

# **Draft Budgetary Plan of the Slovak Republic for 2015**

October 2014



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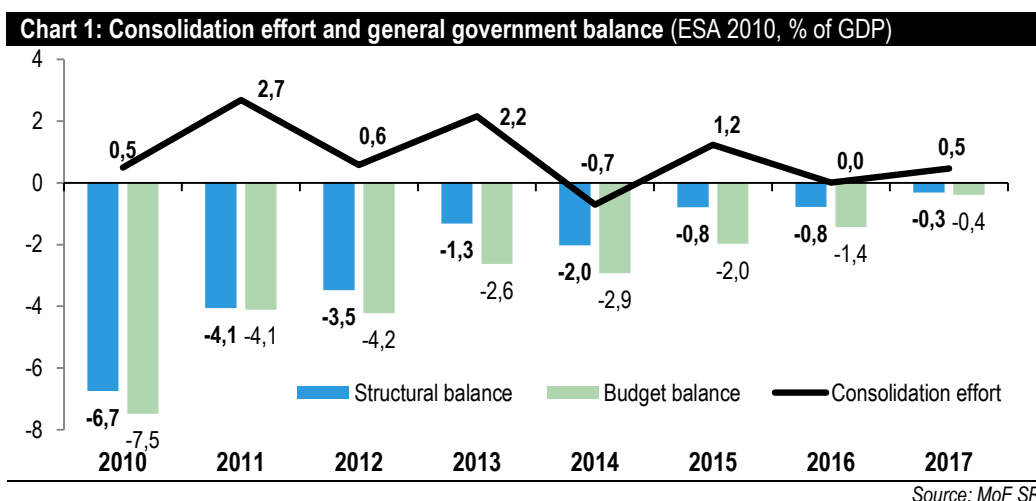
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## SUMMARY

The public finance deficit in 2013 decreased to 2.6% of GDP and the structural deficit reached its lowest historical value of 1.3% of GDP. Slovakia exited the excessive deficit procedure. Over the medium-term the government will continue in revitalising public finances towards achieving a structurally balanced budget. The budget proposal for 2015 is more ambitious than required by European rules and national fiscal legislation. It is based on a budget deficit of 1.98% of GDP, which corresponds to a structural consolidation of 1.2% of GDP. Developments during 2014 indicate a risk of 0.3% of GDP but the original target of 2.64% of GDP remains in place. If no changes in economic policies were made, the deficit in 2015 would reach a level of 3.5% of GDP. Nearly three quarters of the consolidation efforts in 2015 are focused on the expenditure side of the budget. Gross debt in 2013 did not breach the 55% of GDP threshold in 2013 and will gradually decrease in the coming years. The net debt is expected to stabilise at a level of around 50% of GDP.

**After significant consolidation efforts over the past years, Slovakia exited the excessive deficit procedure in June 2014** as the public finance deficit decreased below the 3% of GDP threshold in a sustainable manner. Slovakia achieved one of the highest consolidation efforts amounting to 2.2% of GDP in 2013. Based on the preliminary data from the autumn notification, the deficit decreased to 2.6% of GDP, which implies an improvement of 0.3% of GDP compared to the original budget target. **The structural deficit according to the methodology of the European Commission reached 1.3% of GDP, the lowest value, in Slovakia's history.** Average consolidation efforts from 2010 to 2013 reached a level of 1.5% of GDP, higher than the 1% of GDP recommended by the Council of the European Union.

**The primary objective of the fiscal policy of the Slovak Republic is to ensure effective and sustainable public finances** that facilitate further improvement in the quality of life in Slovakia, which demands continued efforts towards revitalising public finances in the next years. Following the successful exit from the excessive deficit procedure, budget policy strategy will focus on achieving **the medium-term budgetary target** of a structural deficit of 0.5% of GDP in 2017.



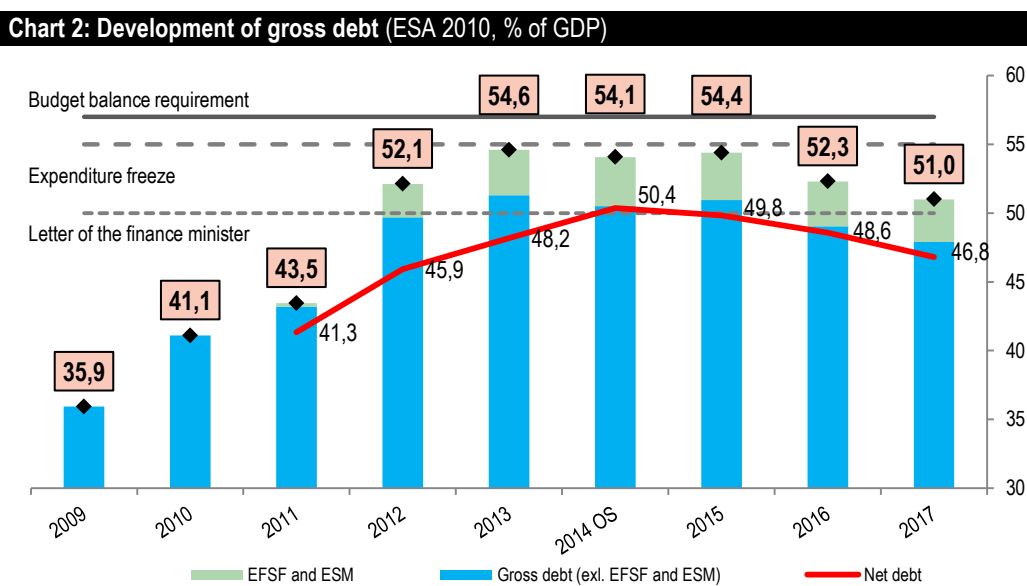
The government's general government budget proposal for 2015 is drawn up with a **deficit of 1.98% GDP**, which corresponds to **structural consolidation of 1.2% of GDP** (compared to the current balance estimate in 2014). The submitted general government budget for 2015 is more ambitious than required by European rules and their transposition into national legislation. The fiscal space created with respect to the fiscal target shall function as a reserve for macroeconomic developments and may be used to cover the costs of health contribution allowance reform (the introduction of a deduction covering health insurance contributions for low-income employees) and

other potential needs with regards to collective bargaining, in particular in the education sector. If the approved budget target for 2014 of 2.64% of GDP is met then a deficit of 2.49% of GDP for 2015 will comply with required annual improvement of the structural balance of approximately 0.5% of GDP.

**The general government budget deficit risk for 2014 is 0.3% of GDP compared to the approved budget target of 2.64% of GDP; however the original target remains valid. If such risk materializes, the deficit in 2014 would stand at 2.93% of GDP.** The main negative factors are the refusal to acknowledge non-tax revenues from dividends as accrued revenues in ESA 2010 methodology, less favourable fiscal performance of local governments, the shortfall of other non-tax revenues, the EU corrections and higher health insurance expenditures. These risks are **significantly mitigated by improved collection of taxes and social security contributions.**

**Assuming no changes in economic policies (No-Policy-Change Scenario, NPC), the general government deficit in 2015 would reach a level of 3.5% of GDP.** The difference in the general government balance between the no-policy-change scenario and the budget proposal for 2015 represents 1.6% of GDP. **The savings compared to the NPC are 1.1% of GDP on the expenditures side.** These savings should be achieved through ESO public administration reform and through the reduction of various public expenditures, including those related to the third level of the debt brake. **The overall positive impact on the revenue side against the NPC is 0.4% of GDP.** The most significant measures are the wide-ranging amendment of the Income Tax Act, the elimination of various exceptions and the broadening of the tax base along with the value-added tax rate maintained at 20%.

**General government gross debt** reached a level of 55.4% of GDP in 2013 according to the original April Eurostat notification. GDP revision resulting from the new ESA2010 methodology and changes in the classification of entities into the general government sector has likely ensured that **the share of debt to GDP for 2013 in the October notification will not exceed 55% of GDP** and sanctions from breaching the debt brake limit need not to be applied in this case. Debt should decline in 2014 for the first time since 2008 and should reach a level of 54.1% of GDP. Subsequently debt should continue to drop to 51% of GDP in 2017. The decline in debt is driven by improvements in the primary balance (general government deficit net of interest expenses) and GDP growth. Given the on-going consolidation, primary general government budget surplus is expected in 2016. Net debt at the end of 2013 reached 48.2% of GDP, which is significantly below the level of gross debt and will stabilise in this year just below a level of 50% of GDP.



Source: MoF SR

**Planned structural and expenditure measures** are focused on supporting economic growth and employment while increasing the efficiency of public expenditures. The most significant measures from the perspective of expenditures include ESO public administration reform, increasing efficiency in the healthcare sector and the construction of new nurseries. A majority of structural measures are focused on the labour market, currently the greatest challenge of the Slovak economy. The concurrence of material need benefits and wages should help increase employment of low-income employees.

Over the medium-term the draft budgetary plan is based on the general government budget proposal for 2015 to 2017 as approved by the Government of the Slovak Republic on 15 October 2014. The draft budgetary plan is prepared under the 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. The submission of the draft budgetary plan, which presents the development of fiscal position, the expected development of the economy and a description of budget policy measures to achieve defined medium-term targets is a specific monitoring instrument. The presented data enable a more detailed assessment of the development of public finances in the coming year, which are based upon the current general government budget proposal as opposed to the Stability Programme. The European Commission will subsequently publish its opinion on budgetary plan; if a serious breach of the Stability and Growth Pact is identified, the Commission may request that the concerned Member State to 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 draft budgetary plan has been prepared in accordance with the documents specifying the minimum requirements for draft budgetary plans - updated Specification on the implementation of the Two Pack and Guidelines on the format and content of draft budgetary plans, economic partnership programme and debt issuance report.

## I. Macroeconomic assumptions of the budget proposal

*The pace of recovery of Slovakia's main trading partners remains slow, in particular due to the on-going geopolitical conflict in the Ukraine and the anchoring of inflation at low levels. Monetary policy in the euro area remains relaxed. The euro area has been helped slightly by the performance of the American economy. Expected growth in Slovakia remains at a solid level, primarily thanks to the recovery of household consumption and fixed investments. The dynamics of growth in real wages were the highest in the last seven years due to the lowest inflation in history. Household consumption has also been supported by the creation of new jobs, which has also been reflected in declining unemployment rate. The economic growth of the Slovak Republic will accelerate gradually and reach 3.5% by the end of the forecast period. GDP, compared to the no-policy-change scenario, will grow at a rate that is 0.5 percentage points slower, primarily as a result of expenditure consolidation.*

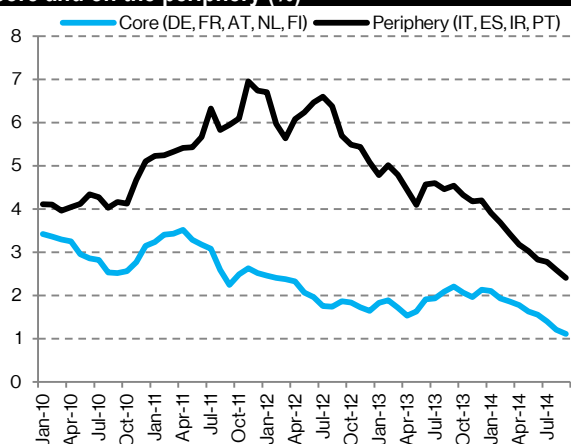
### I.1. External assumptions in the forecast

**Recovery of the external environment will slow down as a result of increased uncertainty.** The economic recovery of our business partners in the euro area will be slow and gradual. Economic growth in the most important economy in the euro area, Germany, will remain at a level below 1.5% during 2014-2015. The recovery of foreign economies has been slowed, primarily as a result of the uncertainty associated with the conflict in Ukraine and the anchoring of inflation at low levels. The on-going economic imbalances and structural problems likewise restrict the potential for significant growth in the euro area.

**Financial markets have been dominated over the last few months by diverging monetary policies of the European Central Bank (ECB) and the Federal Reserve (FED).** The ECB has lowered rates to a new historic minimum (a base rate of 0.05% and refinancing rate of 0.3%) in an environment of decreasing inflation expectations in the euro area. The unprecedented step among large central banks was a decrease in the deposit rate to a negative level (-0.2%), which along with conducting targeted LTRO programmes and the purchases of asset-backed securities (ABS) has been set to stimulate inflation expectations in the future and improve the monetary policy transmission channel. The FED was encouraged by positive reports from the American economy and continued in a controlled tightening of loose monetary policy (known as tapering) and officially announced a rate increase in 2015.

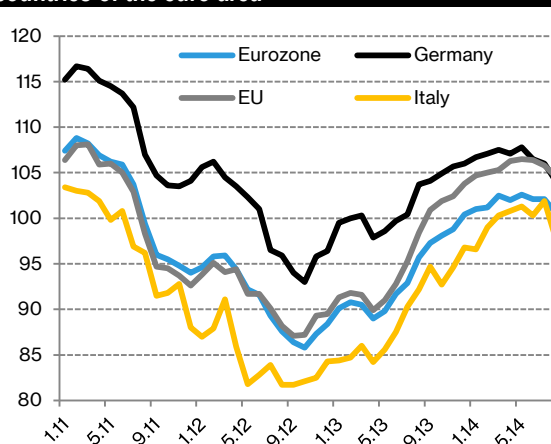
**Equity markets reached new highs, but short-term volatility increased again significantly due to the Russia-Ukraine conflict.** Yields on European bond markets decreased slightly from the previous year due to inflation expectations significantly below the target level of 2% and the relaxed monetary policy of the ECB. The situation in peripheral countries has been stabilised to a large degree and all of them have returned to the financial markets (Greece is still primarily financed from the financial programme). The differences in the banking sectors of the Eurozone states and their structural problems resulted into the positive developments in financial markets not being reflected equally in all the countries. The slow recovery in credit financing of large companies was partially offset by corporate bond issuances on the financial markets. The price of Brent crude oil over the last four months has dropped significantly (from US\$115 per barrel to US\$97 per barrel). The euro also weakened significantly against the dollar as a result of the measures adopted by central banks and remains at a level below €1.30 per dollar.

**Chart 3: Comparison of the revenues of countries in the core and on the periphery (%)**



Source: Bloomberg

**Chart 4: Development of confidence indicators in the countries of the euro area**



Source: Eurostat, European Commission

**The euro area economy stopped growing in the second quarter.** The on-going recessions in large countries such as France and Italy signal their continued structural problems. The second quarter delivered a surprise with a decline in the strongest economy in the euro area, Germany. Early indicators forecast a minimum of acceleration in economic activity in the second half of the year. IFO and ZEW indicators point to continued stagnation in Germany as well.

**Prospects for economic growth in 2015 have deteriorated.** The recovery of the euro area will be a slow process. Growth is expected at a level of 1.3% in 2015 (compared to 0.7% in 2014). Uncertainty associated with developments in the conflict in Ukraine and anchoring inflation at low levels are expected to have a negative impact on the expected economic growth in the euro area.

## 1.2. Macroeconomic forecast - growth to also be driven by household consumption

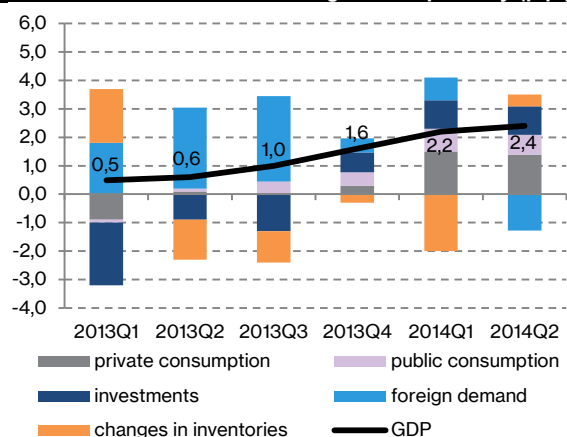
**GDP continued its positive development in the second quarter.** Quarterly growth of 0.6% ranked Slovakia among the fastest-growing countries in the euro area. As opposed to previous years, the driving force behind such economic growth was domestic demand, which grew at its fastest rate since the crisis broke out at the end of 2008. Growing household consumption was supported by a drop in consumer prices, favourable lending conditions and positive developments on the labour market in particular. Investments also accelerated growth, in particular in non-financial corporations and in services with higher added value. Growth of domestic demand also supported gains in employment and wages. On the other hand, growth in exports slowed above the rate of worsening foreign demand, which indicates a slower speed of gaining export market shares has been recorded in the past. Growth in domestic demand led to an increase in the growth of imports with net exports ultimately working against GDP growth.

**The Slovak economy will grow by 2.4% this year and GDP growth is expected to accelerate in 2015 to 2.6%.** A slowdown in foreign demand is expected in the second half of this year and resulting effects should be fully felt in 2015. In addition, the economic growth will be dampened by further consolidation efforts and the decrease in government consumption will be the most significant since 2011. The pace of growth of private consumption will slow slightly under pressure from slower growth in the creation of new jobs and investment growth will gradually recover. A slowdown in the growth of domestic demand shall lead to slower growth in imports and foreign demand shall once again contribute to positive growth. In the following years the economic growth will accelerate and its structure will be balanced with a slight predominance of foreign demand.



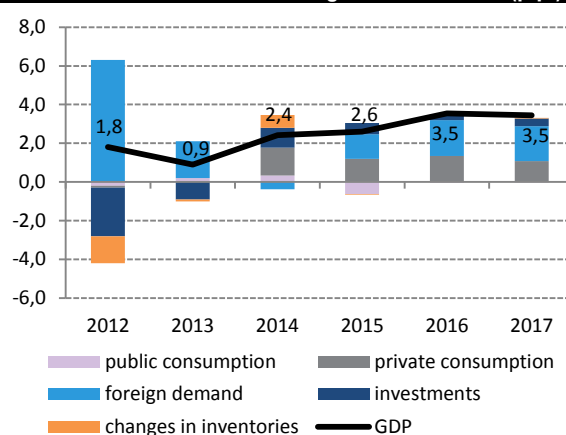


**Chart 5: Contributions to GDP growth - quarterly (p.p.)**



Source: MoF SR

**Chart 6: Contributions to GDP growth - forecast (p.p.)**



Source: MoF SR

**Unemployment rate this year will drop to 13.5%** and will decrease further in the following year. The recovery of economic growth in this year will translate into employment gains, in particular in the sectors of market services and manufacturing as well as in general government. Conversely negative developments in employment in the construction sector are expected to continue.

**Real wages will increase by more than 4% in 2014, which is the highest rate in the past seven years.** The reasons for such significant growth are a zero increase in prices and above-average growth in nominal wages. Growth of real wages will slow down in the following years and their development will match labour productivity. Increasing wages are primarily seen in manufacturing and market services, while such increases in the public sector will be dampened by on-going consolidation.

**Inflation this year will be at the lowest level since the establishment of the Slovak Republic** The expected year-on-year increase in consumer prices this year is 0.1%. The slowed growth of prices is the result of positive developments in cost factors and weak reaction to demand signals. The disinflation signal from the cost side is primarily due to decreases in the prices for energy and primary materials on global markets. The dynamics of costs factors are expressed through decreases in the prices for goods, foodstuffs and energy sources. In the following year we expect an acceleration of price dynamics as a result of improved results on the labour market and stronger price reactions to recovering demand. As a result, inflation in the following year should reach the level of around 1.0%.

