



REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Fulfilment of conditions for the existence of exceptional circumstances in 2022

April 2021

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The assessment was drafted following a request by the Government of the Republic of Slovenia to establish the existence of exceptional circumstances (received on 25 March 2021). Data available up to and including 31 March 2021 were used.

Legislative framework

On 25 March 2021, pursuant to paragraph two of Article 12 of the Fiscal Rule Act (hereinafter: the FRA) the Government of the Republic of Slovenia communicated a decision of the 66th regular session of 24 March 2021 requesting the Fiscal Council to assess the existence of the exceptional circumstances referred to in paragraph one of Article 12 of the FRA in 2022.

Pursuant to Article 12 of the FRA, the Government shall establish whether exceptional circumstances have arisen or have ceased to exist after obtaining the assessment of the Fiscal Council. Pursuant to point 7 of paragraph two of Article 7 of the FRA, the assessment regarding the occurrence or cessation of exceptional circumstances shall be drafted and, pursuant to paragraph two of Article 12 of the FRA, submitted in no later than 15 days, if the assessment is requested by the Government. The FRA does not specify the period that the Fiscal Council's assessment concerning the aforementioned conditions should refer to, as it merely requests that the Fiscal Council provide its assessment on the existence or cessation of the conditions based on which exceptional circumstances may be enforced.

Fulfilment of conditions for the existence of exceptional circumstances in 2022

The Fiscal Council notes that in 2022, given the available information and forecasts at the time of drafting this assessment, at least one of two conditions will be met which under Article 12 of the FRA enable exceptional circumstances to be enforced and thus permit a deviation from the applicable rules within the measures aimed at mitigating the consequences of an unusual event, provided that this does not jeopardise the medium-term sustainability of the public finance. Such a finding is subject to uncertainty and may change in the future. The Fiscal Council will regularly check the fulfilment of the stated conditions for the enforcement of exceptional circumstances in the case of any updated macroeconomic forecasts or assessment of future budget documents.

On 17 March 2020, the Fiscal Council assessed¹ that the announcement of the epidemic constitutes an unusual event, which, under Article 12 of the FRA, makes it possible to invoke exceptional circumstances for measures aimed at mitigating the consequences of such an event and thus to temporarily deviate from the medium-term fiscal balance.² The Fiscal Council made the assessment on its own initiative in order to enable the government to take measures to fight the epidemic as soon as possible. Given the pandemic nature of the crisis, it expressed the expectation that EU Member States would also adopt joint solutions to address the crisis and alleviate its consequences, and called on the government to bring measures in Slovenia in line with other Member States and bodies of the European Union. It pointed out that it was important for Slovenia to avoid exposing itself to the financial markets as much as possible when securing financial resources.

At the end of September 2020, the government again requested the Fiscal Council to assess the occurrence of exceptional circumstances in accordance with the FRA, which, in view of the epidemiological situation at the time of drawing up the budget documents in October 2020, considered that the conditions for the exercise of exceptional circumstances at the time of drawing up the assessment were still applicable.³ It assessed that given the known data and available forecasts, both conditions were met at the time of making the assessment in 2020, which under Article 12 of the FRA permit the exercise of exceptional circumstances and thus a temporary deviation from the medium-term balance of public finances. In the period covered by the submitted budget documents, according to the Fiscal Council assessment at the times, at least one condition could be met in 2021, which permits such a derogation, while the fulfilment of the conditions for 2022 could not be unambiguously established. The Fiscal Council noted that the government's request was not in line with the budget preparation process, as it was submitted at the same time as the budget documents, the compliance of which was assessed by the Fiscal Council.⁴ At the same time, the Fiscal Council found that the government, which is bound by the second paragraph of Article 12 of the FRA in determining the occurrence of ex-

¹ Available at: http://www.fs-rs.si/wp-content/uploads/2020/10/Exceptional-circumstances_October-2020.pdf

