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SLOVAKIA: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE APRIL 2009 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term budgetary programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 24 June 2009. Comments should be sent to Vladimir Solanic, Renata Hruzova and Corina Weidinger Sosdean (Vladimir.Solanic@ec.europa.eu, Renata.Hruzova@ec.europa.eu, Corina.Weidinger-Sosdean@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' April 2009 spring forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying methodological paper prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 June 2009. The ECOFIN Council adopted its opinion on the programme on 7 July 2009.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

1. INTRODUCTION

This document assesses the April 2009 stability programme of Slovakia. It takes into account all currently available information, notably the Commission services' Spring 2009 Forecast and the short-term fiscal stimulus measures adopted by the Slovak authorities in response to the economic downturn. The programme, which was submitted on 30 April 2009, covers the period 2008-2011 and builds on the latest official economic forecast of 2 February 2009 by the Slovak Ministry of Finance and the consequential revision of the budgetary targets for 2009-2011. It was approved by the government and presented to the Slovak Parliament for a debate. The programme contains a description of the fiscal stimulus measures adopted by the Slovak authorities in response to the economic downturn. The budgetary projections reflect the impact of the fiscal stimulus measures. The late submission of the stability programme was due to the necessity to update the macroeconomic forecasts and subsequently also the fiscal framework.

2. MAIN CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

Slovakia has experienced several years of high GDP growth, reaching its peak of 10.4% in 2007. The first signs of the crisis appeared in the fourth quarter of 2008 when the economy started to lose momentum and GDP growth slowed down to 2.5% year-on-year. As a small, open economy, Slovakia is affected by the economic downturn through a significant drop in external demand. In 2008, the sum of exports and imports amounted to almost 170% of GDP. Exports have been on a steeply declining path since the fourth quarter of 2008 with negative repercussions on industrial production and business confidence. The current account deficit is relatively high (6.5% of GDP in 2008) due to a deficit in income and trade balances and it is set to widen further in 2009. As the data of the first quarter show, economic slowdown has been driven also by falling investment and private consumption. The manufacturing sector is the most hard-hit by the crisis. The car sector in particular is adversely affected by plummeting demand which lead to a slump of production by slightly more than 40% in the first quarter of 2009 year-on-year. Despite the fact that the Slovak financial sector has been only marginally affected by the financial crisis, credit conditions for businesses have begun to tighten.

The crisis is taking its toll on the Slovak labour market. After a period of a gradual decline, the unemployment rate started to rise in the fourth quarter of 2008, against the backdrop of lay-offs due to the economic downturn. Low-skilled workers in the manufacturing sector are the most affected by the crisis. At the same time, there is a need to address the persistently high long-term unemployment and to increase participation of disadvantaged groups in economic activity.

The euro adoption has so far not had an important impact on price developments, as the Slovak government adopted several measures to prevent unjustified price increases by companies because of the changeover. In anticipation of the euro adoption, the Slovak koruna appreciated markedly which, coupled with a relatively strong wage increase in 2008, has somewhat diminished Slovakia's competitiveness compared to other countries in Central and Eastern Europe whose currencies depreciated during the economic downturn. However, this effect might be temporary as neighbouring countries with depreciating currencies are facing higher level of inflation.

Slovakia has been running a positive output gap in recent years. The output gaps in the Commission services' spring 2009 forecast are expected to narrow significantly in 2009 and

go into negative territory in 2010. Slovakia can therefore be considered to be in "bad times" after 2009. The key challenge for the Slovak economy in the current juncture is to sustain aggregate demand. The openness of the Slovak economy means that it is highly dependent on demand from its main European trading partners. Their recovery will provide a key impulse for the Slovak economy.

According to the Commission services' spring 2009 forecast, public finances are projected to worsen considerably in 2009 and 2010 as a result of the deteriorating economic outlook. The better-than-expected general government deficit of 2.2% of GDP in 2008 is set to widen to 4.7% of GDP in 2009 and 5.4% of GDP in 2010 unless further corrective measures are taken. Deterioration of public finances entails a rapidly shrinking fiscal room for manoeuvre. The government debt is well below the 60% of GDP threshold (27.6% of GDP in 2008) but is set to increase rapidly over the next two years.

The Slovak authorities took several stimulus measures in order to counter the adverse impact of the economic crisis. The three stimulus packages adopted so far include measures targeted at specific sectors or disadvantaged groups as well as measures encouraging employment, providing temporary tax relief, stimulating R&D and energy efficiency investment. The overall budgetary impact of the stimulus packages is estimated at around 1% of GDP over the next two years (2009 and 2010). Some measures will be co-financed from the EU funds and/or the EBRD and EIB. The main stimulus measures include:

- Increase in the basic tax allowance of the personal income tax from €3,435 to €4,026
- Increase in the employee tax credit targeted at low-income taxpayers
- Accelerated write-offs of capital goods
- Lower social contributions for mandatorily ensured self-employed
- Simplification of legislative requirements for social enterprises
- Subsidies to create and sustain employment (partial compensation for employers for short-time work, financial aid for unemployed who find a job or start a business, contribution to cover travelling costs for employees)
- Car scrapping scheme
- Incentives for SMEs
- Subsidies and tax reliefs to finance R&D activities in the private sector
- Refundable financial aid provided to the state-owned railway companies

Most measures are related to the medium-term reform agenda and the country-specific recommendation proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

As discussed in Annex 1, given the lack of both financial and production diversification, fiscal policy has an enhanced role to play as regards demand management and fostering structural change through a high quality of public finance.

Measures to help stabilise the financial system

In response to the financial crisis, the Slovak authorities introduced a full guarantee for deposits, thereby abandoning previous limits. More stringent liquidity requirements for banks were introduced by the National Bank of Slovakia. In order to ease credit tightening for businesses and boost exports, the Slovak authorities increased capital in the Slovak Guarantee and Development Bank and Eximbanka and opened a credit line with the European Investment Bank. A Memorandum on cooperation and exchange of information for co-financing of SMEs was signed between the Ministry of Finance, the Slovak Bank Association, Eximbanka and the Slovak Guarantee and Development Bank with the aim of providing bank guarantees for loans issued by commercial banks to SMEs.

3. MACROECONOMIC SCENARIO

The macroeconomic scenario underlying the programme envisages that real GDP growth will fall from 6.4% in 2008 to 2.4% in 2009 before recovering to 3.6 % in 2010 and rising to an average rate of 4.8% over the period 2011-2012. Assessed against currently available information[1], this scenario appears to be based on markedly favourable growth assumptions in 2009 and 2010, and on more plausible growth assumptions thereafter taking into account average potential growth, while acknowledging that these estimates are subject to increased uncertainty at the current juncture[2]. According to the latest figures, GDP contracted by 5.6% year-on-year in the first quarter of 2009. In view of the rapid deterioration of the economic outlook for the main trading partners of Slovakia in recent month, exports are projected to decline more markedly in 2009 in the Commission services' spring 2009 forecast while their rebound in 2010 is projected to be more subdued than expected in the programme. The projections of the final domestic demand for 2009 in the programme appear also overly optimistic and contribute the large differences in growth assumptions between the programme and the Commission services' spring 2009 forecast. Moreover, the recovery of the economy in 2010 is based on the assumption that potential growth will not be affected by the current downturn, which appears to be unlikely given the expected decline in fixed investment. The programme's projections for inflation appear more realistic but still on the high side in 2010.

With respect to labour market developments, the programme expects the unemployment rate to rise moderately to 10.5% in 2009 and decline thereafter. The Commission services' spring 2009 forecast foresees a more pronounced deterioration with the unemployment rate reaching more than 12% in 2009 and 2010. Labour productivity growth will remain in positive territory in 2009 according to the programme while the Commission forecast predicts a drop by 0.9%.

Overall, the main downside risk to the programme's scenario stems from a worsening economic outlook for Slovakia's main trading partners which would have an adverse impact on exports, investment and unemployment. The fiscal stimulus measures adopted in response to the downturn are incorporated in the programme's macroeconomic scenario.

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1 The assessment notably takes into account the Commission services' 2009 spring forecast, but also other information that has become available since then.

2 The programme presents an alternative, not fully fledged scenario, which is based on still rather favourable growth assumptions for 2009 and more plausible assumptions for 2010, as it expects GDP growth to fall from 6.4% in 2008 to -1% in 2009 before recovering to 1% in 2010.

Table I: Comparison of macroeconomic developments and forecasts

	2008		2009		2010		2011
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	6,4	6,4	-2,6	2,4	0,7	3,6	4,5
Private consumption (% change)	6,1	6,1	0,5	3,1	0,9	3,5	4,4
Gross fixed capital formation (% change)	6,8	6,8	-5,2	2,2	0,2	3,6	5,1
Exports of goods and services (% change)	3,2	3,2	-10,2	-2,7	0,2	3,1	6,2
Imports of goods and services (% change)	3,3	3,3	-7,6	-2,2	0,3	2,5	5,5
Contributions to real GDP growth:							
- Final domestic demand	6,0	6,4	-0,7	3,0	0,8	3,0	3,7
- Change in inventories	0,5	0,5	0,1	0,0	0,0	-0,3	-0,5
- Net exports	-0,2	0,0	-2,0	-0,6	-0,1	0,6	0,8
Output gap[1]	8,0	6,5	0,9	3,5	-2,2	1,7	1,0
Employment (% change)	2,9	2,8	-1,7	0,1	0,4	0,4	1,0
Unemployment rate (%)	9,5	9,6	12,0	10,5	12,1	10,4	10,1
Labour productivity (% change)	3,3	4,3	-0,9	2,3	0,2	3,2	3,5
HICP inflation (%)	3,9	3,9	2,0	2,2	2,4	3,6	4,1
GDP deflator (% change)	2,9	2,9	3,6	1,7	3,7	3,3	4,0
Comp. of employees (per head, % change)	8,7	7,4	4,9	n.a.	5,5	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-5,6	-5,8	-7,6	-4,2	-6,2	-2,9	-2,6

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source :

Commission services' April 2009 spring forecasts (COM); Stability programme (SP)

4. BUDGETARY STRATEGY

4.1. Budgetary implementation in 2008

According to the current stability programme the general government budged deficit was 2.2% of GDP in 2008 (confirmed in the recent fiscal notification and verified by Eurostat), which is slightly lower than the 2.3 % of GDP envisaged in the previous convergence programme. The slightly better outcome is due mainly to a better overall starting position from 2007 (by 0.6% of GDP) and higher-than-anticipated revenue growth, largely offset by faster-than-budgeted growth of expenditure. (See also Table 1 in Annex 2).

