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NOTE

From:	General Secretariat of the Council
To:	Delegations
No. Cion doc.:	ST 9080/21 - COM(2021) 525
Subject:	COUNCIL RECOMMENDATION delivering a Council opinion on the 2021 Stability Programme of Slovakia

Delegations will find attached the above-mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2021) 525 final.

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COUNCIL RECOMMENDATION

of …

delivering a Council opinion on the 2021 Stability Programme of Slovakia

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(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

After consulting the Economic and Financial Committee,

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1 OJ L 209, 2.8.1997, p. 1.

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Whereas:

(1) On 20 March 2020, the Commission adopted a communication on the activation of the general escape clause of the Stability and Growth Pact. The general escape clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) No 1466/97 and Articles 3(5) and 5(2) of Council Regulation (EC) No 1467/97[2], facilitates the coordination of budgetary policies in times of severe economic downturn. In that communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 pandemic, the conditions for activating the general escape clause were met. On 23 March 2020, the ministers of finance of the Member States agreed with the assessment of the Commission. The general escape clause has granted Member States budgetary flexibility to deal with the COVID-19 crisis. It has facilitated the coordination of budgetary policies in times of severe economic downturn. Its activation allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, provided that this does not endanger fiscal sustainability in the medium term. On 17 September 2020, in its communication on the 2021 Annual Sustainable Growth Strategy, the Commission announced that the general escape clause would remain active in 2021.

(2) On 20 July 2020, the Council adopted a Recommendation[3] ('the Council Recommendation of 20 July 2020'). It recommended Slovakia to take all necessary measures, in line with the general escape clause, to effectively address the COVID-19 pandemic, sustain the economy and support the ensuing recovery. It also recommended Slovakia to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

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[2] Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

[3] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Slovakia and delivering a Council opinion on the 2020 Stability Programme of Slovakia (OJ C 282, 26.8.2020, p. 164).

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(3) The 2021 Council Recommendation on the economic policy of the euro area indicates that fiscal policies should remain supportive in all euro-area Member States throughout 2021 and that policy measures should be tailored to country-specific circumstances and be timely, temporary and targeted. When the epidemiological and economic conditions allow, emergency measures should be phased out, while combatting the social and labour-market impact of the crisis. Member States should pursue fiscal policies that are aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. Member States should pursue reforms that strengthen the coverage, adequacy and sustainability of health and social protection systems for all.

(4) On 18 November 2020, the Commission adopted its opinions on the 2021 draft budgetary plans of the euro-area Member States, which were based on a qualitative assessment of the fiscal measures. The Commission was of the opinion that the draft budgetary plan of Slovakia was overall in line with the fiscal policy recommendations set out in the Council Recommendation of 20 July 2020, and that most of the measures included in the draft budgetary plan supported economic activity against the background of considerable uncertainty. However, some measures did not appear to be temporary or matched by offsetting measures.

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(5) Next Generation EU, including the Recovery and Resilience Facility, will ensure a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 of the European Parliament and of the Council[4], which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility will provide financial support for the implementation of reforms and investment, entailing a fiscal impulse financed by the Union. It will contribute to the economic recovery and to the implementation of sustainable and growth-enhancing reforms and investment, in particular to promote the green and digital transitions, and will strengthen the resilience and potential growth of the Member States' economies. It will also help public finances to return to more favourable positions in the near term and will contribute to strengthening sustainable public finances and to growth and job creation in the medium and long term.

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4 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

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(6) On 3 March 2021, the Commission adopted a communication providing further policy orientations to facilitate the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes. The overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. At the same time, given the expectation that economic activity will gradually normalise in the second half of 2021, Member States' fiscal policies should become more differentiated in 2022. Member States' fiscal policies should take into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. In view of the need to support a sustainable recovery for the Union, Member States with low sustainability risks should gear their budgets towards maintaining a supportive fiscal policy in 2022, taking into account the impact of the Recovery and Resilience Facility. Member States with high debt levels should pursue prudent fiscal policies, while preserving nationally financed investment and making use of grants under the Recovery and Resilience Facility to fund additional high-quality investment projects and structural reforms. For the period beyond 2022, fiscal policies should continue to take into account the strength of the recovery, the degree of economic uncertainty and fiscal sustainability considerations. A refocusing of fiscal policies towards achieving prudent medium-term fiscal positions, including by phasing out support measures in due course, will contribute to ensuring fiscal sustainability in the medium term.

(7) In its communication of 3 March 2021, the Commission also took the view that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy, with the level of economic activity in the Union or euro area compared to pre-crisis levels (end of 2019) as a key quantitative criterion. On the basis of the Commission's 2021 spring forecast, on 2 June 2021 the Commission considered that the conditions for continuing to apply the general escape clause in 2022 and for deactivating it as of 2023 were met. Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.

(8) On 12 May 2021, Slovakia submitted its 2021 Stability Programme, beyond the deadline established in Article 4 of Regulation (EC) No 1466/97.

(9) In 2020, based on data validated by Eurostat, Slovakia's general government deficit was 6,2 % of gross domestic product (GDP), while general government debt increased to 60,6 % of GDP. The annual change in the primary budget balance amounted to -4,8 % of GDP, including discretionary budgetary measures of 3,6 % of GDP in support of the economy and the operation of automatic stabilisers. Slovakia also provided liquidity support to companies and households (such as guarantees and tax deferrals, which do not have a direct and immediate budgetary impact) estimated at 2,1 % of GDP; the actual take-up of the public guarantees in 2020 is estimated by the Commission to be roughly equivalent to 1 % of GDP.

(10) On 2 June 2021, the Commission issued a report under Article 126(3) of the Treaty. That report discusses the budgetary situation of Slovakia, as its general government deficit in 2020 exceeded the 3 %-of-GDP Treaty reference value, while its general government debt exceeded the 60 %-of-GDP Treaty reference value. The report concluded that the deficit criterion was not fulfilled, but the debt criterion was complied with.

(11) The macroeconomic scenario underpinning the budgetary projections is realistic in 2021 and 2022, given the current uncertainty. The 2021 Stability Programme projects real GDP to grow by 3,3 % in 2021 and 6,3 % in 2022. By comparison, the Commission's 2021 spring forecast projects a more front-loaded recovery, with real GDP growth of 4,8 % in 2021 and 5,2 % in 2022.

(12) In its 2021 Stability Programme, the government plans an increase in the general government deficit from 6,2 % of GDP in 2020 to 9,9 % of GDP in 2021, while the debt ratio is planned to increase to 64,1 % of GDP in 2021. According to the 2021 Stability Programme, the change in the primary budget balance in 2021 compared with the pre-crisis level (2019) is set to amount to -4,0 % of GDP, reflecting the discretionary budgetary measures of 2,3 % of GDP in support of the economy and the operation of automatic stabilisers. The planned deficit and debt ratios are higher than those projected by the Commission's 2021 spring forecast. The Commission forecasts a general government deficit of 6,5 % and a debt ratio of 59,5 % in 2021. The Commission's 2021 spring forecast does not include a provision for pandemic-related expenditure of 2,4 percentage points of GDP, and higher expenditure of State enterprises and of the Social Insurance Agency, which are both included in the general government, because information was not available at the forecast cut-off date. The Commission forecasts revenues that are 0,2 percentage point of GDP higher and expenditure that is 3,4 percentage points lower than the 2021 Stability Programme. The major differences in expenditure are attributed to lower intermediate consumption, lower social payments and lower subsidies assumed in the Commission's 2021 spring forecast. The Commission's lower debt forecast is primarily explained by a lower primary balance (by 3,6 percentage points).

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(13) In response to the COVID-19 pandemic and related economic downturn, Slovakia has adopted budgetary measures to strengthen the capacity of its health system, contain the COVID-19 pandemic and provide relief to those individuals and sectors that have been particularly affected. This forceful policy response has cushioned the contraction in GDP, which, in turn, has curtailed the increase in government deficit and public debt. Fiscal measures should maximise support to the recovery without pre-empting future fiscal trajectories. Therefore, measures should avoid creating a permanent burden on public finances. When Member States introduce permanent measures, they should properly fund them to ensure budgetary neutrality in the medium term. The measures taken by Slovakia in 2020 and 2021 have been in line with the Council Recommendation of 20 July 2020. However, some of the discretionary measures adopted by the government over the period 2020 to 2021 do not appear to be temporary or matched by offsetting measures. Beyond the horizon of the Commission's 2021 spring forecast, in 2023, the cumulative remaining impact of those non-temporary measures is preliminarily estimated at around 1 % of GDP, mainly consisting of the reintroduction of Christmas bonuses, changes in the green energy scheme, higher remuneration for military officials, a reduction in the motor vehicles tax, the cancellation of the bank levy, grants to healthcare facilities and tax credits for children. Those non-temporary measures were only partly compensated by the freezing of the minimum pension and the growth of ministries' operating costs.

(14) The 2021 Stability Programme does not include receipts of grants under the Recovery and Resilience Facility in the fiscal aggregates. Nonetheless, it assumes investment and reforms financed by grants under the Recovery and Resilience Facility amounting to 0,2 % of GDP in 2021, 1,1 % in 2022 and 1,3 % in both 2023 and 2024 in its underpinning macroeconomic scenario. The Commission's 2021 spring forecast includes these grants in its budgetary projections.

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(15) The established indicators of fiscal adjustment set out in Regulation (EC) No 1466/97 need to be considered in the context of the current circumstances. First, there is significant uncertainty surrounding output gap estimates. Second, there is a need for fiscal policy to stand ready to rapidly adapt to the evolution of the COVID-19 pandemic, shifting from emergency relief to more targeted measures once health risks diminish. Third, the current context is characterised by a significant policy response to support economic activity. In the presence of sizeable transfers from the Union budget (such as those from the Recovery and Resilience Facility), the established indicators do not capture the full impulse provided to the economy by fiscal policies. Against this background, the structural balance does not appear adequate in the current circumstances. The expenditure benchmark also needs to be adapted[5] and complemented with additional information in order to fully gauge the fiscal policy orientation.

