Ján **Tóth**
CHAIRMAN

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Dear Ms. Grilo and Mr. Suardi,

Independent fiscal institutions became an important part of the fiscal environment in the European Union. By offering non-partisan assessments, we help to enhance transparency, foster informed public debate, improve accountability in fiscal management and strengthen the credibility of Member States' public finances.

The Economic Governance Review aimed to expand the role of the independent fiscal institutions, traditionally mandated to monitor compliance with the national frameworks, to participate in the economic governance framework of the Union. Even though our new roles in the reformed framework are less prominent than initially proposed by the European Commission, we remain committed to monitor the recent developments and the implementation of the reformed economic governance rules.

On 15th of October 2024, the Slovak government has submitted the Medium-term fiscal-structural plan ("the Plan") to the European Commission and on the same date, the European Commission published its underlying calculations for the reference trajectory.

The debt sustainability analysis, which is the cornerstone of the reformed rules, clearly shows the unsustainable situation of the Slovak public finances. The required annual improvement of the structural primary balance by 1.3 percent of GDP over four years is very demanding (cumulatively 5.2 percent of GDP), but necessary, if the government aims to achieve a sustainable path for our public finances. What concerns us, is the way how this requirement was translated into the reference net expenditure path, i.e. **implicitly assuming unitary elasticity of revenues to potential GDP**.

I would like to stress that I am not challenging the equal treatment principle and the common methodology that was agreed, but I would like to draw your attention to the case of Slovakia (which could be relevant also to some other countries). One of the key objectives of the economic governance reform was to strengthen country-specific dimension aimed at enhancing national ownership (EU regulation no. 2024/1263, recital para 42). I think that the revenue elasticity should be such a specific issue. As Slovakia is the member state with the highest long-term sustainability risks in the Union – according to the EC 2023 Debt Sustainability Monitor (Institutional Paper 271) – a cautious and more elaborate approach is highly warranted, as any errors in setting the reference trajectory may have unproportionally large adverse consequences.

According to national committee for tax forecasts latest projection, used in the budget (which we labelled "realistic"), the assumption of the unitary elasticity of revenues to potential GDP does not hold in the medium run in Slovakia. The extent of the issue can be illustrated by the figures presented by the Slovak government in the Plan (page 11, chart 7, grey and red dots). Over the 7-year period, the headline deficit does not decrease at all during 2025-2028 and remains at circa 4.7 percent of GDP. Over the 4-year period, which seems to be the case for Slovakia, the headline deficit is set to decrease from 5.8 percent of GDP in 2024 to 2.8 percent of GDP in 2028 if the government meets its net expenditure growth targets. In terms of the structural primary balance, **such consolidation would lead to an estimated total improvement of a mere 3.7 percent of GDP over 2025-2028 instead of 5.2 percent of GDP assumed in the calculation**. This means on average annually by 0.9 percent of GDP, instead of 1.3 percent of GDP assumed. Thus, compared to the DSA adjustment scenario, an unrealistic revenues assumption worsens the structural primary balance on average by 0.4 percent of GDP annually.

As a consequence, slower improvement in the structural primary balance based on the Ministry of Finance forecasts would not lead to stabilisation of debt over the medium horizon (as shown in the Plan, page 11, chart 8, red line) and neither to a sustainable decrease of deficit below 3 percent of GDP in the 10-year horizon after the Plan, which are the main goals of the reformed rules.

I would like to emphasize that those estimates presented in the Plan are based on macroeconomic and revenue forecasts endorsed by an independent body which is an international good practice, and, in case of macroeconomic forecast, also a requirement set by EU regulation (no. 473/2013, Art. 4, para 4). Our latest revenue forecast is slightly more pessimistic, and the implied improvement of structural primary balance is even slower. Since our tax revenue forecast is within the 1 percent deviation from the forecast presented in the publication, we labelled the committees' independent forecast as "realistic".

Lower forecast elasticity of revenues (shown in the Plan, page 14, chart 13) can be explained by two main factors – current legislation and inelastic revenues:

- In the year before the submission of the Plan, i.e. in 2023, several legislative changes temporarily affecting revenues have been adopted (a bank levy, increased health insurance contributions). Their impact will automatically be phased out leading to a decrease in structural revenues by 2028. Thus, the assumption of the inelastic revenues is in clear contradiction of the costing of the legislation.
- The second factor is that a non-negligible part of total revenues is inelastic to GDP, such as excise taxes levied on units of certain goods and non-tax revenues. Without government intervention (increasing tax rates, adjusting service fees etc.), their share in GDP automatically declines over time. Furthermore, Slovakia is systematically experiencing a deterioration in terms of trade – resulting in faster GDP growth than domestic consumption. Since the majority of taxes are tied to domestic consumption and/or household income, the tax base grows slower than the GDP.

So, if the Slovak government would like to achieve sustainable levels of deficit and debt calculated in the debt sustainability analysis, the net expenditure growth should be much lower than 8.1 percent set by the European Commission and adopted by the Slovak government on a cumulative 4-year basis. Adjusting for the impact of lower than unit elasticity of revenues would imply only a cumulative 4.8 percent growth rate of net expenditures over the same period.

Net expenditure growth rate (%)

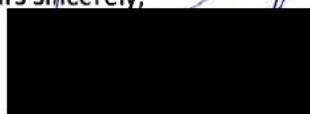
	2025	2026	2027	2028	cumul.
EC reference trajectory	2.8	2.0	1.6	1.5	**8.1**
Reference trajectory – removing the unrealistic revenues assumption	2.0	1.2	0.8	0.7	**4.8**

Source: EC, RRZ

Being advocate of fiscal sustainability in Slovakia, I perceive a quite significant risk that meeting the original expenditure trajectory could lead to serious divergence from the goals of the reformed rules, including the targeted primary structural balance trajectory. Over the time, based on today's knowledge and including the independent forecast used by the Ministry of Finance, the divergence of the primary structural balance is to widen to as much as 1.5 percent of GDP during 2025-2028 period. Such a sizeable divergence is not well justified and could put the new framework efficiency, and thus its credibility, in jeopardy.

I hope the provided information will be helpful and carefully considered. I will be happy to provide you more information at your convenience.

Yours sincerely,



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