Draft Budgetary Plan

of the Slovak Republic for 2016

October 2015

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Summary

The primary objective of Slovakia's fiscal policy is to ensure effective and sustainable public finance, facilitating permanent growth of quality of life, which with regard to the closing of output gap requires continued efforts towards revitalising public finance until reaching a structurally balanced budget. Following a significant post-crisis consolidation leading to the exit from the excessive deficit procedure, the general government deficit will remain under the 3% of GDP threshold both in 2014 and 2015. The 2016 budget proposal with deficit of 1.93% of GDP corresponds to the structural balance consolidation by 0.8 percentage points. The strategic objective of reaching the MTO in 2017 does not change, owing to the ambition of further significant reduction of deficit to the level of 0.4% of GDP in 2017. In 2018, the Slovak economy is expected to reach balanced budget for the first time in the history of Slovakia. Assuming no changes in economic policies, the deficit would reach 2.2% of GDP in 2016. The consolidation included in the budget is on the expenditure side. The on-going consolidation and solid economic growth will lead to a decrease of the general government debt to safe levels. According to the current forecast, gross debt should gradually fall under the level of 49% of GDP in 2018, while net debt should decline towards 45% of GDP. The government's medium-term budgetary strategy is still fully compliant with both national and European fiscal rules.

According to the preliminary data from the autumn notification, the public finance deficit reached 2.79% of GDP in 2014. Mainly higher tax revenues contributed to the improvement compared to the spring deficit notification in the amount of 2.87% of GDP. In regard to general government deficit in 2015, additional risks compared to the budgetary objective of 2.49% of GDP were identified in the amount of 0.25% of GDP. These risks followed mainly from the anticipated amount of EU funds corrections (0.30% of GDP). Other expenditure risks are fully matched by higher revenues. If the risks materialise, the deficit will reach 2.74% of GDP in 2015. The fiscal position in 2015 will be evaluated as neutral and compliant with the European rules requirements. In the case of inclusion of corrections into one-off measures, which is more correct from the economic point of view, the structural balance will decrease by 0.2% in 2015 compared to 2014.

The government proposal of general government budget for 2016 is drawn up with a deficit of 1.93% of GDP. It also lays down the budgetary objectives for the following years, namely a deficit of 0.42% of GDP in 2017 corresponding to MTO, and for the first time balanced budget in 2018. In case budgetary objectives are met, the fiscal performance of general government excluding interest payments will be close to a balanced budget in 2016 and will result in primary surplus since 2017 onwards. With the economic performance approaching its potential in 2016 and a slight overheating since 2017, the fiscal policy will be restrictive again since 2016. Taking into account the current estimates of budget balance for the year 2015, structural consolidation amounting to 0.8% of GDP will take place in 2016. To reach the MTO, consolidation in the amount of 1.1% of GDP will be needed in 2017. Major part of the consolidation is already included in the current budget proposal.

Structural balance (% of GDP)
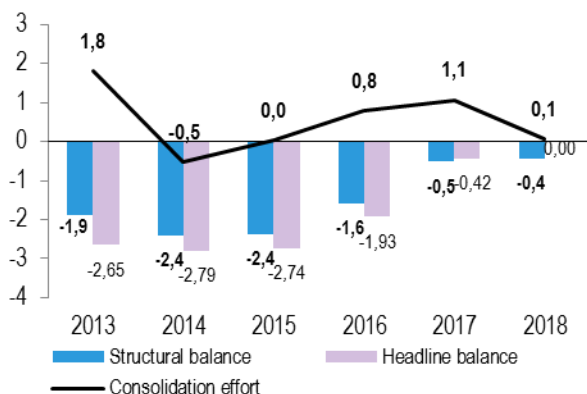
Source: MoF SR

General government gross debt (% of GDP)
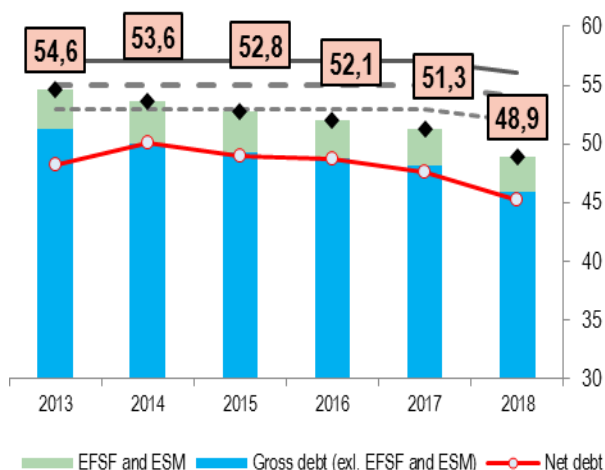
Source: MoF SR

Assuming no changes in economic policies, the general government deficit would reach the level of 2.2% of GDP in 2016. The difference in the general government balance between the no-policy-change scenario and the 2016 budget proposal totals 0.25% of GDP. On the expenditure side, the difference compared to the NPC amounts to 0.3% of GDP. The financing of social package, increasing of wages and provisions for lower VAT on selected foodstuff are compensated by savings in other areas. Overall, current expenditure should fall by 0.6% of GDP and capital expenditure should go down by 0.1% of GDP. On the revenue side, the overall development compared to the NPC is expansive at the level of 0.1% of GDP. The general government deficit in the no-policy-change scenario would reach 1.8% of GDP in 2017 and 1.6% of GDP in 2018. Also in the coming years, the consolidation in the budget is focused on the expenditure side with a slight fiscal impulse on the revenue side.

General government gross debt reached 53.6% of GDP in 2014 and fell for the first time since the outbreak of the financial crisis in 2008. In the coming period, it should gradually fall under 49% of GDP in 2018. Hence, at the end of the budgetary period, it should drop **under the lower sanction bound for breaching the debt brake limits**. The decline in debt is driven mainly by the planned improvements of the primary balance and a robust GDP growth. Net debt culminated around the 50% of GDP level at the end of 2014 and should gradually fall to 45% of GDP in the following years.

General government revenues and expenditures in ratio to GDP are significantly lower compared to the EU average. From the 2015 level which was supported by higher draw-down of EU funds, a decline is expected in the following years. The decline on the revenue side in the long run is also connected with non-existent indexation of part of revenues, resulting in their fall in ratio to GDP (for instance, in the case of real estate taxes and administrative fees). On the other hand, the ongoing fight against tax evasion is helping to increase revenues at present, bringing additional revenues on VAT alone at the level of 0.9% of GDP in 2015 compared to 2012. On the expenditure side, expenditures on general public services and economic area will fall the most. Compared to the average of EU28 and V3 (year 2013), Slovakia will spend a greater share of general government expenditures on healthcare in 2016 (by 5.1 p.p. compared to V3, by 3.2 p.p. compared to EU28).

Comparison of general government expenditures development (% of GDP)
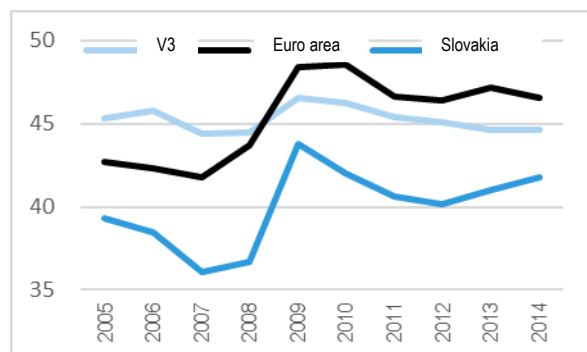
Source: MoF SR

Effective VAT rate (%)
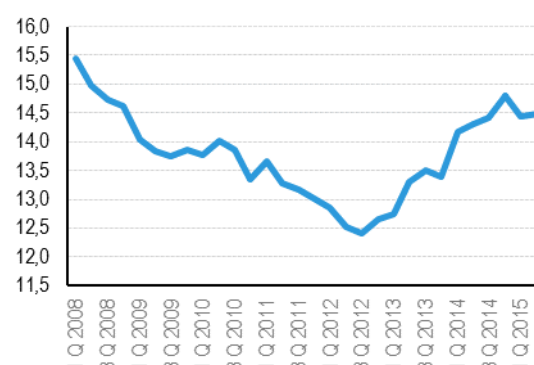
Source: MoF SR

The government has prepared a set of structural measures aimed at boosting the economic growth and employment. Major challenges faced by the Slovak economy include the labour market, healthcare and elementary education. As regards the education sector, the government focuses on, in particular, linking the vocational education and apprenticeship (dual education), development of new kindergartens, and supporting the integration of marginalised communities. The positive development in the labour market will be further supported by the employment services reform and extension of active labour market policy tools. In healthcare, the government will focus on the development of data and information infrastructure and benchmarking of prices of large expenditures. The government also plans a comprehensive reform of decision-making processes relative to its operation, investments, policies and regulations based on the value for public money.

In the medium-term horizon, the draft budgetary plan is based on the general government budget proposal for 2016 to 2018. 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 developments of fiscal position, the forecast of the economy and a description of budgetary policy measures to achieve the defined medium-term objectives is a specific monitoring instrument. The presented data will enable, apart from other things, a more detailed assessment of the development of public finance in the coming year, which are based on the current general government budget proposal as opposed to the Stability Programme. The European Commission will subsequently publish its opinion on the budgetary plan. If a serious breach of the Stability and Growth Pact is identified, the Commission may request that the concerned Member State redrafts its budgetary plan.

The content and the format of the document are fully based on the European Commission guidelines. Similarly to the Stability Programme, draft budgetary plans are prepared on the basis of documents specifying the minimum requirements for draft budgetary plans – updated Specifications on the implementation of the Two Pack and Guidelines on the format and content of draft budgetary plans, economic partnership programmes and debt issuance reports.

I.   Macroeconomic assumptions of the budget proposal

The Slovak economy will keep its solid growth rate next year in spite of a slower growing foreign demand. Slowdown will occur mainly in China and Russia, but also at our neighbours. The impact of the foreign demand slowdown on the growth of the Slovak economy will be still dampened by low oil prices. Household consumption will accelerate thanks to solid growth of labour market and continuing low inflation; however, the dynamics of public investments will ease off. The growth structure will be more balanced compared to 2015. Slovakia's economic growth will slowly accelerate, reaching 3.6% at the end of the forecasted period. Risks of the macroeconomic forecast are balanced.

I.1.   External assumptions in the forecast

The development of global economy is dominated by two opposing trends. An optimistic outlook is based mainly on the results of the US economy. On the other hand, the development of large emerging economies casts doubts about the future growth of the world economy. The outlook of China's economic growth was significantly downgraded. And Russia with Brazil, two large countries, struggle with deepening economic recession. The economy of Europe has returned to growth trajectory. In addition to external factors, the space for a more significant growth in the euro area is also restricted by the continuing uncertainty over the institutional set-up of the monetary union and significant macroeconomic imbalances.

Tightening of monetary policies in the world has been postponed. The key factors for the continued relaxed monetary conditions are the persistent low inflation caused mainly by low commodity prices and the increased risk of slowdown of the global growth. The European Central Bank (ECB) continues in the quantitative easing programme with no changes for now; however, its significant transmission into the real economy is expected as late as next year. Considering mainly the results of labour market, the US Federal Reserve has not yet undertaken the long-awaited rate hike in spite of a good condition of the US economy.

At the end of August, equity markets all around the world experienced a significant turmoil. The chaos on the Chinese equity market driven by negative growth outlook for the Chinese economy led to a slump of the Shanghai Composite index. The fall corresponded to the erasure of profits reported during the last year which were considerably above the fundamentals of the Chinese economy. The contagion has spread to all world stock markets. However, the sell-off of European or US indices was of a temporary nature. Following the July's agreement between Greece and creditors, bond yields fell across all euro area countries. However, the contagion towards other peripheral countries was restricted even in the period prior to the agreement. At the end of summer, the trend of falling yields was enhanced by investors' pivot away from risky assets.

Oil prices reached a new post-crisis low in August. The forecast expects only a moderate growth of oil prices in line with the futures market. Oil markets are significantly influenced by supply factors which are dominated by the OPEC decision not to reduce oil production. Lack of demand from large emerging economies started to influence oil prices during the year. Weakening demand in China also led to a fall of prices of other commodities in world stock markets.

Chart 1: Development of oil prices and other commodities
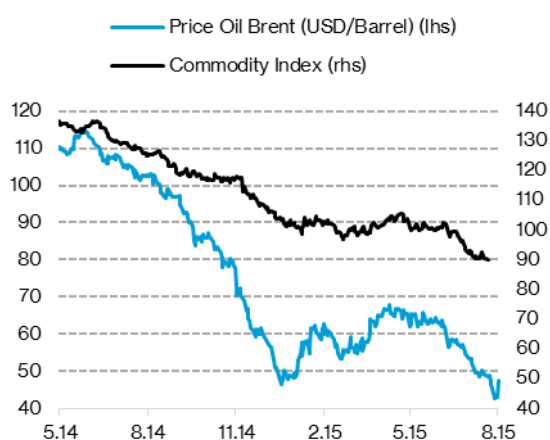
Chart 2: Development of confidence indicators in the euro area countries
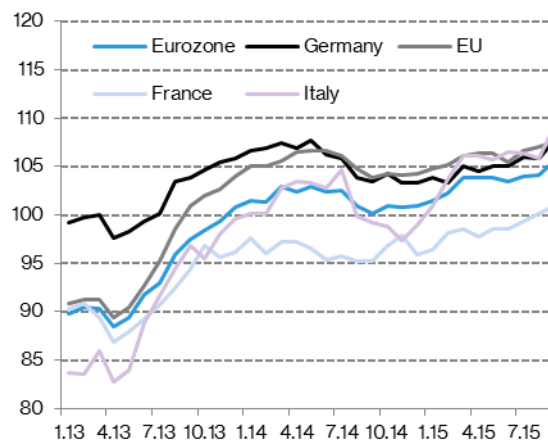
The economy of Europe grew; however, the growth no longer accelerates. In the first half-year 2015, the euro area grew by 1.5% YoY. The German economy experienced similar and balanced growth in terms of sectors. Early indicators in the euro area forecast keeping of the pace of economic activity also in the second half of the year, but with no further acceleration. The economies of the Czech Republic, Poland and Hungary grew similarly to the Slovak economy, twice as fast than the EU average. The growth in these countries is largely supported by accelerated draw-down of EU funds.

The prospects of the economic growth in 2016 have slightly deteriorated. Growth in the euro area will accelerate to around 1.8% (compared to 1.5% in 2015). However, the economies of neighbouring countries outside the euro area will grow slower, since their growth will not be supported by the investment stimulus in the form of draw-down of EU funds. The outlook for next year deteriorated also in response to the significant correction of the expected growth of large emerging economies (China, Russia, and Brazil).

I.2.   Macroeconomic forecast

The growth of the Slovak economy did not ease off in the second quarter. An increase by 0.8% (QoQ) is one of the highest in the past three years. The growth was driven exclusive by domestic demand. The on-going positive development of the labour market along with a historically low inflation support the acceleration of household consumption growth. Public investments pick up speed mainly thanks to the infrastructure projects co-financed from the EU funds. On the other hand, export reported the expected correction in the second quarter following an extraordinarily strong beginning of the year. Growth in domestic demand led to an acceleration in the growth of imports with net exports ultimately working against the GDP growth.

The Slovak economy will grow by more than 3% both this and next year. Exports will return to their growth trajectory since the second half of this year owing to the continued growth of foreign demand, although more slowly than in the first half of the year. The slowdown of Chinese economy will affect Slovak exports mainly through a lower demand from Germany. A weaker economic performance of our main trading partners will be fully reflected as late as in 2016. Accelerated growth of loans supported by relaxed monetary policy and growing rate of capacity utilization will boost the acceleration of private investment growth next year. Public investments,

however, will not repeat the 2015 results. Household consumption will speed up thanks to higher growth of real disposable income. Deceleration in the growth of domestic demand will lead to a weaker growth of imports, thus net exports will again have positive contribution to the growth after two years. The economic growth will pick up its speed to 3.6% in the following years. Its structure will be balanced with a slight predominance of domestic demand.

Chart 3: Contributions to GDP growth – quarterly (p.p.)
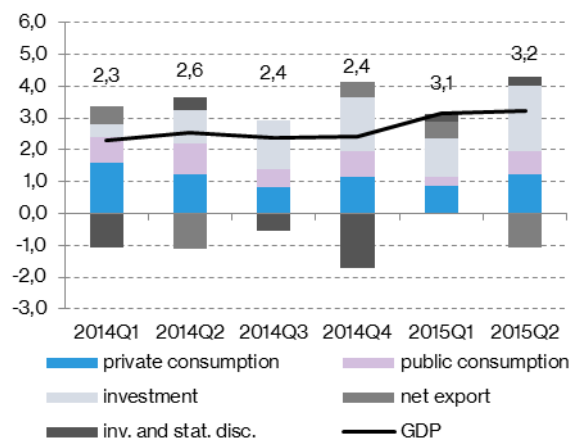
Chart 4: Contributions to GDP growth - forecast (p.p.)
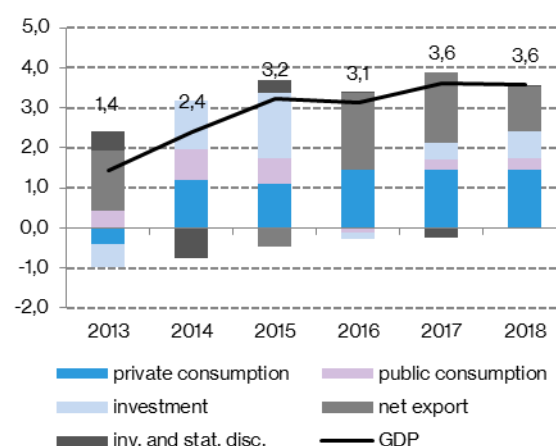
Source: MoF SR

Source: MoF SR

Fast growth of employment will continue in 2016. The pace of employment growth will ease off slightly, however, it will still reach solid 1%, i.e. 24 thousand new jobs. Jobs will be created evenly across all sectors of the economy, except for the public sector. Unemployment rate will attain 10.6% thanks to the positive development. Although we expect a moderate slowdown of the labour market dynamics in the following years, the unemployment rate will still fall to a single-digit level.

Nominal wage will grow at the pace of 3.1% in 2016, an acceleration compared to the year 2015. Growth of real wages will be lower compared to the growth of real labour productivity. In terms of sectors, wages in the public sector will report the most dynamic development, while the market services will experience the lowest pace. In the following years, we expect acceleration of the growth of nominal wages beyond 4% in line with an increase of nominal labour productivity and return of standard price development.

Chart 5: Contribution of sectors to employment growth (p.p.)
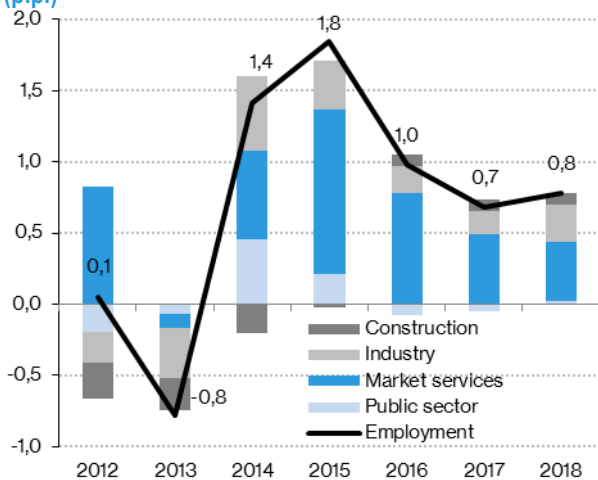
Chart 6: Development and forecast of inflation, including contributions of single components (p.p.)
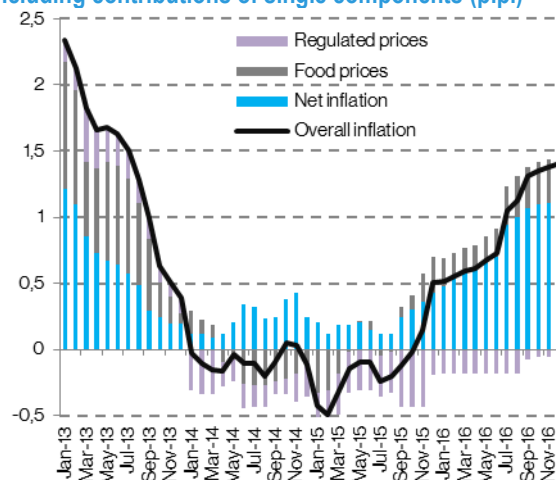
Source: MoF SR

Source: MoF SR

Inflation will accelerate to the 0.9% level next year. Falling commodity prices in world markets will lead to a decrease of electricity, gas and heat prices for households at the beginning of the year. Foodstuff prices will start to grow gradually; however, a decrease of VAT on selected foodstuff will partially retard that trend. Growth of fuel prices will speed up gradually in line with the expected development of oil prices and euro exchange rate. The awaited effect of quantitative easing and delayed influence of euro depreciation will have an inflationary effect on the prices of other imported goods. A delayed transmission of demand factors ensuing from the solid performance of labour market should gradually reflect in a slower acceleration of prices of services. However, demand factors will be still limited considering the slowly closing output gap. Inflation will reach standard levels in the following years of the medium-term horizon.

