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**COMMISSION OPINION**

**of 22.11.2017**

**on the Draft Budgetary Plan of Slovakia**

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#### GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

#### CONSIDERATIONS CONCERNING SLOVAKIA

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 12 October 2017 by Slovakia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Slovakia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium term budgetary objective (MTO) of -0.5 % of GDP. In 2017, it should achieve an annual fiscal adjustment of 0.5 % of GDP. In 2018, it should pursue a substantial fiscal effort, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Slovakia's public finances. According to the commonly agreed adjustment matrix under the SGP, that translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 2.9 % in 2018, corresponding to an annual structural adjustment of 0.5 % of GDP.
5. The macroeconomic assumptions underpinning the Draft Budgetary Plan appear to be plausible in both 2017 and 2018. Following a moderation in economic growth in 2016, Slovakia's real GDP growth is expected to maintain a robust pace of 3.3% in 2017, according to the Draft Budgetary Plan. Private consumption is set to become the key contributor to growth in 2017. Investment is projected to recover in 2017, driven largely by private investment in the automotive industry, while public investment will remain subdued reflecting the slow start of projects under the new EU funding period. The Draft Budgetary Plan expects economic growth to pick up to 4.2% in 2018, buttressed by a substantial strengthening in (net) exports. The completion of a new car factory along with large investment projects such as the Bratislava ring road is anticipated to cause investment growth to peak in 2018. The expected pace and composition of economic growth in the Draft Budgetary Plan is broadly in line with the latest Stability Programme. The macroeconomic scenario underlying the Draft Budgetary Plan is also broadly in line with the Commission 2017 autumn forecast, with the latter projecting a slightly slower pace of economic expansion in 2018.

6. Slovakia complies with the requirement of Regulation (EU) No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced by the Institute for Financial Policy of the Ministry of Finance and have been endorsed by the Macroeconomic Forecasting Committee.
7. The Draft Budgetary Plan projects the deficit to decline to 1.6% of GDP in 2017 and to decrease further to 0.8% of GDP in 2018. The targets in both years are higher compared to the latest Stability Programme – by 0.4% and 0.3% of GDP in 2017 and 2018, respectively. The Draft Budgetary Plan states that the principal reason for the upward revision of the deficit targets are worsened projections for corporate income tax revenue in both years due to the base effect of a downward revision of corporate income tax revenue in 2016. The general government debt is set to decline to 51.1% of GDP in 2017, 0.7 percentage point lower compared to the 2017 Stability Programme. The difference is accounted for by a revised stock-flow adjustment. The Draft Budgetary Plan projects a further decline of the debt-to-GDP ratio in 2018 to 49.9%, which is confirmed by the Commission 2017 autumn forecast. The (recalculated) structural balance<sup>1</sup> is set to improve from -2.0% of GDP in 2016 to -1.5% of GDP in 2017 and further to -0.9% of GDP in 2018, driven by an improved primary balance.
8. The Draft Budgetary Plan presents several measures for 2018 on both the revenue and expenditure side of the budget. The overall impact of revenue measures is likely to be broadly neutral. Revenues are expected to increase due to a new 7% dividend tax, the new taxation of gambling, an extension of the withholding tax on insurance premiums, and a better targeting of the healthcare contribution allowance towards the low-paid. The abolition of the minimum corporate income tax and the further reduction of the pension contributions towards the public pension pillar in favour of the private one are expected to reduce revenues. Two additional measures – the exemption from social security payments of pensioners' income from so-called 'agreement contracts' and of the new, voluntary 13<sup>th</sup> and 14<sup>th</sup> monthly salaries – are projected to reduce revenues. However, the Draft Budgetary Plan accounts for their negative impact on the expenditure side (through higher reserves) rather than the revenue side. On the expenditure side, the Draft Budgetary Plan defines for 2018 mainly expansionary measures including higher outlays on the public wage bill, pensions, social policies (e.g. for the disabled) and investment. Despite these deficit-increasing measures, which are estimated in the Draft Budgetary Plan at 1 % of GDP, the expenditure-to-GDP ratio is expected to decline thanks to a drop in intermediate consumption and investment (which mainly reflect the expected decline in the drawdown of EU funds) as well as high nominal GDP growth.
9. The Commission 2017 autumn forecast projects a 2017 deficit of 1.6 % of GDP – the same as in the Draft Budgetary Plan – although the structure of the improvement compared to the 2016 deficit of 2.2% of GDP differs, with the Commission projecting higher investment growth but a slower increase of intermediate consumption. In 2018, the Commission forecast projects a deficit of 1 % of GDP, slightly higher than in the Draft Budgetary Plan. The Commission projects lower revenue from dividends, from the sale of emission allowances and from fees for emergency oil stocks storage as well as lower social contributions, but expects a higher drawdown of EU funds. On the expenditure side, the Commission forecast

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<sup>1</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

assumes a slower deceleration in growth of healthcare spending compared to the Draft Budgetary Plan, while the contributions to the EU budget are expected to be lower. Unlike the Draft Budgetary Plan, the Commission forecast does not take into account the provision of reserves on the expenditure side that capture the negative budgetary impact of the introduction of a voluntary, social contribution-free 13<sup>th</sup> and 14<sup>th</sup> salary, the exemption of pensioners' contract work earnings from paying social security contributions, and lower dividend revenue. Instead, the Commission forecast directly accounts for the expected lower revenue from these items on the revenue side. Finally, the expected higher drawdown of EU funds and the associated co-financing translates into higher projected investment in the Commission forecast. The expenditure-to-GDP ratio hence decreases less in the Commission forecast. The structural balance in the Commission forecast is set to improve from -1.6 % in 2017 to -1.2 % in 2018.

10. Slovakia is required to achieve an annual fiscal adjustment of 0.5 % of GDP towards the medium-term budgetary objective in 2017. According to the information provided in the Draft Budgetary Plan, the real growth rate of net primary government expenditure in 2017 will exceed the applicable expenditure benchmark rate of 1.3 %, leading to a deviation of 0.3 % of GDP. The structural balance pillar also points to a risk of some deviation, although with a smaller gap. Even though both pillars suggest compliance over 2016-2017 together, the less favourable signals for 2017 alone require an overall assessment. The expenditure benchmark is not impacted by slow revenue growth, which lags behind nominal GDP growth, and it deducts savings from the projected decline in interest expenditure. The expenditure benchmark hence appears to capture more accurately the fiscal effort of Slovakia at the current juncture, implying that information provided in the Draft Budgetary Plan points to a risk of some deviation in 2017. The Commission 2017 autumn forecast confirms this conclusion, as both the expenditure benchmark pillar and the structural balance pillar also point to a risk of some deviation when looking at 2017 alone. The overall assessment hence points to a risk of some deviation in 2017.

According to the Council Recommendation<sup>2</sup> addressed to Slovakia on 11 July 2017, Slovakia's adjustment requirement for 2018 is for the nominal growth rate of net primary government expenditure to not exceed 2.9 %. This corresponds to a structural adjustment of 0.5 % of GDP. Based on the information in the Draft Budgetary Plan, the planned deviation from the expenditure benchmark amounts to 0.3 % of GDP. The structural balance pillar suggests compliance with the preventive arm of the SGP. When taken over 2017-2018 together, the expenditure benchmark pillar suggests a risk of a significant deviation (an average gap of 0.3 % of GDP) while the structural balance indicator still points to compliance. These divergent signals over the two-year horizon call for an overall assessment. In 2018, the expenditure benchmark is not being impacted by revenue shortfalls and volatile investment due to the expected drop in the drawdown of EU funds. However, in 2018, the expenditure projected in the Draft Budgetary Plan foresees two non-spending-related reserves (worth 0.2 % of GDP) that cater for expected revenue shortfalls. Partly netting these from the expenditure aggregate, the expenditure benchmark over 2017 and 2018 taken together would point to a risk of some deviation, which then counts as the overall assessment result over 2017 and 2018 based on the Draft Budgetary Plan. The Commission 2017 autumn forecast broadly confirms the reading based on the Draft Budgetary Plan. In 2018 alone and when

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<sup>2</sup> OJ C 261, 9.8.2017.

taking 2017 and 2018 together, both pillars suggest a risk of some deviation. The overall assessment hence points to a risk of some deviation in 2018.

11. The fiscal adjustment between 2011 and 2017 has been primarily driven by the revenue side. Based on the information provided in the Draft Budgetary Plan, the fiscal adjustment in 2018 is likely to come mainly from the expenditure side as expenditure growth is kept below that of nominal GDP. In recent years, the share of investment in total public spending declined and was strongly linked with EU funds drawdowns, making public investment dependent on EU funds. Outlays on social policies and especially the public wage bill have become more prominent. This trend is expected to endure in 2018.

The Draft Budgetary Plan reports the measures being implemented as a result of the 2016 spending review in the healthcare sector. They are a response to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017, which recommended improving the cost-effectiveness of the healthcare system, including by implementing the value-for-money project.

12. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Slovakia, which is currently under the preventive arm, is broadly compliant with the provisions of the SGP. The Commission invites the authorities to stand ready to take further measures within the national budgetary process to ensure that the 2018 budget will be compliant with the SGP.

The Commission is also of the opinion that Slovakia has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017 in the context of the 2017 European Semester and invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Report and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

Done at Brussels, 22.11.2017

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