EUROPEAN
COMMISSION

Brussels, 15.11.2013
SWD(2013) 612 final

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of SLOVAKIA

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of SLOVAKIA

{C(2013) 8011 final}

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of SLOVAKIA

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of SLOVAKIA

1. INTRODUCTION

Slovakia has submitted its Draft Budgetary Plan (DBP) for 2014 on 15 October 2013 in compliance with Regulation (EU) No 473/2013 of the Two-Pack.

Slovakia is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure for Slovakia on 2 December 2009 and recommended to correct the excessive deficit by 2013 at the latest. After the correction of the excessive deficit, Slovakia will be subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2013 Autumn 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 Commission 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 2013-2014 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

After recording one of the strongest growth rates in the EU in 2012, Slovakia's economy slowed down markedly in 2013 due mainly to a strong contraction in domestic demand. Consequently, the macroeconomic projections in the Draft Budgetary Plan for 2014 have been revised downwards compared to estimates from the latest stability programme.

After sluggish growth in 2013, the Slovak economy is expected to recover and real GDP is projected to grow by 2.2%. Domestic demand is foreseen to have a positive contribution to GDP growth in 2014, after being a drag on growth in 2012 and 2013. Investment is expected to increase after strong declines in 2012 and 2013 while private consumption growth is projected to be stronger than in 2013, Exports of goods and services are foreseen to continue growing in 2014, albeit at a slightly slower pace compared to 2013. Unemployment will remain a serious problem in 2014, with the unemployment rate expected to remain above 14%. Inflation is projected to remain low over the forecast horizon.

The Draft Budgetary Plan projections of real GDP growth are very much in line with the Commission 2013 Autumn Forecast: both expect real GDP growth rates of around 2% in 2014. However, regarding the sources of this growth, there are some differences between the Draft Budgetary Plan and the Commission forecast. In the macroeconomic scenario underlying the Draft Budgetary Plan, net exports are the main contributor to growth, while the

Commission projects that growth will be driven mainly by a recovery in domestic demand. The authorities also expect a stronger resumption of investment, which would expand by 2.9%, as against 1.2% in the Commission forecast. The authorities and the Commission forecast have similar estimates of the output gap, with both foreseeing a negative output gap of around 3% of GDP for 2014.

The risks to the macroeconomic scenario underpinning the Draft Budgetary Plan are balanced. There are downside risks to investment, where the Draft Budgetary Plan scenario could prove to be too optimistic in the event of delays in the implementation of infrastructure construction projects. On the upside, private consumption, given the strong performance in the second quarter of 2013, could rebound more strongly than foreseen in the Draft Budgetary Plan scenario. Overall, the Draft Budgetary Plan scenario appears to be realistic regarding Slovakia's macroeconomic prospects in 2014.

Table 1. Comparison of macroeconomic developments and forecasts

	2012	2013			2014		
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**
Real GDP (% change)	1.8	1.2	0.8	0.9	2.9	2.2	2.1
Private consumption (% change)	-0.2	-0.1	0.5	0.8	1.5	0.8	0.9
Gross fixed capital formation (% change)	-10.5	2.3	-5.8	-5.3	3.3	2.9	1.2
Exports of goods and services (% change)	9.9	3.3	4.8	4.6	4.9	4.3	4.6
Imports of goods and services (% change)	3.3	3.5	1.7	1.9	4.1	3.3	4.3
Contributions to real GDP growth:							
- Final domestic demand	-2.7	0.3	-1.2	-0.6	1.3	0.8	1.5
- Change in inventories	-1.4	0.6	-1.3	-1.2	0.3	-0.1	0.0
- Net exports	5.9	0.2	3.3	2.7	1.3	1.5	0.6
Output gap[1]	-2.1	-2.3	-3.1	-3.3	-1.9	-2.9	-3.4
Employment (% change)	0.1	-0.5	-1.0	-0.3	0.5	0.2	0.3
Unemployment rate (%)	14.0	14.3	14.5	13.9	13.8	14.3	13.7
Labour productivity (% change)	1.7	1.7	1.8	1.2	2.3	2.0	1.8
HICP inflation (%)	3.7	2.4	1.7	1.7	2.5	1.7	1.6
GDP deflator (% change)	1.3	1.9	1.3	1.5	2.0	1.6	1.8
Comp. of employees (per head, % change)	2.8	2.6	2.2	2.0	3.5	2.8	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.1	1.9	4.7	5.6	2.4	5.1	5.2

