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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of SLOVAKIA

Accompanying the document

COMMISSION OPINION

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1. INTRODUCTION

Slovakia has submitted its Draft Budgetary Plan for 2015 on 15 October 2014 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Slovakia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on 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 2014-2015 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 8 July 2014, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

After a slowdown in 2013, Slovakia's economy has gathered pace in 2014, driven by a recovery in domestic demand. The Draft Budgetary Plan expects real GDP growth of 2.4% in 2014, slightly increasing to 2.6% in 2015 (see Table 1). In 2015, private consumption and investment are projected to continue growing, albeit at a slower pace than in 2014. While the contribution of net exports to growth in 2015 is projected to be important, the recovery is expected to be equally driven by domestic demand. The Draft Budgetary Plan foresees employment to increase further, but the unemployment rate is expected to fall only slightly to 13%.

Compared to the latest Stability Programme, the growth projection for 2014 was increased slightly overall, with significant upward revisions of private consumption and investment but also of imports. GDP growth in 2015 was revised downwards mainly because of lower forecasts for public consumption and export growth.

The main difference between the macroeconomic scenarios of the Draft Budgetary Plan and the Commission 2014 autumn forecast is that the latter projects growth in 2015 to be mainly driven by domestic demand, though the contribution from net exports is also expected to be positive. Overall, macroeconomic projections in the Draft Budgetary Plan appear to be plausible.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.4	2.3	2.4	2.4	3.0	2.6	2.5
Private consumption (% change)	-0.7	1.2	2.9	2.8	2.2	2.4	2.3
Gross fixed capital formation (% change)	-2.7	1.8	4.8	4.1	2.4	2.7	2.5
Exports of goods and services (% change)	5.2	4.0	4.3	4.6	4.5	4.3	4.4
Imports of goods and services (% change)	3.8	3.6	5.7	5.7	3.6	3.4	4.0
Contributions to real GDP growth:							
- Final domestic demand	-0.6	1.3	2.8	3.2	1.3	1.2	2.0
- Change in inventories	0.5	0.1	0.7	0.0	0.1	0.0	0.0
- Net exports	1.4	0.9	-0.4	-0.7	1.5	1.3	0.5
Output gap[1]	-3.2	-3.3	-3.3	-3.3	-2.5	-3.2	-3.4
Employment (% change)	-0.8	0.7	1.1	0.8	0.6	0.4	0.7
Unemployment rate (%)	14.2	14.0	13.5	13.4	13.2	13.0	12.8
Labour productivity (% change)	2.2	1.6	1.3	1.6	2.3	2.2	1.8
HICP inflation (%)	1.5	0.8	0.1	-0.1	2.1	1.0	0.7
GDP deflator (% change)	0.5	0.9	-0.4	-0.1	1.4	1.1	0.5
Comp. of employees (per head, % change)	2.6	1.8	3.2	3.5	2.9	2.8	2.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.3	6.0	2.4	1.2	6.7	2.9	0.5

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 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

Box 1: The macro economic forecast underpinning the budget 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 at the end of September and endorsed by the Macroeconomic Forecasting Committee (MFC).

The constitutional act on budgetary responsibility, adopted in December 2011, formally endowed 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). In September 2014, the Council for Budgetary Responsibility, the Slovak fiscal council created in 2011, which had previously had a status of observer, became full member of the MFC with voting rights.

The MFC assesses 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 members. 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

Although the Draft Budgetary Plan formally confirms the target for the general government deficit in 2014 at 2.6% of GDP, as announced in the most recent Stability Programme, it indicates that the deficit would reach 2.9% of GDP by year-end. The higher deficit projection is explained as resulting from shortfalls in dividends from state-owned enterprises (SOEs), higher health-care expenditure, higher spending of local governments and universities and financial corrections related to the EU-financed projects. These developments are expected to be only partially offset by stronger-than-budgeted growth in tax revenue, the freeze of state budget expenditures following the activation of the first stage of the national debt brake and lower co-financing of investment financed through EU funds. Since the Draft Budgetary Plan does not envisage further additional measures in 2014 to counter-balance the negative budgetary developments, the assessment of the Draft Budgetary Plan is based on the expected deficit outturn of 2.9% of GDP rather than on the official target.

The Commission 2014 autumn forecast projects the 2014 deficit to reach 3% of GDP on the back of strong growth in the public wage bill, while investment is slightly lower than in the projection in the Draft Budgetary Plan. A number of uncertainties could negatively affect the final deficit outcome. They are linked principally to the statistical treatment of proceeds from the sale of mobile phone frequency licences and the application of larger-than-expected financial corrections related to the projects financed with EU funds.

