. 50 specific measures have already been implemented in the first phase focusing, in particular, on VAT (e.g. withdrawal of VAT registration from persons avoiding communication or contact, introduction of a security deposit in connection with VAT registration, introduction of joint and several tax liability, creation of new criminal offences - tax fraud and obstruction of tax administration).
2	Receipt lottery	Reduction of tax evasion. Identification of "illegal" cash registers. In the course of two weeks, 253 thousand people registered over 7 million cash register receipts before the first drawing.
2	Introduction of the control statement	Reduction of tax evasion. The Financial Directorate will ensure linking its databases with the systems of banks, construction authorities, registries of motor vehicles and population, and the toll-collection system and then carry out identification and analysis of risks in tax administration and selection of entities for tax audit
2	Specialised courts	Reduction of tax evasion. Establishment of courts with a focus on the tax area.
2	Taxation of real estate based on market value	Fairer tax collection. Higher property taxes. Creation of further room for tax cuts affecting economic activity.



3	Take measures to enhance the capacity of public employment services to provide personalised services to jobseekers and strengthen the link between activation measures and social assistance. More effectively address long-term unemployment through activation measures and tailored training. Enhance the provision of childcare facilities, in particular for children below three years of age. Reduce the tax wedge for low-paid workers and adapt the benefit system.	
3	Implementation of the amendment to the Employment Services Act	Better results of public employment services. New job creation. The Government will further increase the efficiency of active labour market policies by changes at Labour, Social Affairs and Family Offices and by greater emphasis on counselling and personalised public services. The primary emphasis is on improving employment of the long-term unemployed.
3	Better-informed active labour market policies	Centralisation of databases of jobseekers and social benefit recipients, completion and interconnection with the relevant institutions will allow for better monitoring and analysing of the net efficiency and effectiveness.
3	Reduction of the social contributions burden in relation to the long-term unemployed	The long-term unemployed will be provided one-year exemption from health and social contributions from income of up to 67% of the average wage, which will create favourable conditions for their reintegration into the labour market.
3	Programme to support the long-term unemployed	Employment of the long-term unemployed. Subsidising of employers' labour costs for long-term unemployed through active labour market policies.
3	Increased enrolment of children in kindergartens	Extension of the capacity of kindergartens, extension of the existing forms of education to include preschool classes in kindergartens and increased number of hours of preschool education.
3	Changes in social benefits	Better targeting of social benefits. Better employability of recipients of benefits. Reconciliation of professional and family life.
4	Step up efforts to address high youth unemployment, for example through a Youth Guarantee. Take steps to attract young people to the teaching profession and raise educational outcomes. In vocational education and training, reinforce the provision of work-based learning in companies. In higher education, create more job-oriented bachelor programmes. Foster effective knowledge transfer by promoting cooperation between academia, research and the business sector. Step up efforts to improve access to high-quality and inclusive pre-school and school education for marginalised communities, including Roma.	
4	Promotion of youth employment and the guarantees system	Subsidising of employers' labour costs for youth financed from structural funds through active labour market policies. The guarantees system of a quality offer of employment, further education, apprenticeship or traineeship, within four months of becoming unemployed or leaving formal education for young people under 25 years of age, will also be adopted.
4	Improvement of the teacher status	In 2014, wages of teachers and professional staff in regional and tertiary education will increase by 5% (42 euro). This increase will depend on several criteria, including the teacher's performance.
4	Improvement and better linking of vocational training to practice	Better involvement of employers in the system of vocational training, promotion of work-based learning in companies. Assurance of quality in professions in demand in the labour market by means of motivational scholarships. The difference between the average wage of teachers and other university-educated professionals will be reduced.
4	Quality of tertiary education - amendment to the relevant act	Improvement of the quality of tertiary education. Simplification of accreditation and guarantees, modification of the rigid rules for the selection of study sponsors.
4	Better access to preschool education for marginalised communities	Promotion of social inclusion and positive changes in communities, with special emphasis on marginalised Roma communities, through the development of community work in community centres.
5	Step up efforts to make the energy market function better; in particular, to increase the transparency of the tariff-setting mechanism, enhance the accountability of the regulator. Strengthen interconnections with neighbouring countries. Improve energy efficiency, in particular in the construction sector and in industry	
5	Implementation of the Energy Efficiency Directive	Improvement of energy efficiency
5	Roadmap to transparency of regulation	Better transparency of regulation of network industries. The Government will prepare a roadmap containing the possible measures for increasing the transparency of regulation of network industries.
5	Innovative financial instruments (JESSICA - State Housing Development Fund)	Energy efficiency. Promotion of financing energy efficiency renovation of residential units by means a credit facility using ESIF resources, continued implementation in the 2014-2020 programming period with extended funding.
6	Amend the Act on Civil Service to strengthen the independence of the public service. Improve the management of human resources in public administration. Step up efforts to strengthen analytical capacities in key ministries, also with a view to improving the absorption of EU funds. Implement measures to improve the efficiency of the judicial system. Promote alternative dispute resolution procedures and encourage their greater use.	