### Box 1: Macroeconomic forecast in ESA 2010 national account methodology

The macroeconomic forecast was completed based on preliminary ESA 2010 data and past estimates of the Ministry of Finance. The annual national accounts will be published this year in October and the seasonally adjusted quarterly time series will follow at a later time. At the time the forecast was being completed the Ministry of Finance only had preliminary data available for the annual national accounts in current and constant prices for 2005. The basis for the forecast in ESA 2010 was the forecast completed using the standard modelling approach in ESA 95 methodology for this reason. Due to the unavailability of the quarterly profiles, estimated annual GDP growth and its individual components (in constant and current prices) were transposed onto new preliminary levels of the requisite indicators in ESA 2010 modified by Ministry of Finance estimates. The Macroeconomic Forecasting Committee approved the forecast in ESA 2010 methodology including past Ministry of Finance estimates and estimates in constant prices for 2005.

**The introduction of ESA 2010 methodology had a positive impact on the level of GDP.** Based on the data approved by the Macroeconomic Forecasting Committee, GDP in 2012 increased by €1.01 billion (1.5%) over the data in ESA 95 methodology and increased by €1.46 billion (2%) in 2013. The primary changes compared to ESA 95 methodology include the reclassification of expenditures for research and development, military expenditures and small tools.

**Table A: Estimate of impact of major methodology changes on GDP (% change)**

	2011	2012
Research and development	0.4-0.6	0.5-0.7
Military expenditures	0-0.1	0-0.1
Sector classification	0-0.1	0-0.1
Small instruments	0.7-0.9	0.7-0.9
Other	0.1-0.2	0.1-0.2

Source: SO SR

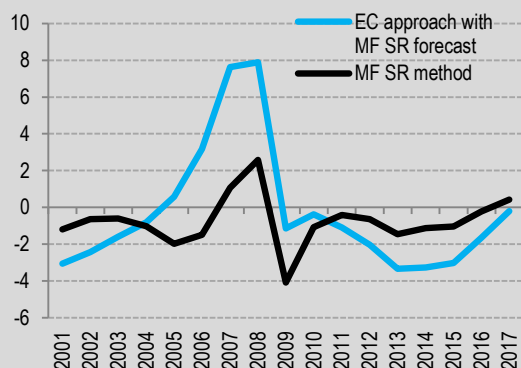
### Box 2: Estimate of the output gap for 2014 and 2015

According to the forecast of the Ministry of Finance, which was prepared in accordance with the European Commission's methodology, Slovakia's output gap for 2014 and 2015 is estimated to reach -3.3% and -3.0% respectively. A slight reduction in the cyclical component is expected in 2015 but the economy will remain under its potential. According to the methodology of the Ministry of Finance, the output gap for 2014 and 2015 is estimated to reach -1.1% and -1.0% respectively.

The aim of the presented output gap forecast is to converge, in terms of methodology, to the estimate of the European Commission used to assess Slovakia's structural balance. Hence the Ministry of Finance applied the its methodology for output gap estimation. The data on the conditions of the economy after 2014 are based on the September forecast of the Ministry of Finance. The goal is to replicate the output gap based on the latest forecasts of the Ministry of Finance using the European Commission's uniform methodology.

The European Commission's methodology consists of two steps. Firstly, the estimates and forecasts 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 European Commission uses the publicly available GAP programme** which uses the Phillips curve and Kalman filter to break down the unemployment rate and total factor productivity into a trend component and a cyclical component. Since the most recent settings of the European Commission's model are not yet available, the Ministry of Finance used the NAWRU and trend TFP contained in the European 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. The CONV programme output gap estimate model is based on the decomposition of the production function of the economy into labour, capital and total productivity factor contributions.

**Chart A: Output gap development (as % of potential GDP) – EC approach and MoF methodology**



Source: MoF SR

**Table A: Contributions of production factors to the potential GDP growth - EC approach**

	Pot. GDP (growth, %)	TFP*	Capital stock	Labour
2009	3.7	2.7	0.3	0.6
2010	3.6	2.6	0.4	0.5
2011	3.7	2.4	0.8	0.5
2012	2.8	2.3	0.2	0.3
2013	2.3	2.2	-0.1	0.2
2014F	2.3	2.1	0.1	0.1
2015F	2.3	2.0	0.2	0.1
2016F	2.1	2.0	0.2	-0.2
2017F	2.0	2.0	0.3	-0.3

\*Total factor productivity

Source: MoF SR

The Ministry of Finance's estimate of the potential output and the output gap differs methodologically from European Commission estimates. The Ministry of Finance publishes its estimate using its internal methodology at regular meetings

of the Macroeconomic Forecasting Committee. According to Ministry of Finance methodology, the output gap for 2014 and 2015 is estimated to reach -1.1% and -1.0% respectively.

The differences in Ministry of Finance and European Commission methodologies affect nearly every calculation component, even though the basic method is the same. Both institutions calculate the potential output using the Cobb-Douglas production function. The greatest difference is in the historical data for total factor productivity (TFP). The Ministry of Finance increases the potential product in 2005-2008 so as to correspond to the structural changes in the economy, which cannot be captured by the the common method of the European Commission. An excessively high output gap in 2007-2008 is given by the European Commission's method, nevertheless no other indicators of imbalance have been confirmed (net inflation, the current account deficit of the balance of payments and unit labour costs). Likewise, the magnitude of underperformance in 2013 compared to 2009 is larger according to the European Commission's methodology, which does not correspond to the relative magnitude of demand shocks in these two "V" in the post-crisis period.

### I.3. Consolidation effects

**Consolidation in 2015 should slow GDP growth down by 0.5 p.p.** Measures with identified direct effect on GDP amount to 1.3% of GDP, with 0.9% of GDP attributed to expenditures and 0.4% of GDP attributed to revenues.

Assuming the no-policy-change scenario (NPC), the general government deficit in 2015 would reach a value of 3.5% of GDP. The general government budget proposal includes measures equal to 1.6% of GDP (€1.211 billion) compared to the no-policy-change scenario. As a result the general government budget deficit should reach a value of 1.98% of GDP in 2015. This section quantifies the overall effect of consolidation on the key macroeconomic indicators. The consolidation measures without a direct effect on GDP have not been included in the calculation of the consolidation package's impact on GDP. Health contribution allowance reform and a slight increase in the teachers' wages have been included on top of the measures stated in the draft budgetary plan.

**Table 1: Size of consolidation measures (ESA 2010, as % of GDP)**

	2015
1. General government balance under the NPC scenario*	-3.54
2. General government balance - budget	-1.98
<b>3. Size of the consolidation measures (2-1)</b>	<b>1.6</b>
- in € million	1,211
<b>4. Size of the measures with a direct effect on GDP</b>	<b>1.3</b>
- in € million	986

\* NPC does not factor in possible changes in debt risk premiums.

**Expenditure measures with a direct effect on GDP amount to €697 million, which represents 0.9% of GDP.**

In terms of current expenditures these cuts primarily involve intermediate consumption (€213 million) and savings in employee compensation based on ESO reforms. Other current expenditures (€52 million) have the opposite effect. The most significant savings are the capital expenditures, which amount to €389 million, where the primary source of savings is expected to come from local governments. Expenditure measures will have an impact on the economy through decreased government consumption, lower growth of employment in the public sector and decreased public investments.

**Table 2: Budgetary measures with effect on GDP (in € million, ESA 2010, differences against NPC)**

	Category	Macroeconomic effects	2015
Increase in revenues with a direct effect on GDP, total (1-3)	R	compensations, I, CPI	289
(in % of GDP)			0.4
1. Maintaining the VAT rate at 20%	R	CPI	270



2.	Changes in other taxes from production and imports	R	CPI, PY	-35
3.	Changes in corporate income tax legislation	R	Compensations, I, PY	213
4.	Changes in personal income tax legislation	R	Compensations, C	7
5.	Withholding tax	R	Prices, I, compensations	5
6.	Health contributions reform	R	Prices, I, compensations	-152
7.	Non-tax revenues	R	Prices, I, compensations	103
8.	Grants and transfers	R	Prices, I, compensations	-122
<b>Decrease in expenditures with a direct effect on GDP, total (4-8)</b>		<b>E</b>	<b>Compensations, G, I</b>	<b>697</b>
<b>(in % of GDP)</b>				<b>0.9</b>
9.	Cuts in public sector's payroll expenditures	E	Compensations, G	62
10.	Expenditures cuts in central government's intermediate consumption	E	G	213
11.	Changes in healthcare expenditures	E	G	85
12.	Cuts in general government investments (local governments)	E	I	389
13.	Other changes in expenditures	E	G	-52
<b>A. Total changes with a direct effect on GDP<sup>1)</sup></b>		<b>R+E</b>		<b>986</b>
<b>(in % of GDP)</b>				<b>1.3</b>
<b>B. Total changes (revenues + expenditures) compared to NPC</b>		<b>R+E</b>		<b>1,211</b>
<b>(in % of GDP)</b>				<b>1.6</b>

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

1) Measures including collective bargaining, in particular in education and the introduction of the health contribution allowance deduction for low-income employees.

The 2015 general government budget proposal contains additional **revenue measures** with a direct effect on GDP amounting to **€289 million (0.4% of GDP)**. Revenue measures should have an impact on the economy through a minor rise in prices and decreasing compensations and profits in the economy, which should translate into decreased private investments.

**Consolidation in 2015 should slow GDP growth down by 0.5 p.p. The anticipated size of the consolidation package** for the purposes of estimating the effects of fiscal consolidation on the economy is 1.3% of GDP, with 0.9% of GDP attributed to expenditures and 0.4% of GDP attributed to revenues. The estimated fiscal multiplier for 2015 reaches 0.4. For comparison purposes, the package multiplier was estimated at 0.4 in 2011, 0.2 in 2013 while in 2014 it is at a level of 0.4<sup>1</sup>. The package will have the most significant impact on government consumption and fixed investments. The effect on wages, employment and household consumption is expected to be moderate. A slowdown in the economic activity should also weaken the growth of imports. The effect on price development is also minor.

<b>Table 3: Effect of measures on GDP (p.p.) according to the IFP macro-model</b>		<b>2015</b>
<b>Measures with a direct effect on GDP</b>		<b>-1.3</b>
<b>Contribution to a year-on-year change in GDP</b>		<b>-0.5</b>
- Of which:	Household consumption	-0.1
	Government consumption	-1.6

<sup>1</sup> 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 [Estimated Impacts of Fiscal Consolidation on GDP Growth in Slovakia](#), the Ministry of Finance's DSGE model. Estimates for 2011 and 2013 were based on real figures, while public finance development forecast was used to make estimates for 2014.

Fixed investments	-0.9
Imports	-0.3
Contribution to the change in CPI	-0.1
Employment	-0.2
Wages	-0.1

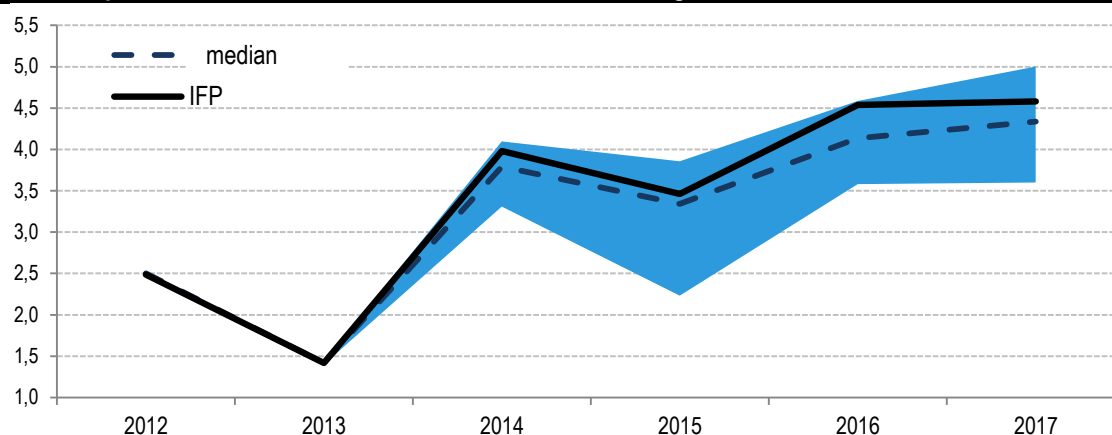
Source: MoF SR

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

**All members** of the Macroeconomic Forecasting Committee (NBS, Slovak Academy of Sciences, Infostat, Tatra banka, UniCredit, SLSP, VÚB, ČSOB and Sberbank) **assessed the current medium-term macroeconomic development forecast** prepared by the Ministry of Finance of the Slovak Republic **as realistic**.

The Ministry of Finance's forecast is very close to the median of the Macroeconomic Forecasting Committee members in terms of effects on budget revenues in 2015. 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<sup>1</sup>.

**Chart 7: Comparison of forecasts of macroeconomic bases<sup>2</sup> for budget revenues with MFC members**



Source: MoF SR

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

**The Macroeconomic Forecasting Committee (MFC) and the Tax Revenue Forecasting Committee (TRFC) were established under the 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 February and 30 June of the current fiscal year. In exceptional cases, the committees may be convoked either by the committee chairman, Minister of Finance or by a simple majority of the committee members.

<sup>2</sup> 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%



In addition to the Ministry of Finance officials, the committees consist of representatives of institutions independent from government (NBS, Slovak Academy of Sciences, Infostat and private banks). The Macroeconomic Forecasting Committee members assess the Ministry of Finance's macroeconomic forecast using the terms *conservative*, *optimistic* or *realistic*. The Ministry of Finance's tax revenue forecast is 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. **A Ministry of Finance's 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 of Finance of the Slovak Republic is required to redraft its forecast and submit it to the Committee for re-assessment. The procedure is repeated until the Ministry of Finance's forecast is accepted by the MFC or the TRFC as its own forecast.

## II. Budgetary objectives

The primary objective of the fiscal policy of the Slovak Republic is to ensure effective and sustainable public finances that enable continued improvement in the quality of life in Slovakia, which demands on-going efforts towards revitalising public finances in the following years. Budget policy strategy after successfully exiting the excessive deficit procedure in 2013 anticipates **the achievement of the medium-term budget target of 0.5% of GDP in 2017**. Taking this into account, the target for the general government deficit was set at 2.64% of GDP in 2014. The current estimate anticipates a slightly higher deficit of 2.93% of GDP, however the original target remains in place. Details regarding the changes compared to the approved budget are presented in the Section II.1.

The general government budget proposal anticipates a continued decrease in the general government deficit, though at a more gradual pace than during the excessive deficit procedure. The current budget proposal anticipates a deficit at a level of 1.98% of GDP in 2015. This target is in line with national fiscal rules and is more ambitious than required by European rules.

**Gross debt will likely be revised for 2013 to a level of 54.6% of GDP.** The GDP revision decreased debt by 1.1 p.p. and the reclassification of entities into the general government sector slightly increased debt by 0.3 p.p. This represents a decrease in the estimate compared to the notification from April when gross debt reached 55.4% of GDP. The current budget targets anticipate a decrease in **gross debt at the end of 2014 to a level of 54.1% of GDP**. Throughout the entire forecast period, general government debt shall remain below the 55% of GDP threshold, which is also below the reference value defined by the Stability and Growth Pact. The gross debt will gradually decrease in the next years. The fiscal space is limited by the constitutional Fiscal Responsibility Act, which goes beyond the requirements of the Stability and Growth Pact, and constraints the Slovak fiscal policy in the medium-term (more details are provided in Chapter II.4).

### II.1. Recent development in public finances

The general government budget proposal for 2015 takes into account recent developments in the general government balance as well. This balance is calculated on the basis of macroeconomic and tax forecasts from September 2014. **The estimated general government budget deficit in 2014 was 2.93% of GDP, illustrating a risk of 0.3% of GDP compared to the approved budgetary target of 2.64% of GDP.** Nevertheless, the original target remains in place.

<b>Table 4: Current estimate of general government balance in 2014 (difference against the approved budget)</b>		
<b>Approved general government budget deficit (ESA 95)</b>	<b>-2,000</b>	<b>-2.64</b>
<b>Changes compared to approved budget</b>	<b>-199</b>	<b>-0.3</b>
<b>Positive effects decreasing general government balance (+)</b>	<b>1,081</b>	<b>1.4</b>
General government tax and social security contribution revenues (including penalties)	498	0.7
Blocking of 3% of adjusted state budget expenditures (debt brake)	305	0.4
Savings on expenditures for co-financing and to the EU budget	234	0.3
Antimonopoly Office's fine to the transportation cartel	45	0.1
<b>Negative effects increasing the general government balance (-)</b>	<b>-1,280</b>	<b>-1.7</b>
Unrecognised revenues from dividends	-571	-0.8
Fiscal performance of local governments including local transportation companies (new general government entity)	-183	-0.2
Lower revenue from sales of emission allowances and state budget capital revenues	-128	-0.2
Increased expenditures in public health insurance	-117	-0.2
Lower revenue from the sales of digital dividends	-86	-0.1



EU corrections	-81	-0.1
Expected economic performance of healthcare facilities	-60	-0.1
Other effects	-54	-0.1
<b>Expected actual general government deficit (ESA 2010)</b>	<b>-2,199</b>	<b>-2.93</b>

Source: MoF SR

#### Expenditure effects:

- General government gross debt reached 55.4% of GDP at the end of 2013 (based on the results of the spring notification in ESA 95). This led to the activation of measures based on the constitutional Fiscal Responsibility Act. One of the measures was that the Ministry of Finance **was required to block 3% of all adjusted state budget<sup>3</sup> expenditures**. Beginning in May 2014 the Ministry of Finance blocked a total of €305 million (0.4% of GDP) as a result.
- **Savings from decreased drawing of EU funds** and from the transfer to the EU budget. Decreased co-financing expenditures in the amount of €191 million (0.3% of GDP). This was related to the decrease in the estimate for drawing EU funds by €0.8 billion compared to the budget. Slovakia also paid in €43 million less into the EU budget for 2014. Total savings from the change in EU funds equals €234 million (0.3% of GDP).
- With respect to **other general government entities**, public health insurance is expected to have a greater effect, by €117 million (0.2% of GDP). **The fiscal performance (net of taxes) of local governments** will be worse by €28 million.<sup>4</sup> Other risks include the expenditures of public transportation companies (in Bratislava, Banská Bystrica, Žilina and Košice), which are financed primarily by transfers from these cities.
- Based on an audit of EU funds a **financial EU correction** amounting to €81 million (0.1% of GDP) must be made in the national accounts. This amount represents an increase in capital transfers according to ESA 2010 methodology.
- Based on current developments, we assume **that healthcare facilities**, which are reclassified in the public sector will have a negative income statement, amounting to €60 million (0.1% of GDP).

#### Tax and social security contribution revenues

In comparison to the approved budget it is expected that tax and social security contribution revenues of general government in ESA 2010 methodology will be higher by €498 million (0.7% of GDP), with tax revenues higher by €322 million and social security contributions by €210 million. At the same time a reserve for increasing tax and social security contribution revenues from collective bargaining has been included in the tax forecast (€34 million).

The general government budget proposal for 2015 to 2017 has been prepared using ESA 2010 methodology, while the approved budget for 2014 applied ESA 95 methodology. In terms of tax revenues a difference can be seen in the methodologies of recording tax credits directly in tax revenues, which are subsequently recorded on the expenditure side with no impact on the deficit. The total effect of this change in the methodology equals to a difference of €263 million, which is analytically removed when considering differences against the approved budget.