For 2015, the Draft Budgetary Plan foresees the headline deficit at 2% of GDP, some 0.5 pp lower compared to the target of 2.5% of GDP presented in the latest Stability Programme[1]. It must be noted, however, that while this 2% of GDP deficit target for 2015 was used in the assessment, it is based on the assumption that the second stage of the national debt-brake rule is activated in 2015[2]. It is against this background that the larger part of the budgetary adjustment in 2015 is expected on the expenditure side, with the expenditure-to-GDP ratio falling by 1.5 pps to 38% of GDP (see Table 2)[3]. Moreover, despite revenue-increasing

[1] The Annex of the Slovak language version of the Draft Budgetary Plan presents figures for the 2015 general government deficit that are not consistent with those in the main text. In particular, Table 7 in the Annex reports a deficit of 2.5% of GDP for 2015 whereas the figure reported throughout the main text is 2.0% of GDP. This table is not reported in the English version of the document.

[2] The national debt brake was activated in spring 2014, when the validated debt-to-GDP ratio for 2013 first became available and since it exceeded the 55% threshold. As established in the law, in the first step, as of May the Ministry of Finance froze 3% of state budget spending adjusted for several items. In the second stage, the government submitted to the Parliament a general government budget for 2015 that did not include an increase in (adjusted) nominal expenditure compared to the 2014 budget and local governments were obliged to retain their spending at levels budgeted for 2014.

[3] The comparison of revenue and expenditure ratios in the Draft Budgetary Plan with those in the latest Stability Programme is not directly possible due to the changeover to ESA2010. Both revenues and expenditures increased due to reclassification of several public units in the general government including the National

measures totalling 0.3% of GDP, the Draft Budgetary Plan projects the revenue-to-GDP to decline by 0.6 pp to 36%, driven mainly by indirect taxes and social contributions and given the absence of one-off revenues[4], which improve the 2014 outcome.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**38.4**	**35.2**	***36.6***	**38.0**	**33.7**	***36.0***	**37.9**	**-2.4**
of which:								
- Taxes on production and imports	10.4	10.1	*10.5*	10.5	9.9	*10.4*	10.4	0.0
- Current taxes on income, wealth, etc.	6.4	6.1	*6.5*	6.5	5.9	*6.6*	6.7	0.2
- Capital taxes	0.0	0.0	*n.a.*	0.0	0.0	*n.a.*	0.0	n.a.
- Social contributions	13.5	13.3	*13.4*	13.4	13.1	*13.2*	13.3	-0.3
- Other (residual)	8.2	5.7	*6.2*	7.6	4.8	*5.8*	7.5	-2.4
Expenditure	**41.0**	**38.0**	**39.5**	**40.9**	**36.5**	**38.0**	**40.5**	**-3.0**
of which:								
- Primary expenditure	39.1	36.2	37.7	39.1	34.7	36.3	38.8	-2.8
of which:								
Compensation of employees	8.5	7.0	7.2	8.5	6.7	7.0	8.3	-1.5
Intermediate consumption	5.2	4.6	4.6	5.3	4.3	4.6	5.5	-0.6
Social payments	18.9	18.4	18.4	18.3	17.9	17.8	17.9	-1.1
Subsidies	1.0	1.0	0.8	0.8	0.9	0.8	0.7	-0.2
Gross fixed capital formation	3.0	2.1	3.5	3.2	2.1	2.9	2.9	-0.1
Other (residual)	2.5	3.1	3.2	3.0	2.8	3.2	3.5	0.7
- Interest expenditure	1.9	1.8	1.8	1.8	1.8	1.7	1.7	-0.2
General government balance (GGB)	**-2.6**	**-2.8**	**-2.9**	**-3.0**	**-2.8**	**-2.0**	**-2.6**	**0.6**
Primary balance	**-0.7**	**-1.0**	**-1.1**	**-1.1**	**-1.0**	**-0.3**	**-0.9**	**0.4**
One-off and other temporary	0.0	0.6	0.4	0.4	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-2.6**	**-3.4**	**-3.3**	**-3.4**	**-2.8**	**-2.0**	**-2.6**	**0.6**
Output gap[1]	-3.2	-3.3	-3.3	-3.3	-2.5	-3.2	-3.4	0.0
Cyclically-adjusted balance[1]	-1.4	-1.7	-1.6	-1.7	-2.0	-0.7	-1.3	0.6
Structural balance (SB)[2]	**-1.4**	**-2.3**	**-2.0**	**-2.1**	**-2.0**	**-0.7**	**-1.3**	**0.6**
Structural primary balance[2]	0.5	-0.5	-0.2	-0.3	-0.2	1.0	0.4	0.5

Notes:

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

Source:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

Motorway Company, Eximbanka, and hospitals. As the Draft Budgetary Plan could not have anticipated some of these changes, the reclassification of hospitals was not reflected in its revenue and expenditure projections.

[4] See Section 3.3 for details.

The Commission 2014 autumn forecast projects the 2015 headline deficit at 2.6% of GDP, 0.6 pps higher compared to the Draft Budgetary Plan[5]. The difference compared to the deficit target reflects mainly assumed lower savings on the wage bill, higher intermediate consumption and higher public investment plans. This is because based on the new government finance statistics for 2013 (in ESA 2010) that were validated by Eurostat on 21 October (after the Draft Budgetary Plan was submitted), the debt ratio in 2013, which turned out to be below 55% of GDP, no longer requires the application of the second stage of the national debt brake. The savings assumed in expenditure projections for 2015 presented in the Draft Budgetary Plan now therefore appear to be overly ambitious, as they are no longer mandated by the debt brake. In addition, the Commission forecast takes into account the impact of announced increases in teachers' salaries and the planned introduction of an allowance for healthcare contributions for low-paid workers, first announced in August, which were not reflected in the projections of the Draft Budgetary Plan.

After several years of consolidation, the structural deficit is expected to increase in 2014, according to both the Draft Budgetary Plan and the Commission 2014 autumn forecast. This deterioration is expected to be partly reversed in 2015. While the projected changes in the structural balance are comparable in 2014, they differ significantly in 2015. For 2015, the Draft Budgetary Plan projects a much stronger improvement in the recalculated structural balance[6] due to the assumed application of the national debt brake, which as discussed above, is not expected to materialise. The less pronounced improvement from 2014 to 2015 in the structural balance in the Commission forecast compared to that in the Draft Budgetary Plan is fully explained by the differences in the headline deficits.

3.2. Debt developments

The debt-to-GDP ratio of the general government in 2013 reached 54.6% of GDP, almost a full percentage point lower compared to the latest Stability Programme. The downward revision is almost entirely due to the methodological changes related to the introduction of the new system of national accounts, ESA2010. The debt-to-GDP ratio for 2014 and 2015 in the Draft Budgetary Plan is about one percentage point lower compared to the latest Stability Programme (see Table 3). The revision of the 2013 debt ratio explains part of the difference. In addition, the plan assumes that a part of a cash reserve accumulated during the period of favourable market conditions[7] will be used in 2014 to pay back the debt of the Emergency Oil Stocks Agency, which incurred when it was established in 2013, and to buy back outstanding government bonds. Moreover, the participation of Slovakia in the European financial stabilisation mechanisms will also increase general government debt in 2014. According to the Draft Budgetary Plan, the debt ratio will increase only slightly in 2015 but remain below 55% of GDP, under the assumption that the envisaged privatisation proceeds from the sale of government shares in a telecom company will be used for further debt reduction and no new debt will be added as a result of commitments under the European stabilisation mechanisms.

[5] The Commission 2014 autumn forecast projects higher levels of revenue and expenditure since it uses as a basis the validated fiscal figures (based on the new system of national accounts, ESA 2010), whereas these figures were not available when the Draft Budgetary Plan was prepared. Therefore, the ratios to GDP are not directly comparable. While the Draft Budgetary Plan takes into account in its deficit projections the expected newly created debt of hospitals, it does not cater for changes in the revenue and expenditure figures related to reclassification of hospitals to general government.

[6] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

[7] The cash reserve amounted to some 5% of GDP at the end of September 2014 and is expected to be reduced to about 3% of GDP by the year-end.