² On 23 March 2020, the EU Council, on the basis of a proposal by the EC, adopted a decision permitting "the possibility of a general deviation" (a general escape clause) from fiscal compliance in terms of increased flexibility of fiscal policy during the pandemic. In Article 6 of Regulation (EU) No 1175/2011, general deviation from fiscal rules is mentioned as non-compliance with deviations resulting from the mitigation of consequences of an unusual event outside control of the Member State concerned, and which has a major impact on the financial position of the general government or in the case of a severe economic downturn in the euro area or the European Union as a whole, provided that this does not jeopardise the fiscal sustainability in the medium term. The EC also laid down specific conditions under which measures can be dealt with as part of a general deviation. The manual for implementing the provisions of the Stability and Growth Pact https://ec.europa.eu/info/sites/info/files/economy-finance/ip101_en.pdf (p. 26) places emphasis on the eligibility of such expenditure subject to the following principles: (i) additional spending should be directly linked to the exceptional circumstances, (ii) deviations can only be permitted on a temporary basis; (iii) the permitted deviations should only reflect the additional costs related to tackling exceptional circumstances compared to the previous year; (iv) countries should present the deviations in a transparent manner. These principles also apply to justifying such expenditure in budget documents submitted to the EC by the Member States within the framework of economic governance or the European Semester. Such documents include the Draft Budget Plan and the Stability Programme.

³ http://www.fs-rs.si/wp-content/uploads/2020/10/Exceptional-circumstances_October-2020.pdf

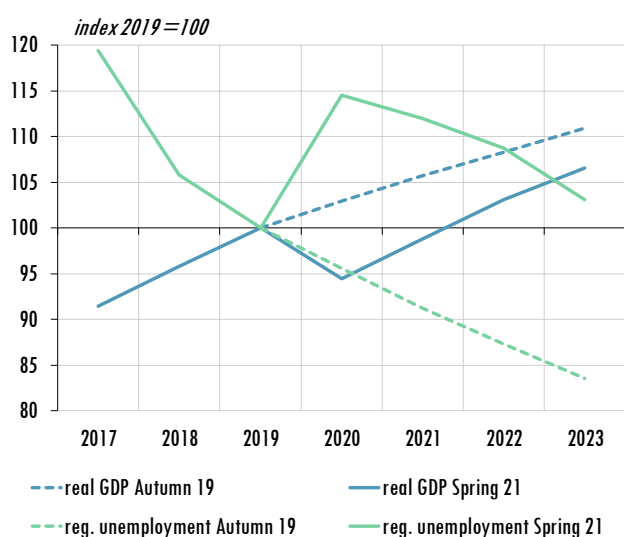
⁴ Nevertheless, the law does not specify the time frame for the preparation of an exceptional circumstances assessment within the timeline of the budget drafting procedure. However, policies in budget documents should be dependent on the assessment of potential occurrence or existence of exceptional circumstances in the period to which these documents refer.

ceptional circumstances on the basis of the Fiscal Council's assessment, had already used the March 2020 Fiscal Council assessment in its documents, whereas it has yet not formally established the occurrence of exceptional circumstances based on the Fiscal Council's assessment.⁵

In March 2021, the European Commission published recommendations for the functioning of fiscal policy, which relate, inter alia, to further implementation or cessation of the general escape clause.⁶ In doing so, the Commission called for a heterogeneous approach to the applicability of the general escape clause, which should depend on the speed of recovery and risks associated with the sustainability of public finances in individual countries and on the need to reduce economic, social and geographical disparities in the EU. It drew attention to the debt increase during the crisis and the declining economic growth trend, which according to the European Commission's analysis raises doubts about the sustainability of public finances in some countries, including Slovenia.⁷ In this context, the Commission recommends credible medium-term fiscal strategies, strengthening the long-term economic potential also on the basis of funds allocated to countries under existing and new European mechanisms, and focusing on the structure and quality of fiscal measures, both on the revenue and expenditure side. In light of the updated Stability Programmes to be submitted by the Member States by the end of April, in May 2021 the Commission will determine the compliance with the quantitative condition in each country, i.e. the level of economic activity compared to 2019, as well in 2022, to maintain the general escape clause.⁸

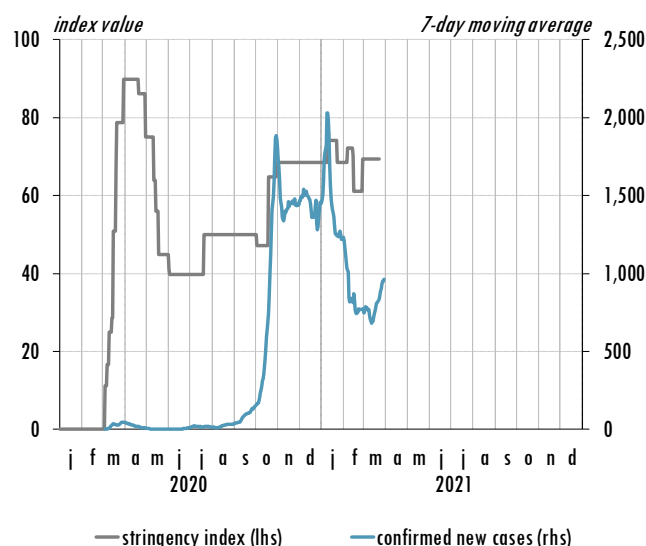
Although refraining from details, the FRA states two conditions for the existence of exceptional circumstances which permit temporary deviations from the medium-term fiscal balance, provided that this does not jeopardise fiscal sustainability. Pursuant to paragraph one of Article 12 of the FRA, such deviation is only permitted (i) in periods of severe economic downturn or (ii) in the case of an unusual event outside the control of the party concerned which has major impact on the financial situation of the general government sector, as defined by the Stability and Growth Pact. The FRA does not

Figure 1: Real GDP and registered unemployment



Sources: SORS, Employment Service of Slovenia, IMAD forecasts, FC calculations.

Figure 2: Stringency index and confirmed new cases



Source: OxCGR, NIJZ, FC calculations.

⁵ <https://www.gov.si/assets/ministrstva/MF/ekonomska-in-fiskalna-politika/evropski-semester/Stability-Programme-2020.pdf>

⁶ https://ec.europa.eu/commission/presscorner/detail/en/ip_21_884

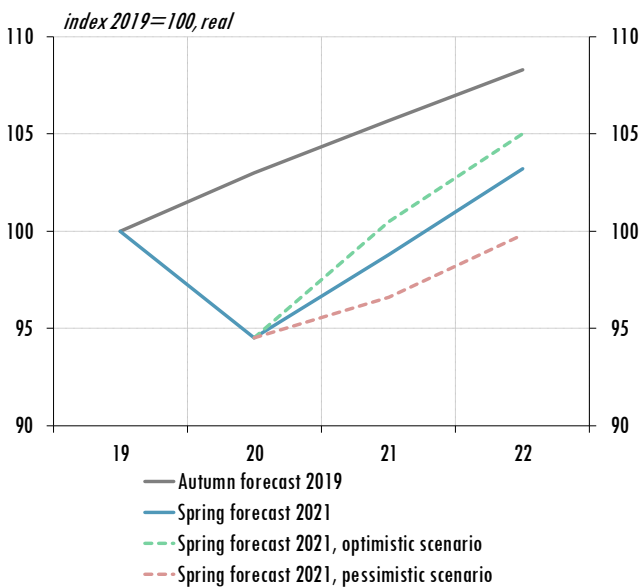
⁷ More on this can be found in the Debt Sustainability Monitor 2020, available at: https://ec.europa.eu/info/sites/info/files/economy-finance/ip143_en.pdf

⁸ The important role of this indicator was indicated by the European Commission in the February 2021 forecast available at https://ec.europa.eu/info/sites/info/files/economy-finance/ip144_en_1.pdf (see Figure 1.16 and Frame 1.3).

set out the detailed quantitative criteria for determining the severity of the economic downturn or the extent of the unusual event having major impact on the financial situation of the general government sector.⁹ For this reason, in its assessment, the Fiscal Council uses criteria to determine the adequacy of conditions which, in our opinion, best reflect the requirements of the FRA.

