COUNCIL OPINION

on the updated stability programme of Slovakia, 2009-2012

(2010/C 144/04)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

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 coordination of economic policies [1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 26 April 2010 the Council examined the updated stability programme of Slovakia, which covers the period 2009 to 2012.

(2) With an average real GDP growth rate of over 7 % over the period 2003-2008, Slovakia was one of the best performing EU countries during the boom phase. Sound macroeconomic policies over that period allowed avoiding large macroeconomic imbalances, which enabled Slovakia to adopt the euro in January 2009. However, given its large trade openness, the Slovak economy was strongly affected by the crisis. Real GDP is estimated to have fallen by 4,7 % in 2009, and the depreciation of neighbouring countries' currencies implied a further appreciation of Slovakia's real effective exchange rate.

To contain the effects of the crisis, the authorities allowed a full operation of automatic stabilisers and, in line with the European Economic Recovery Plan, adopted anti-crisis measures in November 2008 and February 2009 (0,5 % of GDP for both 2009 and 2010). With the government deficit expected at some 6 % of GDP in 2009, on 2 December 2009 the Council decided on the existence of an excessive deficit and recommended its correction by 2013. Considering the weakening of Slovakia's external competitiveness due to temporary depreciation of neighbouring countries' currencies and widening fiscal imbalances during the crisis, a credible and sustainable reduction of the government deficit should be a key element of the authorities' strategy for the coming years.

(3) Although much of the observed decline in actual GDP in the context of the crisis is cyclical, the level of potential output has also been negatively affected. In addition, the crisis may also affect potential growth in the medium term through lower investment, constraints in credit availability and increasing structural unemployment. Moreover, the impact of the economic crisis compounds the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. In particular, for Slovakia it is important to undertake reforms to reduce regulation and administrative burdens on businesses, to improve the functioning of the labour market, and to improve cost competitiveness position relative to trade partners, including through wage moderation.

(4) The macroeconomic scenario underlying the programme projects real GDP growth at 1,9 % in 2010, 4,1 % in 2011 and 5,4 % in 2012. Assessed against currently available information [2], this scenario appears to be based on plausible growth assumptions in 2010 and favourable assumptions in 2011 and 2012.

The projections for the outer years of the programme may not reflect the degree of prudence that should underpin fiscal consolidation strategies, especially given the unusually high uncertainties in the current post-crisis environment. Consistent with the assumed recovery, the programme projection for inflation is higher by about 1 pp. in 2011 than in the Commission services' autumn 2009 forecast, and the unemployment rate is projected to decline more rapidly.

(5) The programme estimates the government deficit in 2009 at 6,3 % of GDP, up from 2,3 % of GDP in 2008. The full operation of automatic stabilisers in 2009 triggered a marked decline in revenue and a sizeable increase in social spending. Stimulus measures adopted by the government in the context of the European Economic Recovery Plan (EERP) did not affect the deficit as they were financed by reallocations of spending within the budget. Some of the anti-crisis measures will remain in place in 2010. Nevertheless, in line with the exit strategy

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

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

advocated by the Council, and with a view to correcting the excessive deficit and bringing the fiscal position to more sustainable levels, the government plans a front-loaded consolidation of public finances over the programme period starting in 2010.

(6) For 2010, the programme targets a general government deficit of 5,5 % of GDP. The expenditure to GDP ratio is expected to fall by 1.1 percentage point of GDP, reflecting savings in goods and services expenditure, a moderate increase in public wages, and cuts in public investment. The revenue to GDP ratio is projected to decline by 0,3 percentage point of GDP, reflecting a temporary increase of tax allowances and in-work benefits, and a decline in dividends from public companies. The planned measures are expected to lower the general government deficit by about 1 percentage point of GDP. The fiscal target for 2010 implies a sizable improvement of the structural balance (i.e. cyclically-adjusted balance net of one-off and other temporary measures), by about 1,25 percentage points of GDP, which is in line with the Council recommendation under the excessive deficit procedure.

(7) The main aim of the programme's budgetary strategy is to reduce the general government deficit to 3 % of GDP in 2012, i.e. one year earlier than recommended by the Council under the excessive deficit procedure. The headline deficit is expected to fall from 5,5 % of GDP in 2010 to 4,2 % and 3,0 % of GDP in 2011 and 2012, respectively. Two thirds of the reduction of the deficit between 2010 and 2012 would reflect a frontloaded structural improvement (as measured according to the commonly agreed methodology applied to the information provided in the programme); the remaining third would result from favourable cyclical developments. The main drivers of the structural improvement are significant planned cuts in government consumption and capital expenditures. According to the programme, the annual average fiscal consolidation effort in the years 2010-2012, recalculated according to the commonly agreed method, would amount to around 1 % of GDP, which is in line with the Council recommendation under the excessive deficit procedure. Consolidation is planned to continue in the years after 2012 with a view to progressing towards the medium-term budgetary objective (MTO), which is a balanced budget in structural terms. Given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact. However, the programme does not envisage achieving it within the programme period.