6	Government modernisation	Improvement of the quality of public administration. Process management, performance indicators and central recruitment will be introduced and flexible working time will be made possible. The functionality of the Central Public Administration Portal will be enhanced and the information system of the Integrated Service Points will be launched, which will improve the use of e-government services.
6	Strengthening of analytical capacity	Quality of government. Better-informed and more analytically-based decision-making in economic policy-making through analytical units at ministries and by creating a scholarship programme to attract the best university graduates to work for the government.
6	Efficient, reliable and open government - the ESO Programme	Improving the efficiency of the performance of the central government and other public administration bodies, improvement of management processes, review of functionalities, optimisation of organisational structure and a stronger focus on the needs of the citizens, savings in spending on the functioning of public administration and improvement of its outcomes without increasing funding. It is being implemented using a combination of higher revenues and lower spending.

Table 6.b: EU targets for growth and jobs

National 2020 headline target	Measure	Objective
Jobs	Promotion of youth employment and the guarantees system	Subsidising of employers' labour costs for youth financed from structural funds through active labour market policies. The guarantees system of a quality offer of employment, further education, apprenticeship or traineeship, within four months of becoming unemployed or leaving formal education for young people under 25 years of age, will also adopted.
	Reduction of the contribution burden in relation to the long-term (low-income) unemployed	All health and social contributions for the long-term unemployed will be subsidised by the state from income of up to 67% of the average wage, which will create favourable conditions for their reintegration into the labour market.
	Programme to support the long-term unemployed	Employment of the long-term unemployed. Subsidising of employers' labour costs for long-term unemployed through active labour market policies
	Improvement and better linking of vocational training to practice	Better involvement of employers in the system of vocational training, promotion of work-based learning in companies. Assurance of quality in professions in demand in the labour market by means of motivational scholarships.
	Implementation of the amendment to the Employment Services Act	Better functioning of public employment services. New job creation. The Government will further increase the efficiency of active labour market policies by changes at Labour, Social Affairs and Family Offices and by greater emphasis on counselling and personalised public services. The primary emphasis will be on improving employment of long-term unemployed.
	Better-informed active labour market policies	Centralisation of databases of jobseekers and social benefit recipients, completion and interconnection with the relevant institutions will allow for better monitoring and analysing of the net efficiency and effectiveness.
	Promotion of career guidance for adults	Provision of career guidance within the national project Further Education and Counselling for Adults, as a Tool for Improving their Employability.
Science and research	Promotion of innovative small and medium-sized enterprises through innovative financial instruments and venture capital (JEREMIE - Slovak Guarantee and Development Fund)	Improvement of the innovation potential of companies. Launch of the first loss portfolio guarantee instrument and venture capital funds financed with support of ESIF resources and launch of the portfolio risk sharing loan instrument after the financial intermediaries have been selected.
	Reform of research and development funding	Increasing the efficiency of science and research funding. Comprehensive modification of the grant and support system with emphasis on quality, concentration of resources for quality projects and incentives for cooperation with the private sector. Systematic support in each phase of scientific research (basic research, applied research, experimental development in universities and businesses).
Greenhouse gas emissions	In 2011, greenhouse gas emissions outside the ETS sectors were 9% lower than in 2005. Hence, the Government is far exceeding its commitment to increase emissions by no more than 13%.	
Renewable energy sources	In 2011, energy from renewable sources accounted for 11.3% of gross final consumption. This means that at unchanged policies, Slovakia will most likely exceed the 14% target set for 2020.	



National energy efficiency	Implementation of the Energy Efficiency Directive	Improvement of energy efficiency
	Promotion of energy efficient renovation of residential units by means of innovative financial instruments (JESSICA - State Housing Development Fund)	Improvement of energy efficiency of apartments. Promotion of financing energy efficiency renovation of residential units by means a credit facility using ESIF resources, continued implementation in the 2014-2020 programming period with extended funding.
Early school leaving	All-day educational system	The all-day educational system will be implemented at 200 primary schools attended by a minimum of 20% of pupils from socially disadvantaged backgrounds. Emphasis is placed on interconnecting educational and leisure activities of pupils.
	Increased enrolment of children in kindergartens	Extension of the capacity of kindergartens, extension of the existing forms of education to include preschool classes in kindergartens and increased number of hours of preschool education.
	Better access to preschool education for marginalised communities	Promotion of social inclusion and positive changes in communities, with special emphasis on marginalised Roma communities, through the development of community work in community centres.
	Improvement of the status of teachers	In 2014, wages of teachers and professional staff in regional and higher education will increase by 5%. This increase will depend on several criteria, including the teacher's performance.
Tertiary education	Quality of tertiary education	Improvement of the quality of tertiary education. Simplification of accreditation and guarantees, modification of the rigid rules for the selection of study sponsors.
Poverty	Changes in social benefits	Better targeting of social benefits. Better employability of recipients of benefits. Reconciliation of professional and family life.

Table 7: Divergence from the Stability Programme

	ESA Code	2012 % of GDP	2013 % of GDP	2014 % of GDP
Target general government net lending/net borrowing	B.9			
Stability Programme		-4.35	-2.94	-2.60
Draft Budgetary Plan		-4.47	-2.98	-2.83
Difference		-0.12	-0.04	-0.23
General government net lending projection at unchanged policies	B.9			
Stability Programme		-4.4	-2.9	-3.7
Draft Budgetary Plan		-4.4	-3.0	-4.6
Difference		0.00	-0.04	-0.96