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 (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

Box 1: The macroeconomic forecast underpinning the DBP in Slovakia

Slovakia's Draft Budgetary Plan is based on the macroeconomic forecast published by the Institute for Financial Policy (IFP) of the Ministry of Finance on 25 September 2013. This macroeconomic forecast has been endorsed by the Macroeconomic Forecasting Committee (MFC). The constitutional act on budgetary responsibility, adopted in December 2011, formally endowed 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 board of the MFC consists of a chairman (the Director of the IFP) and members from ten institutions (seven commercial banks, the National Statistical Office, the Academy of Science and the Central Bank). The Council for Budgetary Responsibility, the Slovak fiscal council created in 2011, has an observer status but no voting rights in the MFC. The members of the MFC are charged with assessing if the draft forecast by the Ministry of Finance is "conservative", "realistic" or "optimistic". The minutes of the MFC meetings are published on the website of the IFP. The macroeconomic forecast on which the current Draft Budgetary Plan of Slovakia is based was deemed "realistic" by all but one member, who characterised it as "optimistic". The act on budgetary responsibility established also the second advisory body – the Tax Revenue Forecasting Committee – which is fully operational and works in a similar fashion as MFC when endorsing the tax revenue forecasts prepared by the Ministry of Finance.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Slovakia's Draft Budgetary Plan forecasts the deficit in 2013 to reach 3% of GDP, slightly above the target of 2.9% of GDP in the 2013 stability programme. This projection is in line with the Commission 2013 Autumn Forecast. To address tax revenue shortfalls, lower-than-budgeted revenue from the sale of emission allowances, the accumulation of new hospital debt and expenditure slippages of local governments, universities and various budgetary organizations, additional measures were taken in the course of 2013. Among these measures, the ones with the largest impact were savings within the state budget on both current and capital expenditure and frontloading the sale of emergency oil reserves, the impact of which will have to be assessed by Eurostat. In addition, a slower-than-budgeted drawdown of EU funds will have reduced financing requirements from the state budget. A risk for the 2013 deficit outturn stems from the application of financial corrections related to the projects financed from the EU funds.

An important one-off operation will improve the outcome of public finances in 2013. The government granted pension savers a possibility to opt-out from the private fully funded pension pillar. The related transfer of pension assets in favour of the public pension scheme amounted to 0.3% of GDP. The impact of two other large one-off operations – the postponement of a dividend pay-out from the state-owned companies and anticipating the sale of emergency oil reserves– will have to be assessed by Eurostat.

The Draft Budgetary Plan targets a general government deficit of 2.8% of GDP in 2014. This is somewhat less ambitious than the target of 2.6% of GDP presented in the 2013 stability programme, which, however, did not sufficiently specify the measures to reach the target. The Draft Budgetary Plan projects an increase in revenues (by +1.1 pp of GDP) that is higher than the increase in expenditures (+0.9 pp of GDP). Revenue growth is largely driven by one-off measures, a temporary increase in instalments to repay loans granted to the state-owned companies, the auction of telecom licences (also initially planned for 2013), and sale of assets in the context of the public sector reform. The increase in expenditure is mainly due to a strong increase in intermediate consumption[1]. This partly relates to an acceleration of drawdown in EU funds.