The revenue growth of 11.8% surpassed expectations by more than 3 p.p. due to higher-than-expected income from non-tax revenue sources[3], which yielded above average elasticity, and two one-off effects, namely higher-than-expected transfers from the second pillar to the PAYG pension pillar during the opening of the former (see Box 1 below) and the sale of extra CO_2 emission quotas[4]. This growth more than compensated for the worse starting position

[3] The main sources of higher non-tax revenue were levies from gambling games, refunds to the state budget and revenues from administrative fees.

[4] The stability programme considers that the sale by the Slovak government of CO2 emission permits not used by domestic companies is recorded in ESA95 accounts as revenue, and therefore as deficit reducing. In fact, there is currently no consensus among the EU statisticians on how these transactions should be booked in the accounts. While it appears non-contentious that such a transaction is deficit-reducing, it is not clear what is the appropriate time of recording (e.g. at the time of the cash inflow, or a later stage, notably at the time of

from 2007. The expenditure increase of 12.7% which was almost 5 p.p. above the budgeted figure more than offset the positive revenue surprise. Lower payments of social benefits and savings of local governments have tamed the growth of spending. The negative impact came from two large deficit-increasing one-offs where the state overtook privatisation-related liabilities and forgave the claims against non-financial corporations. Although the expenditure outcome in 2007 was better than anticipated, its subsequent growth in 2008 turned the overall contribution to the 2008 deficit into a negative figure. No extraordinary spending was necessary in 2008 due to the global financial crisis as its direct impacts on the Slovak banking sector were not strong. The government, nevertheless, responded by providing full guarantee on the deposits.

Box 1: Reopening of the second pension pillar in Slovakia

Since the pension reform was fully implemented in 2005, the government has provided opportunities for pension savers to leave the fully funded second pillar and return to the PAYG pillar by temporary reopening the second pillar. The first reopening took place between January and June 2008, the second one is scheduled from November 2008 till June 2009. It can be expected that most pension savers interested in leaving the second pillar have done so already during the first reopening. The reopening has a positive impact on the general government revenue as pension savings under the fully-funded pension pillar are transferred to the PAYG pillar and are therefore recorded as additional revenue.

4.2. Near-term budgetary strategy

The budget for 2009 was approved by the parliament on 28 November 2008, targeting a general government deficit of 2.1% of GDP. In the stability programme, the target is revised upward to 3% of GDP. The updated figure accounts for the slowdown in the GDP growth. The costs of the fiscal stimuli, which were introduced in three phases between November 2008 and February 2009, and comprise a mixture of expenditure and revenue instruments, are estimated at 0.5% of GDP by the Slovak authorities.

Changes in the social security legislation and reopening of the second pension pillar are expected to improve the state budget by 0.4% of GDP with the latter having the main impact. The second factor improving the revenue will be higher excise duties on tobacco products which were adjusted in line with the EU harmonization legislature. With respect to the anti-crisis measures, the temporary increase in the tax-free income, increase in employee tax credit and decrease in social contributions for mandatorily insured self-employed will decrease overall revenue.

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the polluting activity authorised by the permit), whether the transaction is classified as tax or non-tax revenue, or even whether it should be booked as revenue or as negative expenditure (note that sales of some other licences are booked in ESA95 as negative expenditure for conventional reasons)

Table II. Main budgetary measures for 2009

Revenue measures[1]	Expenditure measures[2]
Measures in response to the downturn([3])	
• Income tax (-0.2% of GDP)	• Subsidy for purchases of new cars (0.1% of GDP)
Other measures	
• Excise duties on tobacco (0.2% of GDP) • Changes in social contributions and capital transfers from the second pension pillar (0.4% of GDP)	• Changes in welfare measures (0.5% of GDP)

Notes:

[1] Estimated impact on general government revenue

[2] Estimated impact on general government expenditure

[3] Only the largest anti-crisis measures are mentioned. The total volume of the measures in 2009 is estimated at around 0.5% of GDP.

Source: Commission services, Stability programme of Slovakia 2008-2011, and 2009 budget.

Expenditure is set to rise primarily due to a set of welfare measures amounting to 0.5% of GDP. The demand-oriented spending in reaction to the global downturn supports R&D activities, projects oriented at improving energy efficiency and purchases of new cars. In the labour market the focus is on social enterprises and subsidies to employers towards social contributions for employees. Businesses are helped by amendments to depreciation rules and securitisation of lending facilities for SMEs through capital increase in the state-owned banks. The Slovak cargo and railway companies received a subsidy to continue their operations.

According to the Commission services' structural balance calculations, based on the information in the programme using commonly agreed methodology, the projected policy stance in 2009 is mildly expansionary. The programme foresees a much stronger stimulus to the economy on the scale of 2.4% of GDP due to inclusion of additional resources from EU structural funds and the start of highway construction projects based on the scheme of public and private partnership[5]

[5] The calculations presented in the stability programme foresee higher fiscal expansion than indicated by the change in structural balance as recalculated by the Commission services. Additionally, the figure 2.4% of GDP includes the effect of structural funds and PPP projects which do not enter the government budget

Table III: Composition of the budgetary adjustment

(% of GDP)	2007	2008		2009		2010		2011	Change: 2008-2011
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP
Revenue	**32.5**	**32.7**	**33.4**	**33.6**	**32.1**	**34.1**	**31.6**	**31.8**	**-1.6**
of which:									
- Taxes on production and imports	11.2	10.7	10.8	10.6	10.4	10.2	10.4	10.1	-0.7
- Current taxes on income, wealth, etc.	6.2	6.4	6.4	6.2	6.1	5.9	5.9	6.3	-0.1
- Social contributions	11.8	12.1	12.1	12.5	12.2	12.6	12.0	11.8	-0.3
- Other (residual)	3.3	3.6	4.1	4.3	3.4	5.4	3.3	3.6	-0.5
Expenditure	**34.4**	**34.9**	**35.6**	**38.3**	**35.1**	**39.4**	**34.5**	**34.1**	**-1.5**
of which:									
- Primary expenditure	33.0	33.7	34.4	36.9	33.7	38.1	33.3	32.8	-1.6
of which:									
Compensation of employees	6.8	6.6	6.8	6.8	6.8	6.9	6.5	6.4	-0.4
Intermediate consumption	4.5	3.8	4.8	4.6	4.0	4.3	4.0	3.9	-0.9
Social payments	16.1	15.6	15.7	16.9	16.5	17.6	16.6	16.3	0.6
Subsidies	1.2	1.9	1.4	2.1	1.3	2.2	1.0	1.0	-0.4
Gross fixed capital formation	1.9	1.8	1.5	2.0	1.5	2.1	1.4	1.5	0.0
Other (residual)	2.5	4.0	4.3	4.5	3.6	4.9	3.8	3.8	-0.5
- Interest expenditure	1.4	1.2	1.2	1.3	1.4	1.4	1.2	1.3	0.1
General government balance (GGB)	**-1.9**	**-2.2**	**-2.2**	**-4.7**	**-3.0**	**-5.4**	**-2.9**	**-2.2**	**0.0**
Primary balance	**-0.5**	**-0.9**	**-0.9**	**-3.3**	**-1.7**	**-4.0**	**-1.7**	**-1.0**	**-0.1**
One-off and other temporary measures[4]	0.0	0.2	-0.3	0.1	0.4	0.0	0.1	0.1	0.4
GGB excl. one-offs	**-1.9**	**-2.4**	**-1.9**	**-4.8**	**-3.4**	**-5.4**	**-3.0**	**-2.3**	**-0.4**
Output gap[2]	6.5	8.0	6.5	0.9	3.5	-2.2	1.7	1.0	-5.5
Cyclically-adjusted balance[2]	-3.8	-4.5	-4.1	-4.9	-4.0	-4.7	-3.4	-2.5	1.6
Structural balance[3]	**-3.8**	**-4.7**	**-3.8**	**-5.0**	**-4.4**	**-4.7**	**-3.5**	**-2.6**	**1.2**
Change in structural balance		*-1.0*	*0.0*	*-0.3*	*-0.6*	*0.3*	*0.9*	*0.9*	
Structural primary balance[3]	-2.4	-3.5	-2.6	-3.7	-3.0	-3.3	-2.3	-1.3	1.3
Change in structural primary balance		*-1.1*	*-0.2*	*-0.2*	*-0.4*	*0.4*	*0.7*	*1.0*	

Notes*:*

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

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

[4]The one-off in 2009 includes the expected capital transfer from the fully-funded pension pillar to the PAYG pension pillar in connection with the reopening of the former.

Source:

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations

4.3. Medium-term budgetary strategy

Currently, the mid-term budgetary strategy of the Slovak authorities declared in the programme is to restrain the headline deficit below 3% of GDP thereby avoiding the EDP. The programme notes that if the current economic situation deteriorates further, the government will take measures so that the headline deficit returns below the 3% of GDP threshold by 2011. The stability programme does not explicitly specify the MTO. In the November 2007 update of the convergence programme, the MTO was specified as a structural deficit (i.e. cyclically adjusted and net of one-off measures) of 1% of GDP to be achieved by 2010.The stability programme refers to ambitions of overachieving the MTO by aiming for a

'balanced budget'. However, based on the budgetary targets listed in the programme, the MTO is not foreseen to be reached within the programme horizon.

The programme forecasts a widening of the deficit from 2.2% of GDP in 2008 to 3.0% of GDP in 2009. The government plans to resume consolidation efforts in 2010 and declares to maintain the deficit below the Treaty reference value in 2011 even in case of deteriorating macroeconomic environment. The corresponding deficits are then projected at 2.9% and 2.2% of GDP in 2010 and 2011, respectively. The structural balance as recalculated on the basis of information provided by the programme is expected to improve from -3.8% of GDP in 2008 to -2.6% of GDP in 2011 with a temporary deterioration in the period in between. The implied fiscal stance as measured by the change in the recalculated structural balance is restrictive both in 2010 and 2011. Commission services forecast a slower deterioration of the structural balance in 2009 but also a much slower recovery in 2010.