<sup>3</sup> This process involves blocking 3% of expenditures from the approved State Budget Act for the given year less expenditures for servicing state debt, European Union funds, co-financing funds, transfers to the EU budget, transfers to the Social Insurance Agency and expenditures to remedy damages caused by natural disasters.

<sup>4</sup> Unconsolidated local government's fiscal performance is negative compared to the approved budget by €117 million.



<b>Table 5: Tax and social security contribution revenues of the general government in 2014 (difference against the approved budget, including penalties, in € million)</b>	
<b>Total (1+2+3)</b>	<b>498</b>
<b>1. Tax revenues</b>	<b>322</b>
- Corporate income tax	207
- Excise taxes	70
- Personal income tax	38
- Value-added tax	20
- Other, including penalties	-13
<b>2. Social security contributions</b>	<b>210</b>
- Public health insurance, including penalties	58
- Social insurance, including penalties	151
<b>3. Expected impact of collective bargaining on tax and social security contribution revenues</b>	<b>-34</b>

Source: MoF SR

### Non-tax revenues dividends

The most significant negative impact compared to the budget is based on the shortfall in ordinary dividends according to ESA 2010 from the Slovenský plynárenský priemysel (SPP) and the Slovenská elektrizačná a prenosová sústava (SEPS). **The total shortfall in SPP's ordinary dividends compared to the approved budget for 2014 represents €467 million.** The approved budget for 2014 anticipated revenues from SPP's ordinary dividends amounting to €735 million, which comprised two components<sup>5</sup>: €365 in profits from 2012 and €370 million in profits from 2013. A similar situation occurred in the case of SEPS dividends. The shortfall in SEPS's ordinary dividends according to ESA 2010 methodology represented a total of €63 million (0.1% of GDP) in 2014.

### Other non-tax effects include:

- Lower revenues are expected due to declining prices for **emissions allowances** on the European exchange at a level of €61 million. Expected revenues in the approved budget were €117 million. There was also a shortfall in general government capital revenues amounting to €67 million. The total shortfall in capital revenues is €128 million (0.2% of GDP).
- An **electronic auction for frequency bands, known as the digital dividend**, was held in 2014. Mobile operators paid a total of €164 million in a market auction for these frequencies. The estimated budgeted amount for the auction was €250 million, which led to a shortfall in state budget revenues of €86 million (0.1% of GDP). Another source of budget revenues are the fines issued by the Antimonopoly Office of the Slovak Republic against six construction companies for concluding a **cartel agreement** amounting to nearly €45 million (0.1% of GDP).

## II.2. Structural balance and expenditure benchmark

**Two analytical indicators are used to monitor fiscal targets that better capture the fiscal position of the government than a simple comparison of the general government balance.** The first indicator is the **consolidation effort** which illustrates the trajectory that the government plans to use to meet its medium-term

<sup>5</sup> The general assembly of SPP approved in December 2013 the proposed distribution of profits for 2012 and the payment of a dividend in 2014 amounting to €365 million. Of this amount, €186 million (a 51% share) belonged to the state, specifically the National Property Fund, with accrual impact in 2013. The second portion of the profit from 2012 amounting to €179 million (49% share held by a private shareholder) was paid out on the basis of a decision of the general assembly held in 2014 as cash revenue of the State Treasury. This revenue does not represent accrued revenue of the state according to ESA 2010 methodology and has no impact on the deficit in ESA 2010. Compared to the approved budget for 2014, this led to a shortfall in dividends from 2012 profits amounting to €365 million in ESA methodology. At the same time the shortfall in SPP's ordinary dividends totalled €102 million compared to the expected €370 million. Only ordinary dividends stemming from profits in 2013 amounting to €268 million (0.4%) will be paid out in 2014.

budgetary target. The second is the **expenditure benchmark** that serves to assess the pace of growth in general government expenditures. These are key analytical indicators in the assessment of the draft budgetary plans<sup>6</sup>, which is prepared by the European Commission.

### 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) on general government revenues and expenditures, i.e., the cyclical component.** The Ministry of Finance uses estimates of the sensitivity of the general government balance to changes in the output gap, which is based on OECD methodology<sup>7</sup>, which is fully in line with the European Commission methodology. The method used for calculating consolidation effort according to the European Commission is described in the box. **In the second step, the general government balance is adjusted for one-off and temporary measures.** Based on the definition provided in the General Government Budgeting Rules Act, a one-off effect is understood as any such revenue or expenditure that is not permanent or recurrent in nature and that has a temporary impact on the general government's budget balance. The Ministry of Finance published a manual<sup>8</sup> defining rules for identifying one-off measures that led to their revision for past year as well.

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

**In an effort to consider growth supporting investments in the Member States, the European Commission prepared the so-called investment clause that allows Member States to temporarily deviate from the consolidation effort required in the preventive arm of the Pact when specific conditions are met.** 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 increase in these funds. According to the European Commission's assessment<sup>9</sup> the investment clause can only be applied in 2014 with respect to the forecasted improvement of economic development in the euro area and in particular the closure of the negative output gap in 2015.

Five criteria must be met in order to activate the investment clause, based on which the Member States can request the application of this clause in the preventive arm of the Pact. According to current estimates, **Slovakia meets the criteria needed for the investment clause and has sought its application in the Draft Budgetary Plan for 2014.** The table below provides an overview of criteria and their fulfilment for Slovakia in 2014.

<sup>6</sup> Vade Mecum on the Stability and Growth Pact, European Economy. Occasional Papers. 151. May 2013. Brussels.

<sup>7</sup> The original methodology was presented in Girouard, N., André, Ch. (2005): Measuring cyclically-adjusted budget balances for OECD countries. The process of updating methodology and including new data for calculating elasticity took place in 2014. The methodology was adopted by the Member States in September 2014.

<sup>8</sup> <https://www.finance.gov.sk/Default.aspx?CatID=9595>

<sup>9</sup> Review of the implementation of the investment clause in the preventive arm of the Stability And Growth Pact, Note for the Economic and Financial Committee, Ares (2014) 1693085 - 23/05/2014

**Table 6: Fulfilment of Stability and Growth Pact investment clause criteria for Slovakia**

Investment clause criteria	Fulfilment for Slovakia
Negative GDP growth or growth far below the potential growth level	A negative output gap at the level of 3.2% of potential GDP is estimated for 2014, indicating a considerable cooling of the economy and growth below the country's potential. According to the European Commission's preliminary assessment <sup>10</sup> in the autumn 2013 forecast, Slovakia met the condition for "bad" economic times. According to the spring 2014 forecast, the negative output gap estimate worsened.
The country was outside of the corrective portion of the Pact, meaning it had a 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)	Slovakia exited the excessive deficit procedure in June 2014.
Maximum deviation from the required consolidation effort will be directly linked to the amount of expenditures on co-financing EU projects implemented under the Structural and Cohesion Policies, TEN and CEF	In 2014 funds for co-financing relevant EU projects based on current estimates should reach €448.4 million (0.6% of GDP). A more detailed overview for the individual operational programmes is shown in Annex 2.
In case economic growth is forecasted (or closing of the negative output gap), any deviation due to the application of the investment clause is assumed to be compensated for so that the calendar of reaching the medium-term budget objective is not affected	According to the general government budget proposal for 2015-2017, the deviation for 2014 shall be compensated by increased consolidation in 2015. At the same time, and despite an unfavourable macroeconomic environment and the unexpected shortfall in revenues, significant consolidation was achieved in 2013. 2017 remains valid as a year for reaching the medium-term budget target in line with the recommendations made by the Council of the European Union from June 2013.
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 no decrease has occurred in the general government gross fixed capital formation.	The investments supported by co-financing contribute towards economic growth and have a positive effect on fiscal policy in the medium-term horizon. The current estimate of the Ministry of Finance anticipates a year-on-year increase in public investments by 17% in 2014.

**Slovakia exited the excessive deficit procedure in June 2014 after extensive consolidation efforts in previous years.** One of the highest consolidation efforts since entry into the EU amounting to 2.2% of GDP was achieved in 2013. The deficit dropped below the 3% of GDP threshold to 2.6% of GDP and the annual average consolidation effort from 2010 to 2013 reached 1.5% of GDP, which was higher than 1% of GDP required by the recommendations of the Council of the European Union. According to the spring forecast from the European Commission, the general government deficit shall be kept below the 3% threshold level in 2014 and 2015 as well.

Following significant consolidation since 2009, **a temporary relaxation of fiscal policy shall occur in 2014**, given the on-going unfavourable macroeconomic situation with GDP below the level of potential and the need to adopt measures to restart economic growth. Taking into account the improved results for 2013 based on the preliminary data from the autumn notification and the fulfilment of the budget target for 2014, fiscal expansion will reach 0.4% of GDP. According to the estimated general government balance, there is a risk that structural expansion could reach 0.7% of GDP in 2014 if the budget target is not met. This would lead to a reduction in the consolidation effort by 0.4% of GDP compared to the estimated consolidation effort in the Stability Programme

<sup>10</sup> The investment clause in the preventive arm of the Stability And Growth Pact: preliminary assessment of eligibility, Note for the Economic and Financial Committee, Ares (2013) 3540113 – 22/11-2013



2014 -2017 due to an improved general government final balance for 2013 and worse than expected development of public finances in 2014. Structural expansion is restricted to a single year and is compensated by a markedly consolidation effort in the following year. This preserves the original deadline for achieving the medium-term budget target. No major deviation from the required consolidation based on the Stability and Growth Pact rules should occur when considering the application of the investment clause.

**The planned stronger consolidation effort in 2015 shall compensate for the expected developments in 2014.** The government's general government budget proposal is drawn-up with a deficit of 1.98% of GDP which corresponds to structural consolidation of 1.2% compared to the expected deficit for 2014. The budget proposal is more ambitious than required by European rules and their transposition into national fiscal legislation. The fiscal space created with respect to the fiscal target shall function as a reserve for macroeconomic developments and may be used to cover the costs of health contribution allowance reform (the introduction of a tax deduction covering health insurance deductions for low-income employees) and other potential needs with regards to collective bargaining, in particular in the education sector. In all of the considered scenarios the consolidation effort in 2015 complies with the requirements of the Pact. According to the specific recommendations approved by the Council of the European Union, Slovakia's continued advances towards the medium-term target should reach 0.1% of GDP in 2015 while taking into account all expected negative economic conditions.



**Table 7: Consolidation effort (ESA 2010, % of GDP)**

	2012	2013 <sup>11</sup>	2014 E	2015
<b>1. Net lending/borrowing</b>	<b>-4.22</b>	<b>-2.63</b>	<b>-2.93</b>	<b>-1.98</b>
2. Cyclical component	-0.8	-1.3	-1.3	-1.2
3. One-off effects <sup>12</sup>	0.1	0.0	0.4	0.0
<b>4. Structural balance – cyclically-adjusted balance net of one-off effects (1-2-3)</b>	<b>-3.5</b>	<b>-1.3</b>	<b>-2.0</b>	<b>-0.8</b>
<b>Consolidation effort according to the EC (year-on-year change 4)</b>		<b>2.2</b>	<b>-0.7</b>	<b>1.2</b>
- Investment clause – national co-funding			<b>0.6</b>	
<b>Consolidation effort adjusted for the amount of national co-funding</b>			<b>-0.1</b>	
p.m. scenario of minimal consolidation effort [2.93% of GDP in 2014 compared to deficit from original requirement in EU rules for 2015 (2.49% of GDP)]			-0.7	0.7

Source: MoF SR

### Box 3: Consolidation efforts according to the preventive arm of the Stability and Growth Pact

According to the rules of the preventive arm of the Pact the countries of the euro area<sup>13</sup> which have not yet achieved their medium-term budgetary target must meet a consolidation effort of 0.5% of GDP on the annual basis. According to the new interpretation of Regulation No 1466/97 that has been presented by the European Commission<sup>14</sup> the required consolidation efforts must be differentiated by the cyclical position of the country, the amount of its debt and the risk of fiscal sustainability.

- Consolidation is not required in the given year if economic growth is negative or if the negative output gap exceeds -4% of GDP.
- Consolidation effort must exceed 0.5% of GDP annually (i.e. a minimum of 0.6% of GDP), if debt exceeds 60% of GDP or if there is a significant sustainability risk for debt measured using the S1 sustainability indicator.
- In good economic times, i.e. with an output gap exceeding 1.5% of GDP, the consolidation effort should also exceed 0.5% of GDP on an annual basis. Conversely; consolidation effort should be less than 0.5% of GDP per year, but at least 0.1% of GDP, in the case of a negative output gap that is higher than -1.5% of GDP.

	Required consolidation effort for countries that have not achieved the medium-term budget target according to the Pact (% of GDP)	
	Gross debt < 60% and low or moderate sustainability risk (S1 indicator)	Gross debt > 60% or high sustainability risk (S1 indicator)
<b>No need for consolidation:</b> Real growth < 0% or output gap below -4% of potential GDP	<b>No need for consolidation</b>	
<b>"Bad" economic times:</b> Output gap between -4% and -1.5% of potential GDP	<b>&gt; 0</b>	<b>≥ 0.5</b>
<b>"Neither good nor bad" economic times:</b> Output gap between -1.5% and 1.5% of potential GDP	<b>0.5</b>	<b>&gt; 0.5</b>
<b>"Good" economic times:</b> Output gap > 1.5% or slightly lower than 1.5% but rapidly approaching a value over 1.5% of potential GDP	<b>&gt; 0.5</b>	

<sup>11</sup> Data for 2013 is from the second round of autumn EDP deficit and debt notification to Eurostat.

<sup>12</sup> A more detailed overview of one-off effects is provided in Annex 1.

<sup>13</sup> Regulation No 1466/97 does not specify the required consolidation effort for countries outside of ERMII and the euro area with debts below 60% of GDP and without a high sustainability risk but according to the European Commission's interpretation, such effort should be 0.5% of GDP annually if there is no other reason.

<sup>14</sup> The Significant Deviation Procedure In The Preventive Arm Of The SGP, Note for the Alternates of the Economic and Financial Committee, Ares(2014)1051386 - 03/04/2014

The table below provides an overview of the required consolidation effort for euro area countries that have not achieved their medium-term budget targets. Consolidation effort required by the Pact for countries such as Slovakia must be at least 0.1% of GDP in 2014 and 2015 given debt levels below 60% of GDP, moderate sustainability risk of public finances based on the S1 indicator and a negative output gap exceeding 1.5% of GDP based on the European Commission's spring forecast. According to the specific recommendations approved by the Council of the European Union<sup>15</sup> in June 2014, Slovakia's trajectory towards the medium-term target should reach 0.1% of GDP in 2015 while taking into account expected negative economic conditions.

## 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 enables the assessment of the progress achieved in fiscal consolidation, when compared against the expenditure growth reference rate

The expenditure benchmark is applied differently depending on whether the country concerned has accomplished its medium-term target. Slovakia has not met its individual medium-term target<sup>16</sup> 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 grow 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 expenditure benchmark is taken from the European Commission documents<sup>17</sup>.

The **expenditure benchmark is compared with the expenditure analytically adjusted for factors beyond the Government's reach and those not affecting the general government balance**. These include interest expenditures, changes in unemployment benefit expenditures unrelated to government policies, expenditures funded by EU funds and expenditures covered by the measures on the revenue side. 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.

**Table 8: Expenditure benchmark (ESA 2010, € million)**

	2013	2014 E	2015
<b>1. Total expenditure</b>	<b>30,193</b>	<b>29,680</b>	<b>29,622</b>
2. Interest expenditures	1,393	1,387	1,327
3. Gross fixed capital formation	2,193	2,661	2,224
4. Gross fixed capital formation (average for t-3 through t)	2,271	2,378	2,315
5. Expenditure on EU programmes fully matched by revenues from EU funds	957	1,453	1,682
6. Cyclical unemployment benefit expenditure	28	28	27
7. Expenditures fully matched by revenue increases mandated by law	0	0	0
<b>8. Primary expenditure aggregate (1-2-3+4-5-6-7)</b>	<b>27,892</b>	<b>26,528</b>	<b>26,677</b>
9. Year-on change in primary expenditure aggregate ( $8_t - 8_{t-1}$ )	993	-1,364	149
10. Change in revenues due to measures	1,272	63	283
11. Nominal year-on-year growth of expenditure aggregate net of revenue measures ( $(9_t - 10_t) / 8_{t-1}$ )	-1.0	-5.1	-0.5

<sup>15</sup> [http://ec.europa.eu/europe2020/pdf/csr2014/csr2014\\_council\\_slovakia\\_sk.pdf](http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_council_slovakia_sk.pdf)

<sup>16</sup> Based on recommendations from the Council of the European Union from 2013, Slovakia should meet its medium-term target (structural general government deficit of 0.5% of GDP) by 2017.

<sup>17</sup> [Vade Mecum on Stability and Growth Pact](#), page 30

<b>12. Real year-on-year growth of expenditure aggregate net of revenue measures</b>	<b>-2.9</b>	<b>-6.9</b>	<b>-1.4</b>
<b>13. Expenditure benchmark – expenditure growth reference rate</b>	<b>2.9</b>	<b>2.6</b>	<b>2.6</b>
<b>14. Deviation from expenditure benchmark (12-13)<sup>1</sup></b>	<b>-5.8</b>	<b>-9.5</b>	<b>-4.0</b>
<i>p. m. GDP deflator<sup>2</sup></i>	1.9	1.9	0.9
<i>p.m. Actual growth in expenditure aggregate net of revenue measures at general government deficit pursuant to original requirements of EU rules equal to 2.49% of GDP in 2015</i>			0.1

[1] A negative value represents fulfilment of the expenditure benchmark

Source: MoF SR

[2] Average of two European Commission forecasts

Expenditure development in 2014 and 2015 should **comply with the expenditure benchmark**. A significant real decrease in expenditure aggregate (-6.9%) should occur in 2014 based on current expectations. A more modest decrease in expenditure aggregate (-1.4%) is expected in 2015. Public expenditure development in 2014 and 2015 should comply with the expenditure benchmark.

### II.3. General government gross debt forecast

General government gross debt<sup>18</sup> reached a level of 55.4% of GDP<sup>19</sup> at the end of 2013 according to the original April Eurostat notification. The GDP revision that occurred after the change in methodology is likely responsible for the fact that share of gross debt to GDP will not exceed a level of 55% of GDP in 2013<sup>20</sup>. **Under the assumption that budgetary targets are met, the share of debt to GDP throughout the forecast period shall remain below the 55% of GDP threshold.**

**Debt should decline in 2014 for the first time since 2008 and should reach a level of 54.1% of GDP. A slight temporary increase to 54.4% of GDP is expected in 2015, but this will be followed by gradual declines in the following years, ultimately reaching 51% of GDP in 2017.** The decline in debt is contingent upon improvements in the primary balance (general government deficit net of interest expenses) and GDP growth. Given the on-going consolidation, a primary general government budget surplus is expected in 2016.