[1] The projected increase in 'Other' expenditure in 2014 is related to the sale of emergency oil reserves in 2013. This operation will represent a change in inventories, which is statistically recorded as a negative expenditure.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2012	2013			2014			Change: 2012-2014
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**33.2**	**34.1**	***32.9***	**33.0**	**31.8**	***34.0***	**33.7**	**0.8**
of which:								
- Taxes on production and imports	9.9	9.8	*10.0*	10.0	9.3	*9.8*	9.9	-0.1
- Current taxes on income, wealth, etc.	5.6	5.9	*5.6*	5.6	5.9	*5.8*	5.8	0.2
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	12.7	13.4	*13.6*	13.6	12.8	*13.0*	13.0	0.3
- Other (residual)	5.0	5.0	*3.7*	3.7	3.8	*5.4*	5.0	0.4
Expenditure	**37.8**	**37.0**	**35.9**	**36.0**	**35.2**	**36.8**	**37.0**	**-1.0**
of which:								
- Primary expenditure	35.9	35.1	34.0	34.1	33.3	35.0	35.2	-0.9
of which:								
Compensation of employees	7.1	6.4	6.7	6.7	6.2	6.6	6.7	-0.5
Intermediate consumption	4.4	4.0	4.2	4.2	4.1	4.7	4.8	0.3
Social payments	18.7	18.4	18.4	18.5	17.9	18.0	18.2	-0.7
Subsidies	1.4	1.2	1.2	1.2	1.1	1.3	1.3	-0.1
Gross fixed capital formation	1.9	1.7	1.6	1.6	1.3	1.3	1.3	-0.6
Other (residual)	2.4	3.4	1.9	1.9	2.7	3.1	2.9	0.7
- Interest expenditure	1.9	1.9	1.9	1.9	1.9	1.8	1.8	-0.1
General government balance (GGB)	**-4.5**	**-2.9**	**-3.0**	**-3.0**	**-3.3**	**-2.8**	**-3.2**	**1.7**
Primary balance	**-2.7**	**-1.0**	**-1.1**	**-1.1**	**-1.5**	**-1.0**	**-1.4**	**1.7**
One-off and other temporary measures	0.1	0.8	0.7	0.4	0.4	1.0	1.0	0.9
GGB excl. one-offs	**-4.7**	**-3.7**	**-3.7**	**-3.4**	**-3.0**	**-3.8**	**-4.2**	**0.9**
Output gap[1]	-2.1	-2.3	-3.1	-3.3	-1.9	-2.9	-3.4	-0.9
Cyclically-adjusted balance[1]	-3.9	-2.1	-2.0	-1.9	-2.0	-1.8	-2.1	2.0
Structural balance (SB)[2]	**-4.0**	**-2.9**	**-2.7**	**-2.3**	**-2.4**	**-2.8**	**-3.1**	**1.2**
Change in SB	*1.0*	*1.1*	*1.3*	*1.7*	*0.6*	*-0.2*	*-0.8*	-
Two year average change in SB	*1.6*	*1.1*	*1.2*	*1.4*	*0.8*	*0.6*	*0.5*	-
Structural primary balance[2]	-2.1	-1.0	-0.8	-0.4	-0.5	-1.0	-1.3	1.1
Change in structural primary balance		*1.1*	*1.3*	*1.7*	*0.6*	*-0.3*	*-0.8*	-
Expenditure benchmark								
Applicable reference rate[3]	1.83	1.8	1.8	1.8	1.50	1.50	1.50	-
Deviation[4] (% GDP)	-1.8	-3.0	-4.4	-3.0	0.0	0.0	0.1	-
Two-year average deviation (% GDP)	-2.3	-2.1	-2.6	-2.4	-1.5	-2.2	-1.4	-

Notes:

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

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

[3] 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 lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[4] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

The Commission 2013 Autumn Forecast projects a deficit of 3.2% of GDP in 2014. The difference compared to the target in the Draft Budgetary Plan is due in equal measure to somewhat lower revenue and higher expenditure. The Commission forecast makes a more conservative assumption on non-recurrent revenues.[2] The assessment of the expenditure side reflects mainly a number of implementation risks related to the on-going reform of public

[2] The authorities appear to budget the expected receipts from auctions of telecom licences as revenues, although in ESA this should be recorded under the item Acquisitions less disposals of non-produced non-financial assets (K.2), which appears on the expenditure side as negative expenditure.

administration and health care. Positive risks relate to better VAT collection because of the on-going fight against tax fraud and potentially higher revenue from the auction of telecom licenses. For both years there are also some uncertainties stemming from the statistical classification of some measures.

Both the Draft Budgetary Plan and the Commission forecast point to an improvement in the structural balance in 2013, while they show a deterioration in 2014. Nevertheless, they differ in size of the implied change. Based on the figures presented in the Draft Budgetary Plan, the change in the structural balance shows a less pronounced improvement in 2013 and only a slight deterioration in 2014. The annual change in structural balance from the Commission forecast points to a more significant fiscal effort in 2013, but then also a more substantial deterioration of public finances the year after. The discrepancies are mainly due to the difference in identified one-off operations in 2013 and different expenditure and revenue forecasts for 2014.

3.2. Debt developments

The public debt-to-GDP ratio stood at around 52% in 2012, more than 20 pps. higher than in 2008. This growth has been mainly driven by primary deficits. The accumulation of significant cash reserves in view of favourable market conditions in 2012 (3.7% of GDP) and participation in the stabilisation mechanisms of the EU (2.2% of GDP) have also contributed to the increase in public debt ratio. Slovakia did not incur costs from any bank-saving operations.

