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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plans of Slovakia

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Slovakia

{C(2016) 8017 final}

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1. INTRODUCTION

Slovakia has submitted its Draft Budgetary Plan for 2017 on 12 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Slovakia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2016 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 12 July 2016, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

After an investment-driven expansion in 2015, annual real GDP growth in Slovakia is set to remain solid at 3.6% in 2016, according to the Draft Budgetary Plan (DBP) (see Table 1). The expected downturn in public investment linked to the cycle of EU investment co-funding is largely offset by accelerating private consumption and strengthening net exports. Based on the DBP, the Slovak economy is set to expand by 3.5% in 2017, with household spending and net exports remaining the main drivers of growth. Total investment is forecast to recover on the back of continued private investment activity and a pick-up in public investment spending, reflecting large infrastructure projects such as the Bratislava ring road. At the same time, growth in overall government expenditure is projected in the DBP to ease to below 2% in both years. Following three years of labour market improvement, the DBP expects the unemployment rate to fall below 10% in 2016 and to continue on a downward trend thereafter.

Compared with the latest Stability Programme, the growth rate in the DBP was revised upwards for 2016, mainly on the back of higher government consumption, reflecting the developments in the first half of 2016. In 2017, the DBP macroeconomic scenario is broadly in line with the latest Stability Programme.

The macroeconomic scenario underlying the DBP is broadly in line with the Commission 2016 autumn forecast, with the latter projecting a slightly slower pace of economic expansion in both years. However, the differences are more pronounced with regard to the composition of growth. In contrast to the DBP scenario, the Commission 2016 autumn forecast expects a slightly negative contribution of net exports to overall growth in 2017, mainly on the back of stronger imports reflecting the buoyant investment activity. At the same time, the Commission forecast expects stronger growth in household and government consumption. Overall, the macroeconomic scenario underpinning the DBP appears to be plausible in both years, notwithstanding the somewhat optimistic contribution of net exports to growth and weaker domestic demand in 2017 compared with the Commission forecast.

Box 1: The macro economic forecast underpinning the budget in Slovakia

Slovakia's DBP is based on the macroeconomic forecast published by the Institute for Financial Policy (IFP) of the Ministry of Finance at the end of September and endorsed by the Macroeconomic Forecasting Committee (MFC).

The constitutional act on budgetary responsibility, adopted in December 2011, formally endowed the MFC with the responsibility for assessing macroeconomic forecasts produced by the government. According to the statutes, in its deliberations the MFC is independent and free from the government's influence. The MFC consists of a chairman (the Director of the IFP) and members from nine independent institutions entitled to vote (the Central Bank, the Academy of Science, the Institute of Informatics and Statistics and six commercial banks). There are three other members of the MFC who are in the role of observers without voting rights (the Council for Budgetary Responsibility, the National Statistical Office and one commercial bank).

The MFC assesses whether the draft forecast submitted by the IFP is "conservative", "realistic" or "optimistic". The draft forecast is accepted by the MFC if the majority of voting members assesses the forecast as "conservative" or "realistic". The draft macroeconomic forecast for the DBP was deemed "realistic" by all of the voting members of the MFC at a meeting held on 14 September 2016, according to the minutes published on the website of the IFP.

