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This Survey is published on the responsibility of the Economic and Development Review Committee (EDRC) of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of the Slovak Republic were reviewed by the Committee on 10 September 2014. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 15 October 2014.

The Secretariat's draft report was prepared for the Committee by Lilas Demmou under the supervision of Andreas Wörgötter. Research assistance was provided by Seung-Hee Koh. Arthur Radziwill and Yana Vaziakova contributed at an early stage. The Survey also benefitted from consultancy work by Robert Price, Gabriel Machlica, Martin Halus and Robert Menkyna.

The previous Survey of the Slovak Republic *was issued in December 2012.*

Information about the latest as well as previous Surveys *and more information about how Surveys are prepared is available at* www.oecd.org/eco/surveys.

BASIC STATISTICS OF THE SLOVAK REPUBLIC, 2013

Numbers in parentheses refer to the OECD average*

LAND, PEOPLE AND ELECTORAL CYCLE

Population (million)	5.4		Population density per km^2	110.4	(34.8)
Under 15 (%)	15.3	(18.2)	Life expectancy (years, 2012)	76.2	(80.2)
Over 65 (%)	13.5	(15.6)	Men	72.5	(77.5)
Foreign-born (%, 2011)	n.a.		Women	79.9	(82.9)
Latest 5-year average growth (%)	0.1	(0.5)	Latest general election	March 2012	

ECONOMY

Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	95.8		Primary sector	3.0	(2.5)
In current prices (billion EUR)	72.1		Industry including construction	34.2	(27.8)
Latest 5-year average real growth (%)	1.0	(0.8)	Services	62.8	(69.5)
Per capita (1 000 USD PPP)	26.1	(38.1)			

GENERAL GOVERNMENT

Per cent of GDP

Expenditure	38.7	(42.4)	Gross financial debt	59.9	(109.7)
Revenue	35.9	(36.6)	Net financial debt	28.4	(69.8)

EXTERNAL ACCOUNTS

Exchange rate (EUR per USD)	0.753		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.510		Machinery and transport equipment	57.2	
In per cent of GDP			Manufactured goods	17.1	
Exports of goods and services	97.6	(53.0)	Miscellaneous manufactured articles	8.6	
Imports of goods and services	91.3	(49.0)	Main imports (% of total merchandise imports)		
Current account balance	2.1	(-0.1)	Machinery and transport equipment	42.4	
Net international investment position	-68.2		Manufactured goods	15.1	
			Mineral fuels, lubricants and related materials	13.1	

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate for 15-64 year-olds (%)	59.9	(65.2)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	14.2	(7.9)
Men	66.4	(73.1)	Youth (age 15-24, %)	33.7	(16.1)
Women	53.3	(57.4)	Long-term unemployed (1 year and over, %)	9.5	(2.7)
Participation rate for 15-64 year-olds (%)	69.8	(71.1)	Tertiary educational attainment 25-64 year-olds (%, 2011)	18.8	(31.5)
Average hours worked per year	1 770	(1 771)	Gross domestic expenditure on R&D (% of GDP, 2012)	0.8	(2.4)

ENVIRONMENT

Total primary energy supply per capita (toe)	3.1	(4.2)	CO_2 emissions from fuel combustion per capita (tonnes, 2011)	6.3	(9.9)
Renewables (%)	8.4	(8.8)	Water abstractions per capita (1 000 m^3, 2012)	0.1	
Fine particulate matter concentration (urban, PM10, µg/m^3, 2011)	30.1	(28.0)	Municipal waste per capita (tonnes, 2012)	0.3	

SOCIETY

Income inequality (Gini coefficient, 2011)	0.261	(0.308)	Education outcomes (PISA score, 2012)		
Relative poverty rate (%, 2011)	8.3	(11.1)	Reading	463	(497)
Median equivalised household income (000 USD PPP, 2010)	12.7	(20.4)	Mathematics	482	(494)
Public and private spending (% of GDP)			Science	471	(501)
Health care (2012)	8.1	(9.2)	Share of women in parliament (%, September 2014)	18.7	(26.7)
Pensions (2009)	7.4	(8.7)	Net official development assistance (% of GNI)	0.09	(0.37)
Education (primary, secondary, post sec. non tertiary, 2010)	3.1	(4.0)			

Better life index: *www.oecdbetterlifeindex.org*

* Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

Executive summary

- *Main findings*
- *Key recommendations*

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Main findings

Slovakia's dynamic growth has depended mainly on export-oriented manufacturing FDI, located largely in western Slovakia; the central and eastern part of the country is lagging behind. Government debt has risen sharply since the 2009 global crisis and is now running into constitutional debt ceilings. Indeed, it is too high to allow automatic stabilisers to work. The short-term economic recovery will depend on the improvement of euro area confidence, which will be necessary to finance investments in a context of fiscal restraint. In the longer term, structural reforms in the public sector and to raise growth in the lagging regions will be needed.

Continuing and refining fiscal consolidation. Strong fiscal consolidation contributed to confidence financial markets have in Slovakia. However, it has also undercut domestic drivers of growth, in particular as public investment spending has fallen and tax rates have risen. The efficiency of revenue collection has risen, but can be improved further. Revenues depend too much on wage-related social security contributions, while the share of taxes on environmental consumption and property is low. Constitutional fiscal rules are beginning to bind at the central level, and fiscal restrictions will soon extend to the regions as well. One-off measures have contributed less than initially planned to fiscal consolidation. Structural measures are needed to restore the longer-term sustainability of government operations in a growth and equity friendly way.

Reforming the public sector. Slovakia is underperforming in terms of public sector efficiency which reduces the room of manoeuvre for both ensuring fiscal consolidation and financing growth-friendly measures. The public sector lags behind on the application of e-government and e-procurement. Practiced human resource management has resulted in high turnover of staff. The regulatory framework and judicial system remain insufficiently supportive of business activity and perceived corruption is an impediment to growth. The efficiency of public spending and the absorption of EU funds both suffer from a lack of systematic evaluation and co-ordination between ministries, cumbersome procedures and weak administrative capacity. Public-Private Partnerships had to be cancelled because of non-transparent procedures and high financing costs. Strong centralisation has weakened the incentives for efficiency at the subnational level (which is responsible for 60% of public investment), and many municipalities are too small to efficiently provide public services.

Spurring growth in lagging regions. Regional inequality is among the highest in the OECD. Skills shortages in the Bratislava region persist alongside skills mismatches and uneven availability of technological and human resources in the central and eastern regions. Inadequate transport infrastructure raises costs for those who might establish firms in the lagging regions. The mobility of low skilled unemployed is hampered by the lack of affordable housing where the jobs are and the lack of prioritisation of active labour market policies. At the same time, regional job creation may be hindered by the weak response of local labour costs to local labour market outcomes. The school-to-work transition is weak and vocational education does not provide adequate skills, which is one of the main barriers to regional development. Unequal educational opportunities, in particular for the Roma population, also hold back inclusive growth.

Key recommendations

Continuing and refining fiscal consolidation

- Create enough room over time under the debt ceiling to allow automatic stabilisers to work.
- Implement multi-annual binding spending ceilings to reinforce budget discipline in upturns.
- Continue strengthening revenue collection, and increase taxation on property and environmentally harmful activities.