According to the Draft Budgetary Plan, the debt ratio is projected to grow more slowly compared to the trajectory in the most recent Stability Programme; in 2014 the debt ratio is expected to approach 57% of GDP. A sizable impact of the net accumulation of financial assets, which increases the debt, derives from the accumulation of cash by local governments, especially in 2014. In addition, participation in the financial stabilisation mechanisms of the EU is estimated to also elevate the level of gross debt (by 0.8 pp. and 0.3 pp. of GDP in 2013 and 2014, respectively). On the other hand, the debt management agency is expected to reduce the cash reserve built up in 2012. Moreover, the planned revenue from an extraordinary dividend from state-owned energy companies will be used to reduce the level of debt in 2013. The Commission projects a faster increase in the debt ratio. The discrepancy with the Draft Budgetary Plan is solely due to a different trajectory of the projected headline deficit.

Slovakia did embark on a more intensive strategy of diversifying sources of public financing only in 2012. Therefore, the level of public debt denominated in currencies other than the euro is relatively low and the impact of debt valuation effects is negligible. Given favourable market conditions, Slovakia has been able to finance its debt at a relatively low cost while at the same time extending its average maturity. These developments can contribute to reduce the volatility of debt, therefore decreasing the risks related to debt forecasts.

Table 3. Debt developments

(% of GDP)	2012	2013			2014		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**52.4**	**54.8**	**54.3**	**54.3**	**56.3**	**56.8**	**57.2**
Change in the ratio	9.0	2.4	1.9	2.0	1.5	2.5	2.9
Contributions[2] *:*							
1. Primary balance	**2.7**	**1.0**	**1.1**	**1.1**	**1.5**	**1.0**	**1.4**
2. "Snow-ball" effect	**0.6**	**0.3**	**0.8**	**0.7**	**-0.8**	**-0.2**	**-0.2**
Of which:							
Interest expenditure	1.9	1.9	1.9	1.9	1.8	1.8	1.8
Growth effect	-0.8	-0.6	-0.4	-0.5	-1.5	-1.2	-1.1
Inflation effect	-0.5	-1.0	-0.7	-0.8	-1.1	-0.8	-0.9
3. Stock-flow adjustment	**5.8**	**1.1**	**0.0**	**0.2**	**0.8**	**1.7**	**1.7**
Of which:							
Cash/accruals difference		0.5	-0.4		0.5	0.4	
Net accumulation of financial		0.8	0.8		1.0	1.0	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		0.1	-0.1		0.0	0.4	

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 (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

3.3. Measures underpinning the Draft Budgetary Plan

The consolidation effort for 2014 presented in the Draft Budgetary Plan is concentrated on the revenue side. Several of the underlying measures have a structural character. The special levy on high-profit companies operating in a regulated environment introduced at the end of 2012 was originally planned to end in 2013. However, the government decided to retain this levy in 2014 and beyond. In addition, the government plans to introduce minimum lump-sum payments for the corporate income tax, which would be accompanied by a parallel reduction in the corporate income tax rate from 23% to 22%. The overall impact on public revenue from these measures would be positive. The ongoing efforts to improve tax collection, especially in case of VAT, are also expected to support public revenues in 2014 and beyond.

However, an important number of measures of a one-off nature are also expected to underpin fiscal consolidation. The payout of the dividends from the state-owned companies is projected to increase revenue by of 0.6% of GDP. However, the possible impact of such a meassure will have to be analysed by Eurostat. The Draft Budgetary Plan also envisages revenue of a non-specified amount from the auction of telecom licences[3]. Morever, the government has decided to temporarily increase the regular loan repayment installment of Cargo Slovakia (the railway freight transporter) in 2014. A loan repayment schedule for another state-owned company (water management) has also been changed; in this case the repayment of the outstanding loan was frontloaded to 2014. Finally, temporary revenue is expected also from the public sector reform which assumes a sale of non-financial assets.

[3] The subject of the auction is the freed frequency spectrum following the switch to the digital broadcasting.

