EUROPEAN
COMMISSION

Brussels, 28.11.2014
C(2014) 8814 final

# COMMISSION OPINION

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## on the Draft Budgetary Plan of SLOVAKIA

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GENERAL CONSIDERATIONS

1. Council Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Council Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SLOVAKIA

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October 2014 by Slovakia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Slovakia is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO). On 8 July 2014, the Council recommended Slovakia to reinforce the budgetary measures for 2014 and to ensure the required adjustment of 0.1% of GDP towards the MTO in 2015.

5. After a slowdown in 2013, Slovakia's economy has gathered pace in 2014. The Draft Budgetary Plan expects real GDP growth to be 2.4% in 2014 and to slightly increase to 2.6% in 2015. Compared to the latest Stability Programme, real GDP growth in 2015 was revised downwards mainly because of lower projections for public consumption and export growth. This is in line with the Commission 2014 autumn forecast, even though there are some differences regarding the composition of this growth. According to the Draft Budgetary Plan, growth in 2015 would be equally driven by domestic demand and net exports, while in the Commission forecast it is mainly driven by domestic demand. Overall, the macroeconomic scenario underpinning the Draft Budgetary Plan is deemed realistic.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Macroeconomic Forecasting Committee, which serves as an advisory body to the Ministry of Finance. The Committee consists of representatives of private banks, the central bank, the fiscal council and independent economic analysts. Its independence from government influence is anchored in the Committee's statutes.

7. Although the Draft Budgetary Plan formally confirms the deficit target of 2.6% of GDP for 2014 that was contained in the most recent Stability Programme, it indicates that the deficit would reach 2.9% of GDP by year-end without envisaging further

measures to close this gap beyond those stemming from the activation of the national debt brake in May 2014. Against this background and since the data delivered in the context of the Draft Budgetary Plan also specifies a headline deficit of 2.9% of GDP, the assessment of the Draft Budgetary Plan was carried out based on the new official estimate of 2.9% of GDP for the 2014 government deficit. In 2015, the Draft Budgetary plan foresees the headline deficit at 2% of GDP, some 0.5 pp lower compared to the target presented in the latest Stability Programme. This is based on the assumption that the second stage of the national debt brake would be enforced next year as, at the time of preparation of the Draft Budgetary Plan, the latest validated debt-to-GDP ratio for 2013 stood above the 55% threshold for activating the brake.

8. The Commission 2014 autumn forecast projects the headline deficit in 2014 at 3.0% of GDP, only marginally higher than the estimate in the Draft Budgetary Plan. In addition, it identifies uncertainties that could negatively affect the final 2014 deficit outcome. These are principally linked to statistical treatment of proceeds from the sale of mobile phone frequency licences and larger-than-expected financial corrections related to the projects financed with EU funds. The Commission 2014 autumn forecast estimates the 2015 headline deficit at 2.6% of GDP, 0.6 pps higher compared to the Draft Budgetary Plan. The Commission 2014 autumn forecast does not take fully into account the expenditure savings envisaged in the Draft Budgetary Plan because the second stage of the national debt brake will no longer be activated. Indeed, due to statistical revisions in the context of the changeover to the new system of national accounts (ESA 2010), which were not available when the Draft Budgetary Plan was prepared, the debt-to-GDP ratio in 2013 fell below the 55% of GDP threshold, as a result of which the activation of the national debt brake is no longer foreseen. Moreover, the Commission 2014 autumn forecast factors in additional deficit-increasing measures, which are not included in the Draft Budgetary Plan baseline, including an announced reduction in the tax wedge for low paid workers through lower healthcare contributions and increases in teachers' salaries.

9. The Draft Budgetary Plan projects the debt ratio in 2014 and 2015 to be about 1% of GDP lower compared to the latest Stability Programme. This is mainly due to the lower base in 2013 as well as an envisaged strong reduction of the cash reserve. Under this assumption the debt would reach 54.1% of GDP. In 2015, the Draft Budgetary Plan assumes that the envisaged privatisation proceeds from a sale of government's shares in a telecom company will be used for further debt reduction. This would lead to only a small increase in the debt ratio to 54.4% of GDP. This projection is broadly in line with the Commission 2014 autumn forecast although the latter assumes a somewhat stronger increase in the debt ratio in 2015 due to a higher deficit projection.