Table 1. Comparison of macroeconomic developments and forecasts

	2015	2016			2017		
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**
Real GDP (% change)	3.8	3.2	3.6	3.4	3.6	3.5	3.2
Private consumption (% change)	2.2	3.2	2.9	2.9	2.6	2.5	3.3
Gross fixed capital formation (% change)	16.9	0.9	-0.1	-0.9	1.4	4.0	4.9
Exports of goods and services (% change)	7.0	4.9	5.5	5.2	6.1	5.8	5.2
Imports of goods and services (% change)	8.1	3.6	4.2	4.0	4.6	4.9	5.6
Contributions to real GDP growth:							
- Final domestic demand	5.7	1.8	1.9	1.8	2.1	2.5	3.4
- Change in inventories	-1.1	0.0	0.1	0.3	-0.1	-0.1	0.0
- Net exports	-0.7	1.5	1.5	1.2	1.7	1.2	-0.1
Output gap[1]	-1.0	-1.2	-0.3	-0.4	-1.0	0.2	-0.2
Employment (% change)	2.0	1.3	2.1	2.7	0.9	1.5	1.5
Unemployment rate (%)	11.5	10.4	9.8	9.7	9.5	8.5	8.7
Labour productivity (% change)	1.8	1.9	1.4	0.6	2.7	2.0	1.7
HICP inflation (%)	-0.3	0.2	-0.5	-0.5	1.6	0.9	0.8
GDP deflator (% change)	-0.2	0.1	-0.4	-0.2	1.6	0.7	1.0
Comp. of employees (per head, % change)	3.1	3.3	1.9	2.3	4.5	3.8	3.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.2	3.1	0.5	0.3	4.1	0.9	0.3

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The 2016 Stability Programme set the general government deficit target for 2016 at 2.1% of GDP. The DBP revises this target slightly downwards to 2.0% of GDP (Table 2). This is mainly on account of higher receipts from taxes and social contributions compared to the Stability Programme. These will outweigh spending slippages in investments, intermediate consumption, wages, and higher-than-expected financial corrections related to the EU-financed projects. The Commission 2016 autumn forecast projects the 2016 deficit to have reached 2.2% of GDP. The difference vis-à-vis the DBP is driven in particular by expected lower dividend revenue and higher public wages.

For 2017, the DBP retains the headline deficit target of 1.3% of GDP presented in the latest Stability Programme. However, compared to the Stability Programme, the DBP tax revenue projections are higher, having been adjusted to take into account improved tax collection in 2016 and the impact of fiscal measures adopted in 2016. The additional revenue is expected to be fully spent. Compared to 2016, the revenue-to-GDP ratio is projected to remain unchanged at 39.8% of GDP in 2017. Expenditure as a share of GDP is expected to decline by some 0.7 percentage points to 41.1% of GDP in 2017, suggesting that the growth rate of expenditure is kept below the rate of nominal GDP growth. This decline would be also supported by the outlays on the public wage bill.

The Commission 2016 autumn forecast projects the deficit at 1.5% of GDP in 2017, slightly higher compared to the DBP. This is despite a projection of higher revenues mainly due to including the increases in the ceilings for social contributions which were adopted by the Parliament after the submission of the DBP, and an expectation of higher sales revenue mainly on account of incorporating the JAVYS company in the general government sector (about 0.2% of GDP)[1]. The difference is thus driven primarily by the expectation for public wages. While the DBP plans compensations to grow very mildly without providing underlying reasons for this, the Commission forecast projects public wages to retain the dynamics of previous years and to outpace growth of nominal GDP given favourable labour market developments. In addition, the Commission forecast projects a less pronounced decline in the share of social spending on GDP due to the expectation that the additional revenue from higher social contributions will be used for social policies. Moreover, it is expected that the potential savings in the healthcare sector identified in the context of the Value for Money project (see Section 5) would lead to a reallocation of resources within the sector rather than a reduction of total spending on healthcare.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Slovakia currently standing at 0.3[2]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure in Slovakia is expected to fall from 1.8% of GDP in 2015 to 1.5% in 2016 and is projected to decrease further next year, to 1.3% of GDP, well below the 1.8% recorded back in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Slovakia's plans is broadly confirmed by the Commission forecast.

Based on the DBP, the (recalculated) structural balance[3] would improve from -2.3% of GDP in 2015 to -2.0% of GDP in 2016 and further to -1.4% of GDP in 2017. The improvement in the structural balance in each individual year would hence be less than expected in the latest Stability Programme. The main reason is that the DBP points to a more favourable cyclical position of the economy impacting the cyclical part of the headline deficit The Commission forecast confirms the size of the improvement in both years. In 2016, the size of the adjustment is the same despite a different dynamic in the headline deficit, due to a somewhat larger estimate of the output gap estimated on the basis of the Commission forecast and a different assessment of one-off measures (see Section 3.3). In 2017, the improvement in the (recalculated) structural deficit to 1.4% of GDP reflects mainly the improvement in the primary balance both in the DBP and in the Commission forecast.