On the expenditure side, the Draft Budgetary Plan presents discretionary measures with opposite effects on the deficit, yet with a net deficit-reducing impact. The government intends to undertake renewed efforts to reduce public expenditure in 2014. Lower expenditure (compared to the no-policy-change scenario) is expected from the ongoing public sector reform which concentrates on the central government bodies. Savings are expected mainly on the purchases of goods and services, public investment and compensation of employees.[4] Further reductions in spending are expected from planned efficiency gains in health care. By contrast, several other discretionary measures are expected to have a deficit-increasing effect. The government agreed a fixed lump-sum increase in civil servants' salaries[5] and increased transfers to the railway passenger carrier. Conditional upon supportive tax revenue from VAT and in-year deficit developments, the Draft Budgetary Plan assumes also a higher general expenditure allowance, currenly budgeted under intermediate consumption, but not yet allocated to concrete budgetary units.

The Draft Budgetary Plan broadly describes the measures underlying the reform of the public sector.[6] An important tool to achieve budgeted savings is the reduction in the number of budgetary organisations belonging mainly to various ministries. Achievement of the expected subsequent decrease in, primarily, overhead costs is nevertheless conditional upon successul completion of those mergers. Savings in health care are envisaged through measures that were already specified in the 2013 Stability Programme. However, the adoption of some of those measures has been delayed (i.e. the introduction of a unitary system of healtcare insurance) and several others are scheduled to be fully implemented only after 2014. Thus at the current stage the Draft Budgetary Plan thus does not detail the measures which would increase the sector's efficiency and hence prevent renewed accumulation of debts by hospitals. In response to an increase in the corporate income tax rate from 19% to 23% in 2013, companies appear to have used more aggressive tax optimisation strategies. Against this backdrop, the projected additional revenue steming from the introduction of a minimum lump-sum corporate income tax may not materialise in full.

4 The breakdown of expected savings by budgetary unit presented in the Draft Budgetary Plan, however, does not show a reduction of overall expenditure in nominal terms.

5 This will fully counterbalance envisaged savings on the wage bill in the context of the public sector reform leaving the net budgetary impact at zero.

6 The 2014-16 budget adopted by the government provides some more details.

Table 4. Main discretionary measures reported in the DBP

Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2013	**2014**	**2015**
Taxes on production and imports	n.a.	0.3	-0.3
Current taxes on income, wealth, etc.	n.a.	0.2	n.a.
Capital taxes	n.a.	n.a.	n.a.
Social contributions	n.a.	-0.2	n.a.
Property Income	-0.6	1.2	-0.6
Other	n.a.	0.5	-0.4
Total	-0.6	2	-1.3

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 revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan

Discretionary measures taken by General Government - expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2013	**2014**	**2015**
Compensation of employees	n.a.	0	n.a.
Intermediate consumption	n.a.	0.2	-0.4
Social payments	n.a.	-0.4	n.a.
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	n.a.	0	n.a.
Gross fixed capital formation	n.a.	-0.1	n.a.
Capital transfers	n.a.	n.a.	n.a.
Other	n.a.	0	0
Total	n.a.	-0.3	-0.4

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

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

4.1. Compliance with EDP recommendations

The headline balance in the Draft Budgetary Plan is planned at 3% of GDP in 2013, which is in line with the deadline for correcting the excessive deficit under the EDP, albeit not providing for any safety margin. This is confirmed by the Commission 2013 Autumn Forecast. The deficit projections for 2014 differ between the two sets of projections, however. While the Draft Budgetary Plan targets a headline general government deficit of 2.8% of GDP, the Commission projects the deficit to increase to 3.2% of GDP. Nevertheless, the average annual fiscal effort for the period 2010-13 amounts to 1.3% of GDP in the Commission forecast. When adjusted for changes in potential growth and revenue shortfalls, the adjustment even reaches 2% of GDP annually on average for the relevant period. This is well above the annual average fiscal effort of 1% of GDP recommended by the Council.

Box 2. Council recommendations addressed to Slovakia

On 2 December 2009, the Council recommended Slovakia under Article 126(7) of the Treaty to correct its excessive deficit by 2013. To this end, Slovakia should implement deficit reducing measures in 2010 as planned in the budget for 2010-2012, ensure an average annual fiscal effort of 1% of GDP over the period 2010-2013, and specify the necessary measures for correcting the excessive deficit by 2013, cyclical conditions permitting. It was also recommended to accelerate the reduction of the deficit if economic or budgetary conditions turned out better than expected. In addition, to limit risks to this adjustment, Slovakia was recommended to strengthen the enforceability of its medium-term budgetary framework and improve the monitoring of budget execution throughout the year, in particular to avoid expenditure overruns compared to budget plans.