Currently available data and forecasts show that in 2022 at least one of two conditions permitting enforcement of exceptional circumstances will be met. Given the (a) severe economic downturn in 2020, which according to the available data stood at 5.5% year-on-year, and (b) considering that according to the calculations of the Fiscal Council based on IMAD's spring forecast (March, 2021), the pre-crisis level of GDP in constant prices (from 2019) will be exceeded during 2022¹⁰, while the GDP level forecast before the crisis (autumn forecast, 2019) will not be reached in 2022, the Fiscal Council considers that (i) the condition referred to in the preceding paragraph will be met in 2022. This finding is also confirmed by the fact that despite extensive job retention measures and the projected gradual recovery of the labour market, the number of unemployed is expected to remain higher in 2023 than before the outbreak of the crisis in 2019. In the spring forecast baseline scenario, IMAD used the assumption of an improvement in the epidemiological situation in the second quarter of 2021. More in-depth and longer-term restrictive measures, and in particular a possible slowdown in the vaccination dynamic of the population, would increase the possibility of a negative scenario prepared by IMAD as part of the risk analysis. This scenario suggests the possibility that in 2022 the level of economic activity from 2019 will not yet be reached. The Fiscal Council may determine the fulfilment of condition (ii) only on the basis of the current epidemiological situation or in view of its current worsening trend and in view of the resumption of restrictive measures in early April. The fulfilment of condition (ii) for 2022 cannot be assessed by the Fiscal Council due to considerable uncertainty as to the future course of the epidemic.

Figure 3: Alternative GDP scenarios



Source: IMAD.

Figure 4: Unemployment and potentially endangered jobs



Sources: ZRSZ (Employment Service), FURS (Financial Administration).

⁹ Article 2(2) of Council Regulation (EC) No 1467/1997 defines a severe economic downturn as a negative GDP growth rate in fixed prices or an accumulated GDP loss during a protracted period of very low annual GDP volume growth relative to its potential. According to the Fiscal Council, such definition may apply to the standard conditions of a business cycle, but not in the case when the annual GDP of an individual country and nearly all EU countries shrinks by 5% and 10%.

¹⁰ At the end of the first half of 2022, in the event that an even distribution of the projected annual growth rate of real GDP in 2022 (4.4%) is used over individual quarters.

In addition to both findings concerning the establishment or existence of said conditions, in 2020 the Fiscal Council called for prudence while introducing measures also in periods of exceptional circumstances. It noted, inter alia, that in accordance with applicable European fiscal rules,¹¹ the measures adopted to deal with exceptional circumstances should be temporary and should directly address the exceptional circumstances. The Fiscal Council reiterates its expectations that the government will precisely define and quantify the fiscal effects of the measures aimed at mitigating the epidemic. Upon establishing the occurrence of conditions enabling the enforcement of exceptional circumstances, the Fiscal Council warned that, after the period of exceptional circumstances has ended, the medium-term fiscal balance of the general government should be re-established as laid down by Slovenian and European law.

The Fiscal Council will regularly check the fulfilment of the above conditions for the enforcement of exceptional circumstances when assessing future budget documents, which should set out a path to ensuring the medium-term sustainability of public finance of the part of the budget documents not directly related to the crisis. In assessing the fulfilment of the conditions for the enforcement of exceptional circumstances, there is also a risk of diverging movements in various activities of the economy. While manufacturing and construction have already largely compensated for the drop in economic activity, the service sector is facing a deep crisis, mainly due to restrictive measures, which may also be reflected in a permanent contraction of some activities and possible repercussions on other activities. The assessment regarding the fulfilment of conditions for the enforcement of exceptional circumstances is not static, but may change depending on the given circumstances and projections. Thus, additional uncertainty is introduced into budget planning requiring additional prudence and reflection about the extent and ways of determining the fiscal policy in order to eliminate any future need for implementing measures that could exceedingly change the course of the adopted policy through the budget documents. An appropriate and credible medium-term path for public finance should be outlined in the updated Stability Programme. As it is usually prepared for four years (t up to t+3), the projections in 2023 and 2024, i.e. after the currently permitted period of temporary exceptional circumstances, should gradually show structural re-balancing and ensuring the medium-term sustainability of public finances. As before, the Fiscal Council will continue to prepare assessments of compliance with the legally prescribed fiscal rules when assessing the compliance of budget documents. In doing so, it will continue to consistently distinguish between fiscal measures that are or are not directly related to the Covid-19 crisis.

¹¹ EC (2019). Vade Mecum on the Stability and Growth Pact. 2019 edition, p. 26. Available at: https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.