The Commission projects a faster increase in the debt ratio in 2015 due to a higher projection of the headline deficit.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**54.6**	**55.2**	**54.1**	**54.1**	**56.2**	**54.4**	**54.9**
Change in the ratio	2.5	-0.2	-0.5	-0.5	1.0	0.3	0.8
Contributions[2] :							
1. Primary balance	**0.7**	**1.0**	**1.1**	**1.1**	**1.0**	**0.3**	**0.9**
2. "Snow-ball" effect	**0.9**	**0.1**	**0.7**	**0.6**	**-0.5**	**-0.2**	**0.2**
Of which:							
Interest expenditure	1.9	1.8	1.8	1.8	1.8	1.7	1.7
Growth effect	-0.7	-1.2	-1.3	-1.3	-1.6	-1.4	-1.3
Inflation effect	-0.3	-0.5	0.2	0.1	-0.7	-0.6	-0.3
3. Stock-flow adjustment	**0.9**	**-1.3**	**-2.3**	**-2.3**	**0.5**	**0.2**	**-0.2**
Of which:							
Cash/accruals difference		0.3	-0.1		0.2	0.0	
Net accumulation of financial		-1.3	-2.4		0.7	-0.3	
of which privatisation proceeds		0.0	0.0		-1.3	-1.3	
Valuation effect & residual		-0.2	0.1		-0.1	0.0	

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

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.3. Measures underpinning the draft budgetary plan

The Draft Budgetary Plan foresees a larger part of the consolidation effort in 2015 to be delivered on the expenditure side (see Table 4). In terms of revenues, repealing the automatic reduction of the VAT rate to 19% and maintaining it at 20% is presented in the Draft Budgetary Plan as an important revenue measure. The Commission included this measure in the baseline already in its 2014 spring forecast. A bulk of additional revenue-increasing measures relate to: i) broadening of the tax base for the corporate income tax through changes to the depreciation rules (e.g. by introducing a longer depreciation period for certain items), ii) addressing the issue of transfer pricing by limiting tax deductibility of inter-company loans, and limiting tax expenditures (e.g. through changes to tax deductions based on a VAT coefficient) and iii) fighting tax avoidance (e.g. by an extension of compulsory use of cash registers to doctors and other professions). The estimated impact of these measures appears to be plausible[8] although amendment proposals to the capping of tax expenditures suggest lower

[8] The Tax Revenue Forecasting Committee – an advisory body to the Ministry of Finance, which endorses forecasts of tax and social security revenues – also deemed them realistic.

yields than included in the Draft Budgetary Plan. The planned partial fiscal deductibility of R&D expenditure will reduce government revenues. The Draft Budgetary Plan does not account for the negative budgetary impact of the envisaged introduction of an allowance for healthcare contributions for the low-paid.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by general government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2014	**2015**
Taxes on production and	0.0	0.3
Current taxes on income, wealth,	0.0	0.3
Capital taxes	n.a.	n.a.
Social contributions	0.0	-0.1
Property Income	n.a.	n.a.
Other	0.0	-0.1
Total	0.0	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 revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan 2015

B. Discretionary measures taken by general government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2014	**2015**
Compensation of employees	0.0	-0.2
Intermediate consumption	0.0	-0.1
Social payments	0.0	-0.3
Interest Expenditure	n.a.	n.a.
Subsidies	0.0	0.0
Gross fixed capital formation	n.a.	n.a.
Capital transfers	0.0	0.0
Other	0.0	-0.7
Total	0.0	-1.1

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan 2015

The planned expenditure savings are largely related to the assumed application of the second stage of the debt brake. Given the fact that – as mentioned above – the debt brake will not mandate expenditure freezes anymore, the savings projected in the Draft Budgetary Plan are

not likely to materialise in full. The Draft Budgetary Plan does not specify how and where these cuts would be implemented. However, it indicates that important savings are to be achieved in the context of the state administration reform (ESO) and would come mainly from the wage bill through wage freeze and, to some extent, from labour shedding. It is not clear to what extent the announced wage freezes hinge on the application of the debt brake and whether they would still be enforced also in its absence. In addition, the Draft Budgetary Plan does not include the envisaged increase of teachers' salaries in its baseline projection of expenditures. While the government exerts discipline on the wage bill developments in the central administration, the track record of implementing budgeted employees' compensations at the general government level is rather poor. Increasing efficiency in the healthcare sector is also expected to yield savings, but is subject to risks described in Section 5.

The Draft Budgetary Plan assumes several one-off measures on the revenue side in 2014, including a sale of mobile phone licenses, a penalty for a construction cartel, and frontloading a loan repayment by a state-owned company.(the railway freight transporter). No one-off measures are planned for 2015. The Commission 2014 autumn forecast makes similar assumptions on the nature and the level of one-offs.