Reforming the public sector

- Establish better human resource management, modernise public administration and strengthen horizontal and vertical co-ordination and collaboration across government.
- Reduce regulation in professional services and retail trade, strengthen regulatory impact assessment.
- Strengthen the efficiency and independence of the judicial system.
- Ensure that public procurement achieves the best value for money and continue with measures fighting corruption, *inter alia* by guaranteeing better transparency.
- Streamline administrative procedures and strengthen capacities to manage EU funds.
- Provide the poorer regions with a higher share of EU funds and a stronger role in the design of programmes. Build capacity for more evidence-based decision making.
- Encourage joint public service delivery for small municipalities and strengthen the revenue raising power and spending responsibility of viable local governments.

Spurring growth in lagging regions

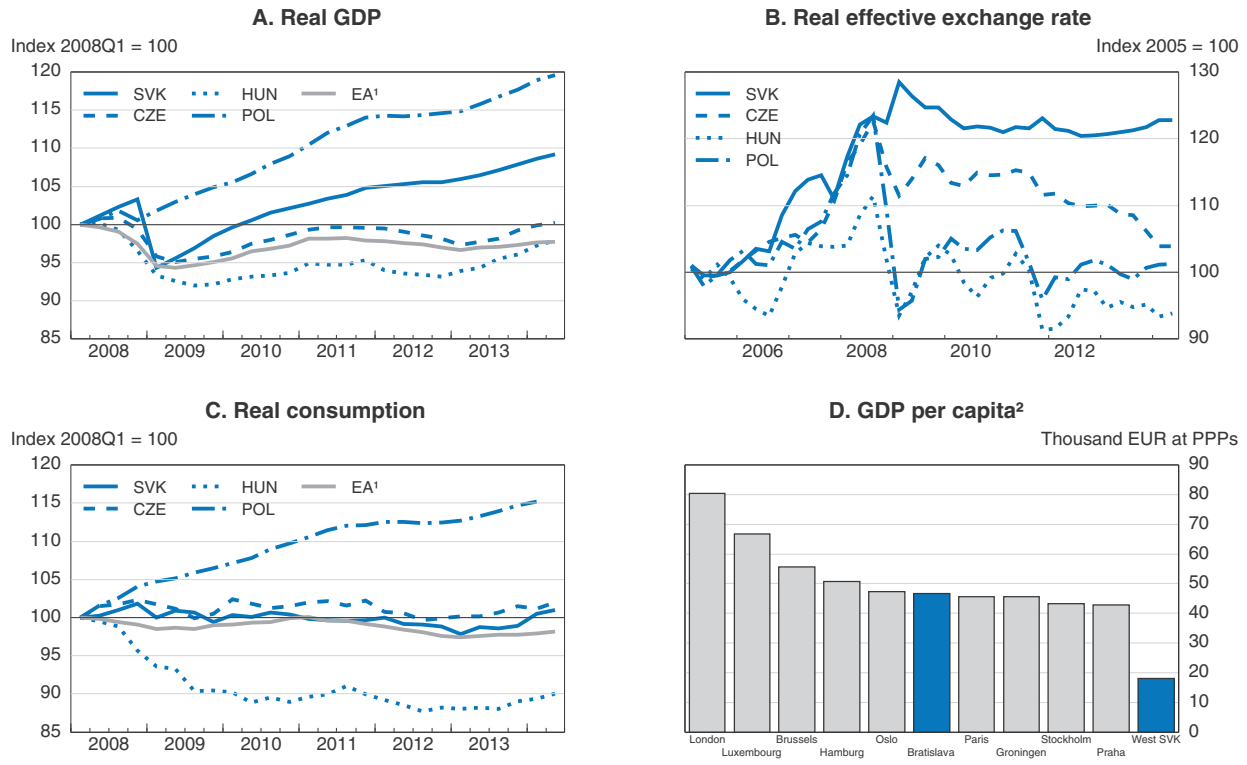
- Develop professional tertiary education and support for co-operation with employers.
- Provide financial incentives for adopting new technology and innovation spending.
- Improve national road and rail transport infrastructure and international connections.
- To develop the rental housing market, phase out support to home ownership and expand means-tested rental housing allowances.
- Develop training as well as job-search support and phase out public works programmes.
- Make sure minimum wages and legal extension are implemented without damaging employment prospects, especially in lagging regions.
- Implement a dual vocational education and training system and give specific attention to school-to-job transition in eastern regions.
- Develop the provision and quality of early childhood education and ensure wide access to low socio-economic background children, especially Roma children.

Assessment and recommendations

- *Short-term economic performance and fiscal policy*
- *Long term growth challenges*
- *Reforming the public sector*
- *Spurring growth in lagging regions*

Slovakia recovered relatively swiftly from the 2009 global crisis (Figure 1, Panel A) and the financial sector is robust (IMF, 2013a). GDP has surpassed the pre-crisis peak by more than any other European country that had a recession in the wake of the global financial crisis. High productivity gains combined with wage moderation helped to restore competitiveness by bringing back the real exchange rate to the pre-crisis level (Figure 1, Panel B), although export growth is still very dependent on the situation in automotive and consumer electronics sectors, and competition from neighbouring countries has become fiercer (Fidrmuc and Wörgötter, 2013). Job creation has been low in the wake of internal devaluation; unemployment rates are staying high. The weak labour market has resulted in sluggish growth of household disposable income and private consumption (Figure 1, Panel C).

Figure 1. **Main growth and inequality challenges in Slovakia**



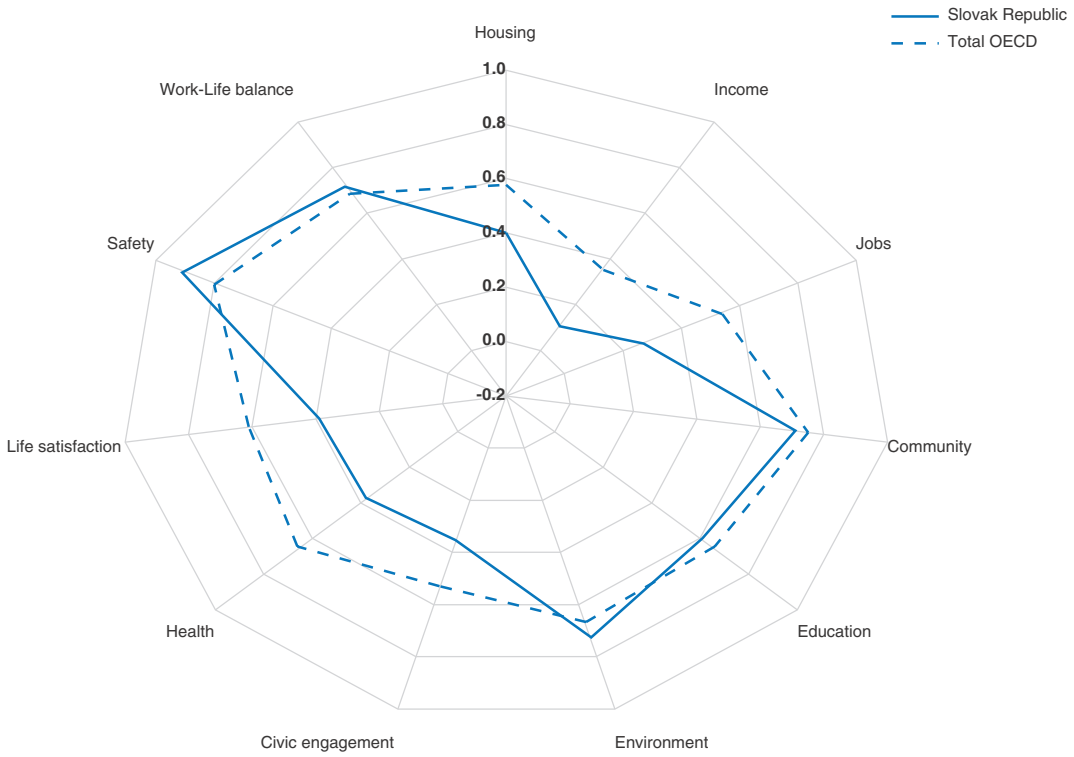
1. OECD euro area of fifteen.
2. The ten most economically active regions in the EU. The region of Western Slovakia (without Bratislava) is ranked at 239th. These statistics are not adjusted for commuting and administrative allocation of economic activities to headquarters.