The macroeconomic forecast risks are balanced. The slowing growth of emerging markets, taking into account specific problems faced by several major economies (China, Russia, and Brazil) is **the main negative risk** of the forecast. Impact of the VW scandal on the German economy and automotive industry at a world-wide level pose just a slight negative risk. **The main positive risk is arrival of Jaguar Land Rover to Slovakia,** leading to an increase of GDP by 0.5 p.p. in 2016.

Box 1 - Estimate of the output gap for 2015 and 2016

According to the forecast of the Ministry of Finance, using the EC methodology, Slovakia's negative output gap is estimated at around 1.2% in 2015 and to fall to 0.7% in 2016. The economy will approach its potential, however, still remaining below it. According to the methodology of the Ministry of Finance, negative output gap is estimated to reach 0.8% and 0.4% in 2015 and 2016.

The aim of the presented output gap forecast is to converge, in terms of methodology, to the estimate of the European Commission (EC) which will be used to assess the structural position of Slovakia's budget. Hence, the Ministry of Finance applied the EC's uniform methodology to estimate the output gap. However, the data about the condition of the economy after 2015 are based on the September forecast of the Ministry of Finance. The goal is to replicate the output gap based on the latest forecast of the Ministry of Finance using the EC's uniform methodology.

The EC's methodology consists of two steps. In the first step, the estimates and forecasts are made for the trend unemployment rate which is consistent with a stable growth of wages in the economy (the so-called NAWRU) and for the trend component of total factor productivity (the so-called TFP trend). For this purpose, **the EC applies 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 EC's model are not yet available, the Ministry of Finance used the NAWRU and TFP trend contained in the EC's spring forecast. In the second step, the estimated trend components of unemployment (NAWRU) and total factor productivity (TFP trend) are used as inputs to forecast the actual output gap in the CONV programme. The output gap estimate model in the CONV programme is based on the decomposition of the production function of the economy into labour, capital and total productivity factor contributions.

The Ministry of Finance's estimate of the potential of the economy and the output gap differs methodologically from the EC's 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 negative output gap is estimated to reach 0.8% in 2015 and 0.4% in 2016.** The output gap will fully close in 2017.

The differences in Ministry of Finance and EC methodologies concern almost all calculation components, 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 the 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 common method of the EC. Slovakia, as a small open economy, faced a significant supply shock caused by the adopted structural reforms. The excessively high output gap in 2007 – 2008, which follows from the EC method, is not confirmed by other imbalance indicators such as net inflation, balance of the current account of the balance of payments and unit labour costs. Dynamic growth of real estate market is a partial exemption to the rule.

Chart A: Output gap development (% of potential GDP) **– EC approach and methodology of the Ministry of Finance**
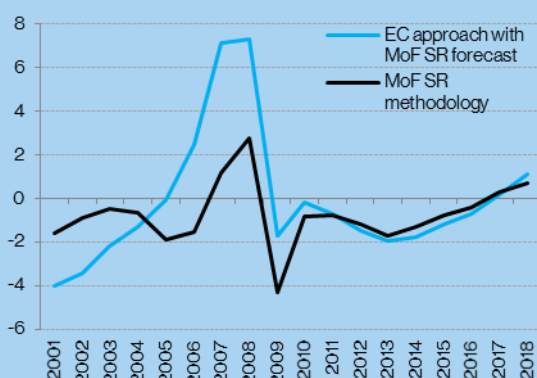
Source: MoF SR

Table A: Contributions of production factors to the potential product growth – EC approach

	Pot. GDP (growth, %)	TFP[*]	Capital stock	Labour
2010	3.3	**2.2**	**0.5**	**0.6**
2011	3.3	**1.9**	**0.8**	**0.6**
2012	2.4	**1.8**	**0.2**	**0.3**
2013	1.9	**1.9**	**-0.1**	**0.1**
2014	2.2	**1.9**	**0.0**	**0.2**
2015F	2.6	**2.1**	**0.4**	**0.1**
2016F	2.6	**2.2**	**0.3**	**0.2**
2017F	2.6	**2.3**	**0.3**	**0.0**
2018F	2.6	**2.4**	**0.4**	**-0.2**

*Total factor productivity   *Source: MoF SR*

In the period following the spring forecast of the EC, the data about the capacity utilization in industry entering the GAP programme of the EC **were considerably revised in the case of Slovakia**. EC is using these data for the breakdown of TFP into a trend component and a cyclical component. The revision considerably influenced the resulting output gap according to the EC methodology: the pre-crisis overheating fell down, the output gap in the crisis year deepened **and the estimates made with the use of the EC and Ministry of Finance methodologies do not show any significant differences after the year 2009**. Since the revision of the EC's output gap estimate is just a consequence of the revision of input data about the use of production capacities and is not caused by changes in the calculation method, the output gap according to the EC will still not satisfactorily reflect the significant supply shocks such as the planned arrival of Jaguar Land Rover car factory. EC has published its revised output gap estimate based on the spring forecast for this year in the AMECO database.

I.3.   Forecast assessment by the Macroeconomic and Tax Revenue Forecasting Committees

All members of the Macroeconomic Forecasting Committee (NBS, ČSOB, Infostat, SLSP, Tatrabanka, Unicredit, VÚB 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 slightly more conservative than the median of the Macroeconomic Forecasting Committee members in terms of effects on budgetary revenues in 2016. The effect is expressed as weighted average of individual relevant bases for budgetary revenues, where weights are given by the share of individual taxes in the total budgetary revenues[1].

Chart 7: Comparison of forecasts of macroeconomic bases[1] for budgetary revenues with Committee members
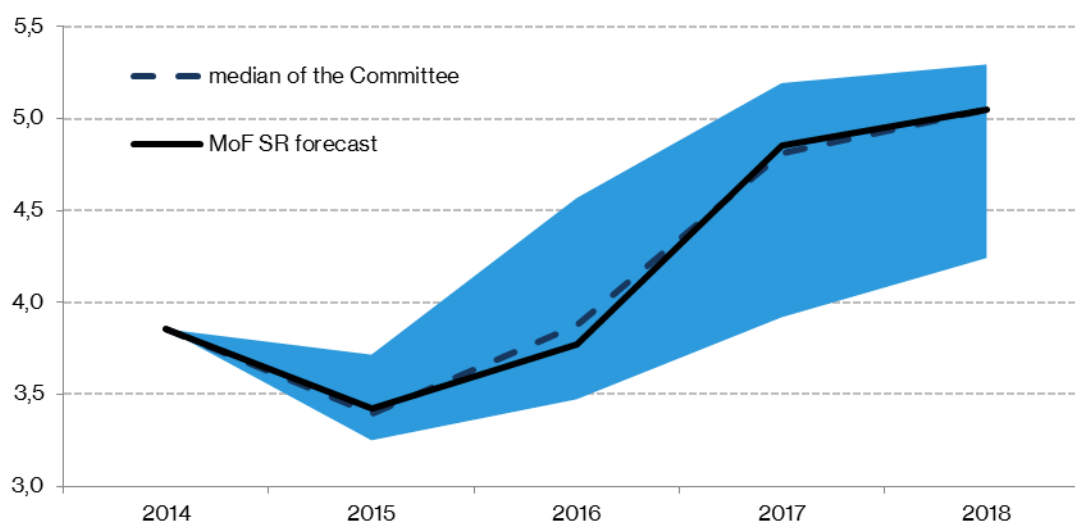
The updated tax revenue forecast prepared by the Ministry of Finance of the Slovak Republic and included in the budget proposal is a follow-up to the macroeconomic forecast which was **evaluated by all** members of the Tax Revenue Forecasting Committee (KRRZ, NBS, Infostat, SISP, ČSOB, UniCreditBank, and Tatrabanka) 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 attain 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.

In addition to the Ministry of Finance officials, the committees consist of representatives of institutions independent from the government (NBS, Slovak Academy of Sciences, Infostat, and private banks). Members of the Macroeconomic Forecasting Committee 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

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[1] 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%.

members of the Tax Revenue Forecasting Committee by submitting their own forecasts; their assessment is calculated automatically, based on a deviation between the two. **A Ministry of Finance's forecast is accepted as committee forecast if a simple majority of members grade the forecast as *conservative* or *realistic*.** 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 as committee forecast.

II.   Budgetary objectives

The primary objective of Slovakia's fiscal policy is to ensure effective and sustainable public finance, facilitating permanent growth of quality of life, which with regard to the closing of output gap requires continued efforts towards revitalising public finance until reaching a structurally balanced budget. Following a significant post-crisis consolidation leading to the exit from the excessive deficit procedure, the general government deficit will remain under the 3% of GDP threshold both in 2014 and 2015. The current budget proposal with the deficit at 1.93% of GDP allows a repeated acceleration of consolidation since 2016. The strategic objective of reaching the MTO in 2017 does not change, owing to the ambition of significant reduction of deficit to the level of 0.4% of GDP in 2017. In 2018 onwards, the Slovak economy is expected to reach balanced budget for the first time in the history of Slovakia. The on-going consolidation and solid economic growth should lead to a decrease of the general government debt to safe levels. According to the current forecast, the debt should gradually fall under the level of 49% of GDP in 2018. The government's medium-term budgetary strategy is still fully compliant with both national and European fiscal rules.

II.1.   Recent development in public finance

The currently estimated general government deficit in 2015 is 2.74% of GDP. The estimate is based on the macroeconomic and tax forecasts from September 2015, current development of the budget and identified risks.

Table 1: Current estimate of general government balance in 2015 (difference against the approved budget) [2]

	€ million	% of GDP
Approved general government budget deficit (ESA2010)	**-1,940**	**-2.49**
Difference against the approved budget	**-184**	**-0.24**
Revenues		
Higher draw-down of EU funds	503	0.6
Higher revenues from grants and transfers	228	0.3
Higher tax revenues	442	0.6
Higher revenues from contributions (except for insurance paid by the state)	278	0.4
Higher non-tax revenues	89	0.1
Higher insurance paid by the state	64	0.1
Expenditures		
Higher capital expenditures	1,014	1.3
Higher expenditures on healthcare	273	0.4
Higher compensations paid to employees	269	0.3
Corrections of EU funds	235	0.3
Higher intermediate consumption	161	0.2
Lower other transfers	-91	-0.1
Savings on interest payments	-53	-0.1
Other (positive influence)	*20*	*0.0*
Expected general government deficit (ESA2010)	**-2,123**	**-2.74**

Source: MoF SR

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[2] Changes adjusted for revenues and expenditures of healthcare facilities, methodological impact of tax credits reporting, tax revenues (from tax assignation) used for financing NGOs` welfare activities and reserve for improved collection of taxes.

The most significant change compared to the approved budget is **an increase in general government capital expenditures by more than €1 billion, largely connected with an improved draw-down of EU funds and grants**.

On the expenditure side, **also expenditures on healthcare, compensations paid to employees and on intermediate consumption are higher** compared to the approved budget. These are partially compensated by **lower transfers and savings on interest payments**. The lower level of transfers is connected mainly with a decrease in the contribution to the EU (by €57 million) in connection with the adopted reviews of EU budget in the course of the year 2015.

Beyond the government's control, **corrections of EU funds**, which are based on audit findings and **amount to €235 million** had also **negative influence on the budget**.

The negative developments are largely compensated by higher revenues. **The general government's tax and contribution revenues** are expected **to increase by €720 million** (0.9% of GDP)[3] **in the ESA2010 methodology** compared to the forecast used for the budget. Collection of health and social contributions is positive, overtaking even the favourable development of the labour market. In 2015, an increase in revenues from healthcare contributions is also attributable to a lower number of health contribution allowance claims[4]. Higher revenues are also expected from corporate income tax, especially thanks to better collection. Likewise, there has been an improvement in the collection of VAT and excise taxes.

Table 2: Tax and social security contribution revenues of the general government in 2015 – difference against the budget (including penalties)

	€ million
Total (1+2)	**720**
1. Tax revenues	**442**
- Corporate income tax	256
- Value-added tax	130
- Excise taxes	39
2. Contribution revenues	**278**
- Public health insurance, including penalties	166
- Social insurance, including penalties	112

Source: MoF SR

Non-tax revenues increased by €89 million compared to the budget. Mainly public universities (€30 million), Railways of the Slovak Republic (€21 million) and municipalities (€11 million) contributed to the increased collection of non-tax revenues.

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[3] The general government budget for 2015 – 2017 contemplated an improvement in collection of taxes by €300 million beyond the scope of tax revenues approved by the Tax Revenue Forecasting Committee (TRFC) in November 2014. In particular, €150 million on CIT, €100 million on VAT, and €50 million on excise taxes.

[4] The budget included an estimate that 90% of eligible insureds will claim the health contribution allowance. At present, only about one quarter of the total number of approximately 400 thousand eligible insureds of VšZP are claiming the allowance. In the light of that development, there is a one-off increase in accrual revenues from healthcare contributions amounting to €120 million in 2015, since the annual settlement of healthcare contributions for the year 2015, which will be made next year, falls in the year 2016 on accrual basis.

II.2.   Structural balance and expenditure benchmark

There are analytical indicators for monitoring of the development of the government's budgetary policy that capture the fiscal position better than the official headline balance of general government. **The first indicator is the structural balance which represents nominal balance of the general government adjusted for economic cycle effects and one-off and temporary budgetary effects**. The medium-term budgetary objective of Slovakia is reaching of a structurally balanced budget, defined by structural deficit amounting to 0.5% of GDP. Year-on-year changes in the structural balance level represent consolidation effort. Consequently consolidation pace towards the medium-term budgetary objective can be evaluated. **The second indicator is the expenditure benchmark, which serves to assess the pace of growth of the general government expenditures.** According to the expenditure benchmark, the growth of expenditures controlled by the government should not exceed the potential economic growth unless the increase is matched by additional revenue measures. Both indicators are crucial when assessing compliance with the preventive arm of the Stability and Growth Pact[5].

II.2.1. Structural balance

The first step in calculating the structural balance is the adjustment of the general government balance for the effects of economic cycle (boom or recession) on the general government revenues and expenditures, i.e. the cyclical component. The Ministry of Finance fully transposes the EC's estimate of the general government balance sensitivity to changes in the output gap, which is based on the OECD methodology[6]. In the second step, the general government balance is adjusted for one-off and temporary measures. The Ministry of Finance published a manual[7] specifying detailed rules for the identification of one-off and temporary effects.

These analytical adjustments result in a structural balance, which shows the general government budget balance under the assumption that the economy performs at its potential level, excluding one-off and temporary budgetary measures. The development of structural balance compliant with European fiscal rules is a basis for the setting of fiscal policy targets (for more see Annex 2).

Table 3: Consolidation effort (ESA 2010, % of GDP)

	2013	2014	2015 E	2016	2017	2018
1. Net borrowing / lending	**-2.65**[1]	**-2.79**[1]	**-2.74**	**-1.93**	**-0.42**	**0.00**
2. Cyclical component	-0.8	-0.7	-0.5	-0.3	0.1	0.4
3. One-off effects	0.0	0.3	0.1	-0.1	0.0	0.0
4. Structural balance (1-2-3)	**-1.9**	**-2.4**	**-2.4**	**-1.6**	**-0.5**	**-0.4**
5. Consolidation effort (YoY change 4)	**1.8**	**-0.5**	**0.0**	**0.8**	**1.1**	**0.1**
- investment clause – co-financing from EU funds		-0.4				
Consolidation effort adjusted for investment clause		**-0.2**				
p.m. required consolidation effort [2]	*EDP*	*0*	*0*	*0.25*	*0.5*	*MTO*
p.m. Net borrowing / lending – spring notification	*-2.59*	*-2.87*				

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[5] Vade mecum on the Stability and Growth Pact, European Economy. Occasional Papers. 151. May 2013. Brussels.
[6] 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 Member States in September 2014.
[7] https://www.finance.gov.sk/Default.aspx?CatID=9595

[1] On the basis of data sent to the Eurostat within autumn EDP notification.

[2] In 2013, Slovakia was in excessive deficit procedure. In 2018, consolidation is not required provided that the MTO is met.

Source: MoF SR

Provided that the deficit reaches 2.74% of GDP in 2015, the structural deficit should maintain its last year's level of 2.4% of GDP. **An almost neutral fiscal policy with the economy still slightly under its potential corresponds to the consolidation effort required by European fiscal rules.** However, an economically meaningful evaluation of the fiscal policy is complicated by the reporting of EU corrections from the entire second programming period in the years 2013-2015 (for more, see Box 2).

The budget proposal for 2016 with the deficit at 1.93% corresponds to the structural consolidation effort of 0.8% of GDP. Due to the maintained deadline for reaching the medium-term budgetary objective, more significant consolidation in 2017 is needed. To achieve the MTO, structural balance will need to be reduced by 1.1% of GDP in 2017. In 2018, the structural deficit should additionally slightly improve up to the level of 0.4% of GDP in accordance with the plan to achieve nominally balanced budget for the first time in the history of Slovak Republic. The planned development of the balance in the entire horizon by the year 2018 is fully compliant with the consolidation effort required by the European fiscal rules.

Box 3 – Fiscal position of Slovakia

Slovakia's fiscal position can be illustrated depending on the change in the structural primary balance and the cyclical indicator of output gap. This view expresses whether the country's fiscal policy is pro-cyclical or anti-cyclical.

The traditional approach compares the change in the structural primary balance to the current level of output gap. That can illustrate how the fiscal policy responds to the economic cycle (the need of a more significant consolidation in good times and of a fiscal stimulus in the case of worse economic development). A slightly different approach follows the change of output gap instead of the level of output gap. The advantage of that approach is its greater stability, since revisions of the size of output gap are more frequent than the revisions of its year-on-year change. To determine the required consolidation effort, the EC also follows the level of output gap and its year-on-year change. For instance, in the case of closing the output gap, greater consolidation effort is required than in the case of opening the output gap.

According to those approaches, After the anti-cyclical fiscal expansion in 2014, savings on interest payments are used for a moderate anti-cyclical fiscal impulse in 2015. The use of a greater than potential economic growth for consolidation is expected since the year 2016. And since 2017, the consolidation should have anti-cyclical restrictive effect on the economy.

Chart A: Change of primary structural balance compared to the output gap level (% of GDP)
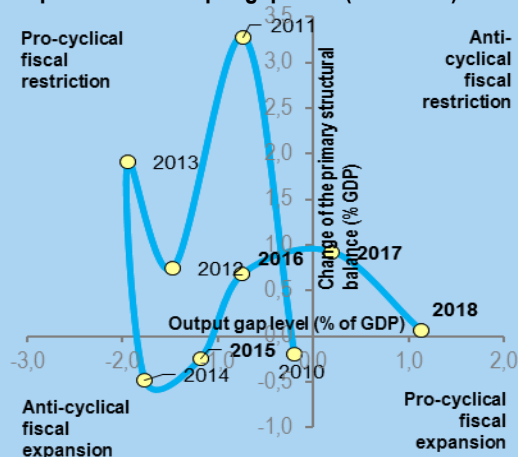
Chart B: Change of primary structural balance compared to the output gap change (% of GDP)
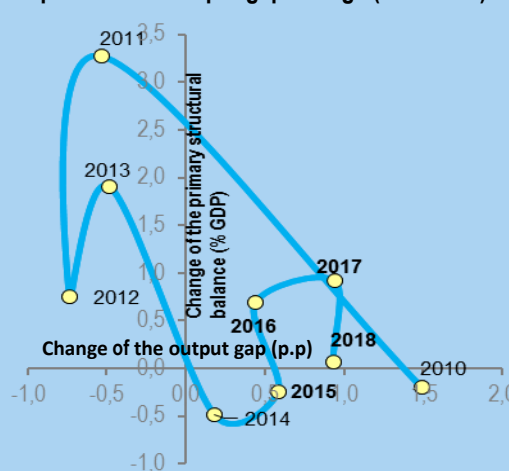
Source: MoF SR

Source: MoF SR

If Slovakia meets its budgetary objectives, it will get close to a primary structural balanced budget in 2016 (deficit of 0.1% of GDP) and consequently reach a primary structural surplus of around 1% of GDP in 2017. Slovakia achieved comparable results of primary structural balance only in the period between 2002 and 2005.

To achieve the budgetary objectives, consolidation of primary structural balance in the amount of 1.7% of GDP is needed compared to the anticipated result in the year 2015 until the year 2018. The objective can be achieved considering previous consolidations. By way of contrast, cumulated consolidation of primary structural balance was 5.5% of GDP in the years 2010 – 2013.

Chart C: 3-year change of primary structural balance (% of GDP)
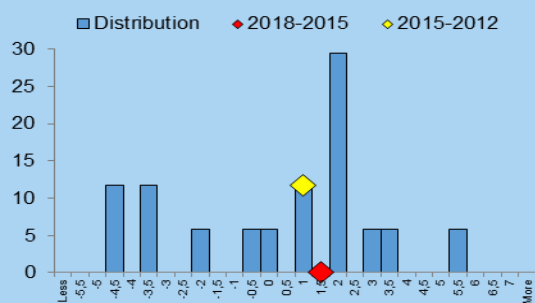
Source: MoF SR

Chart D: 3-year average level of primary structural balance (% of GDP)
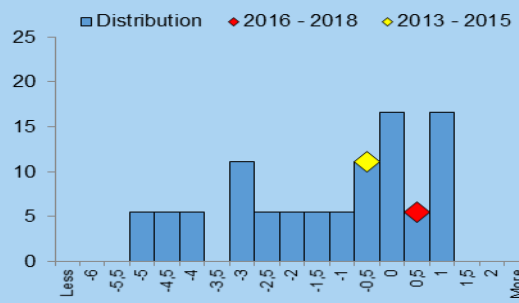
Source: MoF SR

II.2.2. Expenditure benchmark

The revised Stability and Growth Pact introduced an expenditure benchmark as a supplementary tool to analyse the fiscal position. It shows the growth of the expenditure aggregate net of discretionary revenue measures, which enables the assessment of the progress achieved in fiscal consolidation compared against the permitted expenditure growth reference rate, similarly to the structural balance development.

According to the expenditure benchmark, the real general government expenditure should not grow faster than the average potential economic growth, provided there are no additional tax revenues due to new legislation measures.[8]

The development of expenditures is adjusted for the factors which cannot be controlled by the government, such as interest expenditures, changes in unemployment benefit expenditures not connected with government policies and expenditures financed from the EU funds. Moreover, with regard to the high volatility of government investments, average amount of investments for the past three years and the current year are taken into account[9]. Since the application of that approach on the expenditure adjustment could result in distortion of results due to the double deduction of investments financed from the EU funds, the Ministry of Finance made a methodological change, which consists in adjustment for current EU expenditures only. The nominal growth of such adjusted expenditures is consequently translated to real growth by means of a GDP deflator, to allow referencing against the expenditure benchmark.

The expenditure benchmark is applied differently based on whether the country has reached its medium-term budgetary objective or not. The reason is harmonisation of the indicator with the required structural balance

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[8] Positive cyclical revenues in the time of conjuncture (not included in discretionary measures) tend to allow also growth of expenditures above the potential level. The expenditure benchmark monitors this undesired fiscal impact.
[9] Vade Mecum on Stability and Growth Pact, p. 30

development. In practice, the adjusted general government expenditures net of discretionary revenue measures should grow in real terms at a slower pace than the average potential growth of the economy and, at the same time, the development of expenditures has to take into account the required adjustments of structural balance.

Chart 8: Development of expenditure aggregate compared to the expenditure benchmark (% increase)
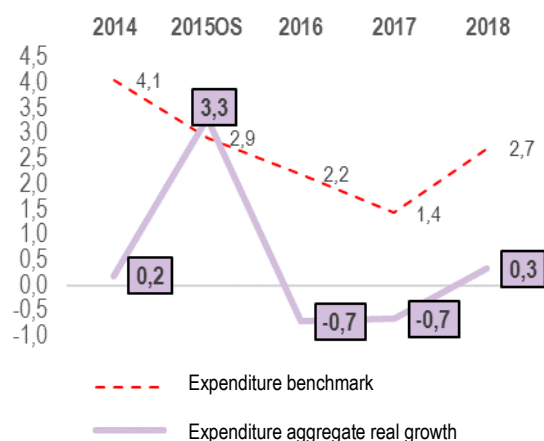
Source: MoF SR

Chart 9: Deviation from the meeting of the expenditure benchmark (% of GDP)
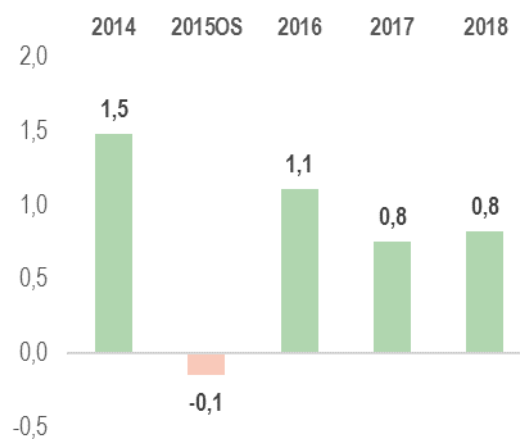
Source: MoF SR

In 2014, Slovakia was in line with the expenditure benchmark with a sufficient reserve. The expenditure aggregate adjusted for new revenue measures stagnated in real terms, while the expenditure benchmark allowed an increase by 4.1% which also takes into consideration application of investment clause.

Adjusted expenditures are expected to grow by 3.3% in 2015. According to the expenditure benchmark, their development should not exceed a 2.9% growth. One of the reasons is that the expenditure benchmark methodology does not allow inclusion of improved collection of taxes into discretionary revenue measures. Moreover, EU corrections also have a negative influence on the meeting of the benchmark. Hence, on the one-year horizon, the expenditure benchmark is met just approximately (the deviation reaches only 0.1% of GDP). The expenditure benchmark is met with reserve on the two-year horizon.

The expenditure development in 2016 should again comply with the expenditure benchmark. According to the budget proposal, the adjusted expenditure aggregate should drop by 0.7% YoY, resulting in a positive gap of 2.9 p.p. compared to the permitted increase. In the following years, the planned development on the expenditure side should still meet the expenditure benchmark with a sufficient reserve and also contribute to the reaching and keeping of the medium-term budgetary objective in the years 2017 and 2018.

Table 4: Calculation of expenditure benchmark compliance (ESA 2010)

	m.u.	2013	2014	2015OS	2016	2017	2018
1. Total expenditure [1]	€ million	**30,284**	**31,462**	**33,284**	**31,985**	**32,485**	**33,707**
2. Interest payments	€ million	1,384	1,441	1,275	1,248	1,200	1,256
3. Gross fixed capital formation	€ million	2,193	2,788	3,342	2,222	2,439	2,727
4. Gross fixed capital formation (average for 4 years)	€ million	2,346	2,445	2,635	2,642	2,688	2,682
5. Common expenditure on EU programmes fully matched by EU funds revenues	€ million	249	310	637	386	485	611
6. Cyclical unemployment benefit expenditure	€ million	17	15	11	7	-2	-12
7. Expenditures fully matched by automatic increase of revenues	€ million	0	0	0	0	0	0
8. Primary expenditure aggregate (1-2-3+4-5-6-7)	€ million	**28,787**	**29,352**	**30,654**	**30,764**	**31,051**	**31,806**

9. Year-on-year change of primary expenditure aggregate (8_t-8_{t-1})	€ million	-	565	1,302	110	288	755
10. Change of revenues due to discretionary revenue measures	€ million	-	-35	113	-68	-72	16
11. Nominal growth of expenditure aggregate net of revenue measures ((9_t-10_t)/8_{t-1})	%	-	2.1	4.1	0.6	1.2	2.4
12. Real growth of expenditure aggregate net of revenue measures	**%**	-	0.2	3.3	-0.7	-0.7	0.3
13. Expenditure benchmark (reference rate of potential GDP growth decreased by the required consolidation)	p.p.	-	4.1	2.9	2.2	1.4	2.7
14. Deviation from the expenditure benchmark (13-12)	p.p.	-	3.9	-0.4	2.9	2.1	2.4
15. Deviation from the expenditure benchmark (% of GDP)[1]	% of GDP	-	1.5	-0.1	1.1	0.8	0.8
16. Two-year deviation from the expenditure benchmark (% of GDP)[1]	% of GDP	-	1.7	0.7	0.5	0.9	0.8
p. m. GDP deflator3	*%*	*-*	*1.9*	*0.7*	*1.3*	*1.8*	*2.0*
p.m. Capital expenditures on EU programmes fully matched by EU funds revenues	*€ million*	*560*	*885*	*1,459*	*708*	*948*	*1,108*

[1] A positive value represents compliance of the expenditure benchmark.   *Source: MoF SR*

[2] Average of two EC forecasts, Macroeconomic forecast of the MoF SR from 2016

II.3.   General government gross debt forecast

The gross debt of the general government reached 53.6% of GDP[10] at the end of the year 2014. For the first time since the economic crisis broke out, the debt fell by 1 p.p. YoY. Further fall of the debt to the level of 52.8% of GDP is expected in 2015. In addition to the fiscal consolidation, the decline will be enabled mainly by the use of cash revenues from Slovak Telekom privatization. With continuing consolidation, primary surplus[11] is expected since the year 2017. Together with the economic growth, the primary surplus will contribute to a more significant fall of the debt. According to the current forecast, the debt should fall under the level of 49% of GDP in 2018.

Table 5: General government gross debt (% of GDP, ESA 2010, state as at 31 December)

	2013 A	2014 A	2015 E	2016 F	2017 F	2018 F
General government gross debt	**54.6**	**53.6**	**52.8**	**52.1**	**51.3**	**48.9**
- Sovereign debt (net of international commitments)	48.6	48.1	47.5	47.1	46.7	44.7
- Slovakia's share in the EFSF facility debt	2.6	2.7	2.6	2.5	2.4	2.2
- Contribution to the ESM	0.7	0.9	0.9	0.8	0.8	0.7
- Debt of other general government entities	2.7	1.9	1.9	1.7	1.5	1.3
p.m. impact of debt revision[1]	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
p.m. impact of nominal GDP revision[1]	*-0.2*	*-0.2*	*-0.2*	*-0.2*	*-0.2*	*-0.2*

[1] On the basis of data sent to the Eurostat within the autumn EDP notification. The impact used for the years 2015 – 2018 are same as those for the year 2014.   *Source: MoF SR, SOSR*

The change in the general government debt is primarily due to the amount of the state budget cash deficit[12] which needs to be refinanced. The state budget cash deficit was €2.9 billion in 2014. **A more significant fall to the level of €2 billion is expected since 2015.**

On the other hand, most of the other effects will drive the level of debt downwards. A significant factor is the financing from the State Treasury. In 2015, revenues from the sale of Slovak Telekom are available with an impact on cash amounting to €800 million (1.0% of GDP).

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[10] 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. The general government debt is expressed as ratio in GDP. The data are based on the spring notification to Eurostat.
[11] Positive result of the general government fiscal performance adjusted for interest payments.
[12] For the purposes of the debt forecast, budgetary objectives are expected to be reached on the condition of the required additional measures on the state budget side.

The gross debt is also influenced by the Slovakia's participation in European bailout mechanisms since the year 2012. In 2015, obligations to the EFSF and ESM increase the general government gross debt by 3.5% of GDP. No additional impacts on general government debt in the period from 2016 to 2018 are expected from the Slovakia's international liabilities towards the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM). The Slovakia's debt is influenced by EFSF obligations that arose in connection with the provision of financial aid to the Member States of the programme. The EFSF will no longer participate in new financial programmes, however, it will continue to administer the repayment of obligations of the debtor countries. Until then, the EFSF commitments will directly influence the amount of gross debt based on the Slovakia's share in the EFSF. Slovakia's contributions to the ESM reduce the funds available to the State Treasury to finance government's operations, and therefore they indirectly contribute to an increase in debt.

The debt calculation also considers changes in methodology[13] such as the discount at the issuance and redemption of bonds. The overall effect of both factors reduces debt in 2014 to 2016. Since the year 2017, the influence of higher issue discount prevails due to the expected rebound of interest rates.

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

Table 6: Impact on the change of the general government gross debt (in €million)

	2013 A	2014 A	2015 E	2016 F	2017 F	2018 F
A. General government gross debt (as at 1 January)	**37,614**	**40,174**	**40,297**	**40,896**	**42,027**	**43,675**
B. Total year-on-year change in the general government gross debt	**2,561**	**123**	**599**	**1,131**	**1,648**	**334**
- Cash-based state budget deficit	2,023	2,923	1,956	1,970	1,882	907
- State Treasury funds used for the financing of government operations	-463	-2,377	-1,298	-719	-250	-554
- Slovakia's share in the EFSF facility debt	401	102	19	0	0	0
- Slovakia's contributions to the ESM	264	132	0	0	0	0
- Issue discount	51	11	18	39	191	100
- Discount at maturity	-68	-114	-86	-61	-67	-6
- Balance of loans to general government entities	318	-521	-19	-97	-107	-111
of that: NDS (National Motorway Company)	-37	-37	32	-37	-37	-37
of that: EOSA	520	-520	0	0	0	0
of that: municipalities	-36	-1	-79	-76	-74	-74
of that: higher territorial units	-21	-38	15	15	15	15
C. General government gross debt (as at 31 December)	**40,174**	**40,297**	**40,896**	**42,227**	**43,875**	**44,609**
in % of GDP	**54.6**	**53.6**	**52.8**	**52.1**	**51.3**	**48.9**
p.m. year-on-year change of general government gross debt (p.p.)		*-1.0*	*-0.8*	*-0.7*	*-0.8*	*-2.4*

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

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[13] The discount on the issuance of state bonds and state treasury bills increases the debt, since in the moment of bond issue the state liabilities increase by the nominal value of the bonds. The state, however, gains a lower amount of cash (decreased by the discount). On the other hand, the discount at redemption of state bonds reduces the debt. This is due to the fact that the debt increased when the bonds were issued, namely in the nominal value of the bonds, rather than at the time of their redemption.

Box 4 – Stochastic forecast of general government gross debt

An alternative approach to predicting the level of debt is a forecast carried out by means of a stochastic model[14]. The fan chart predicts high probability (approximately at the level of 80%) of a decrease of the debt in the medium-term horizon. According to an alternative (median) forecast, the debt is expected to fall even faster compared to the official forecast, reaching 46.6% of GDP in 2018.

The fan chart graphically illustrates a large number of[15] random simulations of debt level on the horizon of the forecast generated in the stochastic model. Lower demand on inputs is a primary advantage of the alternative approach. It provides an independent source of debt estimate as well as quantification of the forecast risks. On the other hand, this approach is limited by the fact that it only takes into account a limited amount of information and presumes that interactions among the components of the model will be the same during the forecasted period as they were in the past. Methodology of the estimate is provided in Annex 4.

Chart A: Stochastic forecast of general government debt (% of GDP)
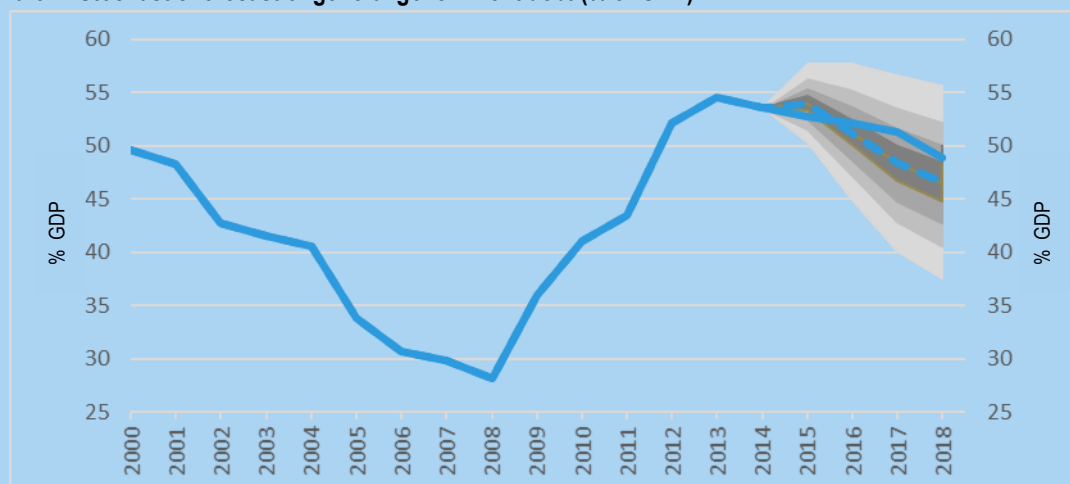
Source: MoF SR

An analytical view of the contributions of individual factors to debt change shows that a **decrease in debt is caused by an improvement in the primary balance** (the general government balance net of interest payments) **and nominal GDP growth.** Given the on-going consolidation, a primary budget surplus is expected since 2017. The accelerating GDP growth should contribute to a more significant decrease of the debt at the end of the forecasted period. The share of interest payments in GDP should gradually fall from 1.9% of GDP in 2014 to 1.4% of GDP in 2018. The development of the debt is also influenced by the contribution of debt and deficit stock-flow adjustment. In the forecasted period, the debt trajectory is also influenced by the State Treasury funds and the difference between cash and accrual reporting of general government balance.

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[14] In the preparatory phase at present. The debt is determined by its past value, interest payments, GDP growth, primary deficit and non-deficit financing. The model comprises a vector autoregression of interest rates, growth of real GDP, inflation of GDP deflator, of these three variables for the EU and exchange rate. Another component of fiscal response function which determines the level of primary deficit with regard to the debt and economic activities. High number of random simulations of this system of models determines various debt trajectories of which probability distribution of the level of debt in future years is subsequently calculated.

[15] 5,000 random debt trajectories were simulated.

Chart 10: Contributions of factors to gross debt change (% of GDP)
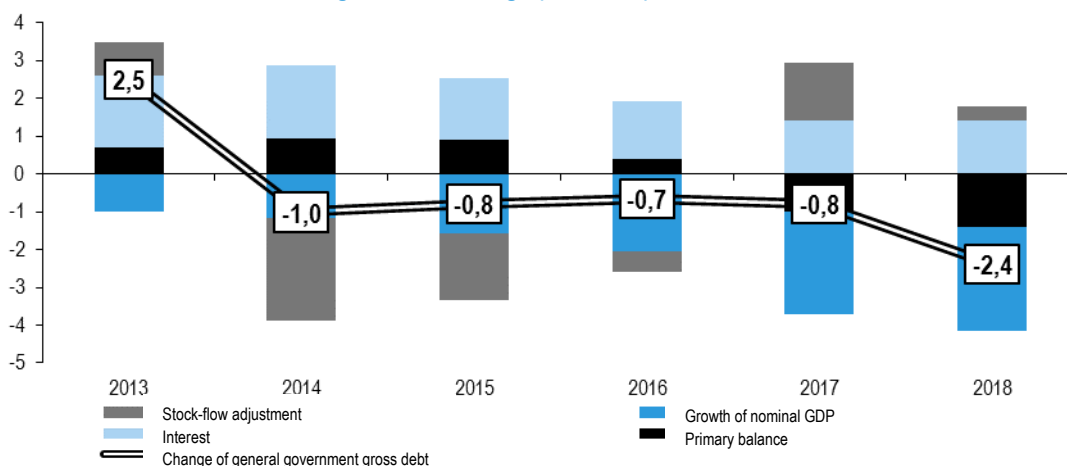
*Note: * Items refer to the contribution of debt and deficit harmonisation, i.e. how the debt changes beyond the extent of the general government balance change.*

Source: MoF SR

From the analytical point of view, it is more useful to monitor real indebtedness also through the development of net debt, which is defined as the gross debt net of liquid assets of the state and, in particular, the actual level of cash. Net debt reached 48.2% of GDP at the end of the year 2013, primarily due to the high level of cash reserve accumulated during the year 2012. In 2014, net debt closely exceeded the 50% of GDP threshold and, according to the forecast, it should decline towards 45% of GDP in 2018. Compared to the gross indebtedness, the net debt should be lower by 4 p.p. on average on the entire horizon of the forecast.

