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COMMISSION OPINION

of 24.11.2021

on the Draft Budgetary Plan of Slovakia

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(Only the Slovakian text is authentic)

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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, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact 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 by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In that Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate 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.[3]

4. On 3 March 2021, the Commission adopted a Communication providing further policy orientations to facilitate the coordination of fiscal policies.[4] In that Communication, the Commission set out its view that the decision on the deactivation or continued application of the general escape clause should be taken on the basis of an overall assessment of the state of the economy, with the level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) as a key quantitative criterion. On 2 June 2021, on the basis of the Commission's 2021 spring forecast, the Commission considered that the conditions to continue to apply the general escape clause in 2022 and to deactivate it as of 2023 were met.[5] Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.

[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[2] The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[3] https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

[4] Communication from the Commission to the Council on one year since the outbreak of COVID-19: fiscal policy response, Brussels, 3.3.2021, COM(2021) 105 final.

[5] Communication from the Commission on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021) 500 final.

5. Next Generation EU, including the Recovery and Resilience Facility, supports a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 established the Recovery and Resilience Facility[6] which provides financing support for the implementation of reforms and investments, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the EU budget. By contributing to economic recovery and to strengthening long-term growth, it supports public finances, growth and job creation in the medium and long term.

6. On 2 June 2021, the Commission emphasised in its communication that the coordination of national fiscal policies remains crucial to underpin the recovery. In this context, the Commission set out its view that the overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. Fiscal policy should remain agile and adjust to the evolving situation as warranted, and a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Finally, with economic activity gradually normalising in 2021, Member States' fiscal policies should become more differentiated in 2022, taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. All Member States should preserve nationally financed investment. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

   In its recommendations on the 2021 Stability Programmes on 18 June 2021, the Council also recommended that, when economic conditions allow, Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, investment should be enhanced to boost growth potential.

   The Council, on 13 July 2021, further recommended to euro area Member States[7] to take action, individually and collectively within the Eurogroup, in the period 2021-2022 to ensure a policy stance that supports the recovery from the COVID-19 crisis. When the epidemiological and economic conditions allow, emergency measures should be phased out while combatting the social and labour-market impact of the crisis. Recalling the need for prudent medium-term fiscal positions and debt sustainability, while enhancing investment, the Council also called for particular attention to the quality of budgetary measures.

   The recovery of the European economy has been strengthening, thanks to the improved health situation and easing of pandemic control restrictions. The volume of output in the euro area is expected to return to its pre-pandemic level by the end of the year. However, bottlenecks in global supply and rising energy and commodity prices have been increasingly weighing on activity in the EU. This together with production bottlenecks, due to the shortage of some input components and raw materials, and capacity constraints vis-à-vis booming demand both in the EU and internationally have been putting upward pressure on consumer prices.

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[6] OJ L57, 18.2.2021, p.17.

[7] Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1–7

7. On 18 June 2021, in its recommendations on the 2021 Stability Programmes, the Council highlighted that 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. Specifically, the assessment of the overall fiscal stance at the current juncture should take into account the transfers from the EU budget (such as those from the Recovery and Resilience Facility). Furthermore, the assessment also needs to take into account the phasing-out of crisis-related temporary emergency measures that were designed to support health systems, and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions, while their withdrawal is accompanied by the easing of lockdown restrictions that will support growth.

   Accordingly, the fiscal stance in 2021 and 2022 is measured by the change in primary expenditure (net of discretionary revenue measures), excluding crisis-related temporary emergency measures but including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth[8]. Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed primary current expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) and investment.

CONSIDERATIONS CONCERNING SLOVAKIA

8. On 14 October 2021, Slovakia submitted the Draft Budgetary Plan for 2022. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

9. On 18 June 2021, the Council recommended that in 2022 Slovakia[9] maintains a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserves nationally financed investment.

   The Council also recommended to pay particular attention to the composition of public finances, on both the revenue and expenditure sides of the national budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery; to prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition; and to 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.

   On 2 June 2021, the Commission issued a report under Article 126(3) TFEU.[10] This report discussed 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

[8] The Commission's estimates of medium-term potential growth do not include the positive impact of reforms that are part of the Recovery and Resilience Plan and can boost Slovakia's potential growth.

[9] Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Slovakia, OJ C 304, 29.7.202021, p. 121.