Source: OECD Economic Outlook Database, OECD National Accounts Database and Eurostat.

StatLink http://dx.doi.org/10.1787/888933153728

The Slovak success story has benefited mainly the western part of the country. GDP per capita in Bratislava is the 6th highest among 272 regions in the EU28 (Figure 1, Panel D), although the country as a whole ranks only 20th out of 28 EU countries. Attracting more economic activity to the lagging regions and removing impediments to those who wish to move to regions where job opportunities are available will require a comprehensive reform effort, which includes better access to public services provided by a modernised administration (Chapter 1) and measures to improve mobility and the capacity of lagging regions to adopt new technologies and attract new investment (Chapter 2). Beyond GDP per capita, providing better jobs, income, housing and educational opportunities, especially in the east, would contribute to improve well-being outcomes which are currently relatively poor in Slovakia (Figure 2).

Figure 2. **Slovakia performs relatively poorly in most measures of material well-being**[1]



1. Each well-being dimension is measured by one to three indicators from the OECD Better Life Indicator set. Indicators are normalised to range between 1 (best) and 0 according to the following formula: *(indicator value-minimum value)/(maximum value/minimum value)*. Each well-being dimension is measured by one to three indicators from the OECD Better Life Indicator set.

Source: OECD Better Life Index Database.

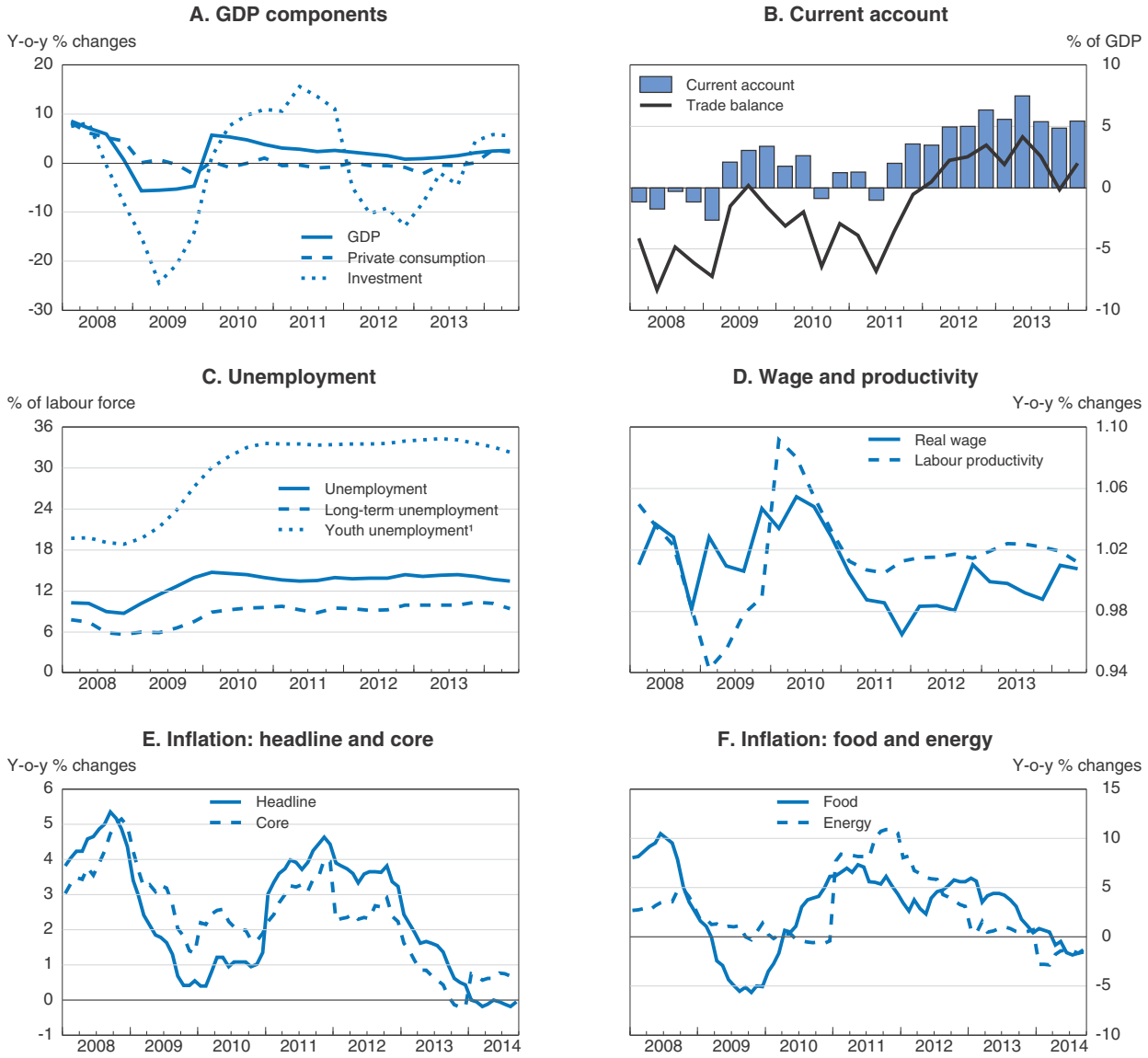
StatLink http://dx.doi.org/10.1787/888933153731

Short term economic challenges and fiscal policy

Short-term economic challenges

In 2013, GDP growth slowed to just 1%, due to weak export market growth, a decline in investment following the completion of large projects in the automotive industry, and a decline in local government investment (Figure 3, Panels A and B). An improved but still sluggish labour market and higher real wages (mainly due to lower than expected inflation), have led to a fragile upturn in private consumption (Figure 3, Panels A, C and D).

Figure 3. **Main short-medium term economic indicators**



1. Persons aged 15 to 24 years. Four-quarter moving average.

Source: OECD Economic Outlook Database, OECD National Accounts Database, OECD Main Economic Indicators Database, Statistical Office of the Slovak Republic and Eurostat.

StatLink http://dx.doi.org/10.1787/888933153742

At the same time, the deflationary episodes at the end of 2013 and during the first part of 2014 combined with the low wage growth and high unemployment rate suggest considerable economic slack (Figure 3, Panels E and F). Therefore, the accommodative monetary policy of the European Central Bank remains appropriate for Slovakia.