Chart 11: Net debt (% of GDP)
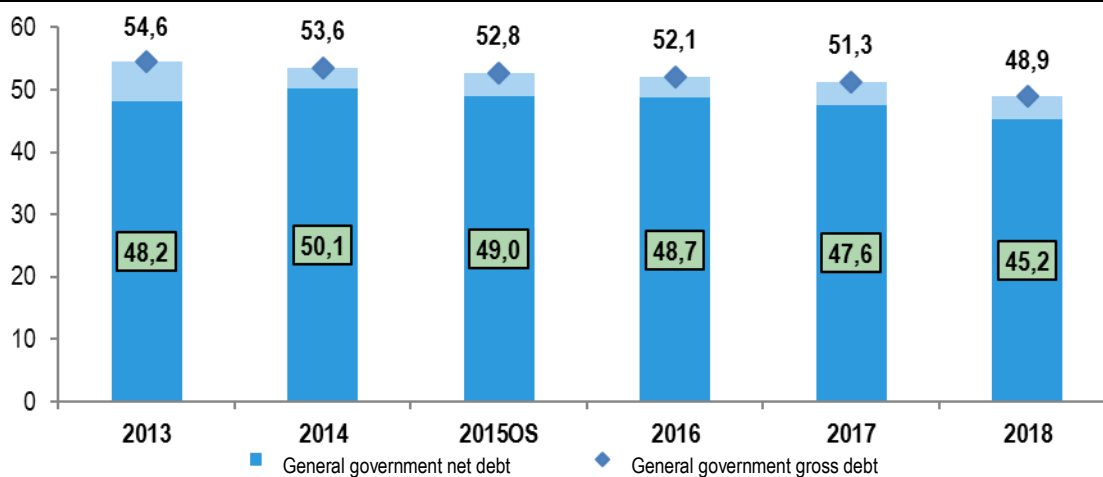
Source: MoF SR, Eurostat

Box 5 – Transparent management of general government debt

The Ministry of Finance plans to further increase the transparency and to formalise management of general government debt according to the best world practice, e.g. from the UK, Germany, the Netherlands and the US. Main objectives are optimisation of interest payments, reduction of risk and cost-effective refinancing of general government debt in financial markets amid unfavourable market environment, and an improvement of Slovakia's credit rating. The regularly published debt management strategy will also contain an evaluation based on a modelling framework.

The first step towards a more transparent general government debt management is regular publication of government bond curve (the so-called zero coupon curve) according to the international standards. The current development and also historical data of yield curves since the year 2003 will be made publicly available. Historical data about the yield curve are an essential input for the creation of model forecast of the development of government bond yields. **Creation of the forecast will allow active management of general government debt, including management of bonds liquidity which has the potential to bring along savings on interest payments**. The yield curve will allow daily monitoring of government bonds liquidity and thereby, indirectly, the possibility to make adjustments to the issue calendar. An important contribution of publishing the yield curve is also reaching a benchmark status of Slovak government bonds, especially by means of simplification of access to data needed for investor decisions.

The modelling framework of the yield curve will facilitate forecasting of interest costs and simulation of scenarios consistent with macroeconomic and fiscal outlooks, also taking into account the developments of European Central Bank's monetary policy. The model will allow quantitative monitoring of the relation between minimising of interest payments, their volatility and other limitations (for instance, demand for certain maturities).

The comparison of estimates of yield curves at present and during the Euro crisis (June 2012) illustrates, for instance, a lower risk premia towards German Bunds at present, but also a smaller spread of yields to maturity around the estimated yield curve, thus higher liquidity of Slovak government bonds. That is, in addition to the development in the euro area, also thanks to the recovery of Slovak public finance.

Chart A: Estimate of zero coupon curve on 12 June 2012 (yield in % according to time-to-maturity in years)
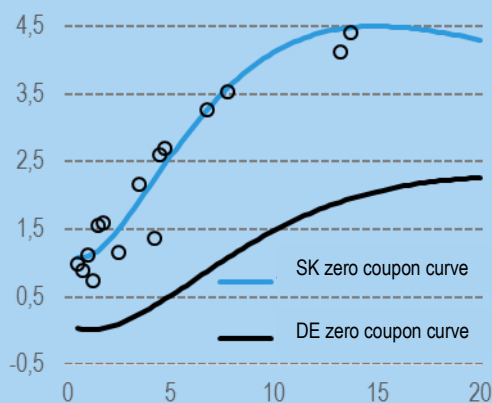
Chart B: Estimate of zero coupon curve on 6 October 2015 (yield in % according to time-to-maturity in years)
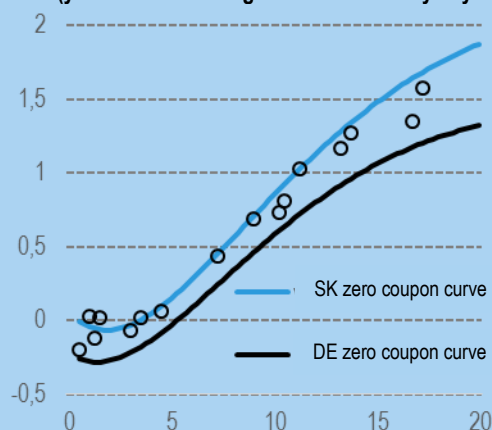
Note: The estimate of the yield curve of Slovak and German government bonds by using the Nelson-Siegel-Svensson (NSS) method. For analytical comparison, the bubbles in the chart represent yields to maturity of Slovak coupon bonds. *Source: MoF SR*

Note: The estimate of the yield curve of Slovak and German government bonds by using the Nelson-Siegel-Svensson (NSS) method. For analytical comparison, the bubbles in the chart represent yields to maturity of Slovak coupon bonds. *Source: MoF SR*

Revenue and expenditure targets of the general government budget

Assuming no changes in economic policies in 2016, the general government deficit would reach 2.2% of GDP in 2016. Compared to the no-policy-change scenario, the general government deficit in the budget proposal for the year 2016 is lower by 0.3% of GDP (€204 million), reached mainly thanks to reduction of expenditures. In the no-policy-change scenario, the general government deficit would reach 1.8% and 1.6% of GDP in 2017 and 2018, respectively. Combating tax evasion remains the priority of the Slovak government in the area of taxes.

II.4.   Revenue targets of general government budget

II.4.1.   Combating tax evasion

The priority of the Slovak government in the area of taxes remains combating tax evasion. Measures to combat VAT evasion adopted during the years 2012 and 2014 facilitated reversal of the long-term negative development of VAT collection. Thanks to the fight against tax fraud, VAT collection improved in 2015 with additional revenues of 0.9% of GDP compared to 2012. At the same time, the improved VAT collection had positive impact on the corporate income tax (CIT) revenue. CIT effective tax rate grew considerably in 2014.

In the case of VAT, the effective tax rate has stabilised in 2015 and measures planned for the following years should assist further improvement of the VAT collection. Transfer of tax obligation to the final recipient of performance in the case of construction sector, the so-called domestic reverse-charge mechanism is going to be introduced since 2016. As the construction sector belongs to the most risky sectors with relatively high VAT gap this measure should improve VAT collection efficiency. Further 30 measures aimed, in particular, at higher effectiveness of identification, collection and overall compliance of taxes are included in the update of the action plan for combating tax evasion. In addition to VAT, efforts are also focused on excise taxes, with the introduction of tax on cigars and cigarillos based on the weight since the year 2016 as opposed to the current state when the rate depends on the number of products in pieces.

Chart 12: Effective VAT rate (%)

Source: MoF SR

Chart 13: Effective CIT rate
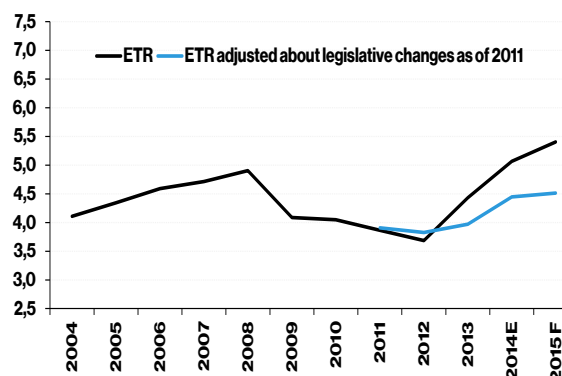
Source: MoF SR

In the case of excise taxes, a tax gap on tax on mineral oils (MO) was quantified[16], reaching €397 million in 2014 (0.5% of GDP), i.e. 27% of potential revenue. Contrary to VAT, however, the gap on excise tax on MO is caused not only by evasion, but also due to cross-border purchases. Thus, more important is the

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[16] For more information see the manual Tax Gap on Tax on Mineral Oils (http://www.finance.gov.sk/Default.aspx?CatID=10192).

information about the growth of the tax gap, especially in the case of excise tax on diesel, in the past, without the price development indicating growth of motivation to make cross-border purchases. Several measures to combat tax evasion in relation to excise tax on MO were put in place in the past years. The most important measures include:

- Records of entities dealing with selected mineral oils
- Monitoring the movement of motor oils without tax rate
- Prevention of tax underpayments
- Prevention of transport of untaxed MO if there is any suspicion that the tax will not be paid

The estimate of the gap on excise tax on MO for the year 2015 can only be prepared with a more significant time delay in 2016, but a simplified view of the current development through the effective tax rate indicates an improved tax collection in the current year.

Chart 14: Tax gap on tax on mineral oil
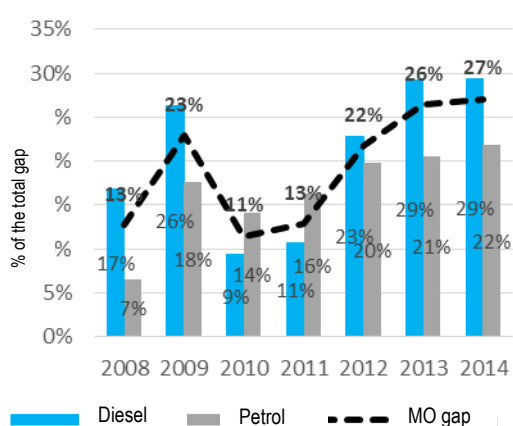
Source: MoF SR

Chart 15: Effective tax rate of tax on mineral oil
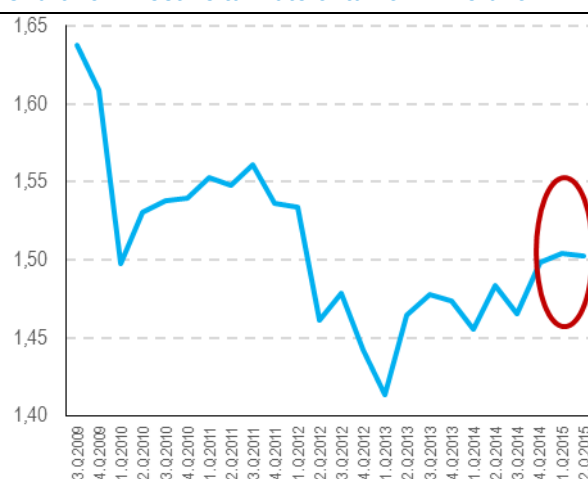
Source: MoF SR

II.4.2. General government revenues in 2015 and 2016

The current budget expects a decrease in general government revenues to 37.7% of GDP in 2016 compared to 40.2% of GDP currently estimated for the year 2015 (Table 6). The decrease is largely attributable to lower revenues from EU funds in 2016 compared to the estimate from the current year when the draw-down of funds from the second programming period is being completed[17]. Faster draw-down of EU funds compared to the GDP growth is expected in the following years.

Table 7: General government revenues in 2015 to 2018 (% of GDP, ESA2010)

	2015 E	2016 F	2017 F	2018 F
General government revenues, total	**40.2**	**37.7**	**37.3**	**37.1**
1. Tax revenues	**17.7**	**17.6**	**17.3**	**17.2**
- Taxes on production and imports	10.7	10.5	10.3	10.1
- Value-added tax	6.8	6.7	6.6	6.6
- Excise taxes	2.7	2.6	2.6	2.5

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[17] Following the adjustment for EU funds, there is reported a decrease by 1 p.p. YoY, namely from 37.3% of GDP in 2015 to 36.4% of GDP in 2016.

- Current taxes on income, wealth, etc.	7.1	7.1	7.0	7.1
- Corporate income tax	3.3	3.3	3.3	3.4
2. Social security contributions	**13.8**	**13.5**	**13.3**	**13.2**
3. Non-tax revenues	**4.8**	**4.4**	**4.3**	**4.1**
4. Grants and transfers	**4.0**	**2.1**	**2.4**	**2.5**
Of that: from the EU	2.8	1.4	1.7	1.9

Source: MoF SR

The total amount of revenues which are managed by the general government in Slovakia is lower compared than the euro area average, as well as the average of other V4 countries (Chart 16). In the euro area, only Latvia and Lithuania have lower revenues. However, revenue to GDP ratio in Slovakia has increased in the past years, approaching the average of neighbouring countries. Observed trend is attributable mainly to the development of tax and social security contribution (SSC, Chart 17), which create more than 80% of the general government total revenues. The budget anticipates **stable development of the most important tax revenues** (value-added tax, corporate income tax and excise taxes) compared to the size of the economy on the entire horizon of the forecast. **Non-existing automatic indexation** of part of tax revenues (real estate tax, administrative fees, incomes and the like) **causes their erosion on GDP** in the remaining years of the forecast. A slight decline of SCC to GDP can be explained by slower growth of wage base compared to the economic performance expressed by GDP growth and, naturally, by the existence of maximum caps and minimum contributions, which obviously do not allow full transformation of wage base growth into assessment bases.

Chart 16: Comparison of general government revenue development (% of GDP)
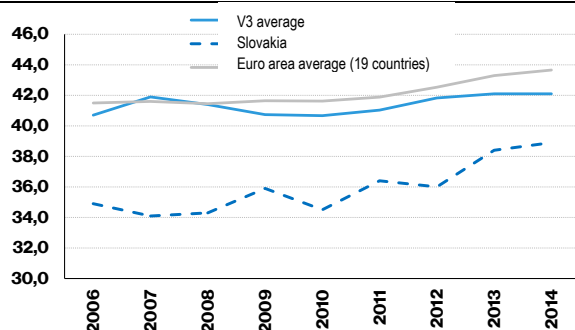
Source: Eurostat

Chart 17: Comparison of general government tax revenue development (% of GDP)
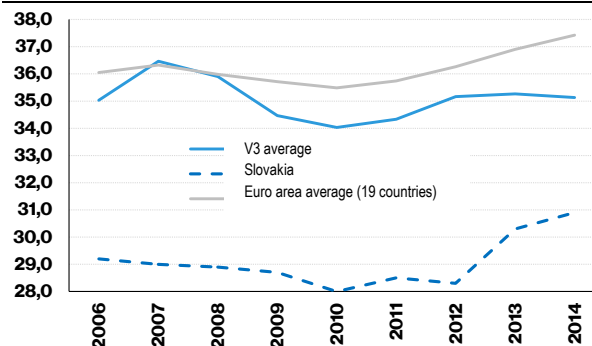
Source: Eurostat

II.5. Expenditure targets of the general government budget by function[18]

General government expenditure[19] in 2016 represents 40% of GDP, which represents a decrease of 3.3 p.p. of GDP compared with the expected results for 2015. The drop in total expenditure is predominantly caused by a decrease in the utilisation of EU funds due to the start of the new programming period. After controlling for this effect the decrease of expenditure is 1.7 p.p. of GDP. The largest share of the total expenditure of the general government is again attributed to social protection (35.6%), healthcare (18%) and general public services (13.1%).

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[18] Note: The methodology of recording expenditures based on functional classification can vary between countries. As a result, different data can enter into the same category in different countries (e.g. taxed and non-taxed pensions). COFOG classification also doesn't take into account expenditure realized through the tax system.

[19] The draft budget doesn't contain items with neutral impact on the deficit: extra-budgetary accounts of the state and local administration and the profit and loss balance of healthcare facilities.

Compared with the 2013 EU average[20], in 2016 the share of expenditure to GDP in Slovakia is significantly lower mainly in the area of social protection (5.5 p.p. of GDP). The share of expenditure in individual categories to total general government expenditure is mostly similar to the EU average (-1.5 p.p. of GDP to 1.5 p.p. of GDP). Larger share of total general government expenditure compared with the EU is budgeted for healthcare (3.2 p.p. of total general government expenditure) and economic affairs (2.7 p.p. of total general government expenditure). Conversely, compared with the EU, lower expenditure is budgeted for the category of social protection (4.6 p.p. of total general government expenditure).

Compared with the V3 average, the total budgeted expenditure of Slovakia is lower by 1.3% of GDP. Category by category, the most significant difference is in the area of general public services (1.7 p.p. of GDP less than V3 average). Healthcare has the highest share of the total general government expenditure compared with the V3 average (5.1 p.p. of total general government expenditure). Conversely, the share is lower in the area of general public services (2.1. p.p. of total general government expenditure) and education (1.9 p.p. of GDP). There are no significant differences in the other categories.

Table 8: General government expenditures based on COFOG

Functions	COFOG Code	SK 2015		SK 2016		EU28 2013		V3 2013	
		% GDP	% TE	% GDP	% TE	% GDP	% TE	% GDP	% TE
1. General public services	1	6.06	14.12	5.20	13.12	6.80	14.10	6.93	15.17
2. Defence	2	1.04	2.42	1.01	2.55	1.40	2.87	1.00	2.23
3. Public order and safety	3	2.14	4.99	2.00	5.04	1.80	3.72	2.00	4.57
4. Economic affairs	4	5.78	13.45	4.54	11.46	4.30	8.81	5.63	12.53
5. Environmental protection	5	0.62	1.43	0.41	1.04	0.80	1.65	0.87	2.03
6. Housing and community amenities	6	0.51	1.18	0.52	1.31	0.70	1.42	0.77	1.77
7. Healthcare	7	7.29	16.98	7.15	18.02	7.20	14.80	5.70	12.90
8. Recreation, culture and religion	8	1.02	2.38	0.93	2.35	1.00	2.15	1.33	2.97
9. Education	9	4.09	9.53	3.78	9.52	5.00	10.27	5.07	11.43
10. Social protection	10	14.40	33.53	14.12	35.60	19.60	40.23	15.37	34.43
Total expenditure	TE	**42.95**	**100.00**	**39.66**	**100.00**	**48.60**	**100.00**	**41.00**	**100.00**

Note: TE – total general government expenditure   *Source: MoF SR, Eurostat*

The most significant year-on-year changes are budgeted in social protection, economic affairs, general public services and in healthcare. **The share of public expenditure to GDP is falling** in all areas except for housing. The structure of the expenditure changes only slightly. The share of social protection expenditure to total general government expenditure is **growing by 2.1 p.p**. The rising trend is explained by growing demands of old-age and disability pensions and an increase in payments for persons insured by the state into the public health insurance system. The share of expenditure for healthcare will also grow, by 1.0 p.p.; this development is mainly tied to increase of wages of healthcare employees.

The share of expenditure for economic affairs is budgeted to decrease next year by 2 p.p., which will be caused mainly by a drop in the utilisation of EU funds due to the start of the new programming period. A decrease in expenditure is also expected in the area of general public services, primarily in the area of state administration costs. Their share of the total general government expenditure is falling by 1.0 p.p. A small decrease of the share of the total general government expenditure is expected in the area of environmental protection (o.4 p.p.). Expenditure in other areas remain unchanged (recreation, culture and religion, as well as education), or the year-on-year changes are negligible (defence, public order and safety, housing and community amenities).

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[20] Latest data available for EU countries based on COFOG.