[10] Report from the Commission prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, Brussels, 2.6.2021, COM(2021) 529 final.

concluded that the deficit criterion was not fulfilled but the debt criterion was complied with.

10. According to the Commission 2021 autumn forecast, Slovakia's economy is expected to grow by 3.8% in 2021, and by 5.3% in 2022, while inflation is forecast at 2.8% in 2021 and 4.3% in 2022. Over this horizon, the post-pandemic recovery is projected to be robust, although slowed down by global supply bottlenecks, hurting Slovakia's manufacturing exports, as well as by COVID-19-related uncertainty still partly weighing on domestic demand. The macroeconomic scenario underlying the Draft Budgetary Plan takes into account the same factors but is more pessimistic than that of the Commission, with real GDP growth of 3.7% in 2021 and only 4.2% in 2022. The main reason for these differences is that, according to the DBP, in the second half of 2021 supply chain disruptions and the intensifying pandemic are expected to have a more pronounced negative effect on exports and consumption, respectively. Moreover, and unlike in the Commission's forecast, the Draft Budgetary Plan seems to assume that the effect of these shocks is permanent in the sense that there is a downward level shift in the path of consumption and exports, with no catching up to their previously assumed paths even after the shocks are expected to dissipate. This results in the DBP projecting a markedly lower GDP growth in 2022 relative to the Commission. The Draft Budgetary Plan also projects a lower inflation rate of 4.0% in 2022. Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible in 2021, and cautious in 2022. Slovakia complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently-produced macroeconomic forecasts.

11. Slovakia submitted its Recovery and Resilence Plan on 29 April 2021. The Council approved the assessment of Country's Recovery and Resilence Plan on 13 July 2021. A pre-financing payment of Recovery and Resilience Facility grants of 0.8% of GDP was made to Slovakia in October 2021. The Draft Budgetary Plan assumes that expenditure amounting to 0.1% in 2021, 0.7% in 2022, 0.9% in 2023, and 0.8% in 2024 will be funded by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt. The Commission 2021 autumn forecast includes a similar amount of expenditures financed by RRF grants in its budgetary projections. Simulations by the Commission services show that the Recovery and Resilience Plan, together with the rest of measures of the European Union Recovery Instrument, has the potential to increase the GDP of Slovakia by between 1.3 % and 1.8 % on average by 2026, not including the possible positive impact of structural reforms, which can be substantial.[11]

12. In its 2022 Draft Budgetary Plan, Slovakia's general government deficit is planned to decrease from 7.9% of GDP in 2021 to 4.9% of GDP in 2022, mainly due to the phasing out of COVID-19 measures (2.4% of GDP). In contrast, new permanent government expenditure measures adopted in 2021, including the additional funds for public railway transport companies, prison and judicial guards, severence payments for police officers and for regional development, will widen the general government deficit. The general government debt ratio is planned to remain stable at 61.5% of GDP in both 2021 and 2022. These projections are in line with

[11] These simulations reflect the overall impact of NGEU, which also includes funding for ReactEU, and increased funding for Horizon Europe, InvestEU, JTF, Rural Development and RescEU.

the Commission 2021 autumn forecast. In addition, the Draft Budgetary Plan includes a provision for anti-pandemic measures and the possible costs of a more intensive third wave of the pandemic of 0.7% of GDP, which is not presented as a discretionary fiscal measure.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including risks related to the evolution of the pandemic and possible scarring effects. Slovakia provided significant liquidity support to companies and households, such as guarantees and tax deferrals. This support does not have a direct or immediate budgetary impact, but guarantees represent contingent liabilities for the general government sector. The Commission estimates that the guarantees taken up amounted to around 1.5% of GDP at the end of September 2021.

13. The deficit in 2021 is driven by new permanent discretionary budgetary measures of 0.6% of GDP, including on the expenditure side, the abolition of co-payments for medicines for selected groups of the population, the introduction of a pregnancy allowance, earlier retirement for selected years, an increase in expenditure on road development and support to regions for education. On the revenue side, the deficit is increased by the abolition of the bank levy, changes in motor vehicle taxation and an increase in the tax allowances. The impact of these measures is partially offset by an increase in the excise duty on tobacco, the reduction of expenditure on goods and services and freezing of the increase in the minimum pension. In addition to the above-mentioned measures, the Draft Budgetary Plan presents other factors increasing the deficit in 2021, such as an increase in the number of pension beneficiaries, a growing contribution to the EU budget due to Brexit, an increase in EU co-financing expenditure, higher-than-expected investments and an increase in public health insurance expenditure not related to the COVID-19 pandemic. The amount of crisis-related emergency measures is estimated at 3.1% of GDP and is affected by the expansion of employment support, the increase of sickness benefit and nursing allowances, the extension of entitlement to unemployment benefit and the creation of a new scheme to support the most affected economy sectors. In addition, a one-off allowance was paid out to families with children, who have fallen in material need because of the pandemic. Other child allowances were also increased on a temporary basis.