[1] Unlike the DBP, the Commission forecast accounts for a newly reclassified unit (JAVYS – Nuclear and Decommissioning Company) in the general government sector in the context of the 2016 autumn EDP notification. While this does not influence significantly the deficit, it impacts the level of revenue and expenditure.

[2] 10-year bond yields as of September 2016. Source: ECB.

[3] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**42.9**	**38.6**	***39.8***	**39.9**	**37.6**	***39.8***	**40.3**	**-3.1**
of which:								
- Taxes on production and imports	10.8	10.6	*10.8*	10.6	10.4	*10.9*	10.8	0.1
- Current taxes on income, wealth, etc.	7.4	7.3	*7.8*	7.7	7.0	*7.7*	7.8	0.3
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	14.0	13.7	*14.3*	14.2	13.5	*14.2*	14.4	0.2
- Other (residual)	10.6	7.0	*6.9*	7.3	6.7	*7.0*	7.3	-3.6
Expenditure	**45.6**	**40.7**	**41.8**	**42.1**	**38.9**	**41.1**	**41.8**	**-4.5**
of which:								
- Primary expenditure	43.8	39.2	40.3	40.6	37.5	39.8	40.4	-4.0
of which:								
Compensation of employees	9.0	8.7	9.0	9.1	8.4	8.7	9.2	-0.3
Intermediate consumption	5.9	5.3	5.6	5.6	5.2	5.6	5.6	-0.3
Social payments	19.0	18.5	19.1	19.0	17.7	18.6	18.7	-0.4
Subsidies	0.6	0.5	0.5	0.6	0.5	0.6	0.6	0.0
Gross fixed capital formation	6.3	3.2	3.1	3.3	3.2	3.4	3.6	-2.9
Other (residual)	3.0	3.0	3.0	3.0	2.5	2.9	2.8	-0.1
- Interest expenditure	1.8	1.5	1.5	1.5	1.4	1.3	1.4	-0.5
General government balance (GGB)	**-2.7**	**-2.1**	**-2.0**	**-2.2**	**-1.3**	**-1.3**	**-1.5**	**1.4**
Primary balance	**-1.0**	**-0.6**	**-0.5**	**-0.7**	**0.1**	**0.1**	**-0.1**	**1.1**
One-off and other temporary measures	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-2.7**	**-2.1**	**-2.1**	**-2.1**	**-1.3**	**-1.3**	**-1.5**	**1.4**
Output gap[1]	-1.0	-1.2	-0.3	-0.4	-1.0	0.2	-0.2	1.2
Cyclically-adjusted balance[1]	-2.3	-1.7	-1.9	-2.0	-0.9	-1.4	-1.4	0.9
Structural balance (SB)[2]	**-2.3**	**-1.7**	**-2.0**	**-2.0**	**-0.9**	**-1.4**	**-1.4**	**0.9**
Structural primary balance[2]	-0.5	-0.1	-0.5	-0.5	0.5	-0.1	0.0	0.5

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.2. Debt developments

The DBP projects the general government debt to increase to 53.5% of GDP in 2016, 0.6 percentage points higher compared to the 2016 Stability Programme (Table 3). The DBP assumes a higher stock-flow adjustment mainly on account of the expected increase of cash reserves in order to secure debt repayments in early 2017. After peaking in 2016, the DBP projects the debt-to-GDP ratio to decline to some 52.7% mainly driven by the impact of growth in nominal GDP on the denominator. A small contribution is also provided by a positive primary balance. The Commission 2016 autumn forecast projects the same debt ratio in 2017. Based on the DBP, net debt would remain relatively stable under 49% of GDP. Information in the DBP suggests that

Slovakia would breach the national debt brake thresholds for the debt-to-GDP ratio. In 2016, it would exceed the ceiling of 53% and in the subsequent year the ceiling of 50% of GDP[4].