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

Slovakia is currently subject to the preventive arm of the Stability and Growth Pact. This implies that it must make sufficient progress towards its MTO (a structural deficit of 0.5% of GDP). Against the background of a high negative output gap and a government debt-to-GDP ratio that is below the Treaty threshold, Slovakia is required to make an effort of 0.1 pp of GDP in approaching its MTO in 2015. The Draft Budgetary Plan confirms the commitment of Slovakia to comply with the requirements of the Stability and Growth Pact.

Box 2. Council recommendations addressed to Slovakia

On 8 July 2014, the Council addressed recommendations to Slovakia in the context of the European Semester. In particular, in the area of public finances the Council recommended to Slovakia to reinforce the budgetary measures for 2014, following the correction of the excessive deficit, in the light of the emerging gap of 0.3% of GDP relative to the preventive arm of the Stability and Growth Pact requirements based on the Commission 2014 spring forecast. In 2015, Slovakia should ensure the required adjustment of 0.1% of GDP towards the medium-term objective taking into account the expected weak economic conditions. Thereafter, until the medium-term objective is achieved, Slovakia should pursue an annual structural adjustment of 0.5% of GDP as a benchmark. The Council recommended Slovakia to further strengthen the fiscal framework, also by ensuring binding and enforceable expenditure

ceilings. Slovakia was also recommended to improve the long-term sustainability of public finances by increasing the cost-effectiveness of the healthcare sector, in particular by rationalising hospital care and management and by strengthening primary care. In addition, Slovakia was recommended to link the basis for real-estate taxation to the market value of the property.

With a structural deficit of 1.4% of GDP in 2013, Slovakia has not yet reached its MTO set at -0.5% of GDP. The structural balance in the Draft Budgetary Plan, recalculated according to the common methodology, is estimated to deteriorate by 0.6 pp in 2014. Since Slovakia is found eligible to benefit from "investment clause" in 2014[9], it is allowed to deviate from the required adjustment path toward MTO for this year by 0.45 pp of GDP. However, this allowance being only temporary, it should be compensated in the following year. Taking into account the "investment clause", the adjustment towards the MTO falls short of the requirement in 2014. Based on projections of the Draft Budgetary Plan, the expenditure benchmark is respected in 2014. An assessment based on the Commission 2014 autumn forecast draws similar conclusions. In 2014, when including the "investment clause", Slovakia's fiscal effort would deviate somewhat from its required adjustment towards the MTO while Slovakia meets the expenditure benchmark. An overall assessment shows that the change in the structural balance is largely driven by (temporary) revenue shortfalls, as actual tax elasticities are lower than their long-term average. As a consequence, the expenditure benchmark indicator appears to better reflect the fiscal effort. Slovakia would thus meet the requirements of the preventive arm of the SGP in 2014.

Based on the information in the Draft Budgetary Plan, the recalculated structural balance is expected to improve in 2015 by 1.3 pps of GDP. Such an improvement will compensate for the deviation allowed in 2014 due to the "investment clause" and Slovakia will be making sufficient progress toward MTO, taking into account the structural balance pillar. The expenditure projection of the Draft Budgetary Plan respects the expenditure benchmark. The Commission 2014 autumn forecast does not assume the application of the debt brake,

[9] The investment clause allows Member States to deviate from the structural balance adjustment path to the MTO by an amount linked to national co-financing of Structural and Cohesion Funds, Trans-European Networks (TEN) and Connecting Europe Facility (CEF). Eligibility for the investment clause is conditional on fulfilling three conditions: (i) the Member State needs to experience negative GDP growth or a largely negative output gap; (ii) the Member State should not be subject to the Excessive Deficit Procedure; and (iii) the co-financed investment should have a positive effect on long-term fiscal sustainability and should not substitute for nationally financed investment. Slovakia applied for the investment clause in autumn 2013 but was found to be ineligible since it was, at the time, subject to the Excessive Deficit Procedure, and total public investment was projected to decline. Slovakia reiterated the request again in the most recent Stability Programme and in the Draft Budgetary Plan and was considered eligible, as it currently fulfils all three criteria.

implying higher government expenditure compared to the Draft Budgetary Plan. The estimated improvement in the structural balance amounts to 0.8 pp of GDP and the growth rate of expenditure is below the expenditure benchmark. The projections of the Commission 2014 autumn forecast, which form the basis for the assessment, thus confirm that Slovakia ensures sufficient progress toward MTO also in 2015. When looking at two-year averages, Slovakia would respect the criteria of the preventive arm for both indicators. It can thus be concluded that the Draft Budgetary Plan complies with the requirements of the preventive arm.