The economy rebounded at the end of 2013, growth has been picking up in 2014 and is projected to accelerate in 2015 and 2016. Exports should gain momentum as the European economy recovers. Investment and consumption should rise as economic confidence improves, employment increases and the pace of fiscal consolidation slows. However, prospects for large greenfield FDI will be limited by competition from neighbouring countries with lower labour

Table 1. **Macroeconomic indicators and projections**

Annual percentage change, volume (2008 prices)

	2011 Current prices (EUR billion)	2012	2013	2014	2015	2016
Gross domestic product (GDP)	70	1.6	1.4	2.6	2.8	3.4
Private consumption	40	-0.4	-0.7	2.7	2.5	2.5
Government consumption	13	-2.0	2.4	2.0	-2.2	0.7
Gross fixed capital formation	17	-9.3	-2.7	3.9	3.5	3.9
Housing	2	0.1	-7.9	0.8	0.3	3.6
Final domestic demand	70	-2.9	-0.6	2.8	1.8	2.5
Stockbuilding[1]	1	-1.3	0.5	0.5	0.0	0.0
Total domestic demand	71	-4.2	0.0	3.5	1.8	2.5
Exports of goods and services	60	9.3	5.2	5.2	5.0	6.2
Imports of goods and services	60	2.6	3.8	5.3	4.1	5.3
Net exports[1]	-1	5.8	1.4	0.1	1.0	1.0
Other indicators (growth rates, unless specified)						
Potential GDP	..	2.6	2.6	2.7	2.9	3.2
Output gap[2]	..	0.1	-1.1	-1.2	-1.4	-1.2
Employment	..	0.5	0.0	1.0	0.6	0.6
Unemployment rate[3]	..	14.0	14.2	13.4	12.8	12.2
GDP deflator	..	1.3	0.5	-0.5	0.9	1.2
Harmonised index of consumer prices	..	3.7	1.5	0.0	1.2	1.6
Core harmonised index of consumer prices	..	3.0	1.4	0.6	1.3	1.6
Household saving ratio, net[4]	..	3.0	2.1	2.5	2.4	2.4
Current account balance[5]	..	2.2	2.1	0.9	1.2	1.7
General government financial balance[5]	..	-4.4	-2.7	-2.7	-2.6	-2.0
Underlying government financial balance[2]	..	-4.7	-3.0	-2.8	-2.2	-1.6
Underlying government primary balance[2]	..	-3.1	-1.3	-1.2	-0.7	-0.2
Government gross debt (Maastricht)[5]	30	51.9	54.3	54.2	55.7	56.5
Government gross debt[5]	33	56.0	58.7	58.6	60.2	60.9
Government net debt[5]	18	25.1	27.8	30.0	31.5	32.0
Three-month money market rate, average	..	0.6	0.2	0.2	0.1	0.1
Ten-year government bond yield, average	..	4.6	3.2	2.2	1.7	1.7

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of the labour force.
4. As a percentage of household disposable income.
5. As a percentage of GDP.

Source: OECD Economic Outlook 95 Database; OECD calculations; and secretariat projections.

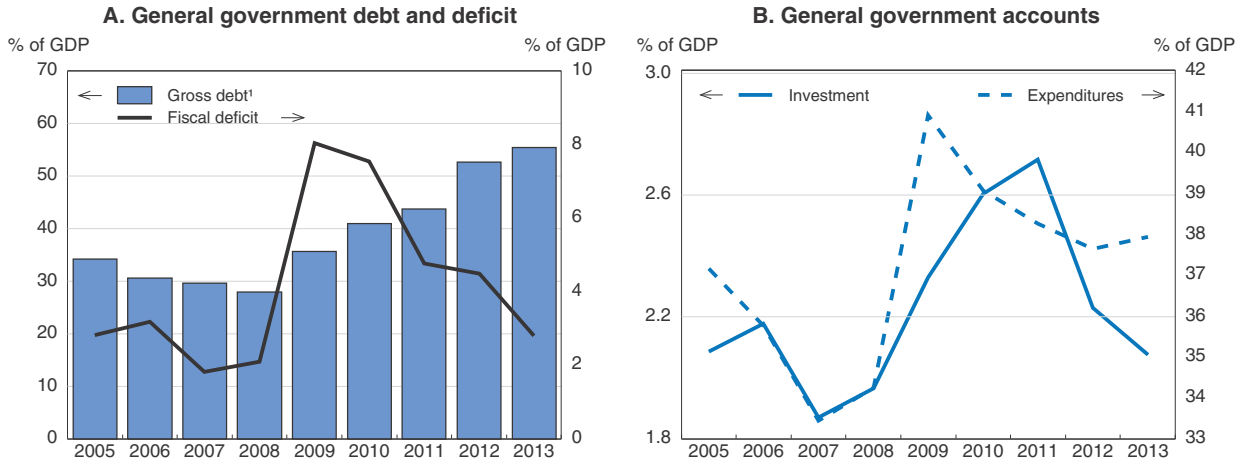
costs. The fiscal deficit will continue to narrow thanks to higher revenues. The debt-to-GDP ratio is projected to remain above the constitutional debt ceiling of 55% of GDP over the projection period, but to stand below the 57% debt ceiling (based on Maastricht definition).

Economic recovery could be delayed if economic growth in the euro area, in particular in Germany, turns out to be lower than expected, or if knock-on effects of events in Ukraine are larger. The high share of domestic government bonds held by the banking sector could be a concern, as it may lead to a negative feedback loop between sovereign and financial sector risks. However, the favourable ranking of Slovak sovereign debt does not make the materialisation of this risk likely. A more evident risks stems from the negative debt dynamics generated by high historical interest rates and low nominal GDP growth in a persistent low inflation environment. On the upside, steps towards a banking union in the euro area, especially if it includes a fiscal backstop, would reduce uncertainty.

Continuing and refining fiscal consolidation

The fiscal position has improved significantly in recent years, with the deficit declining from 8% in 2010 to 2.8% in 2013. This allowed the country to exit from the Excessive Deficit Procedure in 2014 (Figure 4, Panel A), and increased confidence of international financial markets in Slovakia's prospects.

Figure 4. **General government expenditure**



1. Maastricht definition.
Source: OECD Economic Outlook Database.

StatLink http://dx.doi.org/10.1787/888933153754

However, reducing the deficit further might prove challenging, as the ongoing decline in public investment is not sustainable (see Figure 4, Panel B) and in 2014 one-off measures will play a weaker role than initially planned (SP, 2014; EC, 2014a). The quality of consolidation could be improved if specific measures were linked to structural reforms.

Fiscal consolidation can be done in ways which limit its negative impact on growth and equity (Cournede and Pina, 2013). Slovakia implemented tax reforms in 2013 that replaced the flat income tax with a progressive one, which should promote greater equity; and phasing out lower taxation of the self-employed should reduce tax avoidance. On the other hand, the increase in corporate income taxes is likely to prove harmful to growth (Arnold et al., 2011). The authorities should instead increase the currently low taxes on property, increase taxation of and reduce subsidies to environmentally harmful activities (see below). Finally, there is room to increase the efficiency of tax collection and the public sector (Chapter 1).

The fiscal framework is sound and has been strengthened by the establishment of an independent fiscal council, national debt rules and transparent budget rules with broad political support (CBR, 2013). Expenditures ceilings were established in 2013. Expenditure ceilings are generally designed to restrain expenditure increases in boom periods and to allow the automatic stabilisers to work in downturns. However, in Slovakia they are not binding instruments but are triggered only in case of a significant deviation from the medium-term objectives (MTO) or the correction path towards it. This design reduces the constraints imposed on expenditures in good times, when such ceiling is likely to make the most for fiscal consolidation. Another area of reform is to make budgetary targets binding on a multi-annual basis while they are currently binding only for the first year of the budget, the two following years being indicative.