Chart 18: General government expenditures based on COFOG in 2016 (year-on-year changes)
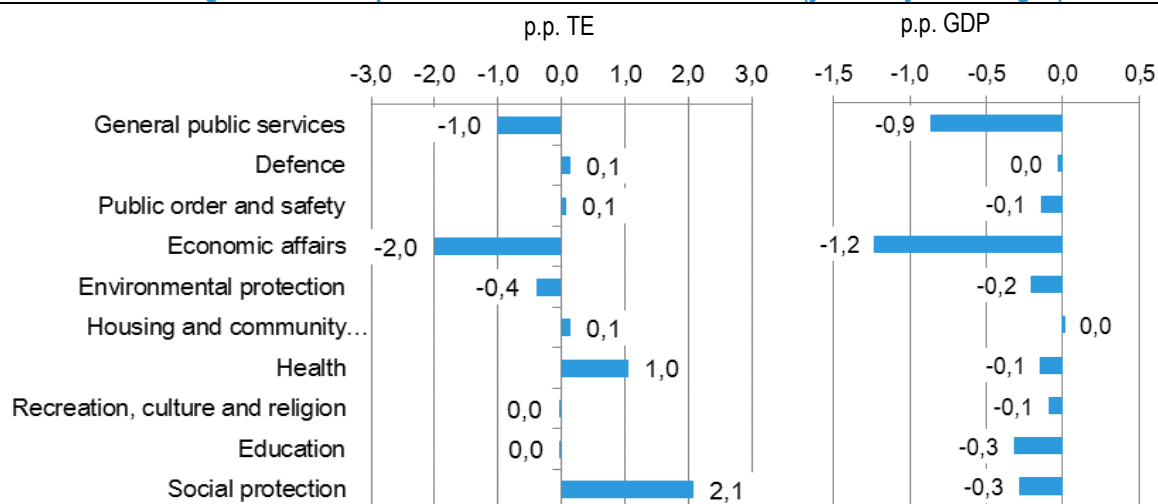
Source: MoF SR

According to the expected results, the share of expenditure to GDP has increased in all categories compared with the budget (total general government expenditure rose by 2 p.p. of GDP). Expenditure grew most significantly in the area of economic affairs (0.6 p.p. of GDP) and education (0.4 p.p. of GDP). The share of individual categories to total general government expenditure has also changed. In most areas the changes were negligible (in the range of -0.1 to 0.4 p.p. of total general government expenditure). The two exceptions were the area of social protection, where the share of expenditure has dropped more significantly (decrease by 1.3 p.p. of total general government expenditure), and general public services (decrease by 0.7 p.p. of total general government expenditure). Expenditure growth was more significant in the area of economic affairs (increase by 0.8 p.p. of total general government expenditure). Despite the increase of healthcare expenditure as a percentage of GDP, their share of total general government expenditure has fallen by 0.1 p.p.[21]

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[21] Healthcare expenditure did not include the expenditure of healthcare facilities in the 2015 budget, they are, however, included in the current expected results for 2015. In order to keep the expenditure comparable, we have deducted from the expected results the amount of 1.8% of GDP (4.2% of total general government expenditure) that is related to the expenditure of healthcare facilities. Before this adjustment healthcare expenditure grew by 2.1 p.p. of GDP (3.6 p.p. of total general government expenditure).

Chart 19: Comparison of general government expenditure based on COFOG classification in 2015 (changes ER compared to GGB)
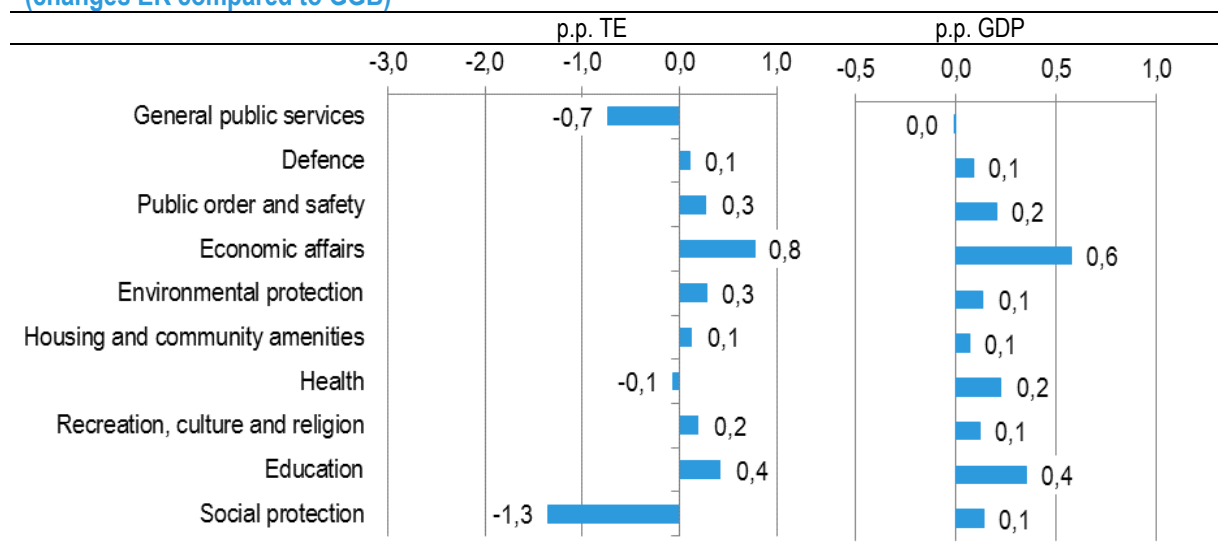
Source: MoF SR

II.6. General government balance under the no-policy-change scenario

The no-policy-change scenario (NPC) is defined as the evolution of public finances under the assumption of no additional measures passed by the government or the parliament together with the macroeconomic development and existing policies, including legislation in force. Based on the NPC, it is also possible to assess the size of the measures necessary to reach budgetary objectives.[22]

The no-policy-change scenario[23] is based on the current estimate of the general government deficit in 2015 of 2.74% of GDP. **Assuming no changes were made in economic policies, the general government deficit would reach the level of 2.2% of GDP in 2016[24]**. The difference in the general government balance between the no-policy-change scenario and the budget proposal for 2016 represents 0.25% of GDP (€204 million). **The difference on the expenditure side is 0.3% of GDP compared with the NPC[25].** Current expenditures will decrease by 0.6% of GDP. Capital expenditures will decline by 0.1% of GDP. **The overall effect on the revenue side is expansionary compared with the NPC in the amount of 0.1% of GDP[26].**

In the no-policy-change scenario, the general government deficit would reach 1.8% and 1.6% of GDP in 2017 and 2018. In the next years the consolidation in the budget is contained on the expenditure side with small fiscal impulse on the revenue side.

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[22] The manual for constructing the NPC scenario is published on the websites of the Ministry of Finance: http://www.finance.gov.sk/Default.aspx?CatID=9301.

[23] 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.

[24] 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 payments will also change if budgetary objectives are achieved.

[25] Including the effect of lower VAT rate for selected basic foodstuffs on the level of 0.1% of GDP. Because this measure was only approved after the September meeting of the Tax Revenue Forecasts Committee, the decrease in VAT is not included in the estimated revenues, instead a reserve equal to the expected impact of the measure was created in the budget on the expenditure size. If the effect of lower VAT were already included on the revenue side, estimated consolidation on the expenditure side would reach 0.4% of GDP, while the expansion on the revenue side would increase.

[26] Excluding the effect of lower VAT for selected foodstuffs. See previous footnote 23.

Table 9: Comparison between the balance of expenditures and revenues and the no-policy-change scenario in 2015 (% of GDP)

	ESA code	NPC			GGBP 2016-2018			GGBP-NPC		
		2016	2017	2018	2016	2017	2018	2016	2017	2018
Total revenues	TR	**37.8**	**37.4**	**37.2**	**37.7**	**37.3**	**37.1**	**-0.07**	**-0.11**	**-0.15**
Taxes on production and imports	D.2	10.5	10.2	10.0	10.5	10.3	10.1	0.02	0.04	0.03
Current taxes on income, wealth, etc.	D.5	7.1	7.0	7.2	7.1	7.0	7.1	-0.01	-0.01	-0.01
Capital taxes	D.91	0.0	0.0	0.0	0.0	0.0	0.0	0.00	0.00	0.00
Social security contributions	D.61	13.5	13.3	13.2	13.5	13.3	13.2	-0.01	0.00	0.00
Property income	D.4R	0.7	0.6	0.6	0.7	0.6	0.6	0.00	0.00	0.00
Other (1)		6.0	6.2	6.2	5.9	6.0	6.0	-0.07	-0.13	-0.17
Tax burden (2)		31.1	30.6	30.4	31.1	30.6	30.4	0.00	0.02	0.02
Total expenditure	TE	**40.0**	**39.2**	**38.8**	**39.7**	**38.2**	**37.5**	**-0.32**	**-1.07**	**-1.31**
Compensation of employees	D.1P	8.3	8.3	8.2	8.5	8.2	7.9	0.22	-0.04	-0.27
Intermediate consumption	P.2	5.5	5.3	5.1	4.9	4.5	4.3	-0.58	-0.75	-0.83
Subsidies	D.3P	0.8	0.8	0.7	0.8	0.7	0.7	-0.02	-0.03	-0.03
Interest expenditures	D.41P	1.5	1.4	1.4	1.5	1.4	1.4	0.00	0.00	0.00
Total social payments	D.6P, D632	18.4	17.7	17.3	18.5	17.8	17.4	0.15	0.08	0.08
of which: unemployment benefits		0.2	0.2	0.1	0.2	0.2	0.1	0.00	0.00	0.00
Gross fixed capital formation	P.51G	2.9	3.1	3.2	2.8	2.9	3.0	-0.15	-0.24	-0.16
Capital transfers	D.9P	0.4	0.5	0.5	0.2	0.3	0.3	-0.16	-0.19	-0.19
Other (3)		2.2	2.3	2.3	2.4	2.4	2.4	0.22	0.09	0.10
General government balance	B.9 (4)	**-2.2**	**-1.8**	**-1.6**	**-1.9**	**-0.9**	**-0.4**	**0.25**	**0.96**	**1.16**

Note:

(1) P.11+P.12+P131+D.39rec+D.7rec+D.9rec (other than D.91rec)

(2) D.2+D.5+D.61+D.91

(3) D.29p+D.5p+D.7p+NP

(4) TR-TE=B.9

II.7.   Description of measures

The following section quantifies and describes the effects of measures incorporated into the budget proposal. Beyond the specified measures, differences between the NPC scenario and the results of budget negotiations included in the budget proposal are also presented. The following section describes incorporated measures including their quantification. The most significant measures on the revenue side are the introduction of VAT payment only after the reception of payment from the buyer, and the decrease of VAT rate to 10% for selected foodstuffs. Expenditure is mostly affected by measures from the second social package and by increases in wages of public sector employees.

Table 10: Measures included in the general government budget proposal (ESA 2010, comparison to NPC)

Measure	Subsector	ESA2010	2016	2017	2018
Effect of legislative measures on GG revenues from taxes and social contributions (% GDP, ESA 2010)	S.1311		0.01	0.03	0.03
Act 145/1995 Coll. on Administrative Charges			0.00	0.00	0.00
Other Changes			-0.08	-0.14	-0.17
Reserve to account for effects of new legislation and other effects (mostly VAT)	S.1311	D.7P	-0.11	-0.11	-0.11
Social packages (measures from 2016)	S.1311 & S1314	P.2 & D.9 & D.62	-0.17	-0.10	-0.10
Compensations	S.1311	D.1P	-0.22	0.04	0.27
Higher wages of nurses and healthcare employees (except physicians)	S.13	D.632P	-0.07	-0.07	-0.07
Other changes compared with NPC on expenditure side:					
Intermediate consumption		P.2	0.63	0.79	0.88
Current transfers		D.7P	-0.12	0.01	0.01
Capital expenditure		P.51G	0.15	0.24	0.16
Capital transfers		D.9P	0.21	0.24	0.24
Subsidies	S.1311	D.3	0.02	0.03	0.03
Other changes	S.13		-0.01	0.00	0.01
Total			**0.26**	**0.96**	**1.16**
- tax and social security contribution revenues			0.01	0.03	0.03
- non-tax revenues			0.00	0.00	0.00
- current expenditure			-0.04	0.59	0.91
- capital expenditure			0.36	0.48	0.40

Note: (+) indicates increased revenue or decreased expenditure

Source: MoF SR

Revenue measures

1. **Measures with positive effect on tax revenues**

   - Introduction **of VAT payment only after receiving payment from customer** (so called cash accounting scheme) for businesses with yearly turnover of less than €100 thousand should improve and ease trading for small businesses. According to the current legislation, tax liability arises when goods or services are delivered. For entities to which the new system will apply, VAT will be due after receiving payment from customer. Equally, the possibility to claim VAT on inputs will be after paying to supplier.

   - In relation to the efforts to curb tax evasion from excise taxes on tobacco and tobacco products, effective as of January 2016, **taxation of cigars and cigarillos based on their weight** is introduced. Currently the tax rate is tied to the number of pieces of product.

2. **Measures with negative effect on tax revenues**

   - In the area of VAT, more lenient conditions for the disbursement of excess VAT returns were adopted, which will enable multiple businesses to request disbursement of excess returns within shortened, 30 day period. According to the valid methodology for accrual, the measure will reduce tax revenues in 2015 by 0.04% of GDP.

   - In order to support investment in the regulated capital market, healthcare contributions from dividends from shares of companies traded on regulated markets will be abolished.

   - A decrease in car registration charge of up to 50% for multiple-seat passenger cars and families with at least four children aims to support families with multiple children.

- As of 2016, the exemption of income from trading with securities on the regulated market after the time test of one year, as well support for long-term investment saving of individuals, are introduced.
- Income in the form of social assistance from the resources of a social fund up to €2000 will be exempt from taxation.
- With the aim to lower the compliance burden the periodicity of withholding income tax payments from non-financial benefits provided to physicians will change. Current quarterly tax payments will be replaced by annual tax payments.
- In 2016 the distribution of revenues from personal income tax will change and the tax revenues will be redirected solely to the local government. The change has a neutral effect on the tax revenue of the general government, but increases revenues of municipalities and higher territorial units compared with the state budget.

Expenditure measures

1.   Measures from the social packages of the government

The budget proposal includes new priority measures of the government with a cumulative effect on public expenditure of €120 million, effective from 2016:

- €26 million was allocated for the state allowance for **skiing training** for students of elementary and secondary schools.
- Expenditure for implementation of measures stemming from the proposed legislation **on the support for least developed counties** represents €10 million.
- €30 million is allocated for the programme of **insulation of family houses**.
- In 2016 a measure from the first government social package, related to **reimbursement for gas payments** for households, enters into force. On average, the state will reimburse 6% of total annual gas consumption costs. Estimated cost of the measure is €48.4 million.
- **Increase of maternity benefits** to 70% of the daily assessment base and **increase of childcare allowance** to 280 euros. The budgetary impact is approximately €10 million.

2.   Increase of wages of public administration employees

On the basis of collective bargaining between unions and the government, **the salaries of civil servants and employees in the public interest will increase** by 4% with an overall impact on public expenditure of €150 million. An **increase of salaries of judicial clerks** is also expected, for which the Ministry of Justice has allocated an amount of €2 million.

3. Healthcare

Salary increases will also affect **healthcare employees**. The budget for 2016 expects an overall increase in wages of nurses and other healthcare employees, except for physicians, by about €55 million.

4. Reserves

A reserve to account for the impact of new legislative provisions and other effects totalling €87 million is created mainly to cover the shortfall in tax revenue due to the reduction of VAT to 10% for selected foodstuffs. The VAT rate on selected foodstuffs will be reduced from the current 20% to 10%. The measure concerns mostly basic foodstuffs such as meat, bread, milk and butter.

5. Other effects

The expected result for 2015 anticipates an increase in liabilities for intermediate consumption amounting to €189 million. The budget is based on the technical assumption that incurred liabilities for which a cash payment is yet to be made are not included/budgeted

In view of the expected drop in EU funds, the budget for capital investments of municipalities assumes an increased use of own funds in the amount of €214 million.

Development compared to NPC scenario in 2017 – 2018

In the next period of the draft budgetary plan, there is a significant decrease in both current and capital expenditure. Compared with the no-policy-change scenario, total expenditure will thus be lower by 1.1% of GDP in 2017 and 1.3% of GDP in 2018. The most significant savings are budgeted in intermediate consumption, where savings of 0.75% of GDP in 2017 and 0.83% of GDP in 2018 are expected. Following the increase of compensation in 2016, a slower growth is budgeted in the next years. In 2017 and 2018, public investment savings of approximately 0.2% of GDP are expected. Compared with the no-policy-change scenario, capital transfers will be lower by 0.2% of GDP in both budgeted years. On the revenue side, there will be only a slight decline in the revenue levels in budget years 2017 and 2018. Compared with the no-policy-change scenario, total revenue will thus be lower by 0.1% of GDP in 2017 and 0.15% of GDP in 2018. This will be mainly caused on the non-tax revenue side, and, in a smaller part, as a result of lower collection of taxes on production and imports as well.

II.8.   Consolidation effects

The starting point for the quantification[27] of the size of the fiscal measures that affect the economy is the no-policy-change scenario (NPC). The macroeconomic impact of the fiscal policy in the period 2016 to 2018 is quantified in two scenarios: the first anticipates measures necessary to achieve the fiscal targets, while the second scenario quantifies only the impact of measures that are already contained in the general government budget for 2016 to 2018.

Table 11: Total size of measures needed to reach the fiscal targets, compared with NPC (ESA2010, % GDP)

	2016	2017	2018
1. Nominal balance – Fiscal targets	-1.9	-0.4	0.0
2. Nominal balance – general government budget	-1.9	-0.9	-0.4
3. Nominal balance – NPC scenario	-2.2	-1.8	-1.6
4. Size of consolidation measures first scenario (1-3)	0.3	1.4	1.6
- size of measures necessary in that year (YoY change)	**0.3**	**1.2**	**0.2**
5. Size of consolidation measures second scenario (2-3)	0.3	1.0	1.2
- size of measures necessary in that year (YoY change)	**0.3**	**0.7**	**0.3**

Source: MoF SR

In the first scenario, revenue measures reflecting the attainment of budgetary objectives in 2017 and 2018 are included on top of the general government budget. The general government budget includes measures amounting to 0.3% of GDP compared with the NPC scenario, thanks to which the deficit should reach 1.9% of GDP in 2016. In 2017, measures amounting to 1.2% of GDP compared with the NPC are necessary in order to reach the fiscal target of deficit of 0.4% of GDP. In the final year of the budgetary framework the required

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[27] More on fiscal policy effects in 2016 to 2018 in Appendix 5.

additional measures amount to 0.2% of GDP. Consolidation measures that do not have direct impact on GDP[28] were excluded from the calculation of the effects of the fiscal policy stance on GDP. **In 2016, consolidation measures will reduce GDP growth by 0.1 p.p. Consolidation leading to a balanced budget in 2018 will reduce GDP growth by 0.5 p.p. in 2017 and 0.1 p.p. in 2018.**

The second scenario only assumes the implementation of the consolidation measures included in the general government budget for 2016 to 2018. The size of the consolidation in 2016 is identical to the first scenario. In 2017 the general government budget includes measures of only 0.7% of GDP compared with the NPC. In 2018 the size of the measures is approximately equal to the first scenario and reaches 0.3% of GDP. **Fiscal consolidation expected on the basis of the general government budget will reduce GDP growth by 0.4 p.p. in 2017 and 0.2 p.p. in 2018.**

The fiscal multiplier is estimated at 0.50 in 2016[29]. The size of the multiplier corresponds to the structure of the measures, which include restriction of the intermediate government consumption and restriction of public investment alongside with simultaneous expansive impact of the social measures on the expenditure side of the budget, as well as expansion on the revenue side in indirect taxes. In the first scenario, in 2017 the implied fiscal multiplier has reached 0.46 and represents a slight predominance of spending measures[30], while in 2018 its value reaches 0.58 because of purely expenditure consolidation. In the second scenario the fiscal multiplier in 2017 is estimated to be significantly higher than in the first scenario because of the absence of revenue measures. Estimates of the fiscal multipliers in the second scenario reach 0.66 in 2017 and 0.59 in 2018, which are levels at the upper limit of the estimates of fiscal multipliers for the Slovak economy.