According to the programme, the consolidation effort will be concentrated in 2010 and 2011 within the central government. The expenditure/GDP ratio is planned to decrease by 1 p.p. in these two years, whereas the revenue expressed as percentage of GDP should experience a decline of only 0.3 p.p.. The major cuts are planned in employee compensations, social payments and subsidies. However, no concrete measures in this respect are spelled out in the programme. The revenue from direct taxes is projected to increase due to discontinuation of the temporary increase in the tax-free income. The positive effect will be more than offset by reduced income from social contributions.

4.4. Risks to the budgetary targets

A number of risks to the budgetary projections can be identified. Most importantly, the macroeconomic scenario provided in the programme is very optimistic, especially in view of the first flash estimate of GDP for the first quarter of 2009 which pointed to a contraction of 5.4% y-o-y. Low levels of unemployment assumed by the programme lead to a likely underestimation of the social benefits payments especially in 2009 and 2010.

A large cutback in compensation of employees and intermediate consumption of about ½ p.p. in 2011 as compared with 2009 is not fleshed out in detail creating uncertainty about the realisation of such efforts. A reduction of subsidies over the programme period appears unlikely in view of the anticipated deterioration of the economy, especially in 2009, as well as prior government practice. Finally, the parliamentary elections, which are scheduled for 2010, may put additional pressure on the government spending.

The revenue side is potentially endangered by two factors. First, lower-than-expected economic growth and subsequently employment will reduce the tax revenue. In addition, in 2009 the government relies strongly on the transfer of funds (0.3% of GDP) from the second to the PAYG pension pillar due to reopening of the former. The expectations are based on an assumption that about 150 000 people would leave the second pillar. As the number of leavers at the end of April was well below 15 000 and the opportunity to rejoin exclusively the PAYG scheme was granted until the end of June, the fulfilment of the envisaged target is imperilled.

Overall, the budgetary projections provided in the programme are subject to downside risks throughout the programme period. The main source is the optimistic macroeconomic scenario followed by lack of detail regarding efforts to reduce expenditure and the uncertainty of revenue targets which rely on one-off income such as capital transfer from the second pension pillar to the PAYG pillar and an increase in excise taxes on tobacco.

5. DEBT DEVELOPMENTS AND LONG-TERM SUSTAINABILITY

5.1. Debt developments

The government gross debt-to-GDP ratio peaked in 2000, reaching 50.4%. It has been on a declining path since then and stood at 27.6% in 2008. The debt ratio was lower than expected both in 2007 and in 2008 due to high GDP growth. The stability programme expects the debt to increase moderately to 32.7% of GDP by 2010 and remain flat afterwards. In comparison, the Commission services' spring 2009 forecast foresees a more significant increase to 36% of GDP in 2010. The difference is mainly due to the markedly more favourable macro-economic assumptions presented in the stability programme. The Commission forecast predicts a more pronounced increase, in spite of a much lower projected stock-flow adjustment in 2009, as a result of falling GDP and higher general government deficit. The higher stock-flow adjustment in the programme is due to the net accumulation of financial assets, which will not be used to repay the debt.

The main risks for the debt development stems from the higher-than-expected primary deficit and lower-than-anticipated growth. Risks to the debt scenario presented in the programme are therefore clearly on the upside.

Table IV: Debt dynamics

(% of GDP)	average 2002-06	2007	2008		2009		2010		2011
			COM	SP	COM	SP	COM	SP	SP
Gross debt ratio[1]	**38.4**	**29.4**	**27.6**	**27.6**	**32.2**	**31.4**	**36.3**	**32.7**	**32.7**
Change in the ratio	-3.7	-1.1	-1.7	-1.8	4.6	3.8	4.2	1.3	0.0
Contributions[2]*:*									
1. Primary balance	**1.6**	**0.5**	**0.9**	**0.9**	**3.3**	**1.7**	**4.0**	**1.7**	**1.0**
2. "Snow-ball" effect	**-1.5**	**-1.8**	**-1.2**	**-1.2**	**1.0**	**0.2**	**0.0**	**-0.8**	**-1.3**
Of which:									
Interest expenditure	2.3	1.4	1.2	1.3	1.3	1.3	1.4	1.2	1.2
Growth effect	-2.2	-2.8	-1.7	-1.7	0.7	-0.6	-0.2	-1.1	-1.4
Inflation effect	-1.6	-0.3	-0.8	-0.8	-1.0	-0.4	-1.1	-1.0	-1.2
3. Stock-flow adjustment	**-3.7**	**0.2**	**-1.4**	**-1.4**	**0.1**	**1.9**	**0.2**	**0.5**	**0.4**
Of which:									
Cash/accruals diff.	0.6	0.0		0.2		0.2		-0.2	0.2
Acc. financial assets	-3.7	0.3		-0.9		1.8		0.6	0.3
Privatisation	-3.3	0.0		n.a.		n.a.		n.a.	n.a.
Val. effect & residual	-0.5	-0.2		-0.7		0.2		0.1	-0.1

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); Commission services' April 2009 spring forecasts (COM); Commission services' calculations

5.2. Long-term sustainability

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology[6].

Table 3 in the Annex 2 shows that the projected increase in age-related spending is rising by 5.5% of GDP between 2010 and 2060, which is above the EU average. Sustainability indicators for two scenarios are presented in Table 4 in the Annex. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2008 level , the sustainability gap (S2)7 would amount to 4.0% of GDP; about 0.5 percentage point less than in last year's assessment, despite the higher cost of ageing in the new projections. This is mainly due to an improvement in the estimated structural primary balance in the starting year. The starting budgetary position is not sufficient to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing. If the 2009 budgetary position of the Commission services' Spring 2009 forecast was taken as the starting point, the sustainability gap would widen to 6½% of GDP.

In contrast to the "2008 scenario", the "programme scenario", which is based on the 2011 structural primary balance, shows a smaller gap. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be somewhat mitigated. Based on the assumptions used for the calculation of the sustainability indicators, Figure 4 in the Annex displays the projected debt/GDP ratio over the long-term. For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. They are summarized in Table 5 in the Annex.

Slovakia appears to be at medium risk with regard to the sustainability of public finances. The long-term budgetary impact is slightly higher than the EU average, due to mainly a relatively high increase in pension expenditure during the coming decades. It is therefore important not to backtrack on the already enacted pension reform in the current juncture. The temporary deterioration of public finances due to the economic downturn should not be a reason for undermining the stability of the fully-funded pension pillar. If the stability of the fully-funded pension pillar is not ensured, the risk to long-term sustainability of public finance will increase as a result of ageing population. The budgetary position in 2008, as estimated in the programme, though improved from the estimated starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. If the 2009 budgetary position as projected by the Commission services Spring 2009 forecast was taken as the starting point, the sustainability gap would worsen substantially. Achieving higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing risks to the sustainability of public finances.

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[6] Economic Policy Committee and the European Commission (2009), 'The impact of aging on public expenditure: projections for the EU-27 Member States on pensions, health care, long-term care, education and unemployment transfers (2008-60)', *European Economy* No. 2/2009. European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006. European Commission (2008), *Public finances in EMU – 2008*, *European Economy* No. 4/2008.

[7] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

A strong feature of Slovakia's budgetary framework is the medium-term nature with a rolling three-year budgetary planning cycle. However, there is room for improvement, in particular as regards binding rules such as expenditure ceilings, which are still lacking. Moreover, deficit targets set out in the past convergence programmes have been achieved mainly owing to stronger-than-expected economic performance and buoyant revenues, while expenditure plans have been exceeded and subsequently revised upwards. In terms of the composition of public expenditure, Slovakia has a relatively low share of general government expenditure allocated to growth-enhancing categories such as education, R&D and innovation in comparison to other EU countries. On the revenue side, the level of taxation is relatively low.

In terms of institutional reforms, the stability programme notes that no significant changes have occurred since the 2007 update of the Convergence Programme. The Slovak authorities began to implement the planned transition to accrual accounting according to the principles of the International Public Sector Accounting Standards (IPSAS) in 2008, and the first consolidated financial statements for the general government will be compiled in 2010. In addition, the general government budgetary rules act was amended in order to introduce a regulatory mechanism for PPP projects.

In June 2008, Slovakia adopted the modernisation programme "Slovakia 21" which includes several measures aimed at simplifying of the tax and social contribution systems and at an integrated collection of taxes, customs duties, health and social contributions. To this end, the creation of a single financial authority is planned for 2013. Implementation of IT systems enabling real-time electronic data exchange between citizens, the public and the private sector is also envisaged. The reform has several stages and its implementation will begin in 2009. These measures would improve the efficiency and effectiveness of public administration. An increase in funds is planned for digitalisation of public administration in 2009 and 2010.

7. ASSESSMENT

This section assesses the budgetary strategy, taking into account risks, in the light of (i) the adequacy of the fiscal stimulus package in response to the Commission Communication of 26 November 2008 on the European Economic Recovery Plan (EERP) as endorsed by the European Council conclusions on the European Economic Recovery Plan (EERP) on 16 December 2008 and the overall fiscal stance, (ii) the criteria for short-term action laid down in the above mentioned Commission Communication, and (iii) the objectives of the Stability and Growth Pact.

The Slovak authorities have adopted three fiscal stimulus packages in response to the economic crisis. On the revenue side, the main measures include a temporary increase in tax-free income, higher in-work benefits for low-income employees, a decrease in social contributions for self-employed and tax reliefs for business R&D activities. The main expenditure measures include subsidies for R&D project carried out by businesses, additional funding of SMEs and social enterprises, a car scrapping scheme and subsidies to create and sustain employment. In addition, the Slovak authorities plan to improve absorption of EU funds and accelerate the implementation of public private partnerships (PPP) for motorway construction.

In view of the limited fiscal room for manoeuvre due to the external imbalances, the limited fiscal stimulus package for 2009 and 2010 adopted by Slovakia appears to be an adequate

response to the economic downturn. The adopted measures are in line with the European Economic Recovery Plan in that they are targeted on specific sectors or disadvantaged groups and are in most cases temporary. With respect to the timeliness, the implementation of the stimulus packages is somewhat back-loaded in the sense that only half of the total fiscal impact will occur in 2009. While the PPP projects for transport infrastructure show the potential of a significant boost to the economy, their implementation may be postponed due to administrative and credit constraints. Overall, the stimulus measures are likely to help mitigate the adverse impact of the crisis on domestic demand. They are related to the medium-term reform agenda and the country-specific recommendations proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

Most measures are of a temporary nature. The package will not have a significant fiscal impact based on the budgetary plans in the stability programme. Most cyclical smoothing will come from the operation of automatic stabilisers. The fiscal stimulus is relatively modest in comparison to other EU countries, which is justified by limited fiscal space for manoeuvre.