The debt rules are an important driver of fiscal consolidation, together with the excessive deficit procedure (EDP) set out by the EC in 2009. However, they can be pro-cyclical once debt exceeds 50% of GDP. The accumulation of cash reserves and European obligations pushed up gross debt to an extent not foreseen at the time of the introduction of the debt ceilings (Box 1). A debate is ongoing about the appropriateness of the gross debt concept. Under current rules, the medium-term solution is to gradually reduce the debt-GDP ratio well below the point at which the ceiling becomes binding and allowing automatic stabilisers to work. Continuing consolidation in line with the MTO of a 0.5% of GDP structural deficit by 2017 would be consistent with such a strategy. However, binding ceilings may generate incentives to expand off-budget measures, notably public-private partnerships (PPP) project (Debrun et al., 2008). The solution is to guarantee fiscal transparency and following best practices identified in OECD guidelines on PPP projects (OECD, 2012a).

Box 1. **Constitutional national debt rules**

National debt rules involve escalating government actions once the debt-GDP ratio exceeds 50%.

The debt rules are based on the concept of gross debt and do not take into account government cash reserves. European obligations (under the EFSF and ESM) are accounted as part of gross debt.

Beginning with a letter to parliament explaining the overrun and laying out measures to correct, actions run through various budgeting constraints and at 60% the government must face a vote of confidence in parliament.

Between 2018 and 2028, the thresholds are to be gradually lowered by 10 pp.

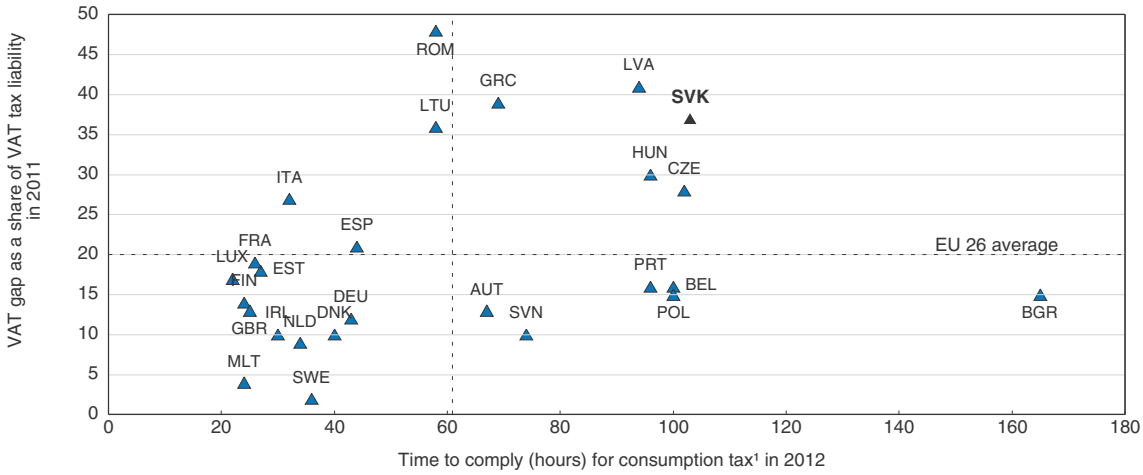
Source: OECD, 2012b.

Slovakia, like many OECD countries, will face fiscal challenges related to pensions and healthcare (EC, 2013a; de la Maisonneuve and Oliveira Martins, 2013). A general pension reform adopted in 2012 and a pension reform of the armed forces in 2013 improved long-term sustainability, notably by linking the retirement age to life expectancy. However, this may prove insufficient. The authorities should consider adapting the retirement age to the financing conditions. A sustainability factor is in place in the pension formula in several other OECD countries, like Sweden or Germany. However, in the Slovak context, reducing the replacement rate may not be desirable, as it may already be too low. Ways to increase the contribution base include raising the statutory retirement age. Furthermore, increasing the employment rate and productivity would create room for financing public pension obligations.

The costs of tax collection are one of the highest of OECD countries and are related to the declining trend in overall revenue (OECD, 2013a; 2012b). Administrative fragmentation is a longstanding problem. The implementation of an integrated tax and customs agency, which would also collect social security contributions, is therefore urgent. Furthermore, Slovakia is characterised by one of the highest VAT gaps between collected VAT and the expected amount (Figure 5). This is not due to exemptions or reduced rates, which are few, but to tax evasion and the long time required for VAT compliance.

Progress has recently been achieved adopting measures of the 2012 action plan, focusing mainly on improving VAT collection, which resulted in a decline of the VAT gap (NRP, 2014; SP, 2014). New measures include in particular the “tax cobra” scheme to fight

Figure 5. **Efficiency of tax collection is low**



1. Time taken to complete the tax compliance process of preparation, filing and payment of the consumption tax. Time is in hours per year. Consumption tax refers to value added tax or sales tax.

Source: PwC (2014), *Paying Taxes 2014*; and European Commission (2013), *Study to Quantify and Analyse the VAT Gap in the EU27 Member States*.

StatLink http://dx.doi.org/10.1787/888933153766

major fraud in co-operation with the police and prosecution services and a lottery encouraging customers to request a receipt (NRP, 2014). Efforts should be continued by implementing the third stage of the action plan aimed at improving tax collection, in particular through a better collection and centralisation of information, and the introduction of an Electronic Registry of Insolvent Entities (NRP, 2014). Progress has been made with electronic tax payments, but in other areas electronic tools to support taxpayers appear limited (OECD, 2013a).

Recommendations for continuing and refining fiscal consolidation

- Create enough room over time under the debt ceiling to allow automatic stabilisers to work.
- Implement multi-annual binding spending ceilings to reinforce budget discipline in upturns.
- Continue strengthening revenue collection, and increase taxation on property and environmentally harmful activities.

Long term growth challenges

In the years before the crisis, strong growth was driven by major export-oriented FDI inflows, mainly into the western part of the country. Estimated potential output growth fell from 5% in the years before the crisis to less than 3% since then. This decline was driven by higher unemployment and lower productivity gains, and further aggravated by widening regional differences. In this context, the government should explore the scope for additional drivers of growth, in particular moving up the value-added chain and widening the regional base for economic activity. Boosting growth requires tackling obstacles for people to move where jobs are available, stimulating innovation capabilities in weak regions, and improving transport infrastructure as well as removing barriers holding back the economy in the Bratislava region.

Increasing labour's contribution to growth

The labour market is a major weakness, and growth is hampered by poor employment prospects. Unemployment in general, for the young and the share of long term unemployed are high (Table 2). This may have long lasting effects and raise concerns about the prospects of job-searchers (Scarpetta et al., 2010). School-to-job transition is not working well and the segmented school system does hinder more youngsters to acquire employable skills (OECD, 2012b, 2007). The risk for structural unemployment is also high for low-skilled workers, whose job prospects are significantly worse than in many other countries. Unemployment is overly concentrated in the central and eastern regions (Chapter 2). Among the Roma, only 20% of men and less than 10% of women participate in the formal labour market (World Bank, 2012). Efforts to improve labour market outcomes should be stepped up, in line with recommendations made in the *2012 Economic Survey*. In particular, specific attention should be given to the provision of childcare to maintain attachment of women to the labour market, and to foster the better integration of children from families with a low socio-economic background (OECD, 2012b).

Table 2. **Labour market performance**

	Unemployment 2012, in per cent	
	Slovakia	OECD
Total (15-64)	14.0	8.1
Long term	8.9	2.7
Youth (15-24)	34.0	16.1
Women	14.6	8.2
Old (55-64)	11.2	5.7

Source: OECD Labour Market Statistics.