Chart 20: Effect of the fiscal policy on GDP (in p.p.)
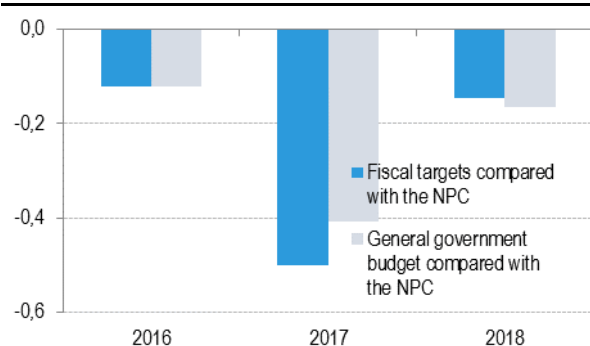
Source: MoF SR

Chart 21: Fiscal multipliers
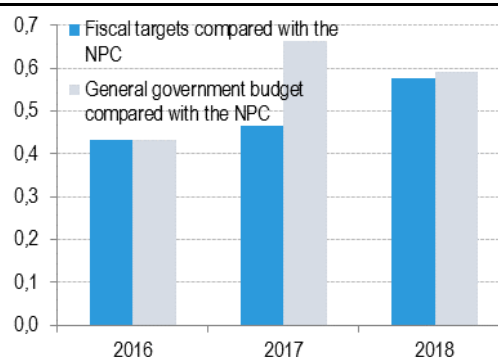
Source: MoF SR

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[28] On the expenditure side these are current transfers and capital transfers, with the exception of measures for the insulation of family houses in the amount of 0.04% of GDP. The effect of grants and transfers is excluded from the quantification on the revenue side of the general government budget.
[29] The transition to ESA2010 has caused a slight increase of fiscal multipliers due to lower openness of the economy.
[30] The ratio of expenditure and revenue measures is 60:40.

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

The government has prepared a set of structural measures focused on supporting economic growth and employment. Labour market, the healthcare system and primary education are among the biggest challenges of the Slovak economy. Structural changes in the area of education will be mainly focused on the interconnection of vocational education and practical experience (dual education), the enlargement of kindergarten capacities and support for the integration of marginalized communities. Positive labour market development will be further supported by the public employment services reform, as well as the broadening of active labour market policies. In healthcare the government will focus on building up data infrastructure and price referencing for large expenditure items.

III.1. Structural measures

The new complex approach to the priorities identification[31], taking into account GDP as well as other life quality aspects, identified the labour market, the healthcare system and primary education as the biggest challenges of the Slovak economy. This chapter describes the most important structural measures that the Slovak government has taken, or plans to implement in the next two years.

From January 2015 a new budgetary rule for local governments has entered into force. Municipalities and higher territorial units will be liable to a penalty in the event of reaching a total amount of debt of 60% or more of real current revenues of the previous budget year[32]. **An amendment to the act on budgetary rules of the general government and the local government that specifies the calculation of the penalty** is in force from August 2015. Minimum penalty amount was established, at the same time the basis for the penalty calculation will not include liabilities from repayable sources of financing used for the repayment of liabilities under receivership. The penalty will be imposed for repeatedly exceeding the 60% limit only if there was a year-on-year increase of debt.

The combat against tax evasion produced positive results in the form of **more effective tax collection**, particularly in the case of VAT. (Chart 12) The VAT gap decreased by one quarter between 2012 and 2014. Further measures have been prepared in the area of combat against tax evasion, which will be gradually implemented. From January 2016, a reverse-charge mechanism will be introduced for domestic transactions between taxable persons doing business in the construction sector, which is one of the most risky sectors. An update to the action plan to combat tax evasion contains 30 additional measures aimed particularly at higher efficiency of identification, collection and recovery of taxes.

The adopted pension system reforms and the consolidation of public finance have led to an **improvement in long-term sustainability**[33]. The consolidation and the reform of the first pension pillar in 2012 have improved the long-term sustainability indicator by 2.7% of GDP to a level of 4% of GDP in 2012. Further consolidation and subsequent reform of the armed forces in 2013 improved the indicator by further 1% of GDP to a level of 3% of

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[31] http://www.finance.gov.sk/Default.aspx?CatID=10131

[32] A unit of the local government is required to pay 5% of the difference between the total amount of debt and 60% of real current revenue of the previous budget year.

[33] The long-term sustainability indicator represents the value of revenue and expenditure measures that would be necessary to bring about a YoY change of general government balance that would be sufficient to keep the debt of the SR below 50% of GDP in 50 years' time. The indicator is published annually by the Council for Budget Responsibility.

GDP. Another reduction of the long-term sustainability indicator to 2.4% of GDP occurred again in 2014 due to the transition to the new ESA2010 methodology.[34]

A minimum pension was established from July 2015 for people who have worked for more than 30 years. From March to June 2015, the second pension pillar was temporarily opened. 159,397 savers left the pillar and 20,647 entered.

Structural changes in the area of education are mainly focused on interconnecting vocational education with work experience (dual education). Projects in the area of inclusion will build on the currently functioning all-day educational system, education of teachers on how to work with children from marginalized Roma communities, the work of teachers' assistants and awareness-raising activities in Roma communities. The Government has allocated €15 million in two rounds for the **enlargement of kindergarten capacities**. From September 2015, measures to decrease the administrative burden for teachers and management in primary and secondary schools were adopted. Measures to support science, research and innovation should increase the volume of public expenditures and enhance the efficient use of public funds.

Unemployment has had a positive trend since the fourth quarter of 2013, and from its peak by the end of 2015 the economy is expected to create 82 thousand jobs (for more details see Chart 5). Seasonally adjusted unemployment rate decreased to 11.5% in the second quarter of 2015 and its level is expected to further fall to single-digits. The government will continue the **reform of public employment services**, the implementation of tools for **active labour market policy** within the guarantee initiative for young people under 29 years and tools to support the long-term unemployed. From September it is possible to submit applications for national projects "Work Experience for Future Employment" and "Graduate Practice Starts up Employment" with a total ESF allocation of €56.6 million. The national project "Family and Work" that supports the employment of mothers with young children with a total ESF allocation of €23 million will continue until October 2015. From January an increased childcare allowance will be provided in order to cover parents' costs of sending their children to private kindergartens. The budget for the measure is €9.3 million for 2016, of which €6.8 million is planned to be funded by the ESF. Projects focused on supporting community centres and field social work in municipalities with Roma population are ongoing.

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[34] Compared to the revised value of the indicator based on the new methodology (1.9% of GDP), long term sustainability deteriorated slightly in 2014 (2.4% of GDP).

Chart 22: Quarterly development of the unemployment rate (seasonally adjusted data, %)
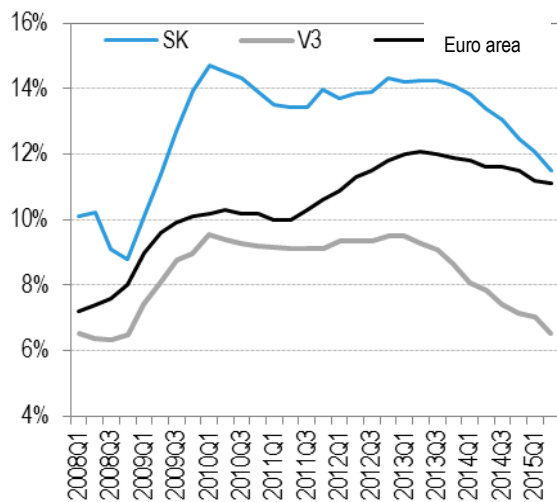
Source: Eurostat, SO SR

Chart 23: Total and long-term unemployment rate (%, 2014)
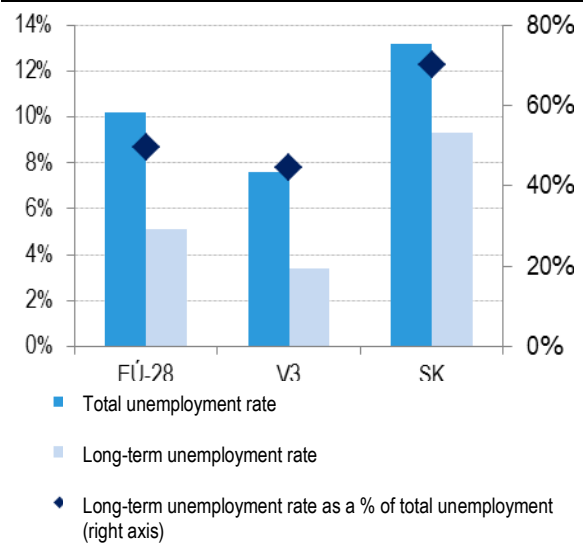
Source: Eurostat

The construction of **missing sections of motorways and expressways**, as well as the construction, renewal and **maintenance of class A roads,** are the main measures in the transport sector. The systematic increase of the significance of railway transportation, as well as the improvement of public passenger transport efficiency is also an important goal.

The modernisation of public administration will continue through the ESO reform (Efficient, Reliable and Open Public Administration) focused on the optimization of regional offices. Support services such as facilities management, accounting, human resources, IT and procurement are gradually being separated from the state and local public administration offices and subsequently reorganized. As part of the ESO reform 25 client centres were open in 2014 and further 14 were created at regional offices by the end of September 2015. The aim of the reform is to gradually open a total of 79 centres by the end of 2016. The reinforcement of analytical capacities in the state administration will continue, including a mechanism for a regular assessment of public expenditure.

The improvement of the judiciary system should be mainly supported by the new Civil Dispute Code, Civil Non-dispute Code and Administrative Procedure Code, which enter in force from July 2016. The reviews of the codes will positively affect the specialization of the court system and of judges. The ongoing creation of the Electronic Case File, the Electronic Legal Code, and the Electronic Registry of Insolvent Entities will also contribute to the speeding up of judicial proceedings. The stabilisation of the judiciary system will be also supported by the increase of the wages budget for employees in court administration. In the combat against letterbox companies, the amendment to the Public Procurement Act prevented the participation of companies that do not reveal their ownership structure up to the level of individuals in public procurement. In the two-year horizon we expect, beyond public procurement, further measures to combat against letterbox companies due to the transposition of the Anti-Money Laundering Directive from May 2015.

IV.   Comparison with the Stability Programme

The Stability Programme was based on data from the Ministry of Finance's macroeconomic forecast from February 2015. It anticipated GDP growth of 2.9% in 2014. The current forecast of the Ministry of Finance from September 2015, which was used to compile the general government budget proposal, assumes higher economic growth in 2015 (3.2%) and lower growth in 2016 (3.1%). In subsequent years the economy will grow by 3.6%.

Table 12: Forecast of selected economic development indicators in SR

No.	Indicator	Unit of measure	Stability Programme				Budget proposal			
			2015	2016	2017	2018	2015	2016	2017	2018
1	GDP, at current prices	€ billion	77.3	81.3	85.7	90.6	77.5	80.6	85.1	89.9
2	GDP, at constant prices	%	2.9	3.6	3.6	3.7	3.2	3.1	3.6	3.6
3	Final consumption of households and non-profit institutions serving households (NPISH)	%	2.8	2.7	2.8	2.9	2.1	2.7	2.7	2.8
4	Final general government consumption	%	2.3	1	1.2	1.3	3.4	-0.7	1.5	1.5
5	Gross fixed capital formation	%	3.7	1.8	1.7	2.1	7.6	-0.7	2.0	3.2
6	Exports of goods and services	%	1.4	5.9	6	6.1	6.1	5.6	6.3	5.6
7	Imports of goods and services	%	1	4.5	4.9	4.8	7.1	3.9	4.9	5.0
8	Average monthly wage in the economy (nominal growth)	%	2.6	3.9	4.4	4.6	2.4	3.1	4.6	4.7
9	Average employment growth, Labour Force Sample Survey (LFSS)	%	0.7	0.7	0.8	0.9	2.2	1.0	0.8	0.9
10	Average employment growth, ESA 2010	%	0.6	0.7	0.7	0.8	1.8	1.0	0.7	0.8
11	Average unemployment rate, LFSS	%	12.9	12.2	11.4	10.5	11.5	10.6	9.8	9.0
12	Average registered unemployment rate	%	11.7	11	10.3	9.4	10.6	9.6	8.8	8.0
13	Harmonised index of consumer prices (HICP)	%	0	1.6	1.8	2	-0.2	0.9	1.8	2.0
14	Current account balance (percentage of GDP)	%	1.9	2.9	3.5	4.5	-0.6	0.9	1.8	1.7

Source: MoF SR

Compared with the Stability Programme the general government balance in 2014 should improve on the basis of the data sent to Eurostat as part of the autumn EDP notification, caused mainly by the update of revenues from the corporate income tax. In the event of the realisation of the negative risks, a deterioration of the general government balance by some 0.2% of GDP is expected in 2015. The draft budgetary objective for 2016 remains unchanged compared to the assumptions of the Stability Programme, while in 2017 and 2018 the objectives tighten by about 0.5% of GDP, reflecting the recent revision of the structural balance.

The update of the macroeconomic assumptions and expectations of the macroeconomic development worsened the general government balance estimate in the no-policy-change scenario in 2016 to 2018. The more pronounced difference in 2016 is caused mainly by the worse expected development of general government balance in the base year 2015, as well as by the slightly more negative economic development over the forecast horizon.

Table 13: Comparison with the Stability Programme

	ESA code	2014	2015	2016	2017	2018
		% GDP	% GDP	% GDP	% GDP	% GDP
Target general government balances	**B.9**					
Stability Programme (1)		-2.9	-2.5	-1.9	-0.9	-0.5
Draft Budgetary Plan (2)		-2.8	-2.7	-1.9	-0.4	0
Difference (2-1)		**0.1**	**-0.2**	**0.0**	**0.5**	**0.5**
General government balances based on no-policy-change scenario	**B.9**					
Stability Programme (1)		-	-	-1.6	-1.5	-1.4
Draft Budgetary Plan (2)		-	-	-2.2	-1.8	-1.6
Difference (2-1)		**-**	**-**	**-0.6**	**-0.3**	**-0.2**

Source: MoF SR

Since the publication of the Stability Programme, a significant statistical revision of data on the output gap has taken place, which enters into the calculation of the structural balance. According to the updated data, the negative output gap of the Slovak economy is smaller compared with the previous estimates that used the EC methodology. As a result, between 2013 and 2018, the structural deficit deepens by an average of 0.5 p.p. due to the changes in the cyclical component

Upholding the plan to achieve the MTO by 2017, changes in the estimates of structural balance affect the budgetary objectives. Due to the advanced state of the budgetary negotiations and the preparatory work on the budget it was not possible to change the budgetary objective for 2016. However, in order to reach the MTO in the original timeframe, it was necessary to change the budgetary objective by almost 0.5 percentage points in 2017. In 2018, there is similarly a revision of the nominal budget balance, slightly exceeding the level of the reduced estimate of the cyclical component.

Chart 24: Comparison of the structural balance in the Stability Programme and the Draft Budgetary Plan
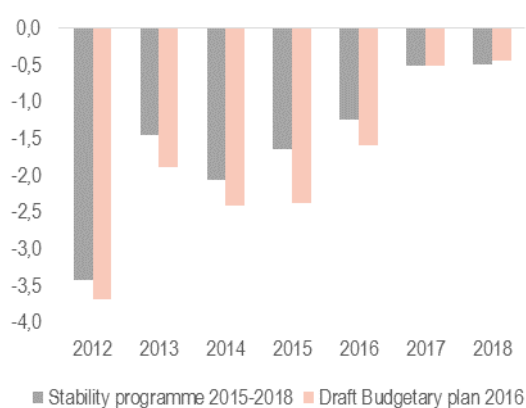
Source: MoF SR

Chart 25: Contributing factors to the revision of the structural balance
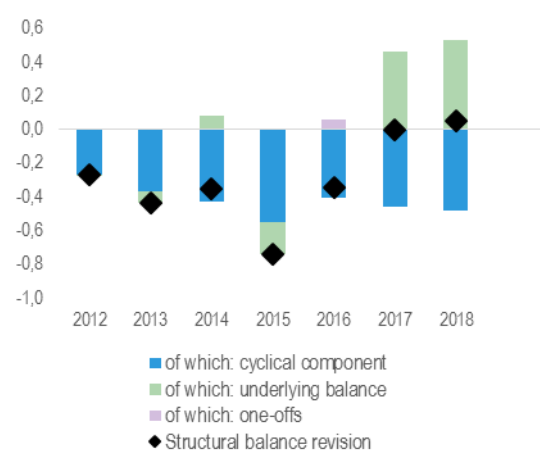
Source: MoF SR

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 effect is understood as any such revenue or expenditure that is not permanent or recurrent in nature and that has a time-limited impact on the general government's budget balance. The Ministry of Finance of the Slovak Republic published a manual[35] defining detailed rules for the recording of one-off measures pursuant to European Commission methodology.

The following one-off measures were identified for years 2015 to 2018:

1. 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 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.

2. In 2016 we expect a one-off increase in expenditure of €48 million due to the payment of reimbursement for the supply of gas to households, which has a direct temporary impact on the expenditure side of the state budget. This is part of the government's first package of measures for the households, which receive back 6% of their annual gas consumption in this way. The decision was taken based on the decrease of gas prices on the market as well as good economic results of the company SPP.

Table A: One-off and temporary measures (ESA 2010, in € million)

	2013	2014	2015 E	2016	2017	2018
Digital dividend	-	164	-	-	-	-
Repayment of Cargo repayable financial assistance (capital transfer in 2009)	-	0	78	-	-	-
Antimonopoly Office fine - construction cartel	-	45	-	-	-	-
Contribution to the EU budget	-	87	-	-	-	-
One – off disbursement of pensions of security forces	-	-58	-	-	-	-
Reimbursement for gas payments for households	-	-	-	-48	-	-
TOTAL	**0**	**238**	**78**	**-48**	**0**	**0**

(+) improves balance, (-) worsens balance   *Source: MoF SR*

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[35] https://www.finance.gov.sk/Default.aspx?CatID=9595

Annex 2: Consolidation effort according to the preventive arm of Stability and Growth Pact

On January 13, 2015, the European Commission published a communication expanding the flexibility of the Stability and Growth Pact (SGP), a key pillar of European fiscal rules. The report responds to the commitment of the new Commission under the leadership of Jean-Claude Juncker to use the existing flexibility in the Stability and Growth Pact in order to create space for pro-growth fiscal position. Without legislative changes, the communication slightly relaxes the rules on the required pace of consolidation and on triggering the excessive deficit procedure. Flexibility covers three areas:

A. **The economic cycle;**
B. **Structural reform clause**;
C. **Investment clause**

A. Economic cycle

The EC has transparently published an updated matrix with the required consolidation effort under different economic conditions, debt levels and long-term sustainability risk. Compared with the original matrix, the possibility for more countercyclical fiscal policy is better reflected in the preventive arm of the pact. The new interpretation tightens the required level of consolidation for overheating economies and, conversely, eases the pace for countries significantly below their potential. The assessment does not change in the corrective arm, where it already takes into account several additional factors reflecting the economic development and errors in the forecasts of the EC.

Condition	Required annual consolidation	
	Debt below 60% and no sustainability risk	Debt above 60% or sustainability risk
Real GDP growth < 0 or output gap < -4	No consolidation need	
-4 < output gap < -3	0	0.25
-3 < output gap < -1.5	0 in case of widening output gap, 0.25 in case of closing output gap	0.25 in case of widening output gap, 0.5 in case of closing output gap
-1.5 < output gap < 1.5	0.5	> 0.5
output gap > 1.5	> 0.5 in case of widening output gap, > 0.75 in case of closing output gap	> 0.75 in case of widening output gap, > 1 in case of closing output gap

B. Structural reform clause

In the preventive and corrective arm of the Pact, the costs (fiscal impacts) of major structural reforms with a verifiable impact on long-term sustainability, including by raising potential growth, will be taken into account. Reforms must meet a number of conditions:

- they must be implemented, or sufficiently specified (including planned implementation timetable);
- at the time of the application of the clause, structural deficit must not be larger by more than 1.5% of GDP compared to the MTO;
- the temporary deviation from the required annual consolidation must not reach above 0.5% of GDP, must not lead to a deficit above the reference level of 3% of GDP. At the same time the MTO must be reached within 4 years of the application of the structural reform clause;

C. Investment clause

The extension of the investment clause follows the establishment of the European Fund for Strategic Investment (EFSI). It is therefore also possible to apply the investment clause with respect to contributions to the EFSI. Compared with the original interpretation, a requirement to achieve the MTO (structurally balanced budget objective) within the four year horizon of the Stability Programme was introduced, while at the same time the debt criteria no longer needs to be taken into account when activating the investment clause. With respect to the application of the clause, only cyclical conditions of individual countries are now decisive (output gap significantly below potential), disregarding the development of the euro area as a whole.