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**52.5**	**52.9**	**53.5**	**53.3**	**52.2**	**52.7**	**52.7**
Change in the ratio	-1.1	0.4	1.0	0.9	-0.7	-0.8	-0.6
Contributions [2] *:*							
1. Primary balance	**1.0**	**0.6**	**0.5**	**0.7**	**-0.1**	**-0.1**	**0.1**
2. "Snow-ball" effect	**-0.1**	**-0.2**	**-0.1**	**-0.1**	**-1.2**	**-0.8**	**-0.8**
Of which:							
Interest expenditure	1.8	1.5	1.5	1.5	1.4	1.4	1.4
Growth effect	-2.0	-1.6	-1.8	-1.7	-1.8	-1.8	-1.6
Inflation effect	0.1	-0.1	0.2	0.1	-0.8	-0.4	-0.5
3. Stock-flow adjustment	**-2.0**	**-0.1**	**0.6**	**0.3**	**0.7**	**0.1**	**0.1**
Of which:							
Cash/accruals difference		-0.4	0.4		1.1	0.0	
Net accumulation of financial		0.2	0.5		0.0	0.0	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		-0.3	-0.6		-0.4	0.2	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The DBP presents several consolidation measures on the revenue side in 2017 which are outweighed by additional spending (Table 4). The DBP plans extra revenues from a number of measures including an extension and increase of the levy on companies in regulated industries, a prolongation of the bank levy, an increase of excise duties on tobacco, an introduction of a 8% tax on non-life insurances, higher fees on gambling, higher fees for the gas storage collected by the Emergency Oil Stock Agency, and other additional non-tax revenue from sales and current transfers. The reduction of the corporate income tax rate from 22% to 21% and an increase of lump-sum deductions for self-employed will in turn reduce the tax receipts. On balance, these measures should yield additional revenue of 0.4% of GDP vis-

[4] When the debt-to-GDP ratio exceeds 50% the Ministry of Finance has to send a letter to the parliament explaining reasons behind the high debt and propose measures to ensure its reduction. When the debt exceeds 53% of GDP, the salaries of the members of the government are frozen and the government has to provide debt-reducing measures.

à-vis the no-policy-change scenario presented in the DBP[5]. The Commission forecast does not consider the growth of sales revenues a discretionary measure.

In 2018, the DPB expects higher revenue from a new 8% dividend tax which was introduced in 2016 alongside with the elimination of healthcare contributions on dividends. In addition to these measures, in 2017 the Commission forecast also projects higher revenue from an increase of the ceiling for social contributions which was adopted by the Parliament after the submission of the DBP. This additional revenue is set to be spent on social policies. The quantified impact of the revenue measures covered in the DBP appears to be plausible.

On the expenditure side, the DBP plans for 2017 measures that would, on balance, increase the overall spending vis-à-vis the no-policy change scenario presented in the DBP. The main drivers would be higher outlays on teachers' wages, additional spending on goods and services[6], investment[7] and social policies due to the indexation of pensions by 2%, which would be above the regular increase. Despite these deficit-increasing measures estimated in the DBP at 1.5% of GDP, the expenditure-to-GDP ratio is expected to decline. This suggests very subdued growth of expenditure under the no-policy-change scenario presented in the DBP, in particular for wages and healthcare. The DBP also assumes an increase in the surplus of local governments in 2017 without specifying the drivers of this improvement. The Commission forecast takes into account all expenditure measures sufficiently specified in the DBP and projects the expenditure-to-GDP ratio to decrease less than in the DBP mainly due to expected faster growth of expenditure on public wages and healthcare.