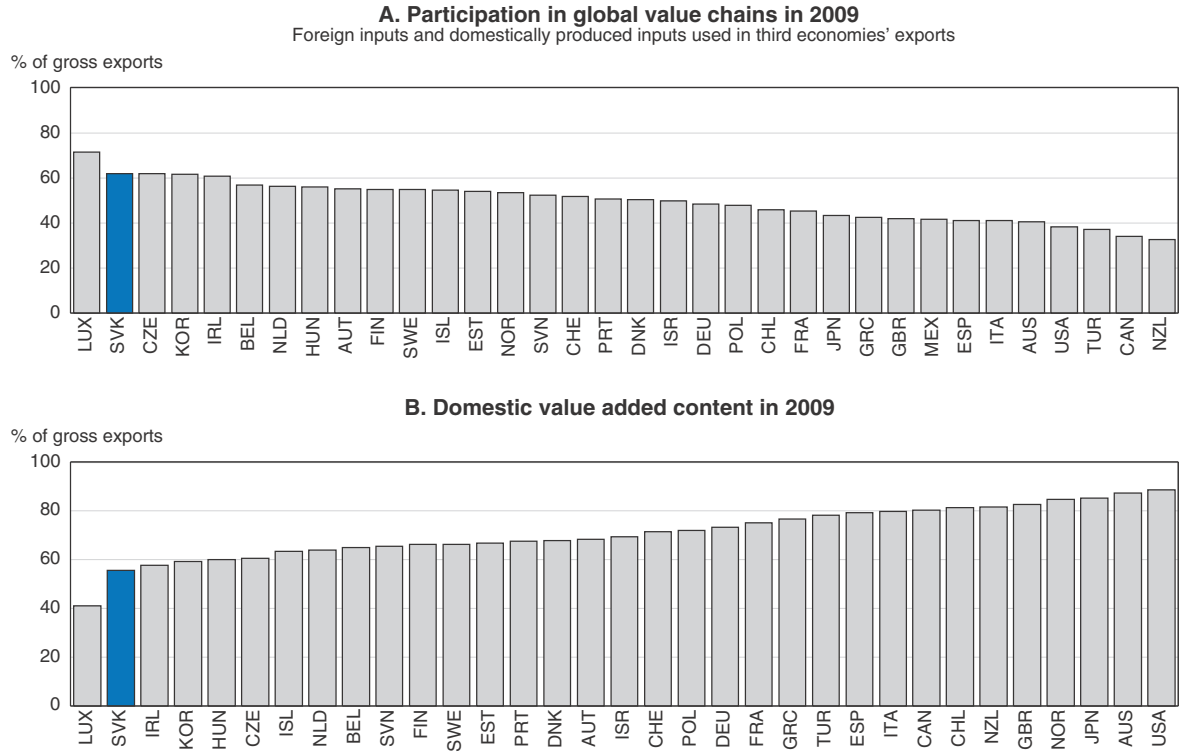
Increasing trade and innovation's contribution to growth

The rapid integration of the Slovak Republic into global value chains (GVCs) contributed to rapid economic convergence before the crisis. FDI boosted the production of exports goods and, through technological transfer, productivity growth (IMF, 2013b). However, the share of domestic value-added in exports is low, because of mainly assembly or components manufacturing (Figure 6). Indeed, the domestic content of value-added has fallen since 1995, with its deeper integration in GVCs in sectors with low domestic value-added, like transport and consumer electronics equipment (OECD, 2013b). Slovakia's position in GVCs is relatively weak because of the low input of R&D (RIS3, 2013).

Even as its role in GVC is being challenged by income convergence and fiercer cost competition from neighbouring countries, Slovakia's innovation capacity is still weak. Spending on R&D by the business sector is low (0.3% of GDP, compared with 1.6% in OECD countries). Relatively few people have tertiary education even though Slovakia is catching up (OECD, 2013c). Co-operation between firms, universities and research centres is not sufficiently developed (RIS3, 2013) and the number of innovative firms and scientific publications is relatively low (OECD, 2013d).

The recommendations from the *2009 Economic Survey* to raise innovative and adaptive capacities in Slovakia are still valid, in particular the need to improve the public support to R&D, the financing of small innovative firms through venture capital, the quality of tertiary education and the co-operation between universities, research institutes and enterprises. There is also room for enhancing competition (Chapter 1), which would boost the adoption of new technology and innovation (Bourles et al., 2013). At the same time, Slovakia's score

Figure 6. **Slovakia is specialised in low value-added manufacturing goods**



Source: OECD (2013), *Interconnected Economies: Benefiting From Global Value Chains*; OECD-WTO, *Trade in Value-Added Database* (TiVA).

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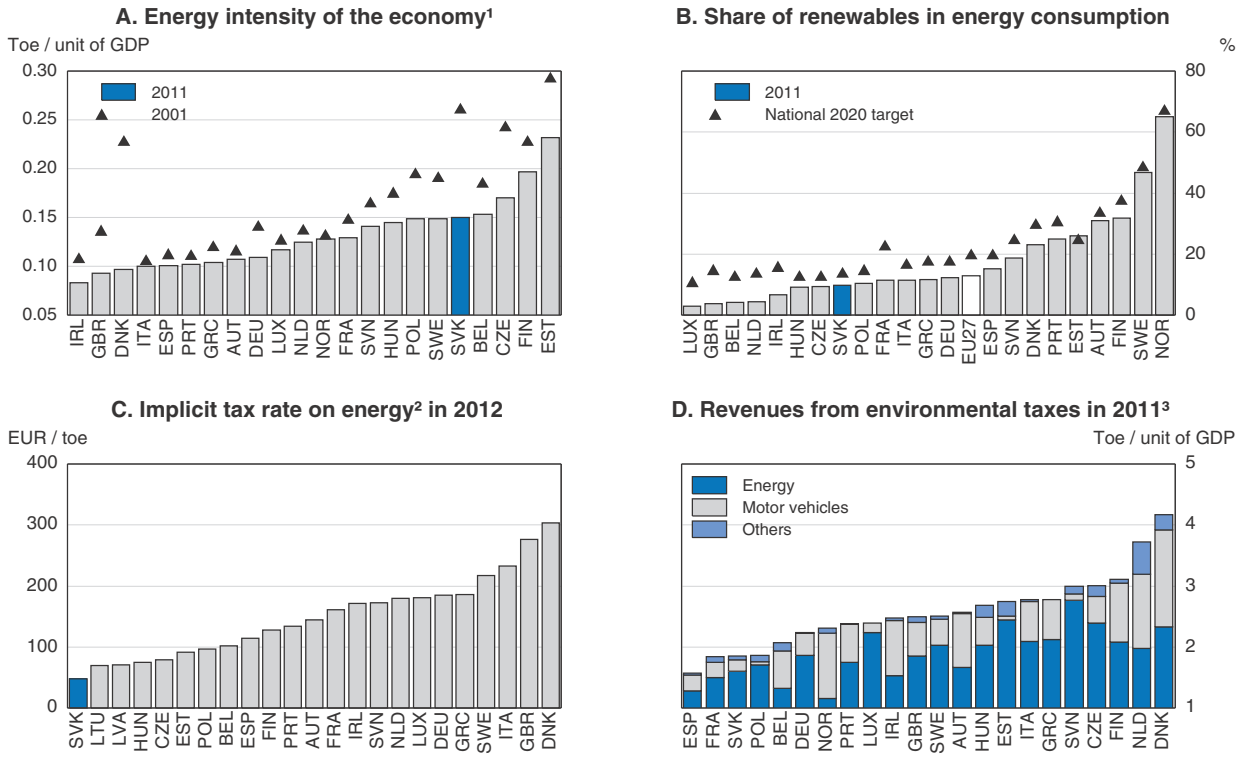
on the Services Trade Restrictiveness Index (STRI) is better than the OECD average in 14 out of 17 service sectors, pointing to the relative liberal regulatory regime applicable to foreign entry in services (OECD, 2014a).