Following an overall assessment of the Member State's Draft Budgetary Plan, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures the adjustment path towards the MTO seems to be appropriate and compliant with the requirements of the preventive arm of the Pact in 2014 and 2015.On the basis of this assessment, it also appears that Slovakia is expected to broadly comply with the fiscal recommendation addressed to it by the Council on 8 July 2014.

Table 5: Compliance with the requirements of the preventive arm of the Stability and Growth Pact

(% of GDP)	2013	2014		2015	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-1.4	-2.1		-1.3	
Structural balance based on freezing (COM)	-1.4	-2.1		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2013**	**2014**		**2015**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	n.a. in EDP in 2013	0.1		0.1	
Change in structural balance[5]		-0.6	-0.7	1.3	0.8
One-year deviation from the required adjustment after considering the relevant factors [6]		-0.3	-0.4	0.7	0.3
Two-year average change in structural balance[5]		n.a. in EDP in 2013		0.3	0.0
Two-year average deviation from the required adjustment after considering the relevant factors [6]				0.2	-0.1
Expenditure benchmark pillar					
Applicable reference rate[7]	n.a. in EDP in 2013	2.6		2.6	
One-year deviation [8]		3.5	1.5	1.6	0.1
Two-year average deviation [8]		n.a. in EDP in 2013		2.6	0.8
Conclusion					
Conclusion over one year	n.a. in EDP in 2013	Overall assessment	Overall assessment	Compliance	Compliance
Conclusion over two years		n.a. in EDP in 2013		Compliance	Overall assessment

Notes

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

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

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

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).

[5] Change in the structural balance compared to year t-1. Ex post assessment (for 2013) is carried out on the basis of Commission 2014 spring forecast.

[6] The difference of the change in the structural balance and the required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[7] 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.

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

Source :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

In response to the CSRs issued in July 2014, the Draft Budgetary Plan discusses several measures. Among these are measures designed to increase cost-effectiveness of the healthcare sector. The plan focuses on stopping the accumulation of debt by state hospitals and optimising their inpatient capacities[10]. Whether these measures can generate sizable savings already in the first year of their implementation is open to question. The plan also assumes reconstruction of old hospitals and construction of new ones and an introduction of a model of integrated healthcare by grouping various specialists in medical centers, all of which will require additional investment. The Draft Budgetary Plan does not mention any measures aimed at strengthening the fiscal framework by designing binding and enforceable expenditure ceilings, reflecting the lack of progress made in this area. First measures to address the CSR on linking the basis for real-estate taxation to the market value of the property are envisaged to be implemented only after 2015.

Box 3. Addressing the tax wedge

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed its commitment to effectively reduce the tax burden on labour. It will take stock of Member States' plans for reductions of the tax burden when discussing the Draft Budgetary Plans.

The tax wedge for a single person without children earning 50% of the average wage was 35.7% compared to an EU average of 34% in 2013, for 67% of the average wage it was 38.4% (EU average: 37.7%) and for the average wage it was at the EU average of 41.1%. At the same time, Slovakia has a high unemployment rate. Long-term unemployment is a particularly serious issue, accounting for around two thirds of total unemployment.

Slovakia's Draft Budgetary Plan contains a plan to introduce a tax allowance for the health insurance contributions of low paid workers. This plan accompanies several other labour market measures, including an increase in the minimum wage and the introduction of the possibility for long-term unemployed workers to still receive benefits for a certain period after taking up a job.

While its final parameters are yet to be decided, the measure does have the potential to increase the labour supply of low-income workers and to neutralise the adverse impact that the rise in the minimum wage would have on the demand for low-income workers. The measure is projected to have a negative impact on government revenue.

[10] Other envisaged measures are planned to be implemented only after 2015 (e.g. the system of diagnosis-related group payments).

6. OVERALL CONCLUSION

Slovakia is not expected to exceed the reference value in the Treaty of 3% of GDP for the government deficit in 2014. Although the national debt brake, which underpinned the estimate for the 2015 deficit in the Draft Budgetary Plan, is no longer expected to apply and therefore the expenditure savings are not expected to materialise in full, the headline deficit in 2015 is expected to remain well below 3% of GDP. Following an overall assessment of its Draft Budgetary Plan and taking into account the investment clause in 2014, the adjustment path towards the MTO in the period 2014-15 seems to be appropriate.

On the basis of this assessment, it also appears that Slovakia is expected to make some progress with regard to the fiscal-structural issues of the other recommendations addressed to it by the Council on 8 July 2014.