The DBP includes two deficit-reducing one-offs in 2016 – a contribution to the Single Resolution Fund (SRF) and savings on the EU budget contribution. The DBP does not incorporate the latest guidance from Eurostat that revenues of the National Resolution Funds and subsequent transfers to the SRF should not have an impact on public balances. The Commission forecast reflects this guidance and hence does not include a contribution to the SRF as a one-off measure. In addition, the Commission forecast includes a small deficit-increasing one-off measure stemming from a correction in the contribution to the EU budget related to the retroactive implementation of the 2014 Own Resources Decision with reference to years 2014 and 2015. Neither the DBP nor the Commission forecast include any one-off measures in 2017.

[5] In addition to the main budgetary scenario, the DBP presents also a fully-fledged no-policy change scenario. Under this scenario, the headline deficit would decline to 0.3% of GDP in 2017. The discretionary measures defined in the DBP are in general measured as a difference between the two scenarios.

[6] A substantial part of this increase is driven by an inclusion of a spending reserve for a potentially faster than expected drawdown on EU funds. This reserve is therefore not yet allocated to any line ministry.

[7] This item also includes a reserve. Thus a certain amount is not yet allocated to any ministry and the reserve would be used mainly for possible faster drawdown on EU funds.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Taxes on production and	0.0	0.1	0.0
Current taxes on income,	0.0	0.2	0.1
Capital taxes			
Social contributions			
Property Income			
Other	0.0	0.2	0.0
Total	0.0	0.4	0.1

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2017

B. Discretionary measures taken by general Government - expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2016	**2017**	**2018**
Compensation of employees	0.0	0.1	0.0
Intermediate consumption	0.0	0.6	0.0
Social payments	0.0	0.1	-0.1
Interest Expenditure			
Subsidies	0.0	0.0	0.0
Gross fixed capital formation	0.0	0.4	-0.3
Capital transfers	0.0	0.1	0.0
Other	0.0	0.3	0.1
Total	0.0	1.5	-0.3

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2017

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Slovakia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO set at -0.5% of GDP. Box 2 reports the latest country-specific recommendations in the area of public finances.

Box 2: Council recommendations addressed to Slovakia
On 12 July 2016, the Council addressed recommendations to Slovakia in the context of the European Semester. In particular, in the area of public finances the Council recommended to Slovakia to achieve an annual fiscal adjustment of 0.25% of GDP towards the medium-term budgetary objective in 2016 and of 0.5% of GDP in 2017.

The structural balance reached -2.3% of GDP in 2015 and remained well below the MTO. In 2016, Slovakia is required to deliver a fiscal effort amounting to 0.25% of GDP. The figures in the DBP point to compliance with the requirements under both the structural balance (with no positive margin) and the expenditure benchmark (a positive margin of 0.2% of GDP) pillars when assessing 2016 alone. When looking over 2015-2016 together, the (recalculated) structural balance pillar points to a risk of some deviation (a gap of 0.1% of GDP) while the expenditure benchmark pillar suggests a risk of significant deviation (a gap of 0.3% of GDP). As the two indicators provide conflicting signals an overall assessment is warranted. In both cases, the results are driven by the 2015 outcomes which were strongly impacted by a surge in drawdown on EU funds, in the final year of the past programming period.[8] In addition, the expenditure benchmark pillar was negatively impacted by a base effect induced by past one-off revenue amounting to 0.3% of GDP. Correcting for these effects in 2015, the two-year average for the expenditure benchmark points to a risk of some deviation, as does the structural balance.[9] Therefore, information provided in the DBP points to a risk of some deviation in 2016.