The projected fiscal stance is mildly expansionary in 2009 according to the Commission services' spring 2009 forecast due to implementation of the fiscal stimulus package. The structural balance is set to improve marginally after 2009 as a result of the planned budgetary consolidation, in particular cuts on the expenditure side. However, both revenue and expenditure targets outlined in the programme will be difficult to achieve as there is a lack of detail regarding efforts to reduce expenditure. Revenues are subject to a significant downside risk due to the economic downturn. The safety margin against breaching the 3% of GDP reference value (-2.0% of GDP) is not respected over the whole programme period. The programme focuses on maintaining the headline deficit below 3% of GDP. The achievement of fiscal targets is likely to be difficult given the programme's markedly favourable macro-economic scenario and a lack of concrete measures to back up the planned expenditure cuts.

ANNEX 1. SPECIAL TOPIC: MANUFACTURING SPECIALISATION AND EURO INTRODUCTION IN SLOVAKIA: THE CASE FOR AN ENHANCED ROLE OF FISCAL POLITY

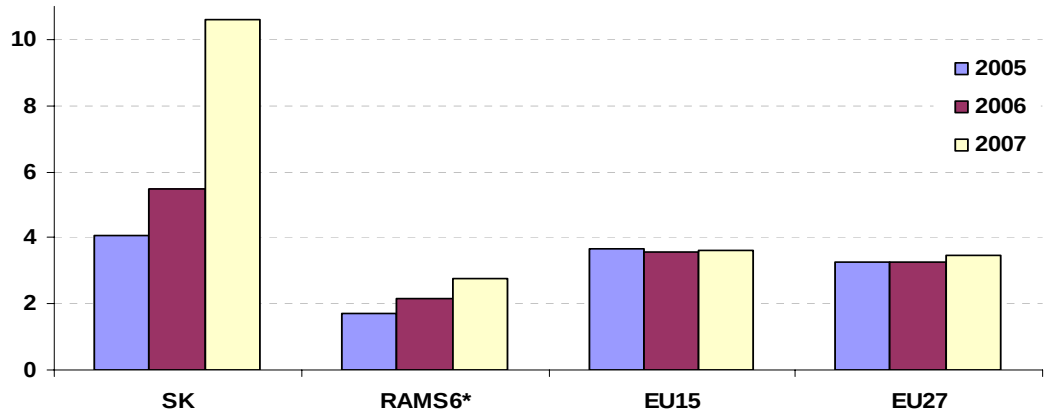
1. SUMMARY

Slovakia is known as a relatively small country where a number of auto manufacturers have launched production in recent years. This creates an impression that Slovakia's manufacturing is clustered around car production. Euro adoption in January 2009 led to a loss of monetary policy and exchange rate flexibility as means of responding to economic downturns. Consequently, the country needs to rely on fiscal policies and flexibility of the economy itself. Given the current set up, a potentially highly specialised manufacturing sector could present a significant risk for the economic stability in the case of a negative sectoral shock. Although the latest available data do not indicate that Slovak manufacturing was extraordinarily specialised in 2006, a continued strong growth of car production in the subsequent years implies that specialisation is likely to have further increased. However, Slovakia is also experiencing a rapid expansion of electronics manufacturing which might partly counterbalance increasing car production. On the other hand, holdings of foreign assets by domestic residents were in 2006 considerably lower in Slovakia than in the euro-zone. As a result, Slovak households could face higher income fluctuation in case of an adverse sectoral shock than households in the rest of the euro-area. Therefore, the government should provide incentives for sufficient diversification of both household savings and the production structure. Fiscal policy can play a catalytic role in fostering diversification through an adequate expenditure composition (focussing, for example, more on research and development and education) and on appropriate taxation system – in short, through an enhanced quality of public finance. In the short term, until diversification measures take effect, fiscal policy also bears added responsibility as a stabiliser of aggregate demand. However, it can only fulfil this role if sufficient fiscal space is created in good times.

2. IS SLOVAKIA TOO SPECIALISED?

In recent years, Slovakia has joined the top ranking countries in terms of per capita car production. In the second half of 2006, car production was launched in two new plants built by Kia Motors and PSA Peugeot Citroen. As a result, car production has almost doubled between 2006 and 2007.

Figure 1: Passenger car production per thousand inhabitants



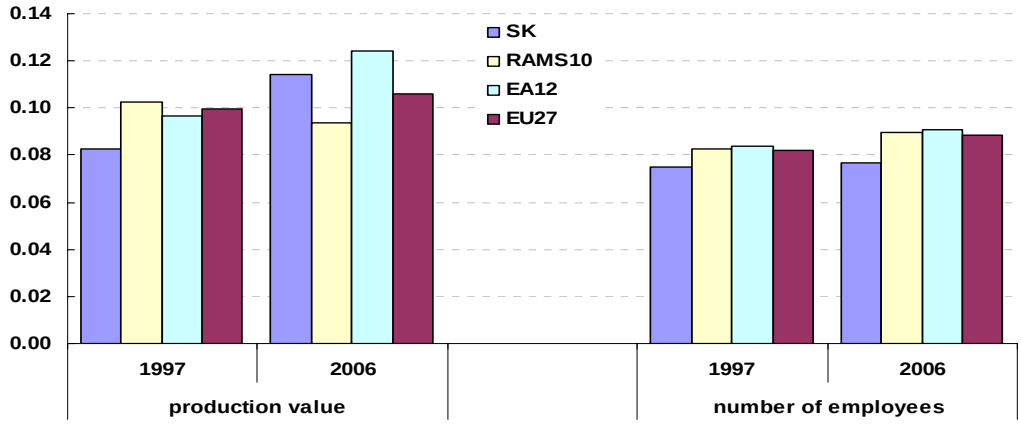
Source: ACEA and the Commission services

**CZ, HU, PO, RO, SK, SI*

The relatively large per capita production of cars creates an impression that Slovakia is a highly specialized economy. However, comparison of manufacturing specialisation across the EU shows that the specialisation indexes[8] for Slovak manufacturing were actually below the EA12 (Euro-area 12) average in 2006 indicating a more diversified manufacturing sector in terms of both production value and employment. While in terms of production value, the specialization index increased significantly since 1997 and exceeded the RAMS10 (recently acceded Member States from central and eastern Europe) average in 2006, in terms of employment, the specialisation index increased only marginally and was still below the RAMS10 average in 2006. Hence, increases in Slovakia's manufacturing specialization seem to have been driven by a relatively faster productivity growth in certain sectors. The more balanced distribution of labour resources (compared to production value) across different manufacturing sectors is likely to be beneficial for stabilising national income in case of adverse sectoral shocks.

[8] $SI_P = \sum_{i=1}^{N} P_i^2 \Big/ P^2$ and $SI_E = \sum_{i=1}^{N} E_i^2 \Big/ E^2$ where SI_P and SI_E denote specialisation indexes based on production value and employment, P_i and E_i stand for production value and employment in the manufacturing sector i while P and E represent overall manufacturing production and employment.

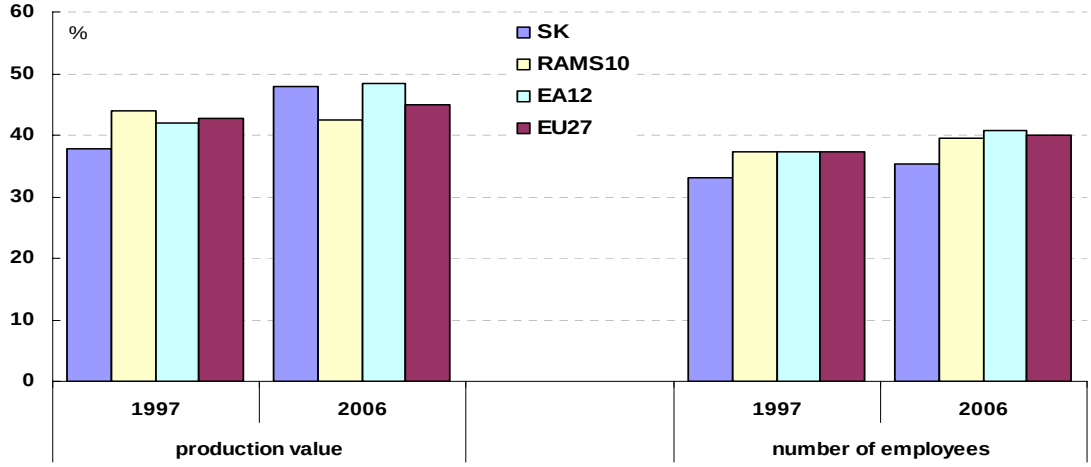
Figure 2: Manufacturing specialisation index



Source: Eurostat

This specialisation pattern is also confirmed by the evolution of the share of the three largest manufacturing subsectors in total Slovak manufacturing. This share has as well increased more in terms of production value than in terms of employment while it does not seem to indicate that Slovak manufacturing was relatively over-specialised in 2006. The three largest subsectors in terms of production value were in 2006 manufacture of (1) motor vehicles, (2) basic metals and (3) radio, television and communication equipment in contrast to manufacturing of (1) basic metals, (2) chemicals and chemical products and (3) machinery and equipment in 1997. In terms of employment, the three largest subsectors in 2006 were manufacture of (1) electrical machinery and apparatus, (2) machinery and equipment and (3) fabricated metal products compared to manufacture of (1) machinery and equipment, (2) basic metals and (3) wearing apparel, dressing and dyeing of fur in 1997.