Promoting green growth

Adopting and developing cleaner industries would support the transition towards a knowledge-based economy (OECD, 2009a). Slovakia has made substantial progress on environmental objectives over the past decade, in particular by significantly reducing greenhouse gas emissions, in line with its 8% emission reduction targets under the Kyoto Protocol's first commitment period (by 2012 from 1990 levels), thanks to changes in the energy mix, energy efficiency savings and industrial restructuring (OECD, 2011). The proportion of renewable energy sources in total primary energy supply increased, but still is below the EU average. Notwithstanding the improvement, energy intensity remains one of the highest among OECD countries, partly due to the specialisation in manufacturing (Figure 7, Panels A and B).

The implicit tax rate on energy remains the lowest in the EU, suggesting the need for further adjustment (Figure 7, Panels C and D). Subsidies to environmentally harmful economic activity (for example, electricity production from domestic coal) are slowing the adoption of cleaner technologies and encouraging unsustainable waste disposal. The authorities should reconsider environmentally harmful subsidies, and help lagging regions to cope with adverse knock-on effects. Tax exemptions, such as those on electricity consumption, also have a harmful environmental impact. Environmental taxation would

Figure 7. **Ensuring a transition towards cleaner activities**



1. Total primary energy supply (estimated for 2012) in tonnes of oil equivalent (toe) per thousand USD. GDP in constant prices and purchasing power parities.
2. Implicit tax rate is defined as the ratio between energy tax revenues (deflated euro) and final energy consumption (toe).
3. Data for Poland refer to 2010.

Sources: OECD/EEA, *Database on Environmental Policy Instruments*; WHO (2013), *Global Health Observatory Data Repository*; IEA (2013), *Energy Balances of OECD Countries 2013*; International Energy Agency, *OECD Environment Database* and Eurostat.

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also be improved by introducing a carbon tax in sectors not covered by EU ETS (e.g. households) and by adding an environmental dimension to the motor vehicle tax, such as air pollution or energy consumption.

Reforming the public sector

Strengthening the efficiency and effectiveness of public sector spending is essential in the context of fiscal constraints on the one hand, and the need to protect growth and equity enhancing spending on the other (Chapter 1; OECD, 2012b). Modernising and improving public administration, reducing red tape, better absorbing EU funds, and refining the devolution of responsibilities are interrelated priorities. Sequencing will be important for the effectiveness of this comprehensive reform effort, and therefore the government should put an initial emphasis on human resource management reform and the improvement of administrative capacity.

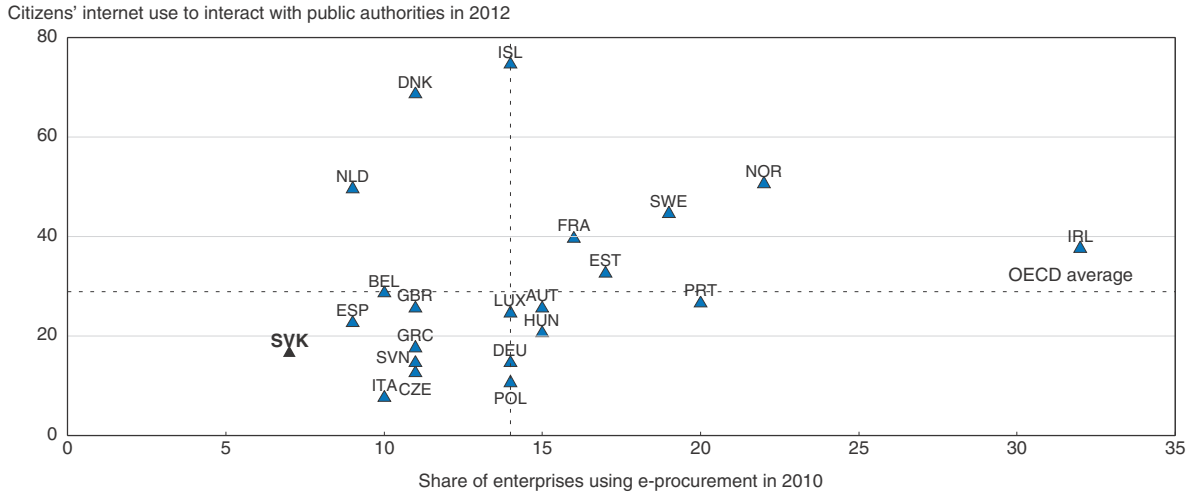
Strengthening public administration efficiency and effectiveness

Seeking efficiency across all categories of spending is essential to make the most of available resources and to avoid cutting needed services and growth enhancing spending. A comprehensive and ambitious programme to address this issue is underway, notably

through the ESO ("Effective, Reliable and Open Administration") programme which is aimed at streamlining state administration, strengthening capacities and modernising the public sector. Monitoring, evaluating and audit functions, including *ex post* evaluation, could be strengthened further by focusing more on outcomes, rather than inputs, and by tracking policy achievements. The lack of co-ordination and collaboration between ministries and the existence of multiple advisory bodies undermines the efficiency and effectiveness of public policy. This is particularly the case for policies to tackle regional disparities, as they require collaboration both within the central government and across levels of government.

Expanding the use of e-government can improve the efficiency and effectiveness of public sector service delivery. Firms and citizens do not widely use government websites to access information (Figure 8), and services, such as electronic handling of administrative procedures or e-mailing of forms, are still underdeveloped. To ensure functionality and cost efficiency, more attention needs to be paid to the capacity to exchange and interpret data. This is a prerequisite to establishing single contact points, which in turn would reduce red tape for citizens and firms. Slovakia is also lagging in the area of e-procurement that provides contract management tools and contract outcome tracking. Increasing the use of e-procurement would reduce transaction costs, enhance transparency, and reduce opportunities for corruption. On the positive side, more recently VAT payers, tax advisors and attorneys are required to communicate with the financial administration using online services.

Figure 8. **The public administration lags behind in developing e-government tools**