Annex 3: Measures included in the general government budget proposal (ESA 2010, compared to NPC)

Impact of legislative measures on tax and security contributions revenues of the GG (% GDP, ESA 2010)

	Subsector	ESA2010	2016	2017	2018
Act 222/2004 Coll. on VAT			0.01	0.00	0.00
VAT	S.1311	D.211	0.01	0.00	0.00
Act 106/2004 Coll. on Excise taxes from tobacco products			0.01	0.04	0.04
Excise tax on tobacco	S.1311	D.214A	0.01	0.04	0.04
VAT	S.1311	D.211	0.00	0.00	0.00
Act 595/2003 Coll. on Income tax			-0.01	-0.01	-0.01
Personal income tax	S.1311	D.51A	-0.01	-0.01	-0.01
Personal income tax from dependent activity	S.1311	D.51A	0.00	0.00	0.00
Personal income tax from self-employment	S.1311	D.51A	0.00	0.00	-0.01
- of which: municipalities	S.1313		0.04	0.04	0.04
- of which: Higher territorial units	S.1313		0.02	0.02	0.02
- of which: state	S.1311		-0.07	-0.07	-0.07
Corporate income tax	S.1311	D.51B	0.00	0.00	0.00
Withholding income tax	S.1311	D.51E	-0.01	0.00	0.00
Social security contributions	S.1314	D.61	0.00	0.00	0.00
Healthcare contributions	S.1314		0.00	0.00	0.00
Act No. 580/2004 Coll. on Healthcare insurance and changes and amendments to the Act No. 95/2002 Coll.			0.00	0.00	0.00
Healthcare contributions	S.1314		0.00	0.00	0.00
Act on Sport	S.1311		0.00	0.00	0.00
Act 145/1995 Coll. on Administrative charges			0.00	0.00	0.00
Administrative charges (isn't tax revenue of the GG budget according to the economic classification of the budget)			0.00	0.00	0.00
Other changes			-0.08	-0.14	-0.17

Note (+) higher revenues

Impact of legislative measures on the expenditure of the GG (% of GDP, ESA 2010)

	Subsector	ESA2010	2016	2017	2018
Social packages (measures from 2016)			-0.17	-0.10	-0.10
Skiing training (social package 2)	S.1311	P.2	-0.03	-0.03	-0.03
Support for regions (social package 2)	S.1311	P.2	-0.01	-0.01	-0.01
Subsidies for insulation (social package 2)	S.1311	D.9	-0.04	-0.04	-0.04
Reimbursements for gas (social package 1)	S.1311	D.62	-0.06	0.00	0.00
Increase of maternity benefits (social package 2)	S.1314	D.62	-0.01	-0.01	-0.01
Increase of child care allowance (social package 2)	S.1311	D.62	0.00	0.00	0.00
Compensations			-0.22	0.04	0.27
Collective bargaining – 4% growth of tariffs in the GG	S.1311	D.1P	-0.19	-0.18	-0.18
Judicial clerks	S.1311	D.1P	0.00	0.00	0.00
Other changes compared to NPC		D.1P	-0.03	0.22	0.45
Healthcare			-0.07	-0.07	-0.07
Increase of wages of nurses and healthcare professionals (except physicians)	S.13	D.632P	-0.07	-0.07	-0.07
Reserves			-0.11	-0.11	-0.11

Reserve to account for effects of new legislation and other effects (mostly VAT)	S.1311	D.7P	-0.11	-0.11	-0.11
Other changes compared to NPC on the expenditure side:					
Intermediate consumption total		P.2	0.63	0.79	0.88
Current transfers		D.7P	-0.12	0.01	0.01
Gross fixed capital formation total		P.51G	0.15	0.24	0.16
Capital transfers total		D.9P	0.21	0.24	0.24
Subsidies	S.1311	D.3	0.02	0.03	0.03
Other changes	S.13		-0.01	0.00	0.01

Note (+) decrease of expenditure

Source: MoF SR

Annex 4 – Methodology for stochastic debt forecast (in short version)

The level of government debt is the result of multiple factors. As a result it is not easy to determine its statistical properties directly in order to quantify the forecast risk. For this reason an indirect simulation approach[36] was used. It generates a large number of random trajectories for each determinant of debt and these trajectories are then aggregated using a standard equation for debt development:

$$d = (1+i)/[(1+g)*(1+p)]*d\{-1\} - ps + nondeffin$$

The debt equation states that in each year the debt is dependent on its value in the previous year, the interest paid on the value of the debt, the primary deficit, the size of the non-deficit debt financing and, finally, the growth of nominal GDP. All variables, including debt itself, are expressed in proportion to the nominal gross domestic product.

The resulting stochastic debt forecast, along with confidence intervals, is based on a simulation of a large number[37] of random trajectories of these components, which determine the individual trajectories of debt through the debt equation. These debt simulations can then be easily used to extract the median forecast, which is presented as an alternative forecast, as well as quantiles for the graphical representation of the probability distribution of debt over the forecast horizon using a so-called fan chart. The fan-chart graphically presents the probability distribution of future values of debt. 80% of all potential future realizations of debt should lie within the shaded areas, while each colour interval represents the width of an interval which contains 10% of all realizations of debt levels.

Trajectories of debt determinants are obtained in three different steps, which are explained in more detail below in the text. The macro model first generates the simulations of real GDP growth along with its price and interest rates. Independently of the other components, the non-deficit financing is simulated. Finally, the trajectories of the primary budget balance are obtained using the fiscal reaction function. Since the value of the primary balance in each year depends also on the amount of debt in the previous period, the fiscal reaction function must be simulated together with the debt equation. The result of this step is thus the trajectory of the debt itself along with the primary balance forecast.

The random trajectories of the macro variables, i.e. real GDP growth, inflation in price of GDP and interest rates are simulated using a vector autoregression model of a small open economy with seven variables: real GDP growth, inflation in GDP deflator, interest rates (yields on government bonds), the same three variables corresponding to the European Union aggregates, and the nominal effective exchange rate. The model is restricted in such a way that foreign variables influence domestic variables, while the domestic variables have no effect on the foreign variables. The estimated model, together with its residuals' variance-covariance matrix, is used to simulate the random trajectories of macro variables that enter into the other parts of the debt model. The advantage of a model that features only macro variables is that it can be fairly reliably estimated using quarterly data[38]. If fiscal variables (such as deficit or debt) were included in the model, the model would have to be specified using annual data, which would significantly limit the number of observations and reduce the quality of the estimates. The quarterly data needs to be subsequently annualized, as the data in the next steps is measured on an annual basis.

Non-deficit debt financing represents the residual in the debt equation. The statistical properties of this component suggest that it can be modelled as an i.i.d. process, i.e. independently of the other components of the

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[36] The methodology we have chosen is closest to Medeiros (2012): Stochastic debt simulation using VAR models and a panel fiscal reaction function: results for a selected number of countries, European Economy, Economic Papers, No. 459
[37] We simulated 5000 trajectories.
[38] The VAR (3) model is estimated on date from 1997Q1 to 20015Q2.

debt equation and even independently of its past values. The question remains whether this component should be modelled in the same form in which it enters the debt equation, i.e. as a share of GDP, or as a level variable. If this component were simulated as a share of GDP, the GDP trajectories obtained in the previous step would be ignored, because such a simulation implicitly contains an assumption on GDP development. Conversely, since the of this components is specified in nominal terms, it can be assumed that it grows in time (in absolute value). A simple simulation based on a constant standard deviation abstracts from the nominal growth. It may, however, be reasonably assumed that during the four year period of the forecast this problem does not pose a significant risks of inaccuracies, and therefore the simulation of the level of non-deficit financing together with GDP trajectories from the first step is preferred, ensuring consistency.

The remaining component, primary deficit, is calculated from the estimated fiscal reaction function[39].

$$ps = a0 + a1*d(t-1)\ a2*gap + res$$

The fiscal reaction function quantifies the reaction of the primary deficit on past level of debt and the state of the economic cycle[40]. The state of the cycle is characterized by the output gap obtained from the individual trajectories of GDP simulated in the first step using the HP filter. A randomly generated value of the residual in the fiscal function closes the set of information which is necessary for estimating the primary deficit. The estimate of the primary deficit, together with the results of the first and the second step, are sufficient for calculating the level of debt in each year using the first equation from the beginning of the text. This process is iterative, i.e. the simultaneous deficit-debt calculation is repeated for each year of the forecast and for all trajectories of the variables from the first and the second step.

Required statistics are easily calculated from the trajectories of the debt. The median forecast is presented as an alternative forecast. The individual colour intervals in the fan chart represent percentiles (10, 20, 30, 40, 60, 70, 80, 90) of the simulated trajectories.

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[39] The estimated fiscal reaction function is taken from Medeiros (2012), who estimated fiscal functions for OECD countries using panel data methods. To our knowledge this represents the best estimate of reaction function for Slovakia.
[40] and potentially other factors

Annex 5 – Impacts of fiscal policy on the economy in 2016-2018

1. Fiscal consolidation scenarios

In the first scenario for the years 2016 to 2018, it is expected that the fiscal targets will be achieved. The size of the required fiscal measures is calculated with respect to the no-policy-change scenario based on the estimated general government deficit for 2015. **In 2016 the budgetary objective assumes that the fiscal consolidation will be 0.3% of GDP compared with the NPC scenario.** In the next years the required additional permanent consolidation measures amount to 1.2% of GDP in 2017 and 0.2% of GDP in 2018.

Total measures required to achieve the fiscal targets, compared with NPC (ESA2010, % GDP))

	2016	2017	2018
1. Nominal balance – Fiscal targets	-1.9	-0.4	0.0
2. Nominal balance – general government budget	-1.9	-0.9	-0.4
3. Nominal balance – NPC scenario	-2.2	-1.8	-1.6
4. Size of measures in the first scenario (1-3)	0.3	1.4	1.6
- additional consolidation measures requirement in given year (YoY change)	**0.3**	**1.2**	**0.2**
5. Size of measures in the second scenario (2-3)	0.3	1.0	1.2
- additional consolidation measures requirement in given year (YoY change)	**0.3**	**0.7**	**0.2**

Source: MoF SR

In 2017 and 2018 consolidation in the first scenario consists of two types of measures:

- **Consolidation measures specified in the general government budget compared to NPC, which reach 0.7% GDP in 2017 and 0.3% GDP in 2018**
- **Measures beyond the general government budget that are required to achieve the fiscal targets in the amount of 0.5% GDP in 2017; in 2018 they represent a small expansion of 0,0% GDP in 2018**

In 2016 the expenditure side of the government budget contains measures with a direct impact on the GDP of 0.4% of GDP. Within current expenditure there are mainly cuts in intermediate government consumption (0.6% of GDP). Conversely, the compensations of employees will have an expansionary fiscal policy effect, primarily due to the 4-percent increase of tariffs for general government employees (0.2% of GDP). The increase of social transfers in kind (payment to healthcare facilities) includes the adjustment of remuneration of nurses (0.1% of GDP). Significant savings will be achieved in capital expenditure (0.1% of GDP). Measures on the expenditure side will impact the economic growth negatively through lower final consumption of the government and reduced public investments. The growth of compensations in the general government (including salaries of healthcare professionals) will support the growth of the average wage in the national economy. Measures in the area of social benefits (0.1% of GDP) will increase the disposable income of households and, together with the growth of real wage base, will have a positive impact on household consumption.

The expansion on the revenue side of the general government budget with a direct impact on GDP will reach 0.1% of GDP in 2016. The most significant measure is the reduction of VAT on selected types of food, which will slow the pace of inflation and enhance the purchasing power of households.

In 2017, the measures in the general government budget have an identified direct impact on the GDP of 0.6% of GDP and they are present on the expenditure side of the budget (0.6% of GDP). Expenditure measures are included mainly in the current expenditure of the general government budget, specifically in compensations of employees (0.2% of GDP), intermediate government consumption (0.2% of GDP) and social

benefits (0.1% of GDP). The capital expenditure of the general government budget is planned to contain savings of 0.1% of GDP. The measures will slow down economic growth mainly through lower government consumption, but also by transmission of the slower growth of real wage base in the public sector and household disposable income into lower private consumption. The negative impact on the investment dynamics in the economy will be moderate.

Measures with identified direct impact on GDP included in the general government budget will reach 0.3% of GDP in 2018, and, as in 2017, will be predominantly present on the expenditure side of the budget (0.3% of GDP). In 2018, expenditure measures will include mainly cuts in current expenditure of the general government budget. As in 2017, compensations of employees will be reduced (0.2% of GDP), but the consolidation in the intermediate government consumption will be more moderate (0.1% of GDP). Unlike in the previous year, there will be no savings in social benefits. The increase of capital expenditure above NPC will have an expansionary effect (0.1% of GDP). Fiscal policy will thus slow down the economic growth primarily through lower government consumption and wage base in the public sector. At the same time its stance will be neutral in the social transfers to households channel and slightly expansionary in public investment.

As the measures in the general government budget are concentrated almost entirely on the expenditure side, **measures beyond the general government budget are assumed only on the revenue side of the budget**. A proportional distribution of revenue increases is assumed between direct and indirect taxes and contributions (so called tax and social contributions mix) based on the notified final structure of the government budget in 2014. As a result, this group of measures will impact the economy through all the transmission channels of fiscal policy.

Scenario 1 Transmission macroeconomic channels (% GDP)

	2016	2017	2018
Size of measures	-0.26	-1.18	-0.23
Size of measures with an impact on GDP	**-0.24**	**-1.08**	**-0.25**
Government consumption	**-0.28**	**-0.43**	**-0.35**
Intermediate consumption of the government	-0.58	-0.19	-0.13
Compensations of employees	0.22	-0.25	-0.23
Social transfers in kind (healthcare facilities)	0.07	0.00	0.00
Market production	0.02	0.01	0.01
Investment	**-0.15**	**-0.17**	**0.07**
Government	-0.15	-0.10	0.07
Other	-0.01	-0.07	0.00
Gross disposable household income	**0.12**	**-0.25**	**0.01**
Inflation	**0.07**	**-0.23**	**0.02**

Source: MoF SR

In the second scenario for the years 2016 to 2018, the macroeconomic impact of reaching the deficits of the general government budget for the years 2016 to 2018 are modelled. In 2016 the consolidation is identical to the first scenario, reaching 0.3% of GDP. In 2017 and 2018, the second scenario contains only the measures included in the general government budget, i.e. only the first group of measures from the first scenario, which amount to 0.7% of GDP in 2017 and 0.3% of GDP in 2018.

Scenario 2 Transmission macroeconomic channels (% GDP)

	2016	2017	2018
Size of measures	-0.26	-0.72	-0.25
Size of measures with an impact on GDP	**-0.24**	**-0.62**	**-0.28**
Government consumption	**-0.28**	**-0.43**	**-0.35**
Intermediate consumption of the government	-0.58	-0.19	-0.13
Compensations of employees	0.22	-0.25	-0.23
Social transfers in kind (healthcare facilities)	0.07	0.00	0.00
Market production	0.02	0.01	0.01
Investment	**-0.15**	**-0.11**	**0.07**
Government	-0.15	-0.10	0.07
Other	-0.01	0.00	0.00
Gross disposable household income	**0.12**	**-0.06**	**0.00**
Inflation	**0.07**	**-0.01**	**0.00**

Source: MoF SR

2. Quantification of macroeconomic impacts of fiscal scenarios

In the following part, the aggregate impact of fiscal policy on the main macroeconomic variables of the Slovak economy, including secondary effects, is calculated using the macroeconomic model of the IFP for medium-term forecasting.

Based on the first scenario, the impact of fiscal policy on GDP growth is negative in 2016, amounting to 0.1 p.p. In the following period the consolidation measures will reduce the economic growth by 0.5 p.p. in 2017 and 0.1 p.p. in 2018. The implied fiscal multiplier reaches 0.50 in 2016. Despite a more significant amount of revenue measures in 2017, the multiplier estimate for 2017 is only slightly lower, at 0.46. The main reason for this is a significantly different structure of expenditure measures. The multiplier estimate is highest for the year 2018, when it reaches 0.58 in accordance with the purely expenditure-based consolidation of public finances.

First scenario – Impact of measures on the GDP (in p.p.) based on the macroeconomic model of the IFP

	2016	2017	2018
measures with a direct impact on the GDP	**-0.2**	**-1.1**	**-0.3**
contribution to the change in CPI of	-0.2	0.4	0.0
employment	0.0	-0.5	-0.3
nominal wage	0.4	-0.3	-0.2
household consumption	0.4	-0.6	-0.1
government consumption	-2.9	-2.7	-2.0
investment	-0.6	-1.3	0.2
imports	-0.3	-0.6	-0.2
contribution to the YoY change of GDP	**-0.1**	**-0.5**	**-0.1**

Source: MoF SR

In the second scenario, the consolidation measures included in the general government budget reduce the economic growth by 0.4 p.p. in 2017 and by 0.2 p.p. in 2018[41]. Due to the fact that in 2017 and 2018 the consolidation consists purely of expenditure measures, the fiscal multipliers are higher, reaching the upper limit of the estimates for the Slovak economy. In 2017 and 2018 they reach the values of 0.66 and 0.59.

Second scenario – Impact of measures on the GDP (in p.p.) based on the macroeconomic model of the IFP

	2016	2017	2018
measures with a direct impact on the GDP	**-0.2**	**-0.6**	**-0.3**
contribution to the change in CPI of	-0.2	0.0	0.0
employment	0.0	-0.4	-0.4
nominal wage	0.4	-0.4	-0.3
household consumption	0.4	-0.3	-0.2
government consumption	-2.9	-2.4	-2.0
investment	-0.6	-0.9	0.2
imports	-0.3	-0.4	-0.2
contribution to the YoY change of GDP	**-0.1**	**-0.4**	**-0.2**

Source: MoF SR

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[41] In 2016 the impact is identical to the first scenario.

Annex 6: Assumptions for the quantification of the effects of legislation

Lowered VAT:

The quantification of the reduced VAT rate is based on the data on the consumption from household accounts survey and on the household consumption basket for calculating the CPI. The calculation of the final effect of the legislative changes analytically reflects the substitution effects of various goods with their close substitutes. The shortfall of revenues is adjusted for the collection efficiency, which means we do not expect a 100% reflection of the reduced rate on the revenue shortfall.

Excise taxes on tobacco:

Change of taxation of cigars and cigarillos from pieces to weight:

The quantification is based on the data from tax returns in 2013 and partly also on the data for the first half of 2014. The positive effect of the legislation is expected due to the removal of the tax advantage of taxation of cigars by pieces which led to rising tax optimization through the salsas of alternative tobacco packaged as selected types of cigars. The estimates of the amounts of standard cigars and alternative cigars with usable tobacco is based on consultations with the representatives of the tobacco industry. The assumed average weight of one piece of cigarillos is 2.3 g and 7.8 g for cigars.

Unification of cigarette packaging to 20 pieces

The quantification is based on the data on the volume and structure of cigarettes in 2014 (98.5% of cigarettes released in the market- 19 pieces in a pack, 1.5% of cigarettes - 20 pieces in a pack). The positive effect is based on the assumption of increased consumption in the part of smokers who smoke a pack a day on average (assuming that consumers who smoked "in pieces" will buy the same number of cigarettes as now). To identify the structure of the smokers, data from individual consumption surveys were used. The calculation of the final impact analytically takes into account the elasticity of demand to price changes as well, based on foreign literature (40%).