Figure 3: Share of the 3 largest subsectors in the manufacturing sector

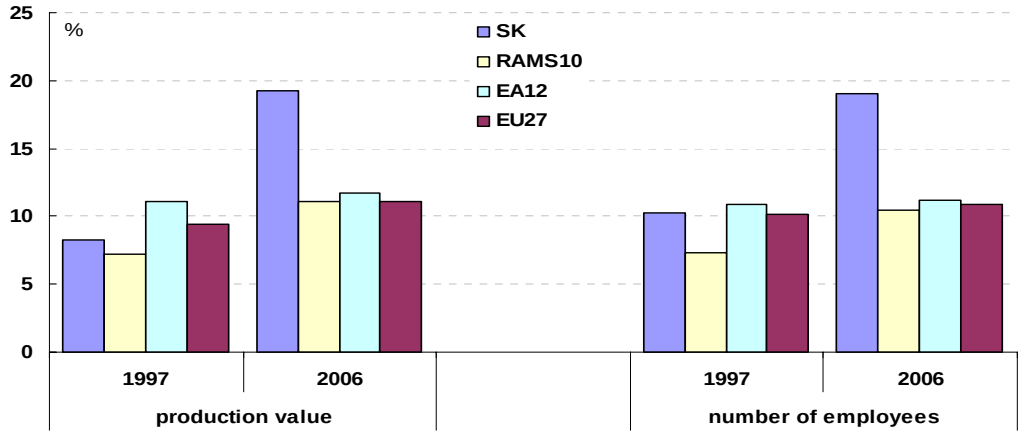


Source: Eurostat

Hence, while in 2006 manufacture of motor vehicles became dominant in terms of production value, the highest number of employees was allocated into the production of electrical machinery. This indicates that the relatively standard manufacturing production

diversification in 2006 can be explained by the fact that apart from car production, Slovakia had also developed into a major centre of electronics manufacturing. Over recent years Samsung and Sony have significantly extended their production capacities, with production of flat screen TVs foreseen to further increase in 2008. However, already in 2006, the share of electrical and optical equipment in total Slovak manufacturing production substantially exceeded the EU27, the EA12 or the RAMS10 average after having increased significantly since 1997.

Figure 4: Share of electrical and optical equipment in total manufacturing production

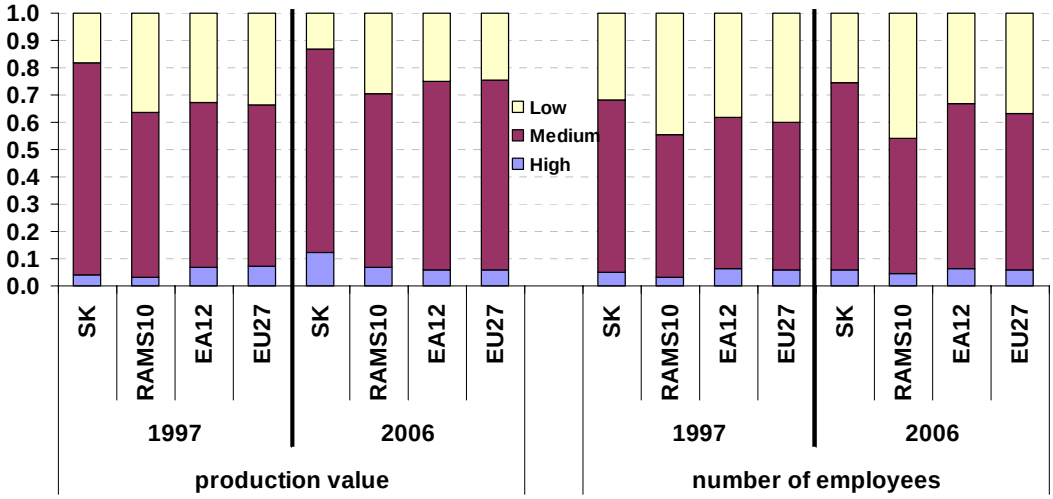


Source: Eurostat

As a result, Slovakia's manufacturing production structure has also gradually shifted towards more high-tech intensive goods.[9] While the share of low-tech manufacturing was already relatively low in 1997, the share of high-tech intensive goods increased further in the following years and by 2006 it already exceeded the EA12 average in terms of production value (12.3% compared to 6.1%) and it was only slightly below the EA12 average in terms of employment (6.1% compared to 6.2%).

[9] Manufacturing sectors classified according to NACE divisions as dl30, dl32 and dl33 are considered here as high-tech and sectors dl15-22 and dl 36-37 as low-tech intensive.

Figure 5: Technology content of manufacturing production (share of total)



Source: Eurostat and the Commission services

Although Slovakia's manufacturing production did not look exceptionally concentrated in 2006 the continued substantial growth of automobile production in the following years (especially in 2007) has likely induced further increases in its production specialisation. Even though a growing share of medium- and high-tech production indicates that Slovakia increasingly specialises in sectors with further growth potential, the question arises how the country's manufacturing specialisation and thus its vulnerability to adverse sectoral shocks is likely to evolve in the euro area and what means for risk diversification are available.

3. SPECIALIZATION AND EURO INTRODUCTION

A decrease in transaction costs and elimination of exchange rate uncertainty associated with the introduction of a common currency are likely to enhance trade. This seems to be also confirmed by empirical studies (see e.g. Rose (1999) or Barro and Tenreyro (2002)). Moreover, increased financial liberalization and integration should also lead to an increase in international risk sharing (see e.g. Bekaert et al (2004) or Artis and Hoffmann (2004)).

Increased international trade fosters and risk-sharing mitigates potential negative effects of national industrial specialization. Increases in trade are likely to mainly materialize in sectors where comparative advantage is the largest either due to relative factor endowments, increasing returns to scale or agglomeration externalities (see e.g. Krugman (1993) or Harrigan (2003)). At the same time, higher international risk sharing can mitigate larger costs of shocks for more specialized economies and thus decrease the disincentive to specialize (see e.g. Ramrachan (2005) or Kalemli-Ozcan et al. (2003)).

Increased policy centralisation, stronger demand linkages induced by higher trade flows and higher international risk sharing should contribute to the synchronisation of aggregate demand in the euro area, counteracting the asymmetry of output fluctuations induced by specialisation (see e.g. Kalemli-Ozcan et al. (2001)).

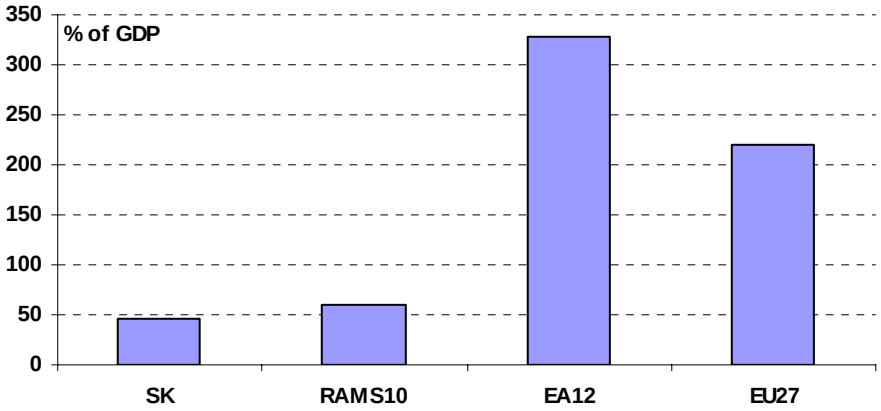
4. INTERNATIONAL RISK SHARING

Cross-border holding of assets (direct or through intermediaries) can help to smooth the income in a country or region and thus provide an ex-ante insurance against idiosyncratic

shocks. Smoothing of regional or national shocks is also possible through borrowing and lending on inter-national markets. The latter can, however, only be used to cope with temporary shocks. Permanent shocks cannot be smoothed out ex-post and would thus, in the absence of ex-ante insurance, lead to permanent adjustment of consumption levels (Kalemli-Ozcan et al. (2003)).

Slovakia's international investment position in 2006 indicates that Slovak residents hold slightly less foreign assets than residents in other new MS and substantially less foreign assets than euro-area residents. This is likely associated with the fact that the overall financial asset holdings are still relatively low in Slovakia.

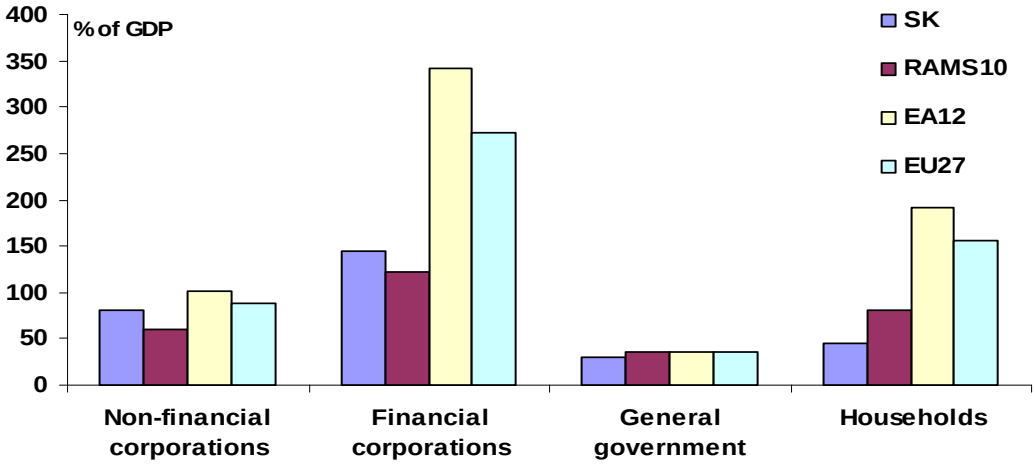
Figure 6: International investment position in 2006 (total assets as % of GDP)



Source: IMF-International Financial Statistics

While non-financial corporations and general government seem to already hold amounts of financial assets broadly equivalent to the whole EU27, RAMS10 countries including Slovakia substantially lag the euro-area countries in terms of holdings of financial assets by households and financial corporations. This is a natural characteristic of a catching-up economy as financial asset holdings of households and financial corporations depend on wealth and income levels. As a result, with converging income levels the amount of financial assets held by Slovak households and of foreign assets held by domestic residents should increase, thus mitigating the potential adverse income effects induced by negative sectoral shocks.

Figure 7: Financial asset holdings in 2006 (total assets as % of GDP)



Source: Eurostat

5. CONCLUSION AND POLICY IMPLICATIONS

Continued increases in car production are likely to have increased Slovakia's manufacturing specialisation, although the parallel robust expansion of the electronics sector is providing a root for diversification. In addition, the euro-area entry might further increase the incentives for industrial specialization. On the other hand, holdings of foreign assets by Slovak residents were still relatively low in 2006.