On 9 July 2013, the Council also 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 implement as envisaged the budget for the year 2013, so as to correct the excessive deficit in a sustainable manner and achieve the fiscal effort specified in the Council recommendations under EDP. After the correction of the excessive deficit, pursue the structural adjustment effort that will enable Slovakia to reach the MTO by 2017. Avoid cuts in growth-enhancing expenditure and step up efforts to improve the efficiency of public spending. Building on the pension reform already adopted, further improve the long term sustainability of public finance by reducing the financing gap in the public pension system and increasing the cost effectiveness of the healthcare sector. Moreover, Slovakia was further recommended to speed up the implementation of the action plan to combat tax fraud and continue efforts to improve VAT collection, in particular by strengthening the analytical and audit capacity of the tax administration; improve tax compliance; and link real estate taxation to the market value of property.

4.2. Compliance with the MTO

On the basis of the recalculated structural balance from the Draft Budgetary Plan the structural balance would slightly deteriorate in 2014 compared to 2013.[7] This compares to a a required fiscal effort of 0.6% of GDP underlying the 2013 CSR and would also fall short of the required effort stemming from the preventive arm of the Stability and Growth Pact.

In the context of the Draft Budgetary Plan, Slovakia also requested to benefit from the investment clause which allows countries to temporarily deviate from the required change in structural balance (i.e. the deviation needs to be compensate for in the subsequent years). Compliance with both the EDP debt and deficit criteria is a pre-requisite to benefit from the investment clause, which is also conditional upon further criteria, including a large negative output gap. At this stage, Slovakia cannot be considered eligible to benefit from the investment clause, as it is still subject to the EDP. The application will be reconsidered by the Commission once the EDP is abrogated and Slovakia may then be granted the possibility to benefit from the investment clause, subject to the conditions being met.

According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, in 2014 is expected to contribute to an annual structural adjustment towards the MTO by 0.5% of GDP. This is because the growth rate of this expenditure is 1.5%, thus meeting the lower rate under the

[7] The Commission forecasts a larger deterioration of the structural budget in 2014. The difference with the Draft Budgetary Plan stems from the different assumption on the impact of one-off measures in 2013 and 2014 – for example, the savings on co-financing of EU funds in 2013 and the reserve for achieving the fiscal target in 2014 are not considered as a one-offs by the Commission forecast – and from the fact that the Commission projects a higher headline deficit in 2014.

expenditure benchmark. Nevertheless, there are risks to expenditure trends remaining in line with the expenditure benchmark, should the envisaged expenditure savings not materialise fully and should discretionary revenues be lower-than-expected.

Overall, a deviation from the adjustment path towards the MTO is to be expected in 2014 which, if repeated the following year, could be significant.

4.3. Other considerations

In addition to consolidation measures, the Draft Budgetary Plan informs about the on-going reforms and measures contributing to meeting the fiscal and fiscal-related country-specific recommendations (CSRs) issued by the Council in June 2013. In particular, prominence is given to the implementation of measures to improve tax collection and fight tax fraud, especially with respect to VAT. In September, a national receipt lottery was launched which has already helped uncover numerous cases of tax fraud. The next steps in the programme to fight tax fraud are the introduction of a VAT monitoring statement, which provides tax inspectors with important data for carrying out controls, and a broadening of application of the principle of reverse charge in cases of suspected VAT fraud. These measures are aimed at meeting the Council country-specific recommendation to Slovakia on improving tax efficiency (CSR 2). The government also plans to exempt wages of low-income workers from paying social security contributions during the first year of employment in response to CSR 3, which calls for a reduction of the tax wedge for low-income workers. With reference to CSR 1, which called for safeguarding growth-enhancing expenditure, Slovakia will reduce expenditure on education in 2014 (both as a percentage of GDP and as a share of overall investment, based on the COFOG classification of expenditure). The Draft Budgetary Plan also projects a decrease in public investment.

5. SUMMARY

Based on currently available information, Slovakia is expected to bring the general government deficit in 2013 within the 3% reference threshold. However, based on the Commission forecast, it seems that the headline general government deficit will not be below 3% of GDP in 2014. In addition, the Draft Budgetary Plan, which provides a comprehensive and detailed overview of fiscal plans, relies significantly on revenue measures of a one-off nature. In 2014 the required adjustment towards the MTO does not appear ensured. Over the forecast horizon, the general government debt ratio is projected to remain below the reference value of 60% of GDP. With respect to the quality of fiscal adjustment against the background of the country-specific recommendations issued under the 2013 European semester, growth-enhancing expenditure on education and investment is projected to decrease.