10. The consolidation effort for 2015 presented in the Draft Budgetary Plan is concentrated on the expenditure side, through savings mandated by the application of the debt brake. The planned expenditure savings are not specified in detail and cannot expected to be implemented in full, as reflected in the Commission 2014 autumn forecast. Additional measures are expected in the context of the state administration reform (ESO), which according to the Draft Budgetary Plan would yield savings mainly from freezing wage bill growth. Savings from planned efficiency increases in the healthcare sector may be overestimated in the short-term. On the revenue side, the Draft Budgetary Plan presents as an important revenue measure repealing the automatic reduction of the VAT rate to 19% and maintaining it

at 20%. Additional revenue measures concentrate on broadening of the tax base for CIT.

11. With a structural deficit of 1.4% of GDP in 2013, Slovakia has not reached its medium term budgetary objective (MTO), a structural deficit of 0.5% of GDP. The Draft Budgetary Plan estimates a deterioration of the (recalculated) structural balance of 0.6% of GDP in 2014, while the deterioration is 0.7% of GDP according to the Commission forecast. Taking into account the "investment clause" in 2014, the planned adjustment towards the MTO, calculated as the change in structural balance, falls short of the requirement in 2014. At the same time, Slovakia meets by a large margin the expenditure benchmark in 2014 according to both estimates. Moreover, the expenditure benchmark appears to better reflect the fiscal effort as, contrary to the structural balance, it is not affected by tax elasiticties that are currently lower than their long-term average. Overall, according to the Commission forecast and in line with the Draft Budgetary Plan, the adjustment path towards the MTO seems to be appropriate and compliant with the requirement of the preventive arm of the Pact in 2014. In 2015, based on projections of the Draft Budgetary Plan, both the change in the recalculated structural balance and the expenditure benchmark pillars are met by a large margin. When looking at two-year averages, Slovakia would respect the requirements of the preventive arm for both indicators. The Commission 2014 autumn forecast, which does not assume the application of the debt brake in 2015, confirms these results. Therefore, the adjustment path towards the MTO seems to be appropriate and compliant with the requirement of the preventive arm of the Pact also in 2015.

12. The Draft Budgetary Plan announces a plan to introduce tax allowances covering the health insurance contributions of low paid workers. While its final parameters are yet to be decided, such a measure has the potential to increase the labour supply of low-income workers and to neutralise the adverse impact that the rise in the minimum wage would have on the demand for these workers. The Draft Budgetary Plan also discusses several measures designed to increase the cost-effectiveness of the healthcare sector, focusing on stopping the accumulation of debt by state hospitals. While these plans are promising, their implementation will only yield results in a middle- and long-term. The Draft Budgetary Plan does not mention any plans to ensure binding and enforceable expenditure ceilings. Finally, measures to address the CSR on linking the basis for real-estate taxation to the market value of the property are envisaged only after 2015.

13. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Slovakia, which is currently under the preventive arm, is compliant with the provisions of the Stability and Growth Pact. In particular, based on the currently available information, the general government deficit would not exceed the Treaty reference value, although there are some uncertainties with respect to the deficit developments in 2014. Slovakia was found to be eligible to the investment clause in 2014, which allows for a temporary deviation from the required adjustment path towards the MTO in that year. In 2015, when this temporary deviation has to be compensated for, Slovakia is projected to make sufficient progress towards the MTO. In light of the above, and taking into account that the national debt brake, underpinning the Draft Budgetary

Plan, is no longer expected to apply, the Commission invites the authorities to stand ready to take the necessary measures within the national budgetary process to ensure that the 2015 budget will remain compliant with the SGP.

The Commission is also of the opinion that Slovakia has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and thus invites the authorities to accelerate implementation.

Done at Brussels, 28.11.2014

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*For the Commission*
*Pierre MOSCOVICI*
*Member of the Commission*