In light of insufficient diversification of its economic structure and its financial assets, the challenge for Slovakia is to sufficiently insure its national income against the risks resulting from growing industrial specialization by promoting sufficient and diversified household savings. Furthermore, education and training policies, R&D, as well as investment incentives should be designed in a way that encourage industrial diversification into sectors with high growth potential. These measures are likely to bear fruit only in the medium and long term in form of a more resilient economy that is more capable to cope with adverse shocks. Moreover, diversification of economic activities can prevent unexpected shortfalls of the government revenue during sectoral shocks, thereby putting the public finance in a better position for adequate responses. In the short term, until diversification measures gradually take effect, fiscal policy needs to play an essential and enhanced role on two fronts. First, it can be used as a direct instrument to promote the structural change which can be achieved by a proper qualitative setting of public finance. Second, it is a primary response tool for stimulating aggregate demand in the event of sectoral shocks. However, government has to ensure the creation of necessary fiscal room in good times to be able to use fiscal policy as demand stabiliser.

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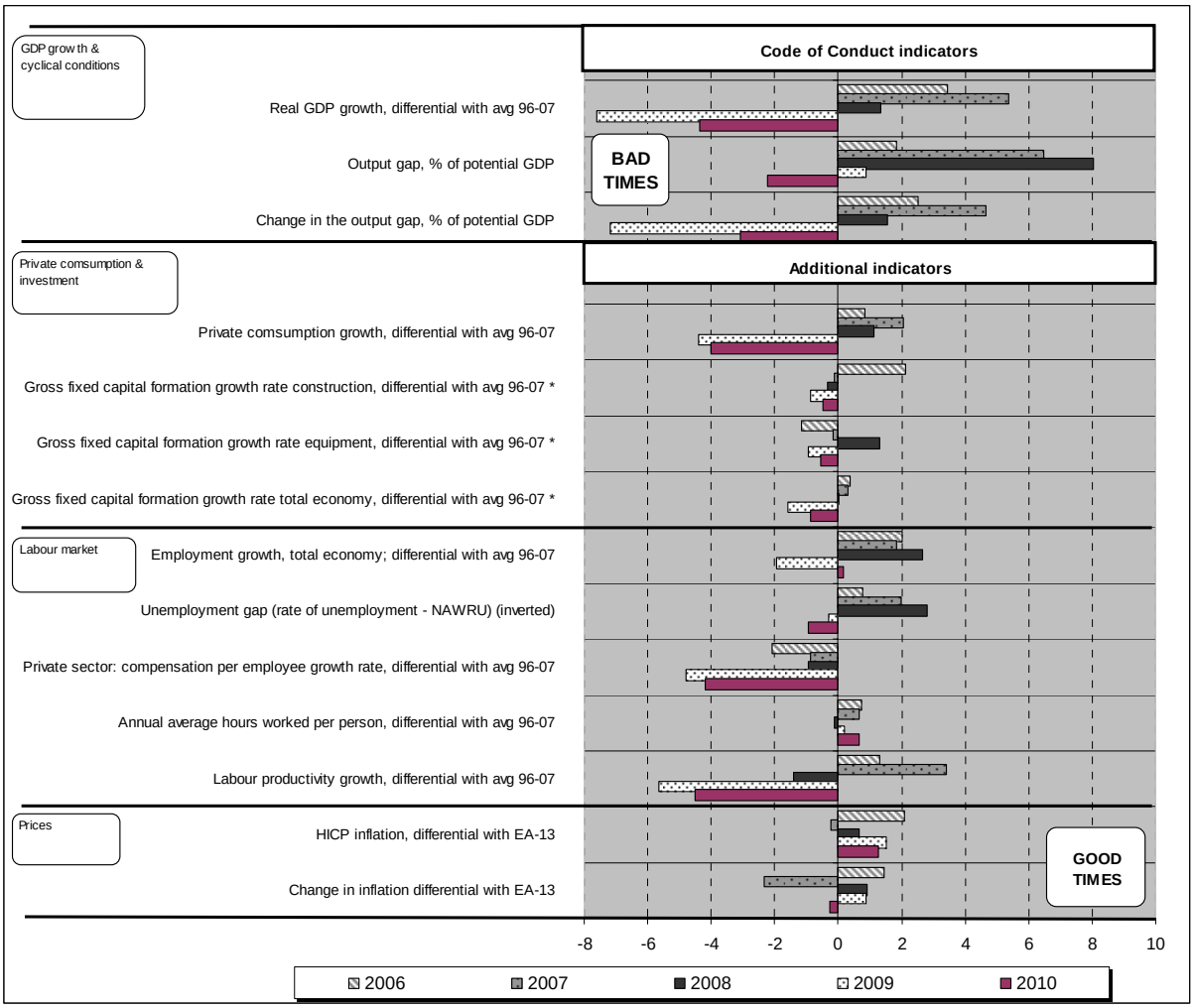
ANNEX 2. ADDITIONAL TABLES AND FIGURES

Figure 1: Good and bad economic times



* These variables have been divided by their standard deviation over the period 2003-2010, with a view to reducing their variability relative to other variables in the graph.

Source: Commission services' April 2009 spring forecast (COM)

Table 1: Budgetary implementation in 2008

	2007		2008	
	Planned SP Nov 2007	**Outcome SP Apr 2009**	**Planned SP Nov 2007**	**Outcome SP Apr 2009**
Government balance (% of GDP)	-2.5	-1.9	-2.3	-2.2
Difference compared to target	**0.6**		**0.1**	
Of which : due to a different starting position end 2007			0.6	
due to different revenue / expenditure growth in 2008			-0.5	
p.m. Denominator effect and residual [2,3]			0.0	
p.m. Nominal GDP growth (planned and outcome)			9.1	9.5
Revenue (% of GDP)	33.2	32.7	33.0	33.4
Revenue surprise compared to target [1]	**-0.5**		**0.4**	
Of which : due to a different starting position end 2007			-0.5	
due to different revenue growth in 2008			0.9	
p.m. Denominator effect [2]			-0.1	
p.m. Residual [3]			0.1	
p.m. Revenue growth rate (planned and outcome)			8.4	11.8
Expenditure (% of GDP)	35.7	34.6	35.3	35.6
Expenditure surprise compared to target [1]	**1.1**		**-0.3**	
Of which : due to different starting position end 2007			1.1	
due to different expenditure growth rate in 2008			-1.4	
p.m. Denominator effect [2]			0.1	
p.m. Residual [3]			-0.1	
p.m. Expenditure growth rate (planned and outcome)			7.9	12.7

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

Table 2: Evolution of budgetary targets in successive programmes

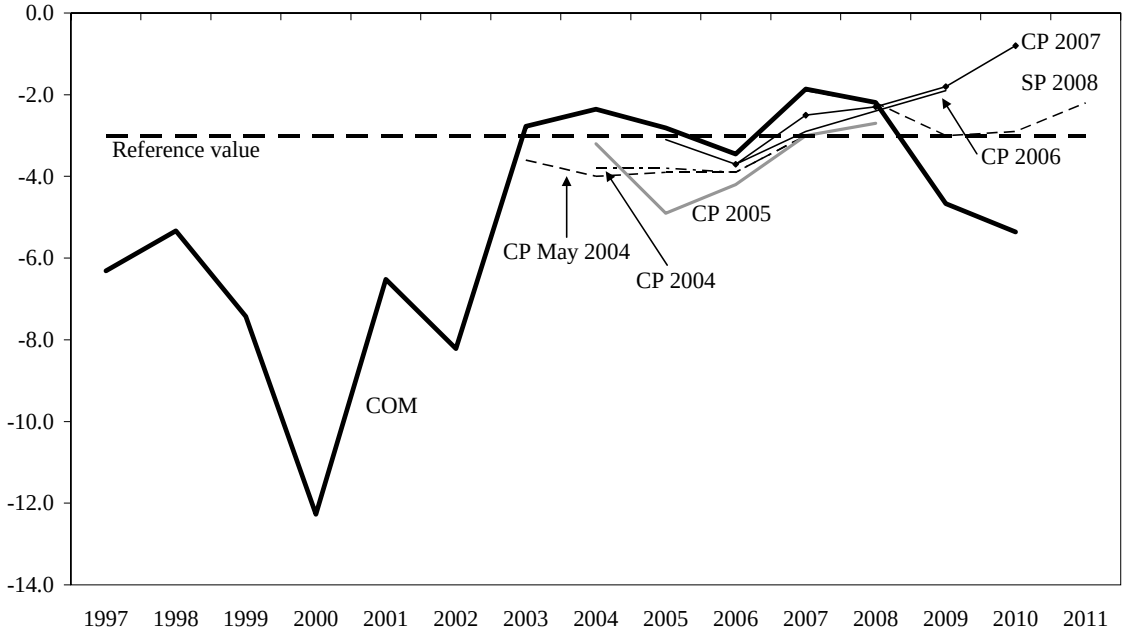
		2007	2008	2009	2010	2011
General government balance (% of GDP)	**SP Apr 2009**	**-1.9**	**-2.2**	**-3.0**	**-2.9**	**-2.2**
	CP Nov 2007	*-2.5*	*-2.3*	*-1.8*	*-0.8*	*n.a.*
	COM Jan 2009	-1.9	-2.2	-4.7	-5.4	n.a.
General government expenditure (% of GDP)	**SP Apr 2009**	**34.6**	**35.6**	**35.1**	**34.5**	**34.1**
	CP Nov 2007	*35.7*	*35.3*	*33.7*	*32.6*	*n.a.*
	COM Jan 2009	34.4	34.9	38.3	39.4	n.a.
General government revenue (% of GDP)	**SP Apr 2009**	**32.7**	**33.4**	**32.1**	**31.6**	**31.8**
	CP Nov 2007	*33.2*	*33.0*	*31.8*	*31.8*	*n.a.*
	COM Jan 2009	32.5	32.7	33.6	34.1	n.a.
Structural balance[1] (% of GDP)	**SP Apr 2009**	**-4.2**	**-3.8**	**-4.4**	**-3.5**	**-2.6**
	CP Nov 2007	*-3.0*	*-3.1*	*-2.4*	*-1.2*	*n.a.*
	COM Jan 2009	-3.8	-4.7	-5.0	-4.7	n.a.
Real GDP (% change)	**SP Apr 2009**	**10.4**	**6.4**	**2.4**	**3.6**	**4.5**
	CP Nov 2007	*8.8*	*6.8*	*5.8*	*5.0*	*n.a.*
	COM Jan 2009	10.4	6.4	-2.6	0.7	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes.
One-off and other temporary measures are 0.8% of GDP in 2007, 0.4% of GDP in 2009, 0.1 of GDP in 2009 and 2010 - deficit-increasing and 0.3% of GDP in 2008 deficit-reducing according to the most recent programme and 0.2% of GDP in 2008 and 0.1% of GDP in 2009 and 2011 deficit-increasing in the Commission services' forecast.