Based on the Commission forecast, the structural balance pillar in 2016 points to compliance (positive margin of 0.1% of GDP); however, a risk of some deviation is detected under the expenditure benchmark pillar (gap of 0.1% of GDP). The structural balance indicator is negatively impacted by revenue shortfalls, but at the same time it is positively influenced by a decline in interest expenditure and a dent in investment. As the expenditure benchmark does not include windfall savings in interest expenditure and accounts better for the dynamics in government investment which peaked in 2015 due to the higher absorption of EU funds[10], it appears to provide a more adequate measure of fiscal effort at the current juncture. The overall assessment over one year thus suggests a risk of some deviation. Over two years, the situation is similar to the DBP. While the structural balance pillar points to a risk of some deviation, the expenditure benchmark pillar suggests a risk of significant deviation. As in the case of the DBP both indicators are impacted by the 2015 results. In line with the arguments above, in particular the past one-offs and the draw-down of EU funds in 2015, the deviation

[8] The drawdown on EU funds increased by almost 140% in 2015 or more than 2% of GDP. The adjustment of the expenditure aggregate takes into account spending matched by EU revenue, but it does not reflect fully the co-financing of these projects which increased in 2015 by some 0.5% of GDP.

[9] This is in line with the assessment of 2015 presented in spring 2016 in the "Assessment of the 2016 Stability Programme for Slovakia".

[10] 2015 was the final year in which Slovakia could draw upon funds available under the 2007-2013 programming period. Consequently, national co-financing also peaked.

under the expenditure benchmark is not to be considered as significant. The overall assessment based on the Commission forecast therefore also suggests a risk of some deviation.

For 2017, based on the information in the DBP, both pillars point to compliance over one year and over 2016-2017 taken together (with positive margins of no more than 0.1% of GDP). The Commission forecast confirms the results of the DBP under the structural balance pillar (positive margin of 0.1% of GDP). However, the growth rate of the government expenditure, net of discretionary revenue measures, is projected in the Commission forecast to exceed the applicable expenditure benchmark rate of 1.3% (by 0.2% of GDP) suggesting a risk of some deviation. An overall assessment is hence needed. Similar to 2016, also in 2017 the expenditure benchmark appears to better capture the underlying fiscal effort. This is because the structural balance indicator is positively impacted by revenue windfalls and the continued decline in interest spending which is excluded from the expenditure aggregate. The overall assessment therefore suggests a risk of some deviation. Similarly, over two years, the Commission forecast points to compliance in terms of the structural balance pillar but to a risk of some deviation when assessed based on the expenditure benchmark (gap of 0.2% of GDP). The expenditure benchmark more adequately reflects the fiscal effort in this case as it does not include windfall savings on interest expenditure and removes the volatile profile of investment. Taking the expenditure benchmark as a leading indicator the overall assessment over 2016-2017 also points to a risk of some deviation.

On 8 November 2016, the Slovak authorities sent to the Commission, then publicly disclosed,[11] a letter containing a clarification about the treatment of expected wage increases in 2017 in the DBP. According to the letter, two reserve items in the draft budget amounting to around EUR 160 million (0.2% of GDP) would cover the expected additional expenditure for wages for collective bargaining and teachers. The Commission has assessed this information and has concluded that in light of the clarification total expenditure in 2017 could be slightly lower than projected in the Commission 2016 autumn forecast. As a result, the expenditure benchmark would be in line with the required effort for 2017.

Following an overall assessment of Slovakia's DBP some deviation from the adjustment path towards the MTO is to be expected in 2016 and compliance in 2017.

[11] The letter is published on the website of the Slovak Ministry of Finance http://www.mfsr.sk/Default.aspx?CatID=84&NewsID=999.

Table 5: Compliance with the requirements of the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-2.3	-2.0		-1.4	
Structural balance based on freezing (COM)	-1.9	-2.0		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.3		0.5	
Required adjustment corrected[5]	0.0	0.3		0.5	
Change in structural balance[6]	-0.3	0.3	0.3	0.6	0.6
One-year deviation from the required adjustment[7]	-0.3	0.0	0.1	0.1	0.1
Two-year average deviation from the required adjustment[7]	-0.3	-0.1	-0.1	0.1	0.1
Expenditure benchmark pillar					
Applicable reference rate[8]	2.9	2.2		1.3	
One-year deviation[9]	-0.9	0.2	-0.1	0.0	-0.2
Two-year average deviation[9]	-0.1	-0.3	-0.5	0.1	-0.2
Conclusion					
Conclusion over one year	Overall assessment	Compliance	Overall assessment	Compliance	Overall assessment
Conclusion over two years	Overall assessment	Overall assessment	Overall assessment	Compliance	Overall assessment