	2012	2013	2014 E	2015	2016	2017
<b>General government gross debt</b>	<b>52.1</b>	<b>54.6</b>	<b>54.1</b>	<b>54.4</b>	<b>52.3</b>	<b>51.0</b>
- Sovereign debt (net of international commitments)	47.7	48.9	48.9	49.5	47.8	46.9
- Slovakia's share in the EFSF facility debt	2.1	2.6	2.7	2.6	2.5	2.3
- Contribution to the ESM	0.4	0.7	0.9	0.8	0.8	0.8
- Debt of other general government entities	2.0	2.4	1.6	1.4	1.2	1.0
p.m. Change in gross debt ratio	8.7	2.5	-0.5	0.3	-2.1	-1.3

Source: MoF SR, SOSR

The change in general government debt is **primarily due to the amount of the state budget cash deficit**, which will decline beginning in 2015. The cash deficit of the state budget in 2014 is expected to reach a level of €2.6 billion (3.5% of GDP), followed by €2.8 billion (3.6% of GDP) in 2015.

**On the other hand, most of the other effects will drive down the level of debt.** One significant factor is the **financing from the State Treasury**. In 2015 revenues from the planned sale of state assets (in particular the

<sup>18</sup> All indicated values are calculated based on the methodology applied in the assessment of compliance with the Maastricht criterion for general government gross debt, the so-called Maastricht general government gross debt

<sup>19</sup> According to the provisions of the constitutional Fiscal Responsibility Act (Act No. 493/2011 Coll.) the government had to execute a number of preventive measures in order to avoid debt levels increase (described in more detail in Chapter II.4) once gross debt exceeded 55% of GDP threshold.

<sup>20</sup> Data for 2013 is from the second round of autumn EDP deficit and debt notification to Eurostat.

sale of a minority ownership interest in Slovak Telekom) are expected with an impact on cash equal to €1 billion (1.3% of GDP).

**No additional impacts on a year-on change in debt in 2015 are expected from Slovakia's international obligations to the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM).** Slovakia's debt was previously impacted by EFSF obligations that arose in conjunction with the provisioning of financial assistance. The EFSF will no longer participate in the new financial programmes; however, it will continue to administer the assistance provided to the debtor 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. In the case of ESM, such contributions reduce the funds available to the State Treasury to finance government's operations, thus contributing to an indirect increase in debt.

The debt calculation also considers **changes in methodology as well as the discount at the issuance and redemption of bonds.** The discount in the issuance of state bonds and treasury bills increases the debt as state commitments increase at the moment the bonds are issued by the nominal value of such bonds. The state does, however, receive a lower amount in cash (decreased by this discount). Conversely, the discount has a positive effect on debt upon redemption of such state bonds. The reason for this is that the increase in debt occurs upon issuance of the bonds in the nominal value of such bonds and not at redemption. The overall effect of both factors will decrease debt in 2015.

Based on Eurostat recommendations<sup>21</sup>, a **loan for the Emergency Oil Stock Agency** amounting to €465 million (0.6% of GDP), which was used to finance the purchase of strategic oil reserves from the State Material Reserves, was included in public debt for 2013, which had a fundamental influence on exceeding the 55% debt threshold in 2013 based on the April Eurostat notification. According to ESA 2010, the EOSA was reclassified in its entirety into the public sector while the total balance of EOSA loans in 2013 totalled €520 million (0.7% of GDP). The gross debt will be decreased by a corresponding amount if the EOSA loan is repaid to the consortium of banks in 2014.

Other changes in the debt forecast are connected to exchange rate differences and a change in the deposits of State Treasury clients outside of the general government.

<b>Table 10: Impact on the general government gross debt (in € million)</b>						
	2012	2013	2014 E	2015	2016	2017
<b>A. General government gross debt (as at 1 January)</b>	<b>30,485</b>	<b>37,618</b>	<b>40,178</b>	<b>40,612</b>	<b>42,374</b>	<b>42,967</b>
<b>B. Total year-on-year change in the general government gross debt</b>	<b>7,134</b>	<b>2,560</b>	<b>434</b>	<b>1,762</b>	<b>593</b>	<b>1,221</b>
- Cash-based state budget deficit <sup>22</sup>	3,811	2,023	2,642	2,841	1,996	1,498
- State Treasury funds used for the financing of government operations	2,051	-463	-1,870	-944	-1,285	-259
- Slovakia's share in the EFSF facility debt	1,321	401	121	0	0	0
- Slovakia's contributions to the ESM	264	264	132	0	0	0
- Discount upon issuance of debt instruments	151	51	9	1	46	151
- Bond repayment (discounts)	-311	-68	-114	-84	-56	-66
- Balance of loans to other general government entities	-131	318	-572	-102	-103	-103
of which: ŽSR (Railways of the Slovak	-1	-131	-4	0	0	0

<sup>21</sup> This recommendation is available on the Eurostat website -

[http://epp.eurostat.ec.europa.eu/portal/page/portal/government\\_finance\\_statistics/documents/SK-Recording\\_of\\_sale\\_of\\_oil\\_reserves.pdf](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/SK-Recording_of_sale_of_oil_reserves.pdf)

<sup>22</sup> Slovakia's cash deficit from 2014 to 2017 is estimated in line with the conservative approach to debt forecasting. The state budget deficit should be lower if the deficit target of 1.98% of GDP in the general government budget proposal for 2015 is met.

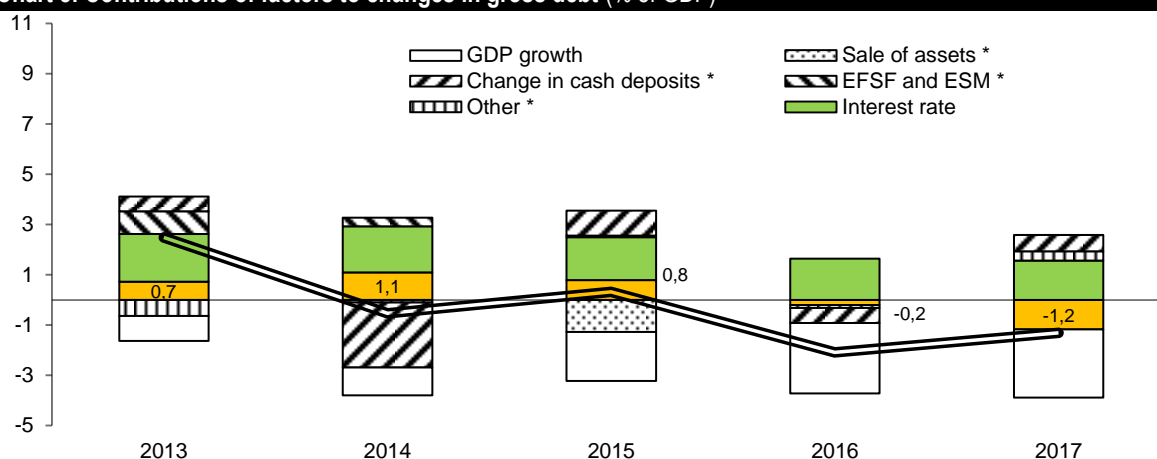


Republic)						
of which: NDS (National Motorway Company)	-37	-37	-37	-37	-37	-37
of which: EOSA	0	520	-520	0	0	0
- Fiscal performance of hospitals *	-1	0	60	50	0	0
- Deposits of State Treasury clients outside of the general government.	-8	17	0	0	0	0
- Other	-15	19	25	0	-4	-1
<b>C. General government gross debt (as at 31 December)</b>	<b>37,618</b>	<b>40,178</b>	<b>40,612</b>	<b>42,374</b>	<b>42,967</b>	<b>44,188</b>
<b>in % of GDP</b>	<b>52.1</b>	<b>54.6</b>	<b>54.1</b>	<b>54.4</b>	<b>52.3</b>	<b>51.0</b>
<i>Note: Positive amounts increase the general government debt as at 31 December of the relevant year, negative amounts decrease the debt.</i>						
<i>* With respect to reclassification, no data on the fiscal performance of hospitals for subsequent years is yet available. A reserve has been budgeted beginning in 2014 to cover any losses.</i>						

Source: MoF SR

An analytical overview of the contributions of individual factors to a change in debt illustrates that a decrease in debt is conditioned upon an improvement in the primary balance (the general government balance net of interest expenses) and upon nominal GDP growth. Given on-going consolidation, a primary budget surplus is expected for the first time in 2016.

**Chart 8: Contributions of factors to changes in gross debt (% of GDP)**



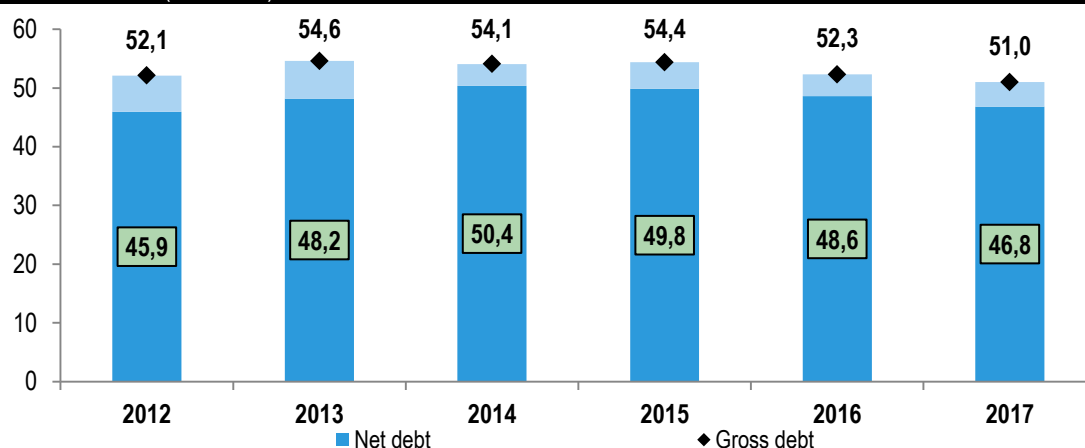
*Note: \* Marked items indicate the debt and deficit stock flow adjustment, i.e. how much the debt will change on top of the change in the general government balance.*  
Source: MoF SR

The stock-flow adjustment has an impact on debt levels. In the forecast period, this contribution is influenced by the development of State Treasury funds and the difference between cash and accrual recording of the general government balance.

From an analytical perspective it is more useful to monitor real indebtedness through the development of net debt, which is net of liquid financial assets and in particular cash deposits. The Ministry of Finance presents net debt as defined in the European Commission's manual for compiling the stability programme and the draft budgetary plan.

The chart illustrates annual development in net debt expressed as the difference between gross debt and liquid financial assets. The increase in liquid financial assets in 2012 is conditioned primarily by an increase in the cash reserve. Net debt at the end of 2013 reached a level of 48.2% of GDP and will culminate in 2014 at just over 50% of GDP and will then recede. Net debt from 2014 to 2017 averages 4 p.p. less than gross debt.

Chart 9: Net debt (% of GDP)



Source: MoF SR, Eurostat

#### Box 4: Impact of ESA 2010 revision of national accounts on public debt

The new ESA 2010 system of European national accounts entered into force in September 2014. This change in methodology decreased debt as a share of GDP thanks to an increase in the level of nominal GDP in all years, including those past and future. Conversely, the reclassification of a number of entities into the general government sector increased gross debt. As a result, the Eurostat debt notification based on the new methodology will be finalized on 21 October, i.e. after submission of the government's general government budget proposal for 2015 to 2017. The presented forecast is compiled on the basis of preliminary Ministry of Finance information for the past years and available information on the fiscal performance of those entities that are likely to be reclassified.

**The transition to ESA 2010 methodology has resulted in the inclusion of a number of entities into the general government sector.** According to the latest information, the National Motorway Company (NDS), the Emergency Oil Stock Agency (EOSA), healthcare facilities (i.e. public hospitals), local public transportation companies and Exim Banka are to be reclassified as other general government sector entities. These entities have unpaid loans or repayable financial assistance that will be included into general government debt after their reclassification. Likewise their fiscal performance in the future will also have an effect on the general government deficit. The reclassification of NDS is likely to have the most substantial impact in terms of a debt increase but these effects should be fully compensated by an increase in nominal GDP.

We anticipate that **healthcare facilities (public hospitals)** will also be classified as a part of the general government sector in line with Eurostat recommendations. The decision was made in 2011 to reclassify accounting liabilities<sup>23</sup> of hospitals into loans after consultations with Eurostat. The fiscal performance of hospital is part in the public finance sector in the new methodology and the state is directly responsible for any losses. After the hospitals are reclassified, the procedure used for calculating debt should be harmonised with other entities classified within general government sector and the previous reclassification of hospital liabilities should be removed from debt. Hospital debt should decrease as Maastricht debt is only affected by fiscal performance of hospital. Within the budget, it is assumed that hospital will contribute to the general government budget by €50 million (0.1% of GDP). With respect to the current reclassification, no data is available for fiscal performance of hospitals in the for subsequent years.

<sup>23</sup> This concerns other liabilities that are not considered as part of Maastricht debt. On the other hand, loans are recorded as debt.

<b>Table A: Effect of revision on gross debt (€ million)</b>						
	2012	2013	2014	2015	2016	2017
<b>Gross debt forecast (as at 31 December)</b>	<b>37,618</b>	<b>40,178</b>	<b>40,612</b>	<b>42,374</b>	<b>42,967</b>	<b>44,188</b>
<b>in % of GDP</b>	<b>52.1</b>	<b>54.6</b>	<b>54.1</b>	<b>54.4</b>	<b>52.3</b>	<b>51.0</b>
<b>of which: Changes from reclassification of entities into general government sector</b>	<b>179</b>	<b>202</b>	<b>136</b>	<b>97</b>	<b>55</b>	<b>12</b>
- NDS	372	335	297	260	223	186
- EOSA		55	-	-	-	-
- Public transportation companies		-	26	25	20	14
- Exim Banka	2	25	25	25	25	25
- Healthcare facilities	-194	-212	-212	-212	-212	-212
<i>p.m. decrease in debt due to change in level of GDP (in % of GDP)</i>	<i>-0.8</i>	<i>-1.1</i>	<i>-1.1</i>	<i>-1.1</i>	<i>-1.1</i>	<i>-1.0</i>

*Source: SOSR, MoF SR*

#### II.4. Application of the constitutional Fiscal Responsibility Act

Slovakia's general government gross debt at the end of 2013 was published by Eurostat in April 2014. Gross debt reached a level of 55.4% of GDP. Based on the provisions of the constitutional Fiscal Responsibility Act (Act No. 493/2011 Coll.), the government has the obligation to submit proposed measures to reduce debt to the National Council if gross debt exceeds 55% of GDP. The sanction mechanism for exceeding the debt threshold of 55% of GDP was activated in the spring of 2014.

Changes related to the implementation of the new ESA 2010 methodology for national accounts will very likely cause the debt for 2013 to drop below the level of 55% of GDP. Debt for 2013 reached only 54.6% of GDP according to the preliminary data<sup>24</sup> from Eurostat's autumn notification. Debt is forecasted to remain below the 55% threshold in the entire forecast period if budget targets are met. There will be no need to apply the sanction mechanism following the finalisation of the autumn notification.

The government has the obligation to submit proposed measures to reduce the debt to the National Council of the Slovak Republic if gross debt exceeds 55% of GDP in order to ensure decreasing debt levels. At the same time the constitutional Fiscal Responsibility Act stipulates a decrease in the wages of all members of the government to the level of the previous year, which was met considering a freeze in wages for the members of the government at their 2013 levels. Another planned restriction is the cancellation of provision of funds from the government and prime minister's reserve, which occurred in May 2014.

**Two restrictions based on exceeding the 55% of GDP threshold have a more significant fiscal effect.** One obligation is to block 3% of the adjusted state budgetary expenditures. Beginning in May 2014 the Ministry of Finance blocked a total of €305 million.

The other major restriction is that the **government cannot submit a budget proposal for 2015 to the National Council of the Slovak Republic that would contain a year-on-year increase in nominal general government expenditure<sup>25</sup>** and the local governments are also required to approve budgets for 2015 not above the level up to a maximum of the expenditures approved in the budgets for 2014<sup>26</sup>.

<sup>24</sup> Data for 2013 is from the second round of autumn excessive deficit procedure deficit and debt notification to Eurostat.

<sup>25</sup> Except for expenditures for servicing state debt, European Union funds, co-financing funds, transfers to the EU budget and expenditures with regards to damages caused by natural disasters.

<sup>26</sup> Except for EU funds and co-financing and expenditures with regards to damages caused by natural disasters.



The general government budgets for 2014 and 2015 are incomparable given the reclassification of multiple entities and methodology changes due to the transition to ESA 2010 methodology. For this reason the approved budget for 2014 can only be compared to the 2015 budget net of these changes. A more detailed calculation of consolidated expenditures is provided in Annex 4.

The anticipated local government expenditures based on the government's budget proposal respect the constitutional debt brake in place for local governments according to their approved budget for 2014.

### III. Revenue and expenditure targets of the general government budget

The general government deficit for 2015 would reach a level of 3.5% of GDP if no changes were made in economic policies in 2015. The general government deficit in the budget proposal for 2015 is 1.6% of GDP lower (€1,211 million) compared to the no-policy-change scenario and nearly three-quarters of this reduction is attributable to reduced expenditures.

The difference in expenditures compared to the no-policy-change scenario (NPC) is 1.1% of GDP. Such difference is primarily based on ESO public administration reform (0.3% of GDP). Local governments should contribute 0.4% of GDP primarily based on the application of the constitutional Fiscal Responsibility Act. Savings will be transposed into a significant decrease in general government expenditures in terms of GDP from 39.5% in 2014 to 38.0% in 2015.

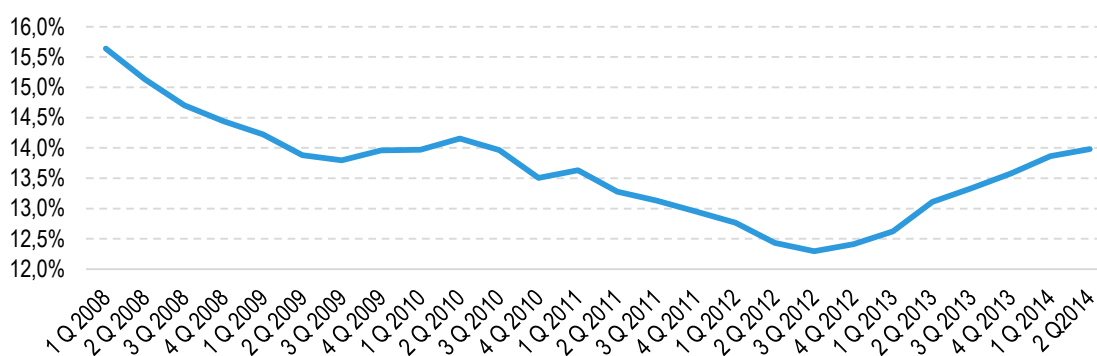
Revenue increase will shrink the general government deficit by 0.4% of GDP compared to the NPC. The priority of Slovakia's government in the area of taxation remains combating tax evasion and new tax legislation is expected to generate estimated revenues of around 0.6% of GDP. Revenues in terms of GDP will decline year-on-year from 36.6% of GDP in 2014 to 36.0% of GDP in 2015.