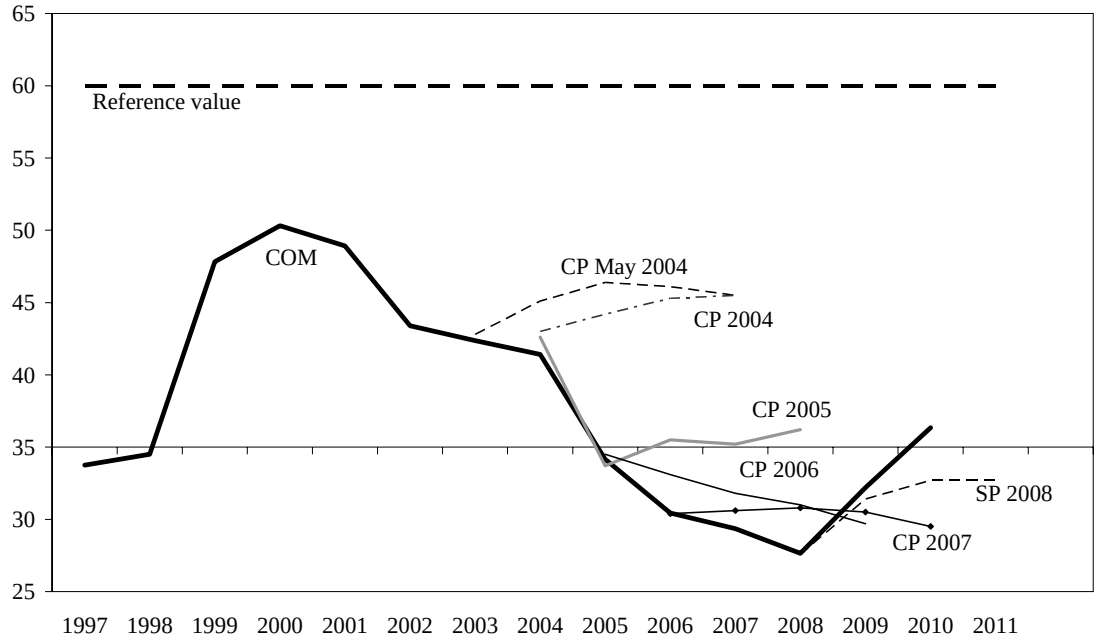
Source :
Stability programmes (SP); Commission services' April 2009 spring forecasts (COM)

Figure 2: Government balance projections in successive programmes (% of GDP)



Source: Commission services' April 2009 spring forecast (COM) and successive stability programmes

Figure 3: Debt projections in successive programmes (% of GDP)



Source: Commission services' April 2009 spring forecast (COM) and successive stability programmes

Table 3: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2040	2060	Change 2010- 60
Total age-related spending	**15.2**	**14.9**	**14.5**	**17.5**	**20.4**	**5.5**
- Pensions	6.8	6.6	6.3	8.3	10.2	3.6
- Healthcare	5.0	5.2	5.7	6.7	7.2	2.1
- Long-term care	0.2	0.2	0.2	0.4	0.6	0.4
- Education	3.1	2.8	2.2	2.1	2.3	-0.5
- Unemployment benefits	0.1	0.1	0.1	0.1	0.1	-0.1
Property income received	**1.5**	**1.4**	**1.2**	**1.1**	**1.0**	**-0.4**

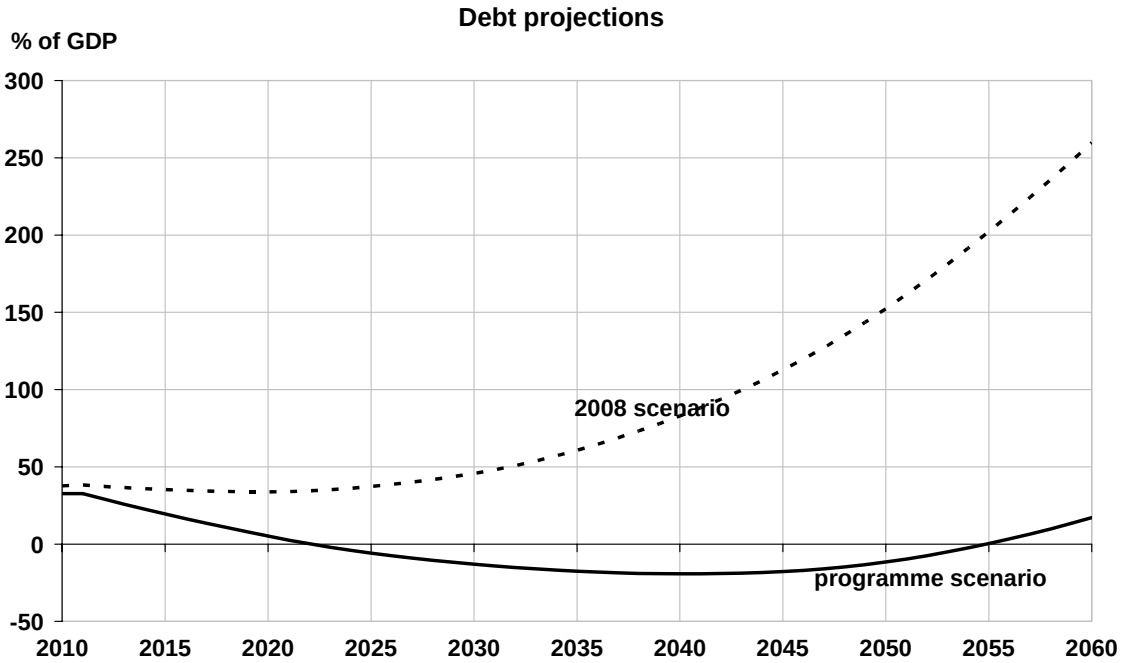
Source: Economic Policy Committee and Commission services.

Table 4: Sustainability indicators and the required primary balance

	2008 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	2.3	4.0	4.2	-0.5	1.2	4.1
of which:						
Initial budgetary position (IBP)	0.9	1.1	-	-1.9	-1.7	-
Debt requirement in 2050 (DR)	-0.3	-	-	-0.3	-	-
Long-term change in the primary balance (LTC)	1.7	2.9	-	1.7	2.9	-

Source: Commission services.

Figure 4: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services.

Table 5: Additional factors

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2010 in COM Spring 2009 forecast	na
Significant revenues from pension taxation	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	-
High tax burden	na
Non-age related budgetary measures with intertemporal effect	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability. 'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".
An explanation on these factors can be found in chapter IV of: European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006.
Source: Commission services.

ANNEX 3. COMPLIANCE WITH THE CODE OF CONDUCT AND TABLES FROM THE PROGRAMME

The programme adheres broadly to the code of conduct with respect to its table of contents. The programme provides nearly all compulsory data (in particular, the table on macroeconomic prospects does not provide the data on changes in inventories and net acquisition of valuables as percentage of GDP).

With respect to the optional data, COFOG figures for 2007 were submitted instead of those for 2006. All the remaining optional figures were provided.

The tables on the following pages show the data presented in the April 2009 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

Table 1a. Macroeconomic prospects[1]

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	*47.4*	10.4	6.4	2.4	3.6	4.5
2. Nominal GDP	B1*g	*61.5*	11.7	9.5	4.1	7.0	8.6
Components of real GDP							
3. Private consumption expenditure	P.3	*25*	7.0	6.1	3.1	3.5	4.4
4. Government consumption expenditure	P.3	*7.9*	-1.3	4.3	4.0	2.4	2.3
5. Gross fixed capital formation	P.51	*13*	8.7	6.8	2.2	3.6	5.1
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
7. Exports of goods and services	P.6	*46.6*	13.8	3.2	-2.7	3.1	6.2
8. Imports of goods and services	P.7	*45.1*	8.9	3.3	-2.2	2.5	5.5
Contributions to real GDP growth							
9. Final domestic demand		-	5.6	6.4	3.0	3.0	3.7
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.5	0.5	0.0	-0.3	-0.5
11. External balance of goods and services	B.11	-	4.3	0.0	-0.6	0.6	0.8

[1]The program used a wrong base year resulting in missing 2007 data, which were additionaly provided by the Slovak authorities.

Table 1b. Price developments[1]

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		*1.28*	0.5	2.9	1.7	3.3	4.0
2. Private consumption deflator		*1.34*	2.1	4.4	2.4	3.6	4.0
3. HICP[2]		*n.a.*	1.9	3.9	2.2	3.6	4.1
4. Public consumption deflator		*1.35*	2.2	4.1	3.3	4.3	4.6
5. Investment deflator		*1.24*	1.2	1.9	1.9	2.8	2.4
6. Export price deflator (goods and services)		*1.14*	0.5	1.4	0.4	1.2	1.6
7. Import price deflator (goods and services)		*1.19*	1.7	3.0	0.2	0.8	1.3

[1]The program used a wrong base year resulting in missing 2007 data, which were additionaly provided by the Slovak authorities.