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:
Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

On 12 July 2016, the Council addressed Slovakia in the context of the European Semester recommendations to improve the cost-effectiveness of the healthcare system and to take measures to increase tax compliance. The DBP discusses to a large extent the 'Value for Money' project led by the Ministry of Finance, which seeks to improve the efficiency of public spending. One part of the project is to carry out annual expenditure reviews in several policy areas. The results are then to be incorporated in the budgetary process. In 2016, spending in three areas was examined, namely, healthcare, transport and IT, which together constitute some 8.6% of GDP.

In the area of healthcare the Value for Money project identified possible savings of some EUR 360 million (0.4% of GDP). About half of this amount was already reflected in the budget for 2017. This should enable a more efficient use of saved resources (rather than reducing overall spending) and thus contribute to better cost-effectiveness of the sector. Savings should be achieved through addressing three areas. Spending on pharmaceuticals, health aids and special health materials is expected to be curbed by tackling overconsumption of pharmaceuticals and price referencing of special medical aids and materials. Better management of hospitals (falling under the Ministry of Health) mainly through improved processes and procurement would be the second source of savings. The last area of improvement would be a reduction of outlays on radio-diagnostic and laboratory examinations.

The DBP also mentions an update of the action plan to fight tax fraud which should be focused on more effective tax administration management. Tax administrators will get a possibility to act more swiftly if they believe that a tax obligation will not be paid on time or will not be recoverable. In addition, tax administrators will be able to issue a tax order if they doubt the correctness of a tax declaration and a tax payer does not communicate with the tax administration.

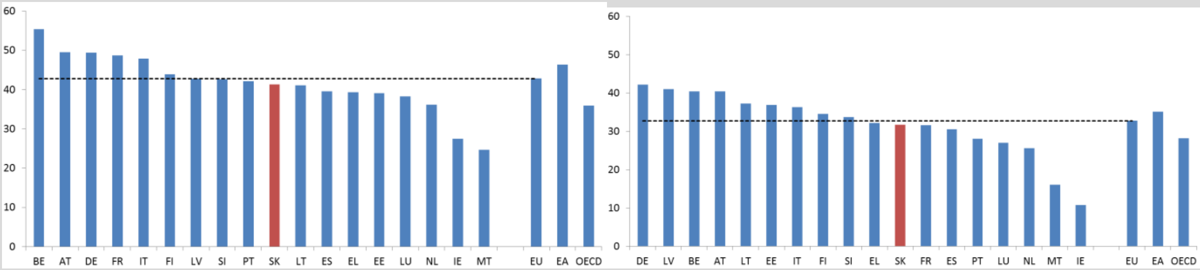
A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Box 3: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Slovakia for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Slovakia at the average wage and a low wage (2015)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Slovakia's Draft Budgetary Plan contains the following measure that affects the tax burden on labour. The lump-sum deductions for self-employed were increased which is likely to decrease tax obligations of this particular group of workers. While no other measures affecting the tax wedge on labour are presented in the DBP, the Parliament approved in October an increase of the ceilings for social contributions. This is likely to increase the tax wedge on labour at higher income levels. The additional revenue is expected to be spent on social policies.

6. OVERALL CONCLUSION

Following an overall assessment of the DBP, the planned structural adjustment would point to a risk of some deviation in 2016 from the required adjustment path towards the MTO based on two-year averages. This conclusion is confirmed by the Commission 2016 forecast. For 2017, the DBP points to compliance under both pillars. Following an overall assessment based on the Commission 2016 autumn forecast, there is a risk of some deviation from the adjustment path towards the MTO given the deviation under the expenditure benchmark pillar. However, taking into account the additional information provided by the Slovak government on 8 November 2016 in relation to the budgeting of expenditure on the public wage bill, the expenditure benchmark would be in line with the required adjustment path towards the MTO.