CBR
COUNCIL FOR BUDGET RESPONSIBILITY

Opinion of the CBR on the Finance Ministry’s proposal to end exceptional circumstances

June 2021

www.rrz.sk

This report presents the official positions of the Council for Budget Responsibility in line with its mandate laid down in Act No. 493/2011 on Fiscal Responsibility.

This publication is available at the CBR's website (https://www.rrz.sk).

Any suggestions or comments on the report are welcome at sekretariat@rrz.sk.

Opinion of the CBR on the Finance Ministry's proposal to end exceptional circumstances

On 10 June 2021[1], the Ministry of Finance (MF SR or the Ministry) published its proposal to end exceptional circumstances declared by the government on 24 June 2020 due to the impacts of the pandemic of coronavirus on Slovakia's economy. During the period of exceptional circumstances, the correction mechanism[2] of the balanced budget rule defined in Act No. 523/2004 Coll. on the General Government Budgetary Rules is not applied. Similarly to the proposal for declaring exceptional circumstances, the proposal to end exceptional circumstances has been assessed by the Council for Budget Responsibility (CBR) in accordance with the applicable provisions of the Act[3] before the government's session.

According to the Treaty on stability, coordination and governance in the Economic and Monetary Union, 'exceptional circumstances' refers to the case of an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn[4] as set out in the revised Stability and Growth Pact, provided that the temporary deviation of the country concerned does not endanger fiscal sustainability in the medium-term. A period of severe economic downturn applies to a relevant country or the euro area as a whole.

The evaluation of whether exceptional circumstances have occurred is assessed by the CBR based on quantitative criteria published in the methodology of evaluation[5]. As regards the proposal to end exceptional circumstances, the CBR assesses whether the circumstances which have led to their activation still persist:

- In 2020, the impacts of the pandemic have caused a severe economic downturn by 4.8%, while the most recent forecasts suggest that Slovakia's economy would start recovering in 2021. According to a macroeconomic forecast published by the Macroeconomic Forecasting Committee on 17 March 2021, Slovakia's economy is expected to grow 3.3% in 2021 and the negative output gap will gradually start closing (in 2021, it is expected to reach -2.6% of the potential output and, in 2022, the economy would start slightly overheating at 0.9% of the potential output). The forecasts

1 Ministry of Finance, Proposal to end exceptional circumstances, June 2021; the Ministry suggests that exceptional circumstances be ended as of the date on which the proposal is approved by the government of the Slovak Republic.

2 The correction mechanism in the form of an expenditure ceiling for 2020 was approved by the government on 15 January 2020 in connection with the identified significant deviation from the adjustment path towards the medium-term budgetary objective in 2018.

3 Pursuant to §30a(3) of Act on the General Government Budgetary Rules, the obligation to apply the correction mechanism is not imposed throughout the duration of exceptional circumstances. The beginning and end of the duration of exceptional circumstances is declared by the government based on a proposal by the Ministry of Finance; before the government declares exceptional circumstances, the proposal is assessed by the Council for Budget Responsibility.

4 Under the definition in the Stability and Growth Pact, a severe economic downturn is a period of a negative annual real GDP growth or an accumulated loss of output during protracted period of very low GDP growth relative to potential economic growth.

5 CBR, Methodology for the evaluation of the balanced budget rule, version 1, December 2019 (available in Slovak only).

prepared by the CBR and the National Bank of Slovakia for the same period expected very similar developments for Slovakia's economy in 2021[6].

- Although the European rules under the Stability and Growth Pact will not be applied even in 2022[7] due to the pandemic, the most recent developments in Slovakia provide, according to the CBR, sufficient margins for ending exceptional circumstances already in the course of year 2021.
- The actions taken by the government during 2020 and 2021 to address the epidemiological aspects of the pandemic and support the domestic economy due to insufficient domestic and foreign demand are one-off measures and do not have an impact on the structural balance. The government could still address the potential deterioration of the pandemic by one-off targeted support and by shifting the future investments into the present, but none of these forms of incentives would permanently worsen the public finances.

Having assessed all the relevant factors, the CBR considers that the reasons for declaring exceptional circumstances in the past no longer apply and agrees with the Ministry's proposal for their ending.

After the exceptional circumstances are ended, a binding correction plan[8] should follow because of the significant deviation of the structural balance from a balanced budget rule and temporary non-application of the correction mechanism which was approved by the government on 15 January 2020. From this perspective, the fact that the government proposed a **new stricter medium-term objective** in the Stability Programme[9], taking into account the currently high risks associated with the long-term sustainability of public finances while setting a deadline by which the objective should be met (a structural surplus of 0.5% of GDP by 2028), **is regarded positively**.

However, the CBR considers the proposed consolidation path to be insufficiently ambitious in particular in the medium-term horizon, because the government's targets until 2024 are worse than the public finance development estimated by the CBR when assuming no change in policies. The reason is that the government expects the development in public finances to be significantly worse in 2021 and intends to start reducing the structural deficit only as late as in 2023.

In CBR's opinion, a gradual decline in the structural deficit could be started already in 2022. Despite the fact that, in general, international institutions (EC, IMF)[10] recommend a slower start-up curve for the consolidation of public finances, Slovakia's economy and public

---

6 The recovery trend in 2021 is also confirmed by a short-term forecast of the Slovak economy's growth (CBR's macroeconomic nowcasting) of May 2021 (available in Slovak only).

7 European Semester Spring Package 2021: economic coordination - Commission Communication, June 2021

8 Pursuant to the Common principles on national fiscal correction mechanisms published by the European Commission on 20 June 2012.

9 Ministry of Finance, The Stability Programme of the Slovak Republic for 2021 – 2024, May 2021

10 The EC recommends that consolidation should be started in 2023, whereas the IMF has not yet presented its opinion whether it would be desirable to start in 2022 or 2023 due to prevailing uncertainty. The IMF consents to intensified incentives in 2021 and recommends consolidation when the recovery of the economy becomes sufficiently rooted. In the event of a better-than-expected development, the unused reserves should be spared and used for debt reduction.

finances are in a specific position allowing the consolidation to start from 2022[11], provided that the third wave of the pandemic is not strong and, therefore, the available macroeconomic forecasts would be fulfilled. According to the most recent forecasts, Slovakia's economy will start overheating already in 2022, while the EC suggests that the level of overheating to be seen in Slovakia will be the highest among the EU countries. The post-crisis recovery of the economy could significantly benefit from the resources received under the Next Generation EU recovery fund which, in Slovakia's case, are almost triple the average level for the EU countries. The urgency of consolidation is underlined by high risks associated with the long-term sustainability of public finances, in which case Slovakia is the worst in the EU, according to the EC (the so-called S2 indicator)[12].

Therefore, in the event where a more favourable public finance development is confirmed in 2021 and the recovery of Slovakia's economy continues, the government should be prepared to reconsider its fiscal targets and achieve a balanced budget at an earlier date.

[11] The reasons are described in the CBR's document, Medium-term fiscal outlook for 2021 – 2024, June 2021, Box 3 on pg. 23.

[12] https://ec.europa.eu/info/sites/default/files/economy-finance/swd-2021-501_en_v2.pdf

CBR
COUNCIL FOR BUDGET
RESPONSIBILITY

Council for Budget Responsibility

Imricha Karvaša 1
Bratislava 1
813 25
Slovakia

www.rrz.sk