(8) The budgetary outcomes in 2010 could turn out somewhat worse than projected in the programme. There are, in particular, uncertainties on the expenditure side, where some measures may not yield the expected savings (e.g. reduction of spending in goods and services). Moreover, the projection for the balance of local governments seems optimistic in view of the assumed impact of crisis on revenues of these entities in 2010. Uncertainties to fiscal targets are larger for the outer years. In particular, the programme is based on favourable macroeconomic assumptions in 2011 and 2012, implying that negative revenue surprises are possible. Furthermore the envisaged measures on the expenditure side, especially those related to the reduction of government consumption, will have to be specified in more details to enhance credibility of the consolidation plan.

(9) According to the stability programme government gross debt increased from 27,7 % of GDP in 2008 to 37,1 % of GDP in 2009. The increase reflects the high deficit and the significant contraction of real GDP in 2009. While remaining well below the Treaty reference value, the debt ratio is projected to increase further in 2010 and 2011, when it would reach 42,5 % of GDP, and to slightly decline in 2012, to 42,2 % of GDP. The evolution of the debt ratio is likely to be less favourable than projected in the programme, especially after 2010, in view of the risks identified for budgetary consolidation compounded by the possibility of less favourable real GDP growth than assumed in the programme.

(10) Medium-term debt projections that assume GDP growth rates to gradually recover to the values projected before the crisis, tax ratios to return to pre-crisis levels and include the projected increase in age-related expenditures show that the budgetary strategy envisaged in the programme, taken at face value and with no further policy change, would not be enough to stabilise the debt-to-GDP ration by 2020.

(11) The long-term budgetary impact of ageing population is slightly higher than the EU average, due to a relatively high increase in pension expenditure during the coming decades. In addition, the budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. Achieving higher primary surpluses over the medium term together with structural reforms, as foreseen in the programme, and reforming the pension system, would contribute to reducing the risks to the sustainability of public finances which were assessed in the Commission 2009 Sustainability Report [1] as high.

[1] In the Council conclusions from 10 November 2009 on sustainability of public finances 'the Council calls on Member States to focus attention to sustainability-oriented strategies in their upcoming stability and convergence programmes' and further 'invites the Commission, together with the Economic Policy Committee and the Economic and Financial Committee, to further develop methodologies for assessing the long-term sustainability of public finances in time for the next Sustainability report', which is foreseen in 2012.

(12) Slovakia's fiscal policy is based on a well-defined and detailed three-year fiscal framework. Nevertheless, medium-term expenditure targets are largely indicative and typically subject to large revisions, which over time undermines their credibility. The 2010 update of the stability programme proposes to strengthen the framework by introducing multiannual expenditure ceilings, which would cover a large share of government finances. Escape clauses would be foreseen in case of negative economic shocks. The programme also proposes to introduce an upper limit on government debt in a constitutional law and improvements in monitoring of budget execution during the year. These efforts to strengthen the institutional set-up for public finances are welcome and should be encouraged. However, as the proposals are only at a very initial stage they should be seen as complementary efforts rather than driving forces of the fiscal consolidation strategy.

(13) There is scope to improve the composition of government spending in Slovakia. The share of government investment in total government expenditure is low compared to neighbouring countries (2 % of GDP). Spending in R&D, education and environment protection is also low by EU standards and compared to regional peers. Against this background, the projected reduction of spending on capital formation over the programme horizon is a source of concern. It may not be sustainable, and desirable, in a catching-up economy like Slovakia. The programme envisages several measures to enhance the efficiency of the government including reorganisation of the central administration through merger of ministries, centralisation of public procurements and management of state property, and better use of information technologies in public services. While still at an early stage, these measures go in the right direction.

(14) Overall, in 2010 the budgetary strategy set out in the programme is consistent with the Council recommendations under Article 126(7). From 2011 on, there are risks that the ambitious consolidation path described in the programme will not be achieved, and the budgetary strategy may not be fully consistent with the Council recommendations under Article 126(7).

The programme presents an ambitious plan to bring the government deficit from 6,3 % of GDP in 2009 to 3,0 % of GDP in 2012, one year before the deadline of 2013 set by the Council. Achievement of the fiscal target for 2010 would imply an improvement of the structural balance by about 1,25 percentage points of GDP. The projected average annual structural effort of around 1 % of GDP over 2010-2012 is in line with the Council recommendation under the excessive deficit procedure. However, both revenue and expenditure targets are subject to risks, especially in 2011 and 2012, when macroeconomic assumptions seem to be on the high side. In addition, further details of measures included in the programme will have to be specified to enhance the credibility of the consolidation plan.

(15) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data [1]. In its recommendations under Article 126(7) of 2 December 2009 with a view to bringing the excessive deficit situation to an end, the Council also invited Slovakia to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. The programme complies with this recommendation.

The overall conclusion is that the fiscal strategy presented in the programme is broadly in line with the Council recommendation under the excessive deficit procedure. It envisages a sizeable, frontloaded fiscal consolidation with a view to bringing the deficit below 3 % of GDP by 2012, one year before the deadline set by the Council, which is commendable. The budgetary projections are however subject to risks due to favourable growth assumptions for the outer years and might need more specific measures to achieve the planned savings on the expenditure side. Intentions to strengthen the fiscal framework are welcome but need to be followed by concrete actions.