Source: OECD (2011, 2013), *Government at a Glance.*

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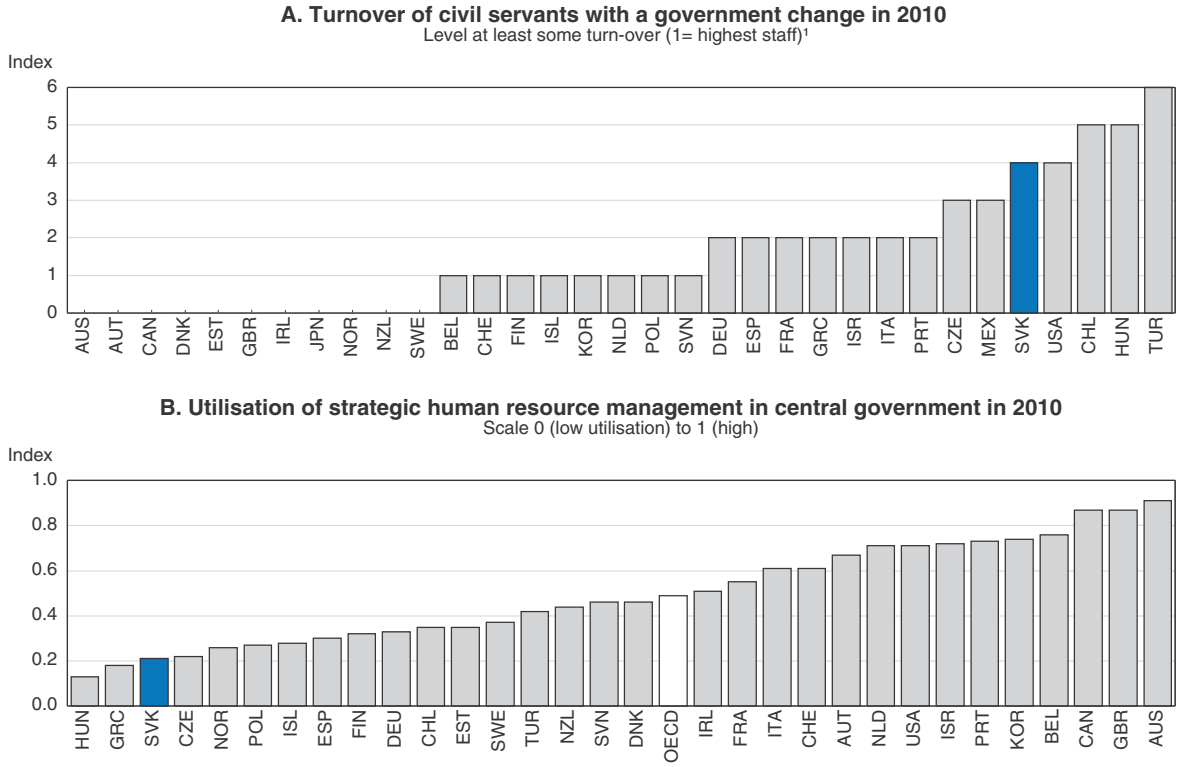
Efficiency and effectiveness of the public sector also depend on dedicated and competent civil servants. However, turnover in the Slovak public service is high (Figure 9, Panel A). For example, in the Slovak Government Office, more than half of the staff changes after a government change (OECD, 2014b). The high turnover of civil servants at all levels and dependence on the political cycle reduce incentives to accumulate important public sector specific skills. Problems are aggravated by the poor use of strategic human resource practices, such as planning, performance assessment, and predictable career paths (Figure 9, Panel B; OECD, 2014b). Analytical capacities could be strengthened by disconnecting further the career of the majority of civil servants from the nomination of

Figure 9. **Management of public human resource is weak**



1. The bar shows to what extent there is a change of positions at different levels of civil servants when the government changes. The level ranges from 1 (most senior) to 6 (lowest). In the eleven countries with no turnover a change of government does not directly affect the employment of staff of public servants. The exception is a small number of public servants employed on a contract, which terminates when the relevant Minister leaves the office. Data for Luxembourg does not exist. Data on turnover in level 5 and/or 6 are not available for Czech Republic, Hungary, Israel, Portugal, Spain and United States.

Source: OECD (2011), *Government at a Glance*.

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high level political appointees. Steps have been taken by centralising some responsibilities for co-ordinating human resource policies at the end of 2013. A new civil service law is also being prepared to enhance the stability, professionalism, and neutrality.

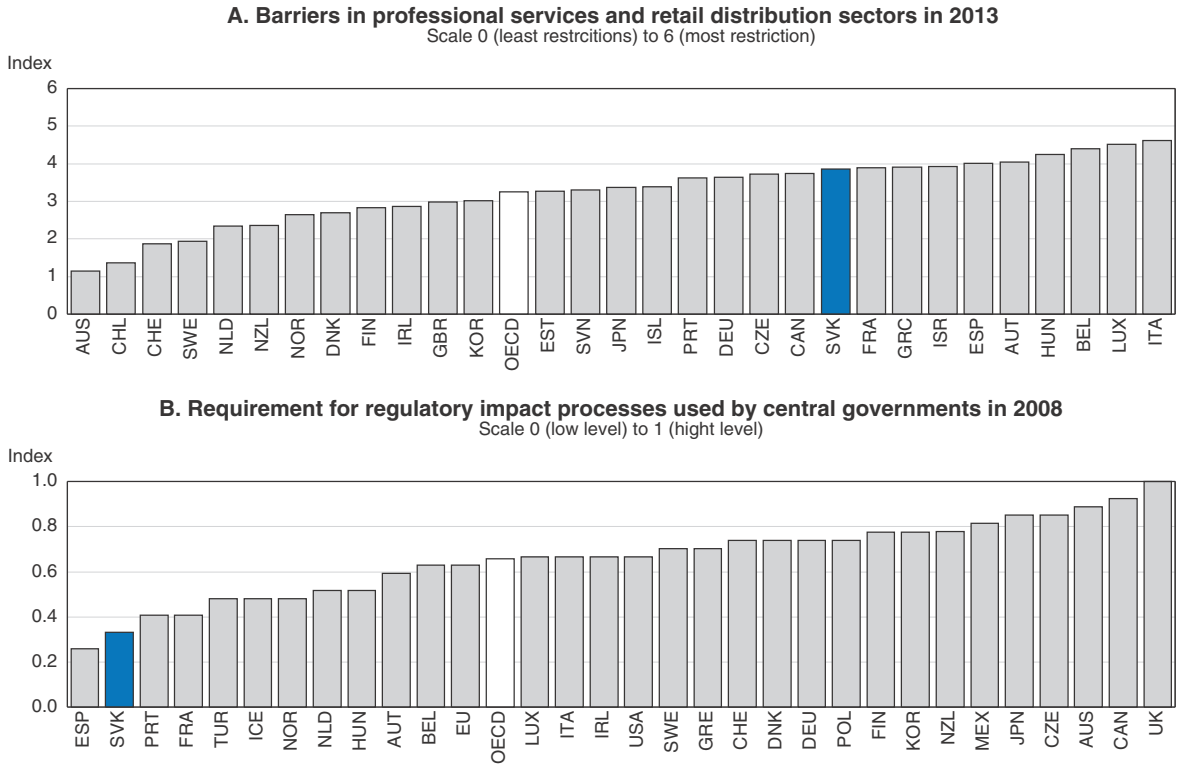
Around 86% of respondents in Slovakia believe corruption exists within public institutions – well above the European average (EC, 2013b; EC, 2014b). Slovakia is also among the worst OECD performers in the 2013 Transparency International Corruption Perception Index. Corruption undermines trust in the government and reduces the cost-efficiency of public services. A comprehensive strategic plan of fighting corruption was adopted by the government in August 2011. Most progress was achieved by establishing clear criteria for issuing licences, permits, loans and state subsidies. In some areas, however, progress has been mixed. For example, the application of the code of ethics for civil servants, adopted in April 2013, is still incomplete, and a draft law on criminal liability of legal persons is still not finalised.

Reducing administrative burdens in competition and judicial frameworks

From 2008 to 2013, Slovakia was among five OECD countries that made the greatest progress in reducing overall regulatory restrictiveness, in particular regarding the removal of barriers to entrepreneurship (OECD, 2013e). Slovak authorities introduced a "silence is consent" procedure, which significantly simplifies the process of opening and operating a business, and created a single internet contact point to handle all the notifications and licenses.

On the other hand, government regulation in the services sector, particularly for professional services, and in the retail sector remains among the most restrictive among OECD countries (Figure 10, Panel A). For instance, competition in the retail sector is limited by the maximum limit allowed on the value of the discount for products, the number of years of relevant compulsory practice for legal profession had increased from 3 to 5 years, and the regulation of prices in telecommunication sector remains tight (OECD, 2013e). The state also directly controls a number of sectors, including electricity, gas and railways, and the pace of privatisation has slowed. Growth could be strengthened by resuming the privