COUNCIL OPINION

of 5 July 2004

on the Convergence Programme of Slovakia, 2004-2007

(2004/C 320/10)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies [1], and in particular Article 9(2) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 5 July 2004, the Council examined the convergence programme of Slovakia, which covers the period 2004 to 2007 and, in addition, provides indicative projections until 2010. The programme largely complies with the data requirements of the revised 'code of conduct on the content and format of stability and convergence programmes'.

The budgetary strategy underlying the programme aims at reducing the general government deficit to 3,0 % of GDP by 2007 from 3,6 % of GDP in 2003 in order to comply with the Maastricht deficit criterion — with the following intermediate deficit targets: 4,0 % of GDP in 2004, 3,9 % of GDP in 2005 and 3,9 % of GDP in 2006. The reduction of the deficit is expected to occur mainly in 2007.

The programme envisages an adjustment based on primary expenditure reductions of 1.5 percentage points of GDP. These reductions are to a large extent underpinned by structural reforms, predominantly in the health care and social protection area, which are mostly already enacted and in force. The reforms on the expenditure side take place against the backdrop of a far-reaching but expected to be basically revenue-neutral tax reform package (effective since the beginning of 2004); the tax reforms essentially constitute a shift of the tax burden from direct to indirect taxation. In addition, a funded pension pillar will be introduced in 2005, which leads to a revenue decrease for general government, starting with an estimated ½ percentage point of GDP in 2005 and amounting to 1 percentage point of GDP by the end of the programme period.

On the basis of currently available information, the macro-economic scenario underlying the programme seems to reflect plausible growth assumptions, i.e. growth of somewhat over 4 % in 2004 and 2005 and an acceleration of growth to almost 5 % in 2006 and 2007 — due to further strengthening exports on the back of an FDI-induced expansion of export capacity. The anticipated drop in unemployment will require the continued vigorous pursuit of policies which address the deep-seated structural problems in the labour market — given the still very high unemployment rate prevailing in Slovakia. The projection of rapid disinflation after 2004, when administrative price adjustments and indirect tax hikes taper off, is within reach if second-round effects are strictly contained. In particular, wage developments, including in the public sector, should not be guided by past inflation developments.

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

The programme foresees the general government deficit to be reduced to the 3 % of GDP reference value in 2007 and to fall further thereafter. Given the assumption of a very robust growth of the Slovak economy, the size and path of the deficit reduction may not look very ambitious. However, in particular the following modulating factors need to be taken into account: the envisaged reduction in primary expenditures, the revenue decrease resulting from the pension reform, and the, partly one-off, adjustment achieved in 2003. The budgetary stance in the programme seems sufficient to reduce the deficit to the 3 % of GDP deficit threshold by the end of the programme period. The risks to the budgetary projections over the overall programme horizon appear broadly balanced. They are tilted to the positive side in 2004, when the deficit is projected to increase marginally. Downside risks seem to be concentrated on the expenditure side and consist mainly in a delay of the proposed further health care reforms and a lack of further public sector rationalisation.

The achievement of the deficit targets will depend on the ability of the government to control primary expenditures, which would be helped by binding medium-term expenditure ceilings. If the implemented structural reforms result in higher growth than expected in the convergence programme of May 2004, this opportunity should be used to accelerate the fiscal adjustment, in particular by dedicating any higher-than-budgeted revenues primarily to faster deficit reduction. In addition to increasing the likelihood of achieving a deficit below 3 % of GDP as soon as possible and by 2007 at the latest, this would pave the way to reach the second major fiscal objective expressed in the programme, namely a structural budgetary position of close to balance or in surplus, earlier than by the year 2010 envisaged in the programme, and to attain a sufficient safety margin against breaching the 3 % of GDP Treaty reference value for the deficit criterion with normal macroeconomic fluctuations. It would also provide a better basis for dealing with potentially surging capital inflows.

In the programme, the debt ratio is projected to increase between 2003 and 2005 by 2½ percentage points to 46,4 % and to fall again to 45,5 % by 2007. Slovakia appears relatively well-placed to meet the budgetary cost of an ageing population. Long-term sustainability is contingent on the strict adherence to the fiscal consolidation targets and the full implementation of the envisaged policies. In particular as regards fertility rates, the demographic assumptions underlying the related programme projections may be on the optimistic side. The main risks to long-term sustainability stem from a lack or a delay in reform implementation or from any backtracking on already implemented reforms.

On 5 July 2004, on the basis of recommendations from the Commission, the Council decided that an excessive deficit existed in Slovakia in accordance with Article 104(6) of the Treaty and made recommendations under Article 104(7) to Slovakia with a view to bringing that situation to an end, in which the Council expresses its policy advice.

Key projections from the convergence programme of Slovakia

	2003	2004	2005	2006	2007
Real GDP growth (%)	4,2	4,1	4,3	5,0	4,7
Employment growth (%)	1,8	0,5	0,6	0,6	0,9
HICP inflation (%)	8,5	8,1	4,0	2,9	2,5
General government balance (% of GDP)	− 3,6	− 4,0	− 3,9	− 3,9	− 3,0
Government gross debt (% of GDP)	42,8	45,1	46,4	46,1	45,5