In view of the above assessment and also in the light of the recommendation under Article 126 TFEU of 2 December 2009, Slovakia is invited to:

(i) implement the deficit reducing measures in 2010 as planned in the budget, and back up the consolidation path for the following years with specific measures to secure the correction of the excessive deficit if possible by 2012, and by 2013 at the latest;

(ii) continue reforms of the pension system with a view to ensuring the sustainability of government finances;

(iii) implement the envisaged measures to further strengthen the fiscal framework, in particular the introduction of enforceable multiannual expenditure ceilings.

[1] In particular, the data on changes in inventories and net acquisition of valuables are not provided.

Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	**SP Jan 2010**	**6,4**	**– 5,7**	**1,9**	**4,1**	**5,4**
	COM Nov 2009	6,4	– 5,8	1,9	2,6	n.a.
	CP Apr 2009	*6,4*	*2,4*	*3,6*	*4,5*	*n.a.*
HICP inflation (%)	**SP Jan 2010**	**3,9**	**1,2**	**2,6**	**3,7**	**4,1**
	COM Nov 2009	3,9	1,1	1,9	2,5	n.a.
	CP Apr 2009	*3,9*	*2,2*	*3,6*	*4,1*	*n.a.*
Output gap (1) (% of potential GDP)	**SP Jan 2010**	**8,9**	**– 1,1**	**– 2,9**	**– 3,0**	**– 1,0**
	COM Nov 2009 (2)	9,2	– 0,8	– 2,1	– 3,0	n.a.
	CP Apr 2009	*6,5*	*3,5*	*1,7*	*1,0*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Jan 2010**	**– 5,3**	**– 4,2**	**– 3,2**	**– 2,7**	**– 1,9**
	COM Nov 2009	– 5,6	– 4,8	– 4,3	– 4,2	n.a.
	CP Apr 2009	*– 5,8*	*– 4,2*	*– 2,9*	*– 2,6*	*n.a.*
General government revenue (% of GDP)	**SP Jan 2010**	**32,5**	**32,8**	**32,5**	**32,3**	**31,7**
	COM Nov 2009	32,5	31,3	31,4	31,4	n.a.
	CP Apr 2009	*33,4*	*32,1*	*31,6*	*31,8*	*n.a.*
General government expenditure (% of GDP)	**SP Jan 2010**	**34,8**	**39,1**	**38,0**	**36,5**	**34,7**
	COM Nov 2009	34,8	37,5	37,5	36,9	n.a.
	CP Apr 2009	*35,6*	*35,1*	*34,5*	*34,1*	*n.a.*
General government balance (% of GDP)	**SP Jan 2010**	**– 2,3**	**– 6,3**	**– 5,5**	**– 4,2**	**– 3,0**
	COM Nov 2009	– 2,3	– 6,3	– 6,0	– 5,5	n.a.
	CP Apr 2009	*– 2,2*	*– 3,0*	*– 2,9*	*– 2,2*	*n.a.*
Primary balance (% of GDP)	**SP Jan 2010**	**– 1,1**	**– 4,5**	**– 3,6**	**– 2,3**	**– 1,1**
	COM Nov 2009	– 1,1	– 5,0	– 4,7	– 4,1	n.a.
	CP Apr 2009	*– 0,9*	*– 1,7*	*– 1,7*	*– 1,0*	*n.a.*
Cyclically-adjusted balance (1) (% of GDP)	**SP Jan 2010**	**– 4,9**	**– 6,0**	**– 4,7**	**– 3,3**	**– 2,7**
	COM Nov 2009	– 5,0	– 6,0	– 5,4	– 4,6	n.a.
	CP Apr 2009	*– 4,1*	*– 4,0*	*– 3,4*	*– 2,5*	*n.a.*
Structural balance (3) (% of GDP)	**SP Jan 2010**	**– 4,2**	**– 6,0**	**– 4,7**	**– 3,3**	**– 2,7**
	COM Nov 2009	– 5,2	– 6,2	– 5,4	– 4,6	n.a.
	CP Apr 2009	*– 3,8*	*– 4,4*	*– 3,5*	*– 2,6*	*n.a.*

		2008	2009	2010	2011	2012
Government gross debt (% of GDP)	**SP Jan 2010**	**27,7**	**37,1**	**40,8**	**42,5**	**42,2**
	COM Nov 2009	27,7	34,6	39,2	42,7	n.a.
	CP Apr 2009	*27,6*	*31,4*	*32,7*	*32,7*	*n.a.*

Notes:

(1) Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

(2) Based on estimated potential growth of 4,7 %, 3,6 %, 3,2 % and 3,6 % respectively in the period 2008-2011.

(3) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,7 % of GDP in 2008, deficit-increasing, according to the most recent programme and 0,2 % of GDP in both 2008 and 2009, both deficit-reducing, in the Commission services' autumn 2009 forecast.

Source:

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.