[2]Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*2 177*	2.1	2.8	0.1	0.4	1.0
2. Employment, hours worked[2]		*3866.7*	2.3	2.2	1.6	1.9	1.9
3. Unemployment rate (%)[3]		*11*	-1.5	0.9	-0.1	-0.3	-0.3
4. Labour productivity, persons[4]		*21819*	8.1	4.3	2.3	3.2	3.5
5. Labour productivity, hours worked[5]		*12284*	6.4	4.7	3.0	3.3	4.1
6. Compensation of employees	D.1	*22404*	10.1	11.7	8.2	8.9	9.9
7. Compensation per employee		*10292*	8.6	7.4	optional	optional	optional

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances[1]

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-4.6	-5.8	-4.2	-2.9	-2.6
of which :						
- Balance on goods and services		-1.0	-2.4	-2.0	-1.2	-0.5
- Balance of primary incomes and transfers		-4.9	-4.4	-3.6	-3.4	-3.5
- Capital account		1.3	1.0	1.4	1.7	1.4
2. Net lending/borrowing of the private sector	B.9	-2.7	-3.6	-1.2	0.0	-0.4
3. Net lending/borrowing of general government	EDP B.9	-1.9	-2.2	-3.0	-2.9	-2.2
4. Statistical discrepancy		n.a.	optional	optional	optional	optional

[1]The program used a wrong base year resulting in missing 2007 data, which were additionaly provided by the Slovak authorities.

Table 2. General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*-1199*	-1.9	-2.2	-3.0	-2.9	-2.2
2. Central government	S.1311	*-1164*	-1.9	-2.6	-2.9	-2.8	-2.3
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-72*	-0.1	-0.1	0.0	-0.1	0.0
5. Social security funds	S.1314	*37*	0.1	0.5	-0.1	-0.1	0.1
General government (S13)							
6. Total revenue	TR	*20093*	32.7	33.4	32.1	31.6	31.8
7. Total expenditure	TE[1]	*21292*	34.6	35.6	35.1	34.5	34.1
8. Net lending/borrowing	EDP B.9	*-1199*	-1.9	-2.2	-3.0	-2.9	-2.2
9. Interest expenditure	EDP D.41	*852*	1.4	1.2	1.4	1.2	1.3
10. Primary balance[2]		*-346*	-0.6	-0.9	-1.7	-1.7	-1.0
11. One-off and other temporary measures[3]		*519*	0.8	-0.3	0.4	0.1	0.1
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*10756*	17.5	17.1	16.4	16.3	16.4
12a. Taxes on production and imports	D.2	*6993*	11.4	10.8	10.4	10.4	10.1
12b. Current taxes on income, wealth, etc	D.5	*3763*	6.1	6.4	6.1	5.9	6.3
12c. Capital taxes	D.91	*0*	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	*7293*	11.9	12.1	12.2	12.0	11.8
14. Property income	D.4	*933*	1.5	0.8	1.2	0.9	0.8
15. Other[4]		*1111*	1.8	3.4	2.2	2.4	2.8
16=6. Total revenue	TR	*20093*	32.7	33.4	32.1	31.6	31.8
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			29.3	29.2	28.6	28.3	28.3
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*7010*	11.4	11.5	10.8	10.5	10.2
17a. Compensation of employees	D.1	*4209*	6.8	6.8	6.8	6.5	6.4
17b. Intermediate consumption	P.2	*2801*	4.6	4.8	4.0	4.0	3.9
18. Social payments (18=18a+18b)		*9879*	16.1	15.7	16.5	16.6	16.3
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*2750*	4.5	4.7	4.9	4.9	4.9
18b. Social transfers other than in kind	D.62	*7129*	11.6	11.0	11.7	11.7	11.5
19=9. Interest expenditure	EDP D.41	*852*	1.4	1.2	1.4	1.2	1.3
20. Subsidies	D.3	*740*	1.2	1.4	1.3	1.0	1.0
21. Gross fixed capital formation	P.51	*1153*	1.9	1.5	1.5	1.4	1.5
22. Other[6]		*1658*	2.7	4.3	3.6	3.8	3.8
23=7. Total expenditure	TE[1]	*21292*	34.6	35.6	35.1	34.5	34.1
p.m.: Government consumption (nominal)	P.3	*10783*	17.5	17.7	17.4	17.1	16.9

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[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.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**2007**	**2011**
1. General public services	1	3.7	4.9
2. Defence	2	1.5	1.2
3. Public order and safety	3	2.0	1.4
4. Economic affairs	4	4.3	4.4
5. Environmental protection	5	0.6	0.9
6. Housing and community amenities	6	0.8	0.8
7. Health	7	6.5	6.5
8. Recreation, culture and religion	8	0.7	0.9
9. Education	9	4.0	3.1
10. Social protection	10	10.6	10.1
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	34.6	34.1

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**2007**	**2008**	**2009**	**2010**	**2011**
1. Gross debt[1]		29.4	27.6	31.4	32.7	32.7
2. Change in gross debt ratio		-1.1	-1.7	3.7	1.3	0.0
Contributions to changes in gross debt						
3. Primary balance[2]		0.6	0.9	1.7	1.7	1.0
4. Interest expenditure[3]	EDP D.41	1.4	1.2	1.4	1.2	1.3
5. Stock-flow adjustment		0.1	-1.4	2.2	0.5	0.4
of which:						
- Differences between cash and accruals[4]		-0.2	0.2	0.2	-0.2	0.2
- Net accumulation of financial assets[5]		1.1	-0.9	1.8	0.6	0.3
of which:						
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		-0.6	-0.7	0.2	0.1	-0.1
p.m.: Implicit interest rate on debt[7]		5.1	4.7	5.3	3.9	4.2
Other relevant variables						
6. Liquid financial assets[8]		4.6	3.7	3.6	3.4	3.1
7. Net financial debt (7=1-6)		24.8	24.0	27.8	29.3	29.6

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments[1]

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Real GDP growth (%)		9.5	7.5	2.4	3.3	4.5
2. Net lending of general government	EDP B.9	-1.9	-2.2	-3.0	-2.9	-2.2
3. Interest expenditure	EDP D.41	1.4	1.2	1.4	1.2	1.3
4. One-off and other temporary measures[2]		0.8	-0.3	0.4	0.1	0.1
5. Potential GDP growth (%)		7.9	7.3	4.8	4.0	4.1
contributions:						
- labour		0.9	1.0	0.6	0.5	0.4
- capital		1.8	2.0	2.0	1.9	2.0
- total factor productivity		5.0	4.3	2.2	1.6	1.7
6. Output gap		1.5	1.7	-0.6	-1.2	-0.9
7. Cyclical budgetary component		0.4	0.5	-0.2	-0.4	-0.2
8. Cyclically-adjusted balance (2 - 7)		-2.4	-2.7	-2.9	-2.5	-2.0
9. Cyclically-adjusted primary balance (8 + 3)		-1.0	-1.5	-1.5	-1.4	-0.7
10. Structural balance (8 - 4)		-3.2	-2.4	-3.3	-2.6	-2.1

[1]The program used a wrong base year resulting in missing 2007 data, which were additionaly provided by the Slovak authorities.

[2]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update		8.8	6.8	5.8	5.0	n.a.
Current update		10.4	6.4	2.4	3.6	4.5
Difference		1.6	-0.4	-3.4	-1.4	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.5	-2.3	-1.8	-0.8	n.a.
Current update		-1.9	-2.2	-3.0	-2.9	-2.2
Difference		0.5	0.1	-1.2	-2.1	n.a.
General government gross debt (% of GDP)						
Previous update		30.6	30.8	30.5	29.5	n.a.
Current update		29.4	27.6	31.4	32.7	32.7
Difference		-1.2	-3.2	0.9	3.2	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2004	2010	2020	2030	2040	2050
Total expenditure	38.0	36.4	36.2	38.0	40.9	45.3
Of which: age-related expenditures	16.2	15.4	15.3	16.5	17.7	19.1
Pension expenditure	7.2	6.7	7.0	7.7	8.2	9.0
Social security pension	7.2	6.7	7.0	7.7	8.2	9.0
Old-age and early pensions	5.4	4.8	4.6	5.0	5.5	6.3
Other pensions (disability, survivors)	1.8	1.9	2.3	2.7	2.7	2.7
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	4.4	4.7	5.2	5.7	6.0	6.3
Long-term care *(this was earlier included in the health care)*	0.7	0.8	0.7	0.9	1.1	1.3
Education expenditure	3.7	3.0	2.2	2.2	2.3	2.4
Other age-related expenditures	0.3	0.2	0.1	0.1	0.1	0.1
Interest expenditure	2.2	1.5	1.4	2.0	3.7	6.7
Total revenue	35.0	31.8	31.6	31.5	31.4	31.2
Of which: property income	1.7	1.1	1.1	1.1	1.1	1.1
Of which : from pensions contributions (or social contributions if appropriate)	12.8	11.5	11.3	11.2	11.1	10.9
Pension reserve fund assets	0.0	7.0	18.9	31.5	45.7	58.0
Of which : consolidated public pension fund assets (assets other than government liabilities)	0.0	0.0	0.0	0.0	0.0	0.0
Assumptions						
Labour productivity growth	5.5	4.9	3.3	2.7	1.9	1.7
Real GDP growth	5.5	5.3	3.3	2.0	0.4	0.3
Participation rate males (aged 20-64)	77.3	79.6	82.1	82.3	79.4	78.7
Participation rates females (aged 20-64)	64.1	67.1	73.5	73.8	70.0	69.1
Total participation rates (aged 20-64)	70.7	73.3	77.8	78.0	74.7	73.9
Unemployment rate	18.1	15.2	9.7	7.0	7.0	7.0
Population aged 65+ over total population	11.5	12.3	16.3	20.8	24.1	29.3

Table 8. Basic assumptions[1]

	2007	2008	2009	2010	2011
Short-term interest rate[2] **(annual average)**	4.3	4.6	2.1	2,8	3,4
Long-term interest rate (annual average)	4.3	40.0	3.1	3.3	4.0
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.37	1.47	1.38	1.38	1.38
Nominal effective exchange rate	n..a.	n..a.	n..a.	n..a.	n..a.
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n..a.	n..a.	n..a.	n..a.	n..a.
World excluding EU, GDP growth	5.7	3.9	1.2	3.3	3.5
EU GDP growth	2.9	1.0	-1.8	0.5	1.2
Growth of relevant foreign markets	3.4	2.0	-1.1	0.1	2.4
World import volumes, excluding EU	8.1	4.1	-1.3	3.6	4.9
Oil prices (Brent, USD/barrel)	72.5	98.5	52.1	61.7	76.0

[1]The program used a wrong base year resulting in missing 2007 data, which were additionaly provided by the Slovak authorities.

[2]If necessary, purely technical assumptions.

* * *