Annex 7: Required Tables

Table 0i - Basic assumptions

	2014	2015	2016
Short-term interest rate (annual average)	0.2	0.0	0.1
Long-term interest rate (annual average)	1.9	0.9	1.6
USD/€ exchange rate (average)	1.33	1.11	1.08
World GDP growth	3.4	3.1	3.6
Nominal effective exchange rate (change in %)	-1.2	0.2	0.5
EA GDP growth	0.9	1.5	1.8
Growth of relevant foreign markets	2.2	2.4	2.3
World imports growth	3.5	3.7	4.1
Oil prices (Brent, USD/barrel)	74.6	48.8	47.9

Source: MoF SR

Table 0ii - Main assumptions

	2014	2015	2016
1. External environment			
Oil prices (€)	74.6	48.8	47.9
2. Fiscal policy			
Net lending/net borrowing of the general government	-2.8	-2.7	-1.9
Gross debt of the general government	54.6	52.8	52.1
3. Monetary policy, financial sector			
Interest rates:			
3M Euribor (average)	0.2	0.0	0.1
Deposit rates	0.8	0.6	0.6
Yield to maturity of 10-year Slovak government bonds (average)	1.9	0.9	1.6
Evolution of deposits	4.6	5.6	4.5
4. Demographic trends			
Evolution of working-age population	0.2	0.3	0.0
Total dependency ratio	40.9	41.6	42.5

Source: MoF SR

Table 1.a - Macroeconomic overview

	ESA code	2014 Level	2014 rate of change	2015 rate of change	2016 rate of change
1. Real GDP	B1*g	72.8	2.4	3.2	3.1
of which					
1.1 Attributed to the estimated impact of aggregated budgetary measures on economic growth		-	-	-	0.1
2. Potential GDP		74.0	2.1	2.6	2.7
contributions:					
- labour		-	0.6	0.8	0.9
- capital		-	0.1	0.2	0.2
- total factor productivity		-	1.4	1.5	1.6
3. Nominal GDP	B1*g	75.2	2.2	3.0	4.1
Components of real GDP					
4. Private final consumption expenditure	P.3	39.2	2.2	2.1	2.7
5. Government final consumption expenditure	P.3	13.2	4.4	3.4	-0.7
6. Gross fixed capital formation	P.51g	15.7	5.7	7.6	-0.7
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53		-0.2	0.0	0.0
8. Exports of goods and services	P.6	69.2	4.6	6.1	5.6
9. Imports of goods and services	P.7	64.2	5.0	7.1	3.9
Contributions to real GDP growth					
10. Final domestic demand		-	3.16	3.36	1.18
11. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.40	0.20	-0.04
12. External balance of goods and services	B.11	-	-0.03	-0.46	1.93

Source: MoF SR

Table 1.b - Price developments

	ESA code	2014 Level	2014 rate of change	2015 rate of change	2016 rate of change
1. GDP deflator		1.0	-0.2	-0.2	0.9
2. Private consumption deflator		1.1	-0.1	0.0	0.8
3. HICP		122.8	-0.1	-0.2	0.9
4. Public consumption deflator		1.1	0.4	0.7	2.3
5. Investment deflator		1.0	-0.1	0.1	0.9
6. Export price deflator (goods and services)		1.0	-3.3	-1.7	0.6
7. Import price deflator (goods and services)		1.0	-3.4	-1.8	0.4

Source: MoF SR

Table 1.c - Labour market developments

	ESA code	2014 Level	2014 rate of change	2015 rate of change	2016 rate of change
1. Employment, persons (thousands) [1]		2 223	1.4	1.8	1.0
2. Employment, hours worked (million)[2]		3 920	0.9	1.4	1.0
3. Unemployment rate (%)[3]			13.2	11.5	10.6
4. Labour productivity, persons (EUR) [4]		32.764	1.0	1.3	2.1
5. Labour productivity, hours worked (EUR) [5]		19	1.5	1.8	2.1
6. Compensation of employees (EUR million)	D.1	28.963	5.6	4.3	4.1
7. Compensation per employee (EUR)		15 274	3.3	2.1	3.0

[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	2014	2015	2016
1. Net lending/net borrowing vis-à-vis the rest of the world	B.9	1.0	0.3	1.9
of which:				
- Balance of goods and services		4.7	4.0	5.7
- Balance of primary incomes and transfers		-4.5	-4.6	-4.8
- Capital Account		0.8	0.9	1.0
2. Net lending/net borrowing of the private sector	B.9	3.8	3.0	3.8
3. Net lending/net borrowing of the general government	EDP B.9	-2.8	-2.7	-1.9
4. Statistical discrepancy		0.0	0.0	0.0

Source: MoF SR

Table 2.a: The development of the general government budget (in % GDP)

	ESA code	2015 % GDP	2016 % GDP
Net lending (+) / net borrowing (-) (EDP B.9) by sub-sector			
1. General government	S.13	-2,7	-1.9
2. Central government	S.1311	-2.6	-2.1
3. State government	S.1312	-	-
4. Local government	S.1313	0.2	0.3
5. Social security funds	S.1314	-0.4	-0.1
6. Interest expenditure	D.41	1.6	1.5
7. Primary balance (1+6)		-1.1	-0.4
8. One-off and other temporary measures		0.1	-0.1
9. Real GDP growth (%)		3.2	3.1
10. Potential GDP growth (%)		2.6	2.7
contributions:			
- labour		0.8	0.9
- capital		0.2	0.2
- total factor productivity		1.5	1.6
11. Output gap (% of potential GDP)		-1.2	-0.7

12. Cyclical budgetary component	-0.5	-0.3
13. Cyclically-adjusted balance (1-12) (% of potential GDP)	-2.3	-1.6
14. Cyclically-adjusted primary balance (13+6) (% of potential GDP)	-0.6	-0.1
15. Structural balance (13-8) (% of potential GDP)	-2.4	-1.6

[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 (% GDP)

	ESA code	**2015**	**2016**
1. Gross debt[1]		52.8	52.1
2. Change in gross debt		-0.8	-0.7
Contribution to change in gross debt			
3. Primary balance		-1.1	-0.4
4. Interest expenditures	D.41	1.6	1.5
5. Stock-flow adjustment		-1.8	-0.5
of which:			
- Differences between cash and accruals		-1.6	-0.4
- Net accumulation of financial assets		-0.4	-0.2
of which: privatisation proceeds		-1.0	-0.0
- Valuation effects and other		0.2	0.1
p.m. Implicit interest rate on debt		3.2	3.1
Other relevant factors			
6. Liquid financial assets		3.8	3.4
7. Net financial debt (1-6)		49.0	48.7
8. Debt amortization (existing bonds) since the end of the previous year		3.2	5.1
9. Percentage of debt denominated in foreign currency		3.5	3.1
10. Average maturity*		6.5	6.5

Note: maturity of the government debt at the end of the year   *Source: MoF SR*

Table 2c:Contingent liabilities (% GDP)

	2014	**2015**	**2016**
Public guarantees	17.8		
of which			
linked to the financial sector	0		

Source: MoF SR

Table 3: General government expenditure and revenue projections according to the no-policy-change scenario (broken down by components)

General government (S13)	ESA code	2015 % GDP	2016 % GDP	2015 € million	2016 € million
1. Total revenue	TR	40.2	37.8	31 160	30 483
Of which		-	-	-	-
1.1. Taxes on production and imports	D.2	10.7	10.5	8 264	8 468
1.2. Current taxes on income, wealth, etc.	D.5	7.1	7.1	5 482	5 739
1.3. Capital taxes	D.91	-	-	-	-
1.4. Social contributions	D.61	13.8	13.5	10 656	10 912
1.5. Property income	D.4	0.8	0.7	584	561
1.6. Other		8.0	6.0	6 175	4 803
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		31.5	31.1	24 402	25 119
2. Total expenditure	TE	43.0	40.0	33 284	32 244
Of which		-	-	-	-
2.1. Compensation of employees	D.1	8.4	8.3	6 494	6 678
2.2. Intermediate consumption	P.2	5.9	5.5	4 545	4 447
2.3. Social payments	D.62, D.632	18.8	18.4	14 578	14 825
of which Unemployment benefits		0.2	0.2	157	147
2.4. Interest expenditure	D.41	1.6	1.5	1 275	1 248
2.5. Subsidies	D.3	0.8	0.8	599	632
2.6. Gross fixed capital formation	P.51	4.3	2.9	3 342	2 342
2.7. Capital transfers	D.9	0.6	0.4	461	319
2.8. Other		2.6	2.2	1 991	1 754

Note.: Data for 2015 represent expected results

Source: MoF SR

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

General government (S13)	ESA code	2015 % GDP	2016 % GDP	2015 € million	2016 € million
1. Total revenue	TR	40.2	37.7	31 160	30 428
Of which					
1.1. Taxes on production and imports	D.2	10.7	10.5	8 264	8 468
1.2. Current taxes on income, wealth, etc.	D.5	7.1	7.1	5 482	5 728
1.3. Capital taxes	D.91	0.0	0.0	0	0
1.4. Social contributions	D.61	13.8	13.5	10 656	10 908
1.5. Property income	D.4	0.8	0.7	584	561
1.6. Other[1]		8.0	5.9	6 175	4 746
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		31.5	31.1	24 402	25 121
2. Total expenditure	TE[3]	43.0	39.7	33 284	31 985
Of which					
2.1. Compensation of employees	D.1	8.4	8.5	6 494	6 857
2.2. Intermediate consumption	P.2	5.9	4.9	4 545	3 975
2.3. Social payments	D.62[6], D.632	18.8	18.5	14 578	14 947
of which Unemployment benefits		0.2	0.2	157	147
2.4. Interest expenditure	D.41	1.6	1.5	1 275	1 248
2.5. Subsidies	D.3	0.8	0.8	599	612
2.6. Gross fixed capital formation	P.51	4.3	2.8	3 342	2 222
2.7. Capital transfers	D.9	0.6	0.2	461	188
2.8. Other[2]		2.6	2.4	1 991	1 935

[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.
Note: Data for 2015 represent expected results.

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

	2014 € million	2014 % GDP	2015 % GDP	2016 % GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	1,195	1.6	2.8	1.4
2. Cyclical unemployment benefit expenditure	15	0.0	0.0	0.0
3. Effect of discretionary revenue measures	-35	0.0	0.1	-0.1
4. Revenue increases mandated by law	0	0	0	0

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

	2014 % GDP	2014 % TE	2015 % GDP	2015 % TE
Education	4.1	9.5	3.8	9.5
Healthcare	7.3	17.0	7.1	18.0
Employment*	0.5	1.1	0.2	0.6

Note: TE – Total expenditure of the general government. *Source: Eurostat*

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

Functions	COFOG code	2015		2016	
		% of GDP	% TE	% GDP	% TE
1. General public services	1	6.1	14.1	5.2	13.1
2. Defence	2	1.0	2.4	1.0	2.5
3. Public order and safety	3	2.1	5.0	2.0	5.0
4. Economic affairs	4	5.8	13.4	4.5	11.5
5. Environmental protection	5	0.6	1.4	0.4	1.0
6. Housing and community amenities	6	0.5	1.2	0.5	1.3
7. Health	7	7.3	17.0	7.1	18.0
8. Recreation, culture and religion	8	1.0	2.4	0.9	2.4
9. Education	9	4.1	9.5	3.8	9.5
10. Social protection	10	14.4	33.5	14.1	35.6
Total expenditure	**TE**	**43.0**	**100.0**	**39.7**	**100.0**

Note: TE – Total expenditure of the general government

Table 5.a: Effect of legislative measure on tax and social contributions revenue of the GG (% GDP, ESA 2010)

	Subsector	ESA2010	2016
Act 222/2004 Coll. on VAT			0.01
VAT	S.1311	D.211	0.01
Act 106/2004 Coll. on Excise taxes from tobacco products			0.01
Excise tax on tobacco	S.1311	D.214A	0.01
VAT	S.1311	D.211	0.00
Act 595/2003 Coll. on Income tax			-0.01
Personal income tax	S.1311	D.51A	-0.01
Personal income tax from dependent activity	S.1311	D.51A	0.00
Personal income tax from self-employment	S.1311	D.51A	0.00
- of which: municipalities	S.1313		0.04
- of which: Higher territorial units	S.1313		0.02
- of which: state	S.1311		-0.07
Corporate income tax	S.1311	D.51B	0.00
Withholding income tax	S.1311	D.51E	-0.01
Social security contributions	S.1314	D.61	0.00
Healthcare contributions	S.1314		0.00
Act No. 580/2004 Coll. on Healthcare insurance and changes and amendments to the Act No. 95/2002 Coll.			0.00
Healthcare contributions	S.1314		0.00
Act on Sport	S.1311		0.00
Act 145/1995 Coll. on Administrative charges			0.00
Administrative charges (isn't tax revenue of the GG budget according to the economic classification of the budget)			0.00
Other changes			-0.08
Social packages (measures from 2016)			-0.17
Skiing training (social package 2)	S.1311	P.2	-0.03
Support for regions (social package 2)	S.1311	P.2	-0.01
Subsidies for insulation (social package 2)	S.1311	D.9	-0.04
Reimbursements for gas (social package 1)	S.1311	D.62	-0.06
Increase of maternity benefits (social package 2)	S.1314	D.62	-0.01

Increase of childcare allowance (social package 2)	S.1311	D.62	0.00
Compensations			-0.22
Collective bargaining – 4% growth of tariffs in the GG	S.1311	D.1P	-0.19
Judicial clerks	S.1311	D.1P	0.00
Other changes compared with the NPC		D.1P	-0.03
Healthcare			-0.07
Increase of wages for nurses and healthcare employees (except physicians)	S.13	D.632P	-0.07
Reserves			-0.11
Reserve to account for effects of new legislation and other effects (mostly VAT)	S.1311	D.7P	-0.11
Other changes compared with the NPC on the expenditure side:			
Intermediate consumption total		P.2	0.63
Current transfers		D.7P	-0.12
Gross fixed capital formation total		P.51G	0.15
Capital transfers total		D.9P	0.20
Subsidies	S.1311	D.3	0.02
Other changes	S.13		-0.01

Note (+) decrease of expenditure or increase of revenues

Source: MoF SR

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

CSR number	Measure	Objectives
1	**Improve the cost-effectiveness of the healthcare sector, including by improving the management of hospital care and strengthening primary healthcare. Take measures to increase tax collection.**	
1	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, publication of corporate income tax payments. 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.
1	Establishment of an analytical unit at the Financial Directorate of the SR	Strengthening of analytical capacities and the establishment of an analytical unit at the Financial Directorate of the SR
1	Payments for DRG groups	Introduction of a system of data reporting required for the correct calculation of the individual weights and the implementation of the system of payments for treatment, which takes into account the difficulty of diagnosis, complications and length of hospital stay (so called Case-mix). This applies to in-patient facilities.
1	Efficiency of financial management of hospital	Balanced economic results of teaching and university hospitals will be achieved by the end of 2015 through more efficient management, optimization of the number of employees and centralized procurement.
2	**Take additional measures to address long term unemployment by introducing activation measures, second chance education and high-quality training tailored to individuals' needs. Improve the incentives for women to remain in or return to employment by improving the provision of childcare facilities.**	

2	New or innovated active labour market policies (ALMP)	Implementation of programmes directed at obtaining on-the-job work experience and consecutive employment of young unemployed persons. From September it is possible to submit applications for national projects "Work Experience for Future Employment" and "Graduate Practice Starts up Employment" with a total ESF allocation of €56.6 million. In order to support labour mobility, the financial support for jobseekers who look for work outside of their place of residence will be modified (in effect from January 2016) The national project "Family and Work" that supports the employment of mothers with young children with a total ESF allocation of €23m will continue until October 2015.
2	Public employment services reform	Internal reallocation of staff of labour offices will take place, the points of first contact for clients will be strengthened and the numbers of professional advisors and agents for the contact with employers will be partially increased. Cross-sectional support activities of labour offices will be made more efficient. Additionally, their capacities will be increased and employees will be re-trained for contact with clients and expert advisory.
	Childcare allowance	From January 2016, an increased childcare allowance will be provided in order to cover the parents' costs of private kindergartens. The budgeted amount for 2016 is €9.3 million, of which €6.8 million is planned to be funded from the ESF.
2	Enlargement of kindergarten capacities	For 2015 a subsidy of €9.5 million was approved for the enlargement of the capacities of 113 kindergartens. In total 167 new classrooms will be supported, attended by 3,670 children. In the second round more kindergartens will be supported with additional €5 million.
3	**Improve teacher training and the attractiveness of teaching as a profession to stem the decline in educational outcomes. Increase the participation of Roma children in mainstream education and in high-quality early childhood education.**	
3	Higher wages for teachers	As in 2013 and 2014, wages of teachers in regional education will also grow by about 5% in 2015. Their average wage should thus reach 115% of the average wage in the national economy in 2015, while in 2012 it was only 105%. In the following years the Slovak government will strive to continue the trend of faster increase in teachers' salaries.
3	Less red tape	From September, the extent of the administrative burden on teachers and managers in primary and secondary schools will be reduced. Excessive red tape burdens teachers and limits their opportunities to dedicate themselves fully to the education process.
3	More teaching experience for students	In addition to the increases of teachers' salaries, the quality of teachers should be also improved by enhanced teaching experience during studies and changes in the credit system. Rules for the continuous education and the remuneration system will be adjusted in order to not give incentives for the acquisition of credits regardless of the quality and effectiveness (new professional competences)
3	Teachers' assistants	In the context of the inclusion of marginalized groups, the project of assistants in schools (all-day education) was expanded by €6 million from 2015.
4	**Boost investment in infrastructure, improve and streamline the administrative procedures for obtaining land-use and construction permits. Increase competition in public tenders and improve supervisory mechanisms in public procurement.**	
4	Investment in transport	Currently around 130 km of motorways and expressways are under construction in Slovakia, of which 46 km were added in 2014. All sections of the main motorway route, the D1 motorway between Bratislava and Kosice, with the exception of two sections, are under construction.
4	Electronization of the building procedure	The project aims to prepare and put into practice the program of computerization of the activities of building offices, secondary appeals authorities and the Ministry of Transport, Construction and Regional Development of the Slovak Republic so that citizens and businesses can complete electronically the entire process from application to the issue of a final decision with accordance to the Building Act.

Table 6.b: EU targets for growth and employment

National 2020 headline target	Measure	Objective
Employment	Public employment services reform	The points of first contact for clients will be strengthened and the numbers of professional advisors and agents for the contact with employers will be partially increased. Cross-sectional support activities of labour offices will be made more efficient. Additionally, the capacities will be increased and employees will be re-trained for contact with clients and expert advisory.
	New or innovated active labour market policies (ALMP)	Implementation of programmes directed at obtaining on-the-job work experience and consecutive employment of young unemployed persons ("Work Experience for Future Employment" and "Graduate Practice Starts up Employment"). The national project "Family and Work" that supports the employment of mothers with young children will continue until October 2015. In order to support labour mobility, the financial support for jobseekers who look for work outside of their place of residence will be modified from January 2016. Labour offices will cooperate with private suppliers of employment services. Projects for disadvantaged jobseekers (long-term unemployed, 50+) will be prepared.
	Childcare allowance	From January 2016, an increased childcare allowance will be provided in order to cover the parents' costs of private kindergartens.
Research and development	Implementation of RIS3 strategy	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 in 2016 - 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.
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 in enterprises	Increased energy efficiency in enterprises will be encouraged through energy audits, which will reveal hidden savings opportunities and possible solutions. Large companies will be automatically required to perform such audits.
	Soft loans for businesses for energy efficiency improvements	The Slovseff 3 programme with a total allocation of €40 million provides, after the compliance of conditions for minimum energy savings, soft loans for increasing energy efficiency in enterprises, increasing the energy efficiency of buildings of households and promoting renewable energy.
	Support for insulation of family houses	The government will use €40 million annually from 2016 to support the insulation of family houses with up to 30% of total cost, up to a maximum of €5,000.

Education	Enlargement of kindergarten capacities	In 2015 €15 million was earmarked for two rounds of kindergarten capacities enlargement. The enlargement of capacities of childcare services for children up to 3 years of age will also be supported from ESF.
	Dual education	Support for dual education through tax relief for employers. Dual education will create conditions for better employability of graduates into permanent employment.
	Higher wages for teachers	In 2015 the wages of teachers and professional staff in regional and tertiary education increased by 5%.
Poverty and social inclusion	Teachers assistants	In the context of the inclusion of marginalized groups, the project of assistants in schools (all-day education) was expanded by €6 million from 2015.
	Better access to pre-school education for marginalized communities	Projects focused on the support of community centres and field social work in towns with Roma population are in progress. A project focused on inclusive education of children in pre-school age is ongoing.