The Draft Budgetary Plan projects in 2022 a freezing of public sector wages in the state budget, reduction of subsidies in agriculture and slower growth in expenditure of local governments and public universities. In contrast to the Draft Budgetary Plan, the Commission forecast does not include any measures presented in the form of provisions for expenditure, as these provisions are not sufficiently specified and their implementation is uncertain.

Based on the Commission's forecast, the crisis-related temporary emergency measures will increase from 1.8% of GDP in 2020, to 3.1% in 2021 and decrease to 0.7% in 2022.

According to the Draft Budgetary Plan, gross fixed capital formation is expected to increase from 4.2% of GDP in 2021 to 4.5% of GDP in 2022, which is a level significantly higher than those recorded over the past five years. These increases are mainly explained by higher expenditure planned in the context of the Slovak Recovery and Resilience Plan and investments co-financed by other EU funds. Without the above-mentioned provisions in the Draft Budgetary Plan for expenditure

on investment measures aimed at supporting the economy, whose implementation is uncertain and which are not specified in detail, the projections in the Draft Budgetary Plan would imply a decline in nationally financed investment. The Commission's lower forecast for gross fixed capital formation is also due to an assumed different profile for the drawdown of EU funds, namely a lower drawdown rate in 2022 and a higher rate in 2023.

The Draft Budgetary Plan presents measures and reforms in order to achieve prudent medium-term fiscal positions and ensure fiscal sustainability in the medium term. These involve for instance the introduction of expenditure ceilings, reform of investment management, reforms of the pension, long-term care and healthcare systems. Moreover, initiatives in the field of environment, renewable energy sources or digital public administration services and digital infrastructure are addressing the recommendation of the Council of 18 June 2021 on supporting the green and digital transition. A complete assessment of the fiscal-structural reforms implemented by Slovakia will be done in the context of the assessment of the implementation of the Recovery and Resilience Plans and the 2022 Country Report.

14. The fiscal stance, which excludes crisis-related temporary emergency measures while including the impact on aggregate demand from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility, is projected in the Commission 2021 autumn forecast at 0.3% of GDP in 2022.[12] Slovakia is projected to use the Recovery and Resilience Facility in 2022 to finance additional investment in support of the recovery. The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 1.3 percentage points of GDP in 2022 compared to 2021. Nationally financed investment is projected to provide a slightly contractionary contribution to the fiscal stance of 0.1 percentage points of GDP in 2022.[13] At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide a contractionary contribution of 1.4 percentage points to the overall fiscal stance.

15. The Draft Budgetary Plan includes medium-term budgetary projections until 2024. The government deficit is planned to decrease gradually to 2.7% of GDP in 2023 and to 2.6% of GDP in 2024. These plans assume a constant structural annual adjustment of 1.0% of GDP in both 2023 and 2024. In turn, government debt is envisaged to peak at 61.5% of GDP in 2021 and 2022 and to decline to 58.7% of GDP by 2024.

16. In 2022, based on the Commission's forecast and including the information incorporated in Slovakia's Draft Budgetary Plan, the fiscal stance, including the impulse provided by the Recovery and Resilience Facility, is projected to be contractionary in a context of high output growth and emerging capacity constraints in 2022, broadly as recommended by the Council. Furthermore, Slovakia plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Broadly as recommended by the Council, Slovakia plans to almost preserve nationally financed investment.

The Commission recalls the importance of the composition of public finances and the quality of budgetary measures, including through growth-enhancing investment,

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

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

notably supporting the green and digital transition. The measures announced in the Draft Budgetary Plan are in line with the recommendation, while small in size.

Taking into account the strength of the recovery, Slovakia is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

Done at Brussels, 24.11.2021

For the Commission
Paolo GENTILONI
Member of the Commission