#### III.1. Revenue targets of the general government budget

##### III.1.1. Combating tax evasion

The priority of Slovakia's government in the area of taxation remains combating value-added tax evasion and such efforts will expand into tax evasion involving corporate income taxes. Measures to combat VAT evasion adopted at the end of 2012 have helped to reverse long-term negative developments. VAT collection efficiency has risen for seven consecutive quarters and reached the level last seen in 2009. Improved VAT collection efforts compared to 2012 have generated €241 million in additional revenues (0.3% of GDP) in 2013 and €514 million (0.7% of GDP) in 2014. In 2014 the most important measure in the area of combating tax evasion was the introduction of a control statement to increase the efficiency of auditing excess credits. Given the complexity involved in auditing such excess credits, the average duration of this process is 6 to 9 months. The impact of the introduction of the control statement may take longer to appear in VAT revenues but may also represent a positive risk with regards to current VAT forecast.

Chart 10: Development of the effective VAT rate (2008-2014)



Source: MoF SR

### III.1.2. General government revenues in 2014 and 2015

**General government revenues according to the budget should equal 36.0% of GDP in 2015 compared to 36.6% of GDP based on latest expectations for 2014.** The decrease in general government revenues in terms of GDP is attributed to a decrease in the level of grants and transfers.

Measures in the general government budget proposal contribute to the stabilisation of tax revenues in terms of GDP. Revenues from VAT as a percentage of GDP would drop by 0.3% if the VAT rate was not kept at its current rate of 20%. Slower growth in household consumption below GDP growth in 2015 used to forecast these taxes shall also contribute to the decreases in excise taxes and VAT in terms of GDP. Without adopting further measures, revenues from corporate income taxes are also expected to drop by 0.1% of GDP. The forecast for corporate income taxes includes the developments from past years, which indicate that the economic growth in 2015 will not be sufficient enough to translate into the same level of growth of profits.

**Table 11: General government revenues in 2014 and 2015 (% of GDP, ESA 2010)**

	2014 E	2015	Difference
<b>General government revenues, total</b>	<b>36.6</b>	<b>36.0</b>	<b>-0.5</b>
<b>1. Tax revenues</b>	<b>17.0</b>	<b>17.0</b>	<b>0.0</b>
- Taxes on production and imports	10.5	10.0	-0.5
- Value-added tax	6.5	6.2	-0.3
- Excise taxes	2.7	2.6	-0.1
- Current taxes on income, wealth, etc.	6.5	6.3	-0.2
- Corporate income tax	2.8	2.7	-0.1
- Capital taxes	0.0	0.0	0.0
- Tax measures incorporated into the general government budget proposal for 2015	0.0	0.6	0.6
<b>2. Social security contributions</b>	<b>13.4</b>	<b>13.2</b>	<b>-0.1</b>
<b>3. Non-tax revenues</b>	<b>2.8</b>	<b>2.9</b>	<b>0.1</b>
<b>4. Grants and transfers</b>	<b>3.3</b>	<b>2.9</b>	<b>-0.5</b>

Source: MoF SR

### III.2. Expenditure targets of the general government budget by function<sup>27</sup>

**General government expenditures in 2015 should reach 38.0% of GDP, representing a decrease of 1.5 p.p. of GDP in comparison with the expected outcome for 2014.** The largest share in total public expenditures (TE) is attributed to social security (35.3%), followed by general public services (16.8%) and healthcare (14.1%).

**Table 12: General government expenditures based on COFOG**

Functions	COFOG Code	2014 E		2015	
		% of GDP	% of TE*	% of GDP	% of TE
1. General public services	1	6.65	16.84	5.45	14.35
2. Defence	2	0.94	2.39	0.95	2.49
3. Public order and safety	3	2.02	5.11	1.91	5.02
4. Economic affairs	4	4.37	11.06	4.99	13.14
5. Environmental protection	5	0.51	1.29	0.47	1.24
6. Housing and community amenities	6	0.55	1.40	0.41	1.07
7. Health	7	5.57	14.11	5.31	13.97

<sup>27</sup> 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). COFOG classification also does not account for expenditures made through the tax system.



8. Recreation, culture and religion	8	1.07	2.71	0.89	2.34
9. Education	9	3.86	9.77	3.71	9.76
10. Social protection	10	13.96	35.33	13.92	36.62
<b>Total expenditure</b>	<b>TE</b>	<b>39.51</b>	<b>100.00</b>	<b>38.02</b>	<b>100.00</b>

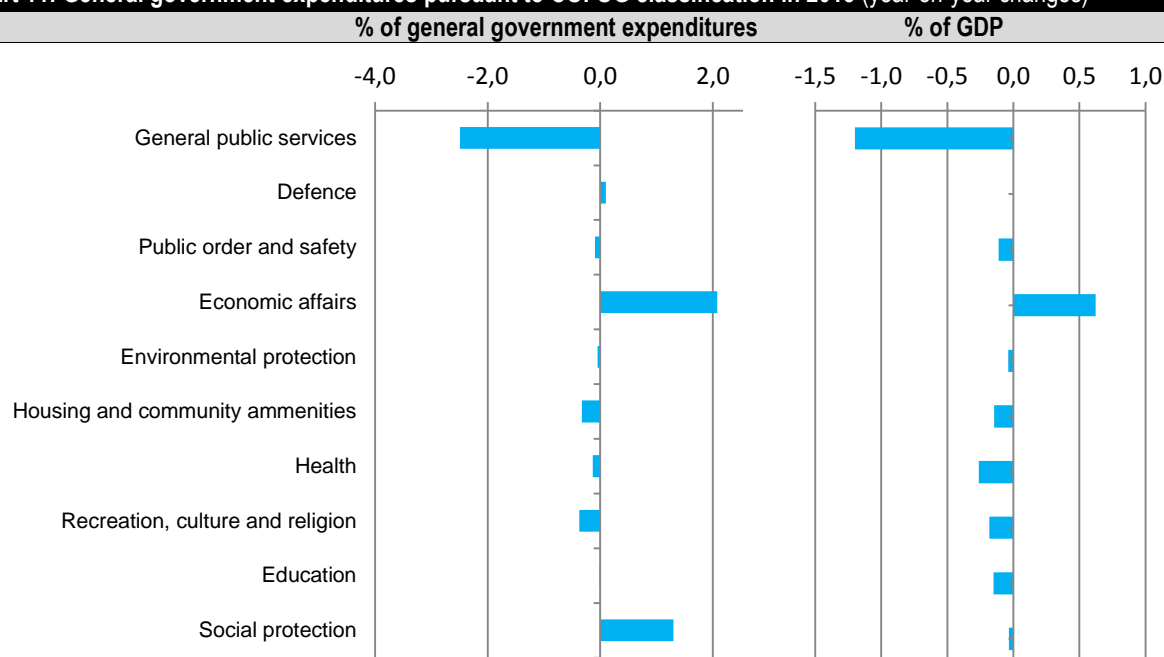
\* TE - Total general government expenditures

Source: MoF SR

The most significant year-on-year changes are in general government services and in economic affairs. **Expenditures for general government services, i.e. primarily the costs of public administration, should decrease significantly in the next year by 2.5 p.p.** of total expenditure. Net of the effects of amendments to Statistical Office of the Slovak Republic decrees regarding COFOG classification (Box 5), this decrease will be a bit lower, at a level of 2.1 p.p. TE. The share of expenditures for economic affairs relative to the overall budget shall increase by 2.1 p.p. The effect of the amended Statistical Office of the Slovak Republic decree is negligible in this category.

**Public expenditures on education and healthcare remain practically unchanged in 2015 in terms of their share of overall expenditures.** Other expenditures in areas such as public order and safety, environmental protection and others stagnate or slightly decline in comparison to total expenditure and GDP. Defence expenditures rise slightly (based on NATO methodology, not COFOG, Slovakia's defence expenditure will reach 1.03% of GDP in 2015).

**Chart 11: General government expenditures pursuant to COFOG classification in 2015 (year-on-year changes)**



Source: MoF SR

**Box 5: Amended Statistical Office of the Slovak Republic decree and methodology instructions regarding COFOG classification**

The manual for classifying general government expenditures by function (COFOG) will change effective in October 2014 based on decree issued by the Statistical Office of the Slovak Republic (SO SR). The manual is published on the Statistical Office's website and is the official manual for general government entities for classifying expenditures. Changes will appear in the budget for 2015 to 2017. The changes represent a response to the most frequent errors as identified by the Statistical Office of the Slovak Republic in analysing source data, in particular:



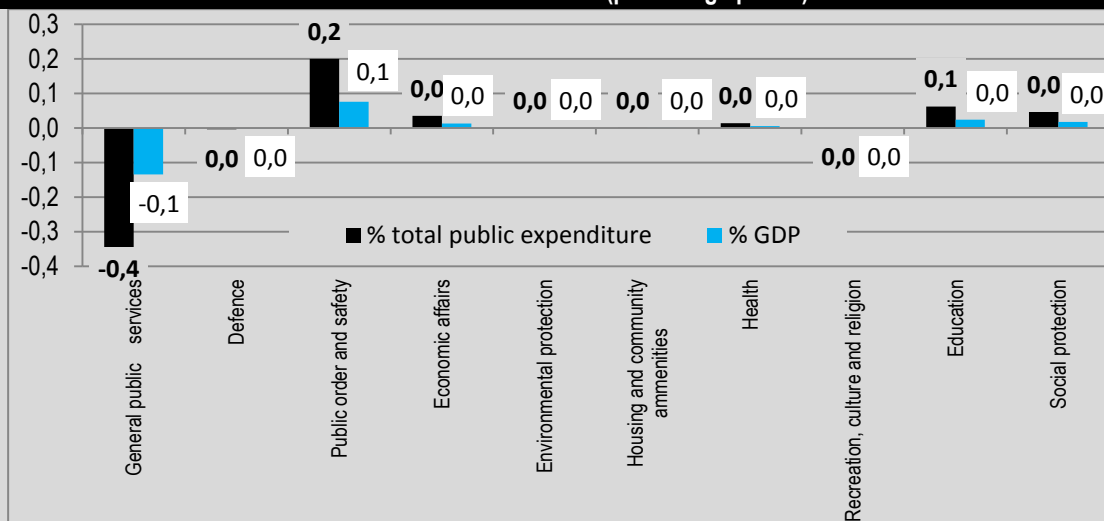
- Expenditures were frequently classified in a single COFOG division but no more detailed classification was made (50% of expenditures)
- Some expenditure with economic classifications that could be clearly classified to a specific COFOG division were reported incorrectly in different COFOG division (66% of expenditure)
- A significant portion of expenditure was reported in the "otherwise unclassified expenditure" group (31% of expenditure)

The manual underwent two basic amendments:

1. Four levels of expenditure categories are used in classification where the fourth level previously represented institutions or types of institutions. Expenditures in this category frequently include expenditures of the entire institution, regardless of function. The fourth level was left in place but only for use in cases where it represented a function or was changed to do so.
2. The Statistical Office of the Slovak Republic then published its expansion for the methodology for classifying expenditures. It undertook to respond to specific requests from entities to classify expenditures. The answers will be published as case studies that can be used by other entities. A total of 35 case studies from the COFOG manual issued by Eurostat were also published. The measure responds to error where entities classified an excessive amount of expenditures into the "otherwise unclassified expenditures" category, likely due to the inability to define a more appropriate classification.

In addition to these two primary changes, the explanations for the individual categories of expenditures were also revised. The changes are intended to more precisely guide general government entities towards the correct classification of expenditures.

**Chart A: Effects of amendments to Statistical Office decree (percentage points)**



Source: Eurostat, MoF SR

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

The no-policy-change scenario<sup>28</sup> is based on the current estimate of the general government deficit in 2014 of 2.93% of GDP. **The general government deficit for 2015 would reach a level of 3.5% of GDP assuming no changes were made in economic policies in 2015<sup>29</sup>.** The difference in the general government balance

<sup>28</sup> 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 baseline methodology remained unchanged. The only difference is that the final balance of general government revenues and expenditures is expressed in key ESA items.

<sup>29</sup> The overall specification of the difference between the budget and the no-policy-change scenario does not consider the impact of changes in interest expenses. In other words, interest expenses will also change if budgetary targets are met.



between the no-policy-change scenario and the budget proposal for 2015 represents 1.6 of GDP (€1,211 million). **The difference on the expenditure side of the budget is 1.1% of GDP compared to NPC.** The decrease in current expenditures shall equal 0.6% of GDP. Capital expenditures shall decline by 0.5% of GDP, primarily due to a lower budget for local governments. **The overall effect compared to NPC on the revenue side is 0.4% of GDP, with tax revenues to increase by 0.6% of GDP thanks to new legislation.** In the case of statutory health insurance deductions, a lower transfer from the state budget is expected.

<b>Table 13: Comparison between the balance of expenditures and revenues and the no-policy-change scenario in 2015 (% of GDP)</b>				
	ESA 2010 code	2015 NPC (1)	2015 GGB (2)	GGB - NPC (2-1)
<b>1. Total revenues</b>	<b>TR</b>	<b>35.6</b>	<b>36.0</b>	<b>0.43</b>
1.1. Taxes on production and imports	D.2	10.0	10.4	0.30
1.2. Current taxes on income, wealth, etc.	D.5	6.3	6.6	0.29
1.3. Capital taxes	D.91	0.0	0.0	0.00
1.4. Social security contributions	D.61	13.4	13.2	-0.13
1.5. Property income	D.4	0.7	0.7	0.00
1.6. Other <sup>1</sup>		5.1	5.1	-0.02
p.m.: Tax burden <sup>2</sup>		29.8	30.2	0.46
<b>2. Total expenditure</b>	<b>TE <sup>3</sup></b>	<b>39.1</b>	<b>38.02</b>	<b>-1.12</b>
2.1. Compensation of employees	D.1	7.1	7.0	-0.14
2.2. Intermediate consumption	P.2	4.8	4.6	-0.27
2.3. Total social payments	D.62,D.632	18.0	17.8	-0.27
of which, unemployment benefits <sup>4</sup>		0.2	0.2	0.00
2.4. Interest expenditures	D.41	1.7	1.7	0.00
2.5. Subsidies	D.3	0.8	0.8	0.00
2.6. Gross fixed capital formation	P.51g	3.3	2.9	-0.48
2.7. Capital transfers	D.9	0.8	0.7	-0.02
2.8. Other <sup>5</sup>		2.6	2.7	0.07
<b>General government balance</b>	<b>B.9</b>	<b>-3.53</b>	<b>-1.98</b>	<b>1.55</b>
<b>- in € million</b>		<b>-2,751</b>	<b>-1,541</b>	<b>1,211</b>
<i>p.m. Primary general government balance</i>		<i>-1.83</i>	<i>-0.27</i>	<i>1.55</i>

Note: GGB – General government budget proposal for 2015 - 2017; NPC - no-policy-change scenario

Source: MoF SR

<sup>1</sup> P.11+P.12+P.131+D.39rec+D.7rec+D.9rec (others as D.91rec)

<sup>2</sup> The tax burden is calculated as D.2+D.5+D.61+D.91-D.995

<sup>3</sup> TR-TE = B.9

<sup>4</sup> Includes social benefits other than D.62 and D.632 in connection with unemployment benefits

<sup>5</sup> D.29p + D.4p (except D.41p) +D.5p +D.7p +P.52+P.53+NP+D.8.

### III.4. Description of measures

The following sections quantify and describe the effects of measures incorporated into the budget proposal. Budget changes are also transposed into the difference between the NPC and the general government budget proposal beyond the framework of specified measures. The following section describes the incorporated measures including quantification. The most significant measures include maintaining value-added tax rate at a level of 20% and a wide-ranging amendment of the Income Tax Act. ESO public administration reform is the major measure on the expenditure side. A difference between the NPC and the budget proposal appears above the framework of the identified measures, in particular other non-tax revenues (-0.07% of GDP) and other changes compared to NPC on the expenditure side (0.64% of GDP).

**Table 14: Measures included in the general government budget proposal (ESA 2010, comparison to NPC)**

Measure	Sub-sector	ESA 2010 code	2015 (% of GDP)
<b>1. Maintaining the VAT rate at 20%</b>	<b>S.1311</b>	<b>D.211R</b>	<b>0.30</b>
<b>2. Changes in tax depreciation of property</b>			<b>0.20</b>
- Extension of depreciation for office buildings from 20 to 40 years	S.1311	D.51R	0.09
- Restricting accelerated depreciation to manufacturing machinery and installations	S.1311	D.51R	0.04
- Cancellation of preferential depreciation for leasing	S.1311	D.51R	0.02
- Depreciation of unclaimed expenditures using a coefficient for VAT deduction	S.1311	D.51R	0.05
<b>3. Measures to increase the effectiveness of tax collection (ECR and pharmaceutical companies)</b>			<b>0.07</b>
- Expansion of obligation to maintain records of revenues in electronic cash registers (ECR)	S.1311	D.51R	0.07
- Withholding tax for pharmaceutical companies on financial and non-financial benefits provided to physicians	S.1311	D.51R	0.00
<b>4. Introduction of thin capitalisation rules</b>	<b>S.1311</b>	<b>D.51R</b>	<b>0.07</b>
<b>5. Deduction of research and development expenditures from the tax base</b>	<b>S.1311</b>	<b>D.51R</b>	<b>-0.03</b>
<b>6. Audit of tax deductible expenditures and other</b>	<b>S.1311</b>	<b>D.51R</b>	<b>0.02</b>
of which: increasing and harmonising social security contribution discount for students	S.1314	D.61R	0.00
<b>Other non-tax revenues</b>			<b>-0.07</b>
- Lower state budget revenues from FOV and EOSA fees	S.1311	D.29A	-0.04
- Higher municipal and higher territorial unit administrative fees	S.1311	P.11	0.15
- State budget and general government administration grants and transfers	S.1311	D.7R	-0.07
- Other lower revenues from state budget refunds	S.1311	D.7R	-0.09
- Other non-tax revenues	S.1311	P.11	-0.02
<b>7. Priority government measures</b>			<b>-0.05</b>
- Compensations	S.1311	D.1P	-0.01
- Intermediate consumption	S.1311	P.2	-0.01
- Subsidies	S.1311	D.3P	-0.02
- Capital expenditure	S.1311	P.5+D.9	-0.01
<b>8. ESO + state contributory organizations from budgetary funds</b>			<b>0.27</b>
- Compensations	S.1311	D.1P	0.17
- Intermediate consumption	S.1311	P.2	0.10
<b>9. Healthcare</b>			<b>0.13</b>
- Transfer for VŠZP (Health Insurance Agency), received	S.1311	D.62P	0.13
- Transfer for VŠZP (Health Insurance Agency), paid	S.1314	D.61R	-0.13
- Social transfers in kind	S.1311	D.632P	0.13
<b>Other changes compared to NPC on expenditure side, of which</b>			<b>0.64</b>
State budget	S.1311		0.10
Public universities	S.1311		0.05
Other general government services	S.1311		0.07
Local governments	S.1313		0.40
Health and social insurance	S.1314		0.03
<b>Total</b>			<b>1.55</b>
- Tax and social security contribution revenues			0.50
- Non-tax revenues			-0.07
- Current expenditure			0.62

- Capital expenditures	0.50
------------------------	------

Note: (+) indicates increased revenue or decreased expenditures

Source: MoF SR

### Revenue measures

1. The amendment of the **Value-Added Tax Act will be maintained at the current tax rate at 20% from 2015.**
2. Multiple **changes have been introduced in the tax depreciation of property**, the common goal of which is to increase the efficiency of tax collection efforts by restricting currently very advantageous depreciation conditions when compared on an international basis. All of the changes in depreciation are applied to property that is currently subject to depreciation. These measures include increasing the depreciation period for office buildings from the current 20 years to 40 years. The previous depreciation period for these buildings did not reflect their actual lifespans and actual utility. Additionally, this period was excessively short when compared to neighbouring countries where the depreciation period is set to 50 years (with the exception of Poland where they are included in the 40 year depreciation group). Preferential depreciation for leasing contracts is also cancelled.
3. In order to **increase the efficiency of tax collection efforts**, the obligation to **record revenues in electronic cash registers into new economic sectors** will be expanded (to hotels and restaurants, professional scientific and technical activities, general practitioners, specialist physicians, dentists, etc.) and an **obligation to tax financial and non-financial benefits from pharmaceutical companies in the form of a withholding tax** will also be introduced.
4. The introduction of **thin capitalisation rules** is a step towards restricting potential tax evasion and diversion of profits between economically-related or personnel-related companies (**transfer pricing**). Thin capitalisation rules represent a standard instrument in nearly all developed countries. With this change Slovakia is joining the ranks of countries actively combating the unfair practices of transferring profits abroad for the purposes of decreasing tax liabilities. The tax-deductible cost of interest on loans from dependent entities will be capped to a maximum of 25% of EBITDA<sup>30</sup>. Measures are also applied to interconnected domestic companies that consolidate their profits and losses within a holding.
5. The introduction of a deduction for research and development expenditures from the tax base will have a positive effect on **investments into research and development** in Slovakia. Measures include a direct deduction of 25% of the total amount of such expenditure, along with 25% of the year-on-year increase in expenditure and 25% of the expenditure on wages for newly hired graduates.
6. The draft amendment of the Income Tax Act proposes limiting selected tax-deductible expenditures on the basis of a **tax audit**. For instance, an upper limit will be applied on the acquisition price of motor vehicles and income from contractual fines will be taxed. Another measure includes increasing and harmonising the social security contribution discount for students.