(16) As in the approach pursued in the assessment of the 2021 draft budgetary plans, temporary emergency measures have been excluded from the expenditure aggregate. These crisis-related temporary emergency measures support health systems and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions; their reversal by the public authorities is contingent on the return of the public health and economic situation to normality. To assess the overall fiscal stance at the current juncture, the sizeable transfers from the Union budget (such as those from the Recovery and Resilience Facility) should be included in the relevant expenditure aggregate. The overall fiscal stance is therefore measured by the change in primary expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures), including expenditure financed by grants under the Recovery and Resilience Facility and other Union funds. Going beyond the overall fiscal stance, the analysis also aims to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions. For that reason, particular attention is paid to the evolution of nationally financed primary current expenditure and investment.

[5] In particular, the four-year smoothing of investment used in the expenditure benchmark does not allow for a proper assessment of the fiscal support for the recovery provided by nationally financed investments.

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(17) In its 2021 Stability Programme, Slovakia's general government deficit is planned to decrease to 5,1 % of GDP in 2022, mainly due to the discontinuation of the temporary support measures adopted in 2020 and 2021. The general government debt ratio is planned to increase to 65,5 % of GDP in 2022. These projections are higher than the Commission's 2021 spring forecast. The Commission's forecast assumes smaller COVID-19 measures and a faster drawdown rate of Union funds in 2022 compared to the 2021 Stability Programme. Based on the Commission's 2021 spring forecast, and on the basis of the specific methodology that reflects the above-mentioned challenges, the overall fiscal stance – including the impact on aggregate demand in 2022 from investment financed by both the national and Union budgets, in particular the Recovery and Resilience Facility – is estimated at +0,9 % of GDP[6]. The positive contribution of expenditure financed by Recovery and Resilience Facility grants and other Union funds is projected to increase by 0,8 percentage point of GDP. Nationally financed investment is projected to provide a contractionary contribution of 0,7 percentage point of GDP.[7] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide a contractionary contribution of 1,1 percentage points of GDP.

[6] A negative sign of the indicator corresponds to an excess of the primary expenditure growth compared with medium-term economic growth, which indicates an expansionary fiscal policy.

[7] Other nationally financed capital expenditure is projected to provide a neutral contribution.

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(18) The quality of Member States' budgetary measures appears particularly important. Fiscal structural reforms aimed at improving the composition of national budgets can support potential growth, create much-needed fiscal space and help to ensure fiscal sustainability over the longer term, including in view of climate change and health challenges. On the revenue side, the COVID-19 crisis has reinforced the importance of reforms for more efficient and fairer public revenue systems. On the expenditure side, it has made it even more crucial to increase the level and quality of sustainable and growth-enhancing investments, in a manner consistent with serving the objectives of enhancing growth potential, economic and social resilience and the green and digital twin transition. The national recovery and resilience plans will allow improving the composition of national budgets.

(19) According to the 2021 Stability Programme's medium-term budgetary plans, the general government deficit is planned to decrease from 4,1 % of GDP in 2023 to 3,8 % of GDP in 2024. The general government deficit is thus planned to exceed the 3 %-of-GDP Treaty reference value for the duration of the 2021 Stability Programme. Based on the 2021 Stability Programme, the overall fiscal stance – including the impact on aggregate demand from investment financed by both the national and Union budgets, in particular the Recovery and Resilience Facility – is estimated at 0,2 % of GDP in 2023 and 2024 on average. The positive contribution of expenditure financed by Recovery and Resilience Facility grants and other Union funds is projected to decrease by 0,3 percentage point of GDP. Nationally financed investment is projected to provide a neutral contribution.[8] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide a contractionary contribution of 1,3 percentage points of GDP. The current estimate of the 10-year average nominal potential growth is 4½ %.[9] However, this estimate does not include the impact of the reforms that are part of the recovery and resilience plan and could therefore boost Slovakia's potential growth.

[8] Other nationally financed capital expenditure is projected to provide an expansionary contribution of 1,6 percentage points of GDP.

[9] Estimated by the Commission in accordance with the commonly agreed methodology.

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(20) The general government debt ratio is planned to increase from 64,6 % of GDP in 2023 to 65,8 % of GDP in 2024. Slovakia is considered to face medium fiscal sustainability risks over the medium term, as per the latest debt sustainability analysis.

(21) In view of the currently still exceptionally high degree of uncertainty, the fiscal policy guidance should remain predominantly qualitative. More precise quantified guidance for the later years should be provided in 2022, if the degree of uncertainty has sufficiently declined by then.

(22) The Council has assessed the 2021 Stability Programme and the follow-up by Slovakia to the Council Recommendation of 20 July 2020,

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HEREBY RECOMMENDS SLOVAKIA TO:

1. In 2022, maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.

2. When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, enhance investment to boost growth potential.

3. Pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition. Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy and sustainability of health and social protection systems for all.

Done at …

For the Council
The President

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