### Expenditure measures

7. Expenditure for the **priority measures** of the government were also incorporated in the budget proposal amounting to €37 million (0.05% of GDP), in particular:
  - Beginning on 17 November 2014 several groups of residents **will be afforded free travel on railways**. Free travel ticket will be provided to children, pupils, students under the age of 26 and pensioners. The estimated cost of this measure equals to €13 million.

<sup>30</sup> EBITDA - earnings before interest, taxes, depreciation and amortisation.



- In order to fulfil the requirements in the amendment to the Material Need Assistance Act, 840 new positions for field workers who work directly with beneficiaries will be created at Labour Offices in 2015. The anticipated costs are approximately €9 million.
  - The allocation for **teacher assistants in regional education** will be increased by €7 million in 2015. Such funds are to cover wage expenses for new teacher assistants who will be assigned as needed to schools with disadvantaged children. This should completely cover demand from schools.
  - The government has also set a target of expanding **capacity in preschool facilities** with the objective of increasing the employment of women and the integration of children from socially-disadvantaged environments. A total of €5 million was dedicated in the budget for 2015 for this use.
  - In order to support the long-term unemployed, 2015 will see the introduction of the ability to **simultaneously receive assistance in material need and wage**. Long-term unemployed individuals or inactive job seekers will be eligible for this benefit after taking up a job (with at least half-time employment) if they are also the member of a household that receives material need assistance or one that no longer receives such assistance as a result of being employed. Income from employment has to be at least at the amount of the minimum wage and maximum of two times the minimum wage. Such an employee will receive €126.44 over the first six months with this amount dropping to €63.07 for the second half year. Currently individuals lose their claim to material need assistance immediately after being employed, even at the level of minimum wage. The costs to cover the increased general government expenditures will be approximately €3 million in 2015.
8. Within on-going **ESO public administration reform**, the government undertook to rationalise the number of state organisations, improve their service processes and increase their effectiveness. Changes in budgetary and contributory organisations will generate savings of €206 million in 2015 compared to NPC. The planned measures and savings within this reform are described in Box 5.
9. **Growth in public health expenditures** in 2015 will be damped by measures amounting to 0.13% of GDP compared to the NPC, despite continued rise of resources in healthcare. Healthcare measures are focused on achieving the highest possible efficiency without threatening the accessibility or quality of treatment and care. Their primary focus is on halting the accumulation of debts by 13 state university and general hospitals, optimising their total in-patient bed capacities and making investments into the construction and renovation of new and more efficient hospitals. An integrated model for providing healthcare will be introduced and treatment procedures will be unified. The financial management of hospitals shall be configured to reward performance and increased efficiency. Hospitals should achieve balanced financial management by the end of 2015. In terms of providing healthcare, treatment procedures will be unified for all diagnoses, which should lead to increased pressure on quality of care and enable the transition to diagnostic group (DRG) payment by 2017.

#### Potential measures not included in the budget proposal

The government is also preparing health contribution allowance reform above the framework of the presented measures targeted at strengthening low-income labour supply and demand for low-income job seekers. This reform is based on tax deduction covering health insurance deductions for low-income employees that fully compensates for the planned increase in the minimum wage (a year-on-year increase of nearly 8%). Given the on-going discussions to the draft legislation, the final parameters of such plan are not yet known and therefore the impacts of such measure cannot be quantified. The introduction of the health contribution allowance also follows these targets:

- Preserving the cost of labour for minimum wage at its current level;
- Decreasing the cost of labour and thereby increasing demand for labour above the level of the minimum wage (low-income employees);
- Increasing the net wages of low-income employees;
- Increasing the consumption of low-income employees.

The maximum health contribution allowance is proposed at the same rate than minimum wage (€380 in 2015). The health contribution allowance will be gradually phased out as income increases (the complete loss of such claim will depend on the final parameters of the health contribution deduction). The estimated number of affected employees as well as the fiscal effects will also depend on the configuration of the final parameters.

Following wage increases in regional education by 5% in 2013 and 2014, the issue of wage increases in the public sector and in particular in regional education in the following years has not yet been closed. Negotiations on a collective bargaining agreement of a higher degree for 2015 are currently under way.

### Box 6: ESO public administration reform

The Government of the Slovak Republic approved the ESO programme (effective, reliable and open public administration) in April 2012 as a component of general government reform. Heretofore adopted measures have primarily involved the following steps:

- A large part of local public administration was merged into integrated district offices through reform. Client centres have been established in the District Offices to provide simpler and more convenient contact with residents.
- Supporting services (such as building administration, accounting, technical and material assurance, human resources and IT services) were also separated and are now conducted by 8 support centres in the regional capitals; a call centre for residents also came into service. Integration of local public administration offices enabled the optimisation of general government services and a simplification of processes.
- Data is being collected on the activities of these offices and the performance of employees through the use of a queuing system and a registry system.
- The reform includes applying pressure to increase the efficiency of public administration. 23 subordinate state budget organisations were merged or cancelled in 2014 with additional savings achieved through internal efficiency measures within the organisations themselves.

Multiple steps as a component of ESO reform are prepared for the following period:

- There will be a need to connect the queuing systems and registry systems to enable monitoring and analysis of progress in handling assigned agendas from the first moment of contact between a resident and the office through complying with requests and closing case files. Data will also be used to identify potential indicators to be introduced and monitored to increase efficiency and quality in the monitoring, assessment and management of offices.
- Reforms will continue in those parts of local public administration that are not integrated into the merged offices. A total of 46 Offices of Labour, Social Affairs and Family will lose legal subjectivity in 2015 and will transfer under the direct management of Central Offices of Labour, Social Affairs and Family. This will provide the government with better control over office expenditures as well as their dissolution and establishment. This will increase the flexibility of human resources management, which will be better able to respond to differences in demand for capacities to deliver employment services in the individual regions. In addition to changes in local public administration, the Slovak Academy of Science will be transformed into new independent legal entities, public research institutions.

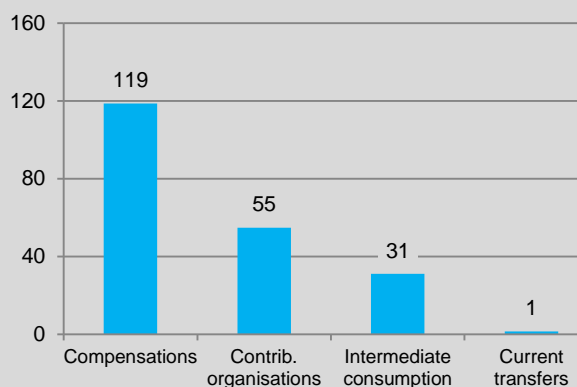
An integral part of ESO reforms is the rationalisation of processes and increasing the internal efficiency of all state organisations. The transformation of state budgetary and contributory organisations is under way (e.g. merging or dissolution) in order to decrease their numbers. The budget proposal includes savings amounting to €150 million compared to the no-policy-change scenario (NPC) on the expenditures of budgetary organisations and €55 million on the expenditures of contributory organisations of the state budget. Savings were identified on the basis of analysis of expenditures, processes and activities of budgetary and contributory organisations, in particular by comparing expenditures on wages and on goods and services per individual employee. These figures represent savings in the broadest sense of the word as the difference between all of the budgeted expenditure for wage costs and for goods and services and the NPC. Only specific expenditure line items have been left out of the savings calculation, for instance expenditures for the Slovak Information Service (SIS) and the National Security Office (NBÚ), payment for availability of PPP motorways, special goods for the Ministry of Defence and election expenditures.<sup>31</sup>

<sup>31</sup> The General ledger of the general government budget applies different methodology and calculates ESO as the €96 million committed in the budget proposal for 2014 - 2016.



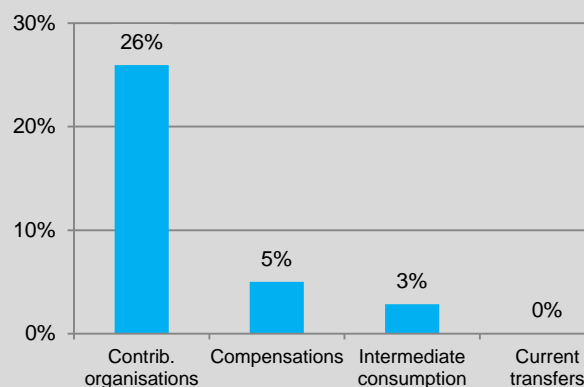
- The largest portion of these savings is accounted for by employee compensations, which decreases by €119 million compared to NPC. This decrease is made possible by freezing wages and reducing the number of positions at the Ministry of Agriculture and Rural Development (151 persons), the Slovak Academy of Sciences (266 persons) and in multiple contributory organisations (134 persons).
- Savings on intermediate consumption (in particular goods and services) total €31 million through reduced overhead and operating costs. Significant savings were also realised in budgetary funds for state contributory organisations (€55 million compared to NPC). Other current transfers are decreased by almost €1.5 million.
- In terms of percentages, transfers for contributory organisations decrease the most, dropping by around a quarter compared to NPC. The compensation package will be decreased by five per cent and intermediate consumption by three per cent. The decrease in current transfers due to ESO is negligible.

**Chart A: Savings by ESA category (€ million)**



Source: MoF SR

**Chart B: Savings relative to NPC**

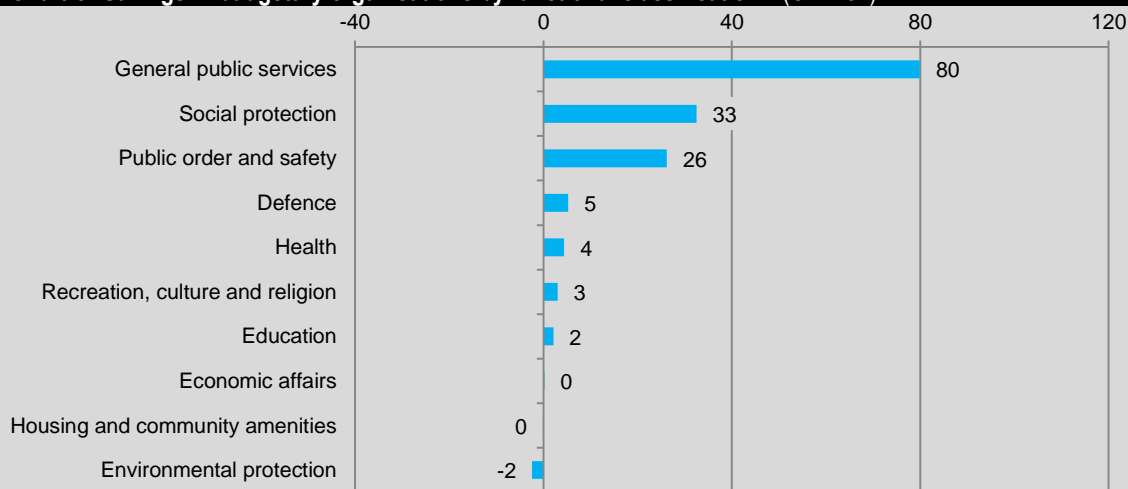


Source: MoF SR

Disregarding contributory organisations, whose expenditures largely depend on their own funding, total savings from ESO in the chapters of the state budget and their subordinate budgetary organisations exceed €150 million.

- In terms of expenditures by function, it is important that the largest decrease (by €80 million compared to the NPC) is observed in general government services, i.e. administrative services.
- Due to internal re-organisation and increasing efficiency, operating expenditures for social security (€33 million), public order and safety (€26 million) and to a lower degree other functions (total of €15 million) also decreased.
- Conversely expenditure on environmental protection and on housing and community amenities will slightly increase on the basis of measurements.

**Chart C: Savings in budgetary organisations by functional classification<sup>32</sup> (€ million)**



Source: MoF SR

<sup>32</sup> Adjusted for the known effects from the modified decrees and methodology guidelines for COFOG classification.

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

*The government prepared a set of structural measures focused on supporting economic growth and employment. Measures with a quantified impact on the budget are described in Chapter III.4. Tables 6a and 6b in Annex 5 respond to the specific recommendations for the Slovak Republic (CSR) and the goals of the EU's growth and employment strategy (Europe 2020).*

*Primary structural and expenditure measures are focused on supporting growth and employment while increasing the efficiency of public expenditure. Among the most significant from the perspective of expenditures include ESO public administration reform, increasing efficiency in the healthcare sector and the construction of new nurseries. A majority of structural measures are focused on the labour market, as the greatest current challenge of the Slovak economy. The health contribution allowance and concurrence of material need benefits and wages should help increase employment among low-income employees. The minimum pension and Christmas bonus contribute to a decrease in social differences.*

### IV.1. Employment

The government is planning significant reforms on the labour market and in social areas. The health contribution allowance and concurrence of material need benefits and wages should help increase employment among low-income employees. The minimum pension, Christmas bonus and more targeted social benefits contribute to greater fairness in the social system. Increasing the discounts on travel expenses for work purposes increases the mobility of residents and decreases regional differences.

The **health contribution allowance** covering health insurance deductions is designed to increase the supply of and demand for labour by increasing net wages and decreasing the cost of labour. This tax deduction will be gradually phased out as income increases (the complete loss of such claim will depend on the final health contribution tax deduction parameters). The estimated number of affected employees as well as the fiscal effects will also depend on the configuration of the final parameters.

In order to support the long-term unemployed, **concurrence of material need benefits and wages will be introduced in 2015**. Long-term unemployed individuals or inactive job seekers will be eligible for this benefit after taking up a job (with at least half-time employment) if they are also the member of a household that receives material need assistance or that no longer receives such assistance as a result of being employed. Income from employment has to be at least at the amount of the minimum wage and at the maximum amount of two times the minimum wage. Such an employee will receive €126.44 over the first six months with this amount dropping to €63.07 for the later half year. Currently single individual loses claim to material need assistance immediately after being employed, even at the level of minimum wage.

**Social security contribution discounts** for students working on the basis of a simple work agreement **will be expanded**. The maximum monthly income for which social insurance contributions would not be paid on the basis of a temporary work agreement for students would thereby be increased to €200. Currently two limits are in place, €68 and €169, depending on the age of the student. The proposed simplification of the current system offers the same advantage to all students. A total of 185,000 temporary work agreements for students are

registered based on current data provided by the Social Insurance Agency (2013). A fiscal impact of €2.2 million is estimated in the first year that this measure is in place.

Beginning in November 2014 several groups of residents **will be afforded free travel on railways**. Free travel ticket will be provided to children, pupils, students under the age of 26 and pensioners. The estimated cost of this measure equals to €13 million.

## IV.2. Education and support for research and development

Education and support for research and development remain priority areas for the government. The objective is primarily to expand capacities in preschools and to gradually increase teachers' wages. The already proven system of teacher assistants assigned to disadvantaged students will be expanded. More complex support for research and development and a set of instruments for technology start-ups should reduce lagging in innovation performance in Slovakia.

Following **wage increases in regional education** by 5% in 2013 and 2014, the issue of wage increases in the following years has not yet been closed. Negotiations on a collective bargaining agreement of a higher degree for 2015 are currently under way.

The government has also committed to expanding **capacity in preschool facilities** with the objective of increasing the employment of women and integrating children from socially-disadvantaged environments.

A component of the new Specialised Education Act will include the introduction of **dual education**. Employers will also receive tax breaks when providing students of specialised schools with opportunities to earn practical experience. This will increase the motivation of employers to provide practical experience and create better prerequisites for the employment of graduates in fulltime jobs.

The allocation for **teacher assistants** in regional education will be increased by €7 million in 2015. Such funds are to cover wage expenses for new teacher assistants who will be assigned as needed to schools with disadvantaged children. This should completely cover demand from schools.

The introduction of a deduction for research and development costs from the tax base will have a positive effect on **investments into research** and development in Slovakia. Measures include a direct deduction of 25% of the total amount of such expenditure, along with 25% of the year-on-year increase in expenditure and 25% of the expenditure on wages for newly hired graduates.

## IV.3. Support for the business environment and growth

The government has prepared a comprehensive **set of instruments to support technology start-ups** to support the development and commercialisation of cutting edge technologies and highly innovative products and services. The focus is on ideas and solutions that are the result of innovations and business ideas from individual, whereby support is limited to the period just before the establishment of a company on through the third year following its establishment. New and existing instruments for improving cash flows, access to financing and supporting services (consulting, mentoring, incubators and co-working spaces) are also made available to companies through these measures. Likewise state support should be made more transparent to render it more administratively accessible and less burdensome for entrepreneurs who are just getting started.



## V. Comparison with the Stability Programme

The Stability Programme is based on data from the Ministry of Finance's official macroeconomic forecast from January 2014, which anticipated economic growth of 2.3% in 2014. The updated forecast from September 2014, which was used to compile the general government budget proposal, considers slightly higher economic growth in 2014 and lower growth in 2015. Additionally, the forecast from September 2014 was completed using the 2010 methodology for national accounts.

No.	Indicator	Unit of measure	Forecast (Stability Programme)*		Forecast (Budget proposal)	
			2014	2015	2014	2015
1	GDP, at current prices	€ billion	74.5	77.8	75.1	77.9
2	GDP, at constant prices	%	2.3	3.0	2.4	2.6
3	Final consumption of households and non-profits institutions serving households (NPISH)	%	1.2	2.2	2.9	2.4
4	Final general government consumption	%	1.9	-1.4	2.0	-3.8
5	Gross fixed capital formation	%	1.8	2.4	4.8	2.7
6	Exports of goods and services	%	4.0	4.5	4.6	4.3
7	Imports of goods and services	%	3.6	3.6	5.7	3.4
8	Average monthly wage in the economy (nominal growth)	%	2.5	3.5	4.2	3.3
9	Average employment growth, Labour Force Sample Survey (LFSS)	%	0.3	0.9	0.8	0.5
10	Average employment growth, ESA 2010	%	0.3	0.6	1.1	0.4
11	Average unemployment rate, LFSS	%	14.0	13.2	13.5	13.0
12	Average registered unemployment rate	%	13.7	13.0	12.8	12.3
13	Harmonised index of consumer prices (HICP)	%	0.8	2.1	0.1	1.0
14	Current account balance (percentage of GDP)	%	4.5	5.3	0.7	1.2

\*) In ESA 95 methodology.

Source: MoF SR

An improvement was noted in the general government balance in 2013 with unchanged budget targets for 2014 and 2015 in comparison with the Stability Programme. In the no-policy-change scenario, the difference is negligible and is caused by changes in macroeconomic assumptions.

	ESA Code	2013 % of GDP	2014 % of GDP	2015 % of GDP
<b>Target general government balances</b>	<b>B.9</b>			
Stability Programme		-2.8	-2.6	-2.5
Draft Budgetary Plan		-2.6	-2.6	-2.5
<b>Difference</b>		<b>0.1</b>	<b>0.0</b>	<b>0.0</b>
<b>General government balances based on no-policy-change scenario</b>	<b>B.9</b>			
Stability Programme		-2.8	-2.8	-3.7
Draft Budgetary Plan		-2.6	-2.9	-3.5
<b>Difference</b>		<b>0.1</b>	<b>-0.1</b>	<b>0.1</b>

Source: MoF SR

## ANNEXES

### Annex 1: One-off measures for the purposes of calculating the structural balance

Based on the definition provided in the General Government Budgeting Rules Act, a one-off and temporary effect is understood as any such revenue or expenditure that is not permanent or recurrent in nature and that has a limited impact on the general government's budget balance. The Ministry of Finance of the Slovak Republic published a manual<sup>33</sup> defining detailed rules for the recording of individual measures pursuant to European Commission methodology. In the future the Ministry of Finance plans to cooperate with the Council for Budgetary Responsibility (RRZ) in preparing unified national methodology for identifying one-off and temporary effects.

A reassessment of one-off measures took place this year due to the change in ESA 2010 methodology. The change affected the transfer of accumulated assets into the 2nd pillar into a pay-as-you-go system, which is no longer considered government revenues. The following one-off measures were identified for 2013 to 2017:

1. In 2014 the Telecommunications Office reported an extraordinary revenue from the proceeds of the electronic auction of available frequency bands to operators known as the digital dividend. The final revenue from the digital dividend was €164 million.
2. A repayable financial assistance was granted to the Cargo Slovakia, a. s. railway company from state financial assets in 2009. This transaction had an impact on the deficit and general government debt in 2009. Completed instalments, pursuant to ESA 2010 methodology, are considered a capital transfer with a positive effect on the general government budget deficit. Only extraordinary extra instalments on a provided repayable financial assistance (Resolution of the Government of the Slovak Republic No. 390/2013) are considered one-off effects given their extraordinary amount and the lack of recurrence in other years.
3. The legal action conducted by the Antimonopoly Office against construction companies suspected of operating a cartel came to a close at the beginning of 2014. The verdict was upheld by the Supreme Court of the Slovak Republic.

<b>Table A: One-off and temporary measures (ESA 2010, in € million)</b>						
	2013	2014 B	2014 E	2015	2016	2017
	-	-	-	-	-	-
Digital dividend	-	250	164	-	-	-
Repayment of Cargo repayable financial assistance (capital transfer in 2009)	-	78	78	-	-	-
Antimonopoly Office fine - construction cartel	-	-	45	-	-	-
<b>TOTAL</b>	-	<b>328</b>	<b>287</b>	-	-	-

(+) improvement in the balance, (-) worsening of the balance

Source: MoF SR

<sup>33</sup> <https://www.finance.gov.sk/Default.aspx?CatID=9595>



## Annex 2: Investment clause

The table below provides a current estimate of expenditure for co-financing the Operational Programmes included in the investment exception.

<b>Table A: Co-financing expenditures by Operational Programme (€ million)</b>		
	<b>2014 E</b>	<b>2015</b>
<b>2nd programming period, of which</b>	<b>361.1</b>	<b>312.6</b>
ERDF	169.1	109.1
ESF	48.9	44.5
Cohesion Fund	105.3	114.2
EAGF	1.1	0.0
EAFRD	36.0	44.5
EFF	0.7	0.3
<b>3rd programming period, of which</b>	<b>71.8</b>	<b>261.7</b>
ERDF	0.1	94.0
ESF	0.6	33.5
Cohesion Fund	0.0	55.9
EAGF	54.0	25.3
EAFRD	17.1	52.6
EMFF	0.0	0.3
<b>Structural and Cohesion Funds, total</b>	<b>324.0</b>	<b>451.3</b>
Agricultural funds, total	108.9	123.0
Other co-financing to EU funds	15.6	98.6
<b>National co-financing, total</b>	<b>448.4</b>	<b>672.8</b>
<b>% of GDP</b>	<b>0.6</b>	<b>0.9</b>

Source: MoF SR

## **Annex 3: Assumptions for the quantification of revenue measures**

### **Changes in depreciation of property**

#### *Introduction of a new, 6th depreciation group with a depreciation period of 40 years*

Quantification is based on the annual data provided by the Statistical Office of the Slovak Republic on the consumption of fixed capital (depreciation) indexed for 2015 - 2017. The distribution of the overall level of depreciation into individual depreciation groups is based on data from international comparison (CBT - Corporate Tax Ranking, Oxford University). Another reference material is the share of office buildings in the total number of buildings within the depreciation group with a depreciation period of 20 years.

#### *Retention of accelerated depreciation for the 2nd and new 3rd depreciation group*

Quantification is based on the difference between technical straight-line and accelerated depreciation in the configured parameters according to the amended legislation. Calculation is based on the annual data provided by the Statistical Office of the Slovak Republic on the consumption of fixed capital (depreciation) indexed for 2015 - 2017. The distribution of the overall level of depreciation into individual depreciation groups is based on data from international comparison and an expert estimation from the Ministry of Finance.

#### *Unification of the depreciation of fixed assets acquired through financial lease with other forms of acquiring fixed assets.*

Quantification is based on the differences between the means of depreciating financial leases and standard forms of depreciation while accepting additional assumptions regarding the share of leasing depreciation. The calculation uses annual data from the Statistical Office of the Slovak Republic on the consumption of fixed capital (depreciation) indexed for 2015 - 2017.

#### *Introduction of the obligation to include undeducted VAT for taxpayers who apply claim to deduct such amounts using a coefficient into the input price of fixed and intangible assets.*

The calculation is based on the use of individual VAT tax declarations for 2013 and specifically data on the share of the output of firms subjected to VAT on total output. The share of depreciation attributed to the individual depreciation groups was defined on the basis of an expert estimation using data from an international comparison of depreciation groups.

### **Thin capitalisation rules**

Quantification is based on currently available individual tax declarations for the 2012 tax year. It uses data on the amount of interest from loans and borrowings in transactions involving foreign dependants and data on EBITDA (earnings before interest, taxes, depreciation and amortisation) from individual income statements.

### **Measures to increase tax collection effectiveness**

#### *Expansion of obligation to maintain records of revenues in electronic cash registers (ECR)*

Quantification of the effects of the expanded obligation to use ECR on VAT and corporate income tax revenues is based on the following assumptions:

- The introduction of ECR in individual sectors shall contribute to decreasing the VAT shortfall by 10% (the sector tax shortfall was estimated by the Institute for Financial Policy in cooperation with the International Monetary Fund)



- In selected sectors with a lower number of transactions and higher amounts, for instance architectural services, the decrease in the tax shortfall is expected at a level of 5%. The lower estimate is also based on the assumption that the service users for these sectors will not have the obligation to furnish a cash register receipt (or proof of payment) in the case of administrative activities connected to the given service (e.g. building permission).
- Additional corporate income tax revenues are based on the estimate of expected VAT revenues. These revenues were estimated as a multiple of the share of corporate income taxes in VAT and the expected VAT revenues as a result of ECR introduction.
- The differences in the reporting from relevant medical offices and household expenditures on these services were the driving reason for the introduction of ECR for out-patient services provided by general practitioners, specialised physicians and dentists. The difference between household expenditure for health services (according to the Statistical Office of the Slovak Republic) and revenues reported by relevant medical offices (according to Ministry of Health data) represented approximately €214 million in 2011.

The estimated positive effect of expanding the obligation to maintain records of revenues in electronic cash registers with full-year applicability is expected to generate €72 million.

*Introduction of a withholding tax for pharmaceutical companies on financial considerations provided to physicians.*

Quantification of the effect is based on data from pharmaceutical companies regarding financial and non-financial considerations from 2011 to 2013 taking into account the actual amounts of tax exempt considerations (registration fees for education, etc.).

#### **Deduction of research and development expenditure**

The calculation is based on the current level of applying domestic expenditure on research and development indexed for 2015 - 2017 on the basis of available Eurostat data for the Slovak Republic.

## Annex 4: Application of the constitutional Fiscal Responsibility Act

The following section describes the calculation of consolidated general government expenditures based on the Act on Budgetary Responsibility.

Given current assumptions, expenditure shall increase in 2015 compared to the approved budget for 2014 given **the addition of new entities into the public sector**. Reclassification of the Railways of the Slovak Republic (ŽSR) occurred in the spring of 2014. The general government budget proposal for 2015 - 2017 includes new general government entities that will be reclassified into this sector in the autumn of 2014 for the first time. Such entities include the National Motorway Company (NDS), the transportation companies in Bratislava, Košice, Banská Bystrica and Žilina, the Emergency Oil Stock Agency (EOSA) and Exim Banka. This methodology change automatically increases the level of consolidated general government expenditure in 2015 compared to the approved budget for 2014 without any government interference into budgetary policy. The total effect on the consolidated expenditures from these entities totals €625 million in 2015. Given to the on-going autumn Eurostat notification round based on the new methodology and the lack of financial statements for healthcare facilities, the government's budget proposal anticipates negative fiscal performance from healthcare facilities amounting to €50 million in 2015.

The second important factor in increasing consolidated expenditures is the transition to ESA 2010 methodology and the resulting **differences in reporting of specific items** with a total effect of €496 million in 2015. This total of €496 million includes tax credits amounting to €257 million. The remainder includes research and development expenditure amounting to €218 million. Another methodology change is the change in the calculation of imputed social contributions amounting to €17 million and the redirection of contributions to the Deposit Protection Fund amounting to €3 million through state budget revenue and expenditure (without any effect on the general government budget deficit).

The general government budgets for 2014 and 2015 are incomparable, however, due to the reclassification of several entities. For this reason the approved budget for 2014 can only be compared to the 2015 budget net of these entities and additional changes resulting from ESA 2010.

**Table A: Consolidated general government expenditure pursuant to the Act on Budgetary Responsibility (€ million)**

	General government budget 2014 - 2016	General government budget proposal 2015 - 2017		
	2014	2015	2016	2017
<b>1 Nominal consolidated general government expenditures</b>	<b>28,050</b>	<b>29,622</b>	<b>29,363</b>	<b>30,107</b>
2 Expenditures for servicing state debt	1,341	1,256	1,271	1,272
3 EU funds	1,198	1,682	1,117	1,389
4 State budget funds for co-financing Slovak and EU programmes	640	673	489	541
5 Transfers to the EU	683	738	750	746
6 Expenditures to remedy damages from natural disasters	11	11	11	11
<b>7 Adjusted expenditures* (1-2-3-4-5-6)</b>	<b>24,177</b>	<b>25,262</b>	<b>25,725</b>	<b>26,148</b>
8 Effect of reclassification of entities to the general government and ESA 2010 methodology	-	1,121	1,111	1,143
9 Volume of required decrease in consolidated expenditures (7(t)-7(2014))	0	1,086	1,548	1,971
<b>10 Volume of required decrease net of ESA 2010 effects (9-8)</b>		<b>-35</b>	<b>437</b>	<b>828</b>
<b>11 in % of GDP</b>		<b>-0.04</b>	<b>0.5</b>	<b>1.0</b>

Note: General government budget 2014-2016 in ESA 95 and general government budget proposal 2015-2017 in ESA 2010

Source: MoF SR

\* Basis for blocking pursuant to Article 12 (5) (c)



Once the 55% debt threshold is exceeded, the individual **municipalities and higher territorial units are obliged to approve budget for the following year with expenditures capped at a maximum of the budgeted expenditures for the previous year** (except for EU funds and co-financing and expenditures to remedy damages caused by natural disasters). This means that municipalities and higher territorial units cannot approve expenditures in their 2015 budgets that are higher than the original budgets for 2014 approved at the end of 2013.

**Anticipated local government expenditures** based on the government's budget proposal respect the constitutional debt brake placed on the local governments as applied during their budget approval processes for 2014. Municipal expenditures on a consolidated basis in 2015 amounting to €3,047 million in 2015, €3,002 million in 2016 and €2,996 million in 2017 are included in nominal consolidated general government expenditures. Higher territorial unit expenditures amount €765 million in 2015, €759 million in 2016 and €756 million in 2017.



## Annex 5: Required Tables

**Table 0i - Basic assumptions**

	2013	2014	2015
Short-term interest rate (annual average)	0,2	0,2	0,1
Long-term interest rate (annual average)	2,6	2,1	2,3
USD/€ exchange rate (average)	1,328	1,340	1,271
World GDP growth	3,2	3,4	4,0
Nominal effective exchange rate (change in %)	-0,9	-1,5	0,3
EA GDP growth	-0,4	0,7	1,3
Growth of relevant foreign markets	0,5	2,0	1,8
World imports growth	3,0	4,4	6,1
Oil prices (Brent, USD/barrel)	108,8	107,3	106,8

Source: MoF SR

**Table 0ii - Main assumptions**

	2013	2014	2015
1. External environment			
Oil prices (€)	81,9	80,1	84,0
2. Fiscal policy			
Net lending/net borrowing of the general government	-2,6	-2,9	-2,0
Gross debt of the general government	54,6	54,1	54,4
3. Monetary policy, financial sector			
Interest rates:			
3M Euribor (average)	0,2	0,2	0,1
Deposit rates	1,0	0,8	0,7
Yield to maturity of 10-year Slovak government bonds (average)	2,6	2,1	2,3
Evolution of deposits	3,1	4,8	5,0
4. Demographic trends			
Evolution of working-age population	0,3	-0,1	-0,1
Total dependency ratio	39,8	40,4	41,1

Source: MoF SR





**Table 1.a - Macroeconomic overview**

	ESA Code	2013 Level	2013 rate of change	2014 rate of change	2015 rate of change
1. Real GDP	B1*g	66,9	1,4	2,4	2,6
of which					
1.1 Attributed to the estimated impact of aggregated budgetary measures on economic growth		-	-	-	0,5
2. Potential GDP		69,2	2,3	2,3	2,3
contributions:					
- labour		-	0,2	0,1	0,1
- capital		-	-0,1	0,1	0,2
- total factor productivity		-	2,2	2,1	2
3. Nominal GDP	B1*g	73,6	2,0	2,1	3,7
Components of real GDP					
4. Private final consumption expenditure	P.3	33,7	-0,7	2,9	2,4
5. Government final consumption expenditure	P.3	11,1	2,4	2,0	-3,8
6. Gross fixed capital formation	P.51g	14,4	-2,7	4,8	2,7
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-0,1	-0,1	0,5	0,4
8. Exports of goods and services	P.6	65,2	5,2	4,3	4,3
9. Imports of goods and services	P.7	56,7	3,8	5,7	3,4
Contributions to real GDP growth					
10. Final domestic demand		-	-0,6	2,8	1,2
11. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0,6	0,7	0,0
12. External balance of goods and services	B.11	-	1,8	-0,4	1,3

Source: MoF SR

**Table 1.b - Price developments**

	ESA Code	2013 Level	2013 rate of change	2014 rate of change	2015 rate of change
1. GDP deflator		1,10	0,5	-0,4	1,1
2. Private consumption deflator		1,24	1,3	0,0	1,0
3. HICP		122,93	1,5	0,1	1,0
4. Public consumption deflator		1,2	1,1	0,4	1,5
5. Investment deflator		1,04	0,4	-0,7	1,3
6. Export price deflator (goods and services)		1,05	-1,9	-3,2	1,6
7. Import price deflator (goods and services)		1,15	-1,4	-3,5	1,8

Source: MoF SR



**Table 1.c - Labour market developments**

		2013	2013	2014	2015
	ESA Code	Level	rate of change	rate of change	rate of change
1. Employment, persons (thousands) [1]		2 192	-0,8	1,1	0,4
2. Employment, hours worked (million)[2]		3 881	-1,8	0,6	0,6
3. Unemployment rate (%)[3]			14,2	13,5	13,0
4. Labour productivity, persons (EUR) [4]		29 917	1,7	1,3	2,2
5. Labour productivity, hours worked (EUR) [5]		16,9	2,8	1,8	2,0
6. Compensation of employees (EUR million)	D.1	26 988	0,3	4,2	3,3
7. Compensation per employee (EUR)		12 311	1,1	3,2	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	2013	2014	2015
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	3,5	2,4	2,9
of which:				
- Balance of goods and services		6,0	5,3	6,0
- Balance of primary incomes and transfers		-3,9	-4,5	-4,8
- Capital Account		1,4	1,6	1,7
2. Net lending/net borrowing of the private sector	B.9	6,1	5,3	4,9
3. Net lending/net borrowing of the general government	EDP B.9	-2,6	-2,9	-2,0
4. Statistical discrepancy		0,0	0,0	0,0

Source: MoF SR

**Table 2a: General government budgetary targets broken down by subsector**

	ESA code	2014 % GDP	2015 % GDP
<b>Net lending (+) / net borrowing (-) (EDP B.9) by sub-sector</b>			
1. General government	S.13	-2,9	-2,0
2. Central government	S.1311	-2,7	-2,4
3. State government	S.1312	-	-
4. Local government	S.1313	-0,1	0,3
5. Social security funds	S.1314	0,0	0,1
6. Interest expenditure	D.41	1,85	1,70
7. Primary balance (1+6)		-1,1	-0,3
8. One-off and other temporary measures		0,4	0,0
9. Real GDP growth (%)		2,4	2,6
10. Potential GDP growth (%)		2,3	2,3
contributions:			
- labour		0,1	0,1
- capital		0,1	0,2
- total factor productivity		2,1	2,0
11. Output gap (% of potential GDP)		-3,3	-3,0
12. Cyclical budgetary component		-1,3	-1,2
13. Cyclically-adjusted balance (1-12) (% of potential GDP)		-1,6	-0,8
14. Cyclically-adjusted primary balance (13+6) (% of potential GDP)		0,2	0,9
15. Structural balance (13-8) (% of potential GDP)		-2,0	-0,8

[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 2b: General government debt development**

	ESA code	2014	2015
1. Gross debt <sup>1</sup>		54,1	54,4
2. Change in gross debt		-0,5	0,3
<b>Contribution to change in gross debt</b>			
3. Primary balance		-1,1	-0,3
4. Interest expenditures	D.41	1,8	1,7
5. Stock-flow adjustment		-2,3	-0,2
of which:			
- Differences between cash and accruals <sup>2</sup>		-0,1	0,0
- Net accumulation of financial assets <sup>3</sup>		-2,4	-0,3
of which: privatisation proceeds		0,0	-1,3
- Valuation effect and other <sup>4</sup>		0,1	0,0
p.m. Implicit interest rate on debt <sup>5</sup>		3,4	3,3
<b>Other relevant factors</b>			
6. Liquid financial assets <sup>6</sup>		3,7	4,5
7. Net financial debt (1-6)		50,4	49,8
8. Debt amortization (existing bonds) since the end of the previous year		4,8	3,8
9. Percentage of debt denominated in foreign currency		4,3	3,5
10. Average maturity <sup>*</sup>		6,7	6,8



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

Source: MoF SR

**Table 2c: Contingent liabilities (% GDP)**

	2013	2014	2015
Public guarantees	13,95	-	-
of which			
linked to the financial sector	0		

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

General government (S13)	ESA code	2014 % GDP	2015 % GDP
1. Total revenue at unchanged policies	TR	36,6	35,6
Of which			
1.1. Taxes on production and imports	D.2	10,5	10,0
1.2. Current taxes on income, wealth, etc.	D.5	6,5	6,3
1.3. Capital taxes	D.91	0,0	0,0
1.4. Social contributions	D.61	13,4	13,4
1.5. Property income	D.4	0,7	0,7
1.6. Other <sup>1</sup>		5,4	5,1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) <sup>2</sup>		30,4	29,8
2. Total expenditure at unchanged policies	TE	39,5	39,1
Of which			
2.1. Compensation of employees	D.1	7,2	7,1
2.2. Intermediate consumption	P.2	4,6	4,8
2.3. Social payments	D.62, D.632	18,4	18,0
of which Unemployment benefits <sup>4</sup>		0,2	0,2
2.4. Interest expenditure	D.41	1,8	1,7
2.5. Subsidies	D.3	0,8	0,8
2.6. Gross fixed capital formation	P.51	3,5	3,3
2.7. Capital transfers	D.9	0,8	0,8
2.8. Other <sup>5</sup>		2,4	2,6

Note.: Data for 2014 represent expected results



**Table 4a: General government expenditure and revenue targets, broken down by main components**

General government (S13)	ESA code	2014 % GDP	2015 % GDP
1. Total revenue target	TR	36,6	36,0
Of which			
1.1. Taxes on production and imports	D.2	10,5	10,4
1.2. Current taxes on income, wealth, etc.	D.5	6,5	6,6
1.3. Capital taxes	D.91	-	-
1.4. Social contributions	D.61	13,4	13,2
1.5. Property income	D.4	0,7	0,7
1.6. Other <sup>1</sup>		5,4	5,1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) <sup>2</sup>		30,4	30,2
2. Total expenditure target	TE <sup>3</sup>	39,5	38,0
Of which			
2.1. Compensation of employees	D.1	7,2	7,0
2.2. Intermediate consumption	P.2	4,6	4,6
2.3. Social payments	D.62 <sup>6</sup> , D.632	18,4	17,8
of which Unemployment benefits <sup>4</sup>		0,2	0,2
2.4. Interest expenditure	D.41	1,8	1,7
2.5. Subsidies	D.3	0,8	0,8
2.6. Gross fixed capital formation	P.51	3,5	2,9
2.7. Capital transfers	D.9	0,8	0,7
2.8. Other <sup>5</sup>		2,4	2,7

[1] P.11+P.12+P.131+D.39r+D.7r+D.9r (except D.91r)

[2] D.29p + D.4p (except D.41p) +D.5p +D.7p +P.52+P.53+NP+D.8.

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

	ESA code	2013	2013	2014	2015
		mill. eur	% GDP	% GDP	% GDP
1. Expenditure on EU programmes fully matched by EU funds revenue		957	1,3	1,9	2,2
2. Cyclical unemployment benefit expenditure		28	0,04	0,04	0,03
3. Effect of discretionary revenue measures		1272	1,7	0,1	0,4
4. Revenue increases mandated by law		0	0	0	0

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

	2014		2015	
	% GDP	% GG E	% GDP	% GG E
Education	3,9	9,8	3,7	9,8
Health	5,6	14,1	5,3	14,0
Employment	0,23	0,59	0,26	0,68

Note: TE – Total expenditures of general government.

Source: Eurostat



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

Functions	COFOG code	2014		2015	
		% of GDP	% TE	% GDP	% TE
1. General public services	1	6,7	16,8	5,5	14,3
2. Defence	2	0,9	2,4	0,9	2,5
3. Public order and safety	3	2,0	5,1	1,9	5,0
4. Economic affairs	4	4,4	11,1	5,0	13,1
5. Environmental protection	5	0,5	1,3	0,5	1,2
6. Housing and community amenities	6	0,6	1,4	0,4	1,1
7. Health	7	5,6	14,1	5,3	14,0
8. Recreation, culture and religion	8	1,1	2,7	0,9	2,3
9. Education	9	3,9	9,8	3,7	9,8
10. Social protection	10	14,0	35,3	13,9	36,6
<b>Total expenditure</b>	<b>TE</b>	<b>39,5</b>	<b>100,0</b>	<b>38,0</b>	<b>100,0</b>

Note: TE – Total expenditures of general government

**Table 5a: Discretionary measures taken by General Government (against NPC)**

Measures	Subsector	ESA2010	Budgetary impact
<b>1. Keeping VAT rate at 20 %</b>	<b>S.1311</b>	<b>D.211R</b>	<b>0,3</b>
<b>2. Changes in tax depreciation methodology</b>			<b>0,2</b>
- Longer depreciation period for administrative buildings (from 20 to 40 years)	S.1311	D.51R	0,09
- Limits to accelerated depreciation method	S.1311	D.51R	0,04
- Abolishing of favourable leasing amortization	S.1311	D.51R	0,02
- Amortization of certain expenditures with VAT coefficient	S.1311	D.51R	0,05
<b>3. Measures for increased tax collection effectiveness (electronic cash registers and pharmaceutical companies)</b>	<b>S.1311</b>	<b>D.211R</b>	<b>0,07</b>
- Compulsory use of electronic cash registers	S.1311	D.51R	0,07
- Withholding tax for fin. and non-financial benefits of pharmaceutical companies	S.1311	D.51R	0,00
<b>4. Transfer pricing rules</b>	<b>S.1311</b>	<b>D.51R</b>	<b>0,07</b>
<b>5. Expenditure deductions for R&amp;D</b>	<b>S.1311</b>	<b>D.51R</b>	<b>-0,03</b>
<b>6. Tax expenditure audit</b>	<b>S.1311</b>	<b>D.51R</b>	<b>0,02</b>
of which: increase in contribution allowance for students	S13.14	D.61R	0,00
<b>Other non-tax revenue</b>			<b>-0,07</b>
- Lower fees from FOV and EOSA	S.1311	D.29A	-0,04
- Higher administrative fees of municipalities	S.1311	P.11	0,15
- Grants and transfers of state budget and public universities	S.1311	D.7R	-0,07
- Other lower revenues from refunds	S.1311	D.7R	-0,09
- Other non-tax revenue	S.1311	P.11	-0,02
<b>1. Keeping VAT rate at 20 %</b>	<b>S.1311</b>	<b>D.211R</b>	<b>0,3</b>
<b>2. Changes in tax depreciation methodology</b>			<b>0,2</b>
- Longer depreciation period for administrative buildings (from 20 to 40 years)	S.1311	D.51R	0,09
- Limits to accelerated depreciation method	S.1311	D.51R	0,04
- Abolishing of favourable leasing amortization	S.1311	D.51R	0,02
- Amortization of certain expenditures with VAT coefficient	S.1311	D.51R	0,05
<b>3. Measures for increased tax collection effectiveness (electronic cash registers and pharmaceutical companies)</b>	<b>S.1311</b>	<b>D.211R</b>	<b>0,07</b>
- Compulsory use of electronic cash registers	S.1311	D.51R	0,07



<b>7. Savings in healthcare</b>			<b>0,13</b>
- payment for persons insured by the state, pay	S.1311	D.6P	0,13
- payment for persons insured by the state, rec	S.1314	D.61R	-0,13
- transfer for healthcare facilities	S.1311	D.6P	0,13
<b>Other changes against NPC, of which</b>			<b>0,64</b>
- state budget	S.1311		0,1
- public universities	S.1311		0,05
- other general government entities	S.1311		0,07
- municipalities	S.1313		0,4
- healthcare providers and Social Insurance Agency	S.1314		0,03
<b>Total</b>			<b>1,55</b>
<b>- tax and social contributions revenue</b>			<b>0,50</b>
<b>- non-tax revenue</b>			<b>-0,07</b>
<b>- current expenditure</b>			<b>0,62</b>
<b>- capital expenditure</b>			<b>0,50</b>

Note (+) means increase in revenues or decrease in expenditures

Source: MoF SR

Table 6.a: NRP response to specific recommendations for Slovakia		
CSR number	Measure	Objectives
1		Following the correction of the excessive deficit, reinforce the budgetary measures for 2014 in the light of the emerging gap of 0.3% of GDP relative to the Stability and Growth Pact requirements based on the Commission 2014 spring forecast. In 2015, ensure the required adjustment of 0.1% of GDP towards the medium-term objective taking into account the expected weak economic conditions. Thereafter, until the medium-term objective is achieved, pursue an annual structural adjustment of 0.5% of GDP as a benchmark. Further strengthen the fiscal framework, also by introducing binding and enforceable expenditure ceilings. Improve the long term sustainability of public finance by increasing the cost-effectiveness of the health-care sector, in particular by rationalising hospital care and management and by strengthening primary care.
1	Consolidation of public finance	Planned measures include: maintaining the VAT revenue and increasing the collection efficiency, cash registers for doctors and other professions, withholding income tax and financial and non-financial considerations from pharmaceutical companies, annual account of the Social Insurance Company, savings in intermediate consumption (ESO).
1	Balanced financial management of faculty and university hospitals	On average, the health care facilities established by the Ministry of Health of the Slovak Republic will operate on a balanced budget without needing additional financial assistance from the state budget and that their indebtedness will be considerably reduced. The measures aimed at streamlining the use of financial resources from health insurance companies and own revenues will ensure a balanced performance of hospitals by 2015.
2		Improve the efficiency of the tax administration by strengthening its audit, risk assessment and debt collection capacity. Link the basis for real-estate taxation to the market value of the property.
2	Combating tax frauds	The third stage of the Action Plan in the form of measures to improve tax collection: in particular centralization of information from the toll system, motor vehicle and population register, access to information on accounts of investigated persons and companies. Introduction of the Electronic Registry of Insolvent Entities, Register of Disqualified Persons and rating of tax entities. In addition, specialized senates at regional courts focused on taxes will be established. Data about payment of the corporate income tax at the level of individual companies together with revenues, costs and profit/loss will be disclosed
2	Analytical capacities	Strengthening analytical capacities and building an analytical unit at the Financial Administration of SR
2	Real-estate taxation	Based on the data on prices of residential properties and their characteristics, an estimated model allows for the market value estimation of the property. The first steps of a new taxing system will be implemented after 2015.



3	More effectively address long-term unemployment through activation measures, second-chance education and tailored quality training. Enhance the capacity of public employment services for case management, personalised counselling and activation of jobseekers, and strengthen the link between activation and social assistance. Effectively tackle youth unemployment by improving early intervention, in line with the objectives of a youth guarantee. Improve incentives for women's employment, by enhancing the provision of child-care facilities, in particular for children below three years of age.	
3	Health contribution allowance and minimum wage increase to 380 EUR	An increase in minimum wage and simultaneous introduction of health contribution allowance will increase net wages without increasing labour costs.
3	In-work benefit within the system of assistance in material need	In-work benefit within the system of assistance in material need will be provided simultaneously up to a certain wage threshold, which will increase the disposable income of unemployed or inactive persons for several months after their hiring.
3	Contribution relief	The implemented contribution relief waived social contributions, applicable up to 67% of the average wage two years ago for a newly-hired employees, who were long-term unemployed for the period of one year.
3	Public employment services reform	Prioritisation of counselling and personalised public employment services, including an increase in their administrative capacities with the aim to improve the access to employment for long-term unemployed persons, low-skilled workers, older people and women. Centralisation of the database of job seekers and beneficiaries of social benefits, assembly and connection with relevant institutions. Analysis of net efficiency and effectiveness of expenditures of individual measures of the ALMPs.
3	Enhancing the provision of child-care facilities	Building of new child-care facilities, especially for children of aged 0 - 3. Extending the capacities of kindergartens, extending the existing forms of education by preparatory kindergarten classes and extending the time subsidy for pre-school education.
4	Take measures to increase the quality of teaching in order to raise educational outcomes. Reinforce the provision of work-based learning in companies in vocational education and training. Adapt accreditation, funding and governance measures to encourage the creation of profession-oriented bachelor-level programmes. Improve the quality and relevance of the science base and implement plans to foster effective knowledge transfer and co-operation between academia, research and business. Adopt systemic measures to improve access to high quality and inclusive pre-school and school education for marginalized communities, including Roma and take steps to increase their wider participation in vocational training and higher education.	
4	Practical training in VET education (dual education)	Firms participating in dual education system will receive financial benefits through tax system, which will increase placement of VET graduates on the labour market.
4	Higher wages for teachers	The wages of teachers in regional schools were increased in 2014 by 5% (42 eur).
4	Teacher's assistants	Within the inclusion of marginalized groups, the project of assistants in schools will be extended and the budget will increase by 6 million EUR by 2015.
4	Marginalized groups pre-school inclusion	The support of social inclusion and positive changes in communities specialized on marginalized Roma groups through community centres. Publishing textbooks and educational texts in the Slovak and Roma languages.
5	Step up efforts to make the energy market function better, in particular by increasing the public transparency of the regulatory framework and by exploring the determinants of the high electricity network charges, notably for industrial consumers. Building on the progress made so far, further develop interconnections with neighbouring countries, including with Ukraine, accordingly to the Memorandum of Understanding signed in April.	
5	Disclosure of an analysis of all major changes in the regulatory period policies	Publishing of papers and underlying analysis for all the changes in regulatory policy.
5	Data warehouse	Building a data centre on the web site of the Regulatory Office for Network Industries.
5	Interconnections of networks	Connection of gas networks with Poland and Hungary. Connection of electricity systems with Hungary.
6	Take measures, including by amending the Act on Civil Service, to increase the independence of the public service. Adopt a strategy to improve the management of human resources in public administration. Step up efforts to strengthen analytical capacity in key ministries with a view to adopting evidence-based policies, and improving the quality of policy impact assessment. Take steps to fight corruption and accelerate efforts to improve the efficiency and quality of the judicial system. Introduce measures to improve business environment including for SMEs. Step up efforts to improve the efficiency of public procurement.	
6	Public service reform	A public administration reform will bring its de-politicisation and more transparency at all levels, from





		hiring staff to remuneration.
6	Increasing efficiency of justice system	Shortening the length of legal proceedings, Electronic Case File, Introduction of the Electronic Legal Code
6	Improving business environment	Government will prepare measures to improve business environment with the aim to decrease the administrative burden, mainly in the areas of establishment of business companies, tax collection and cross-border trade.
6	Efficient, reliable and open state administration - ESO Reform	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. Reforms will continue in that part of the local government, which is not involved in the merger of offices. In 2015, 46 Labour offices will lose legal entity and pass under the direct regulatory responsibility of the Labour, Social Affairs and Family. Ongoing transformation state budgetary and subsidized organizations in order to reduce their number will continue also in 2015.

**Table 6.b: EU targets for growth and jobs**

National 2020 headline target	Measure	Objective
Employment	Health contribution allowance and minimum wage increase to 380 EUR	An increase in minimum wage and simultaneous introduction of social security contribution allowance will increase net wages without increasing labour costs.
	In-work benefit within the system of assistance in material need	In-work benefit within the system of assistance in material need will be provided simultaneously up to a certain wage threshold, which will increase the disposable income of unemployed or inactive persons for several months after their hiring.
	Contribution relief	The implemented contribution relief waived social contributions, applicable up to 67% of the average wage two years ago for newly-hired employees, who were long-term unemployed for the period of one year.
	Public employment services reform	Prioritisation of counselling and personalised public employment services, including an increase in their administrative capacities with the aim to improve the access to employment for long-term unemployed persons, low-skilled workers, older people and women. Centralisation of the database of job seekers and beneficiaries of social benefits, assembly and connection with relevant institutions. Analysis of net efficiency and effectiveness of expenditures of individual measures of the ALMPs.
Research and development	Measures from the RIS3 Strategy Action Plan	The support of the key areas (material research and nanotechnology, information and communication technologies, biomedicine and biotechnology, industrial technology, power engineering, agriculture and environment) through stabilizing public resources and promoting private financing of R&D.



	Slovak Academy of Science transformation	Organizations of the Slovak Academy of Sciences will be transformed into a new form of independent legal entities - public research institutions. This will eliminate the barriers preventing more intensive cooperation with the private sector in R&D and enable to use private resources to finance their R&D activities.
	Start-ups support	Educative and networking activities for start-ups, organize start up events as well as a direct support of particular business plans and involvement of Slovak start-ups with the biggest potential in international start-ups networks. The state will also support implementation of educative and information activities for entrepreneurs, focused on increasing the use of different e-tools and services in enterprising which will help their companies increase the chance to be successful in the global market.
Climate change and energy	In 2012, greenhouse gas emissions outside the ETS sectors were 6,7% lower than in 2005. Hence, the Government is far exceeding its commitment to increase emissions by no more than 13%.	
	In 2012, energy from renewable sources accounted for 10,4% of gross final consumption. This means that at unchanged policies, Slovakia will most likely exceed the 14% target set for 2020.	
	Energy audits for SMEs	Support of the energy audits for SME and their implementation will increase energy their efficiency and increase the competitiveness.
	Higher energy efficiency of houses through innovative financial instruments (JESSICA - ŠFRB)	Since June 2013, the State Fund for Housing Development has been offering advantageous loans – through the JESSICA project – with a zero interest rate and 15-year repayment period for restoration of residential and non-residential buildings in urban areas. EUR 11.5 million were earmarked for this purpose in 2013. After meeting minimum thermal and technical requirements for the reconstruction quality, it is possible to fund even 80% of total costs.
Education	Enhancing the provision of child-care facilities	Building new child-care facilities, especially for children of aged 0 - 3. Extending the capacities of kindergartens, extending the existing forms of education by preparatory kindergarten classes and extending the time subsidy for preschool education.
	Higher wages for teachers	The wages of teachers in regional schools were increased in 2014 by 5% (42 eur). The increase will depend on various criteria including performance of a teacher.



	Practical training in VET education (dual education)	Firms participating in dual education system will receive financial benefits through tax system, which will increase placement of graduates on the labour market.
	Better quality of university education	Increasing quality of university education, changes making accreditation easier, change of rigid rules for guarantor selection.
Poverty and social inclusion	Teacher's assistants	Within the inclusion of marginalized groups, the project of assistants in schools will be extended by 6 million EUR by 2015.
	Marginalized groups preschool inclusion	The support of social inclusion and positive changes in communities specialized on marginalized Roma groups through community centres. Publishing textbooks and educational texts in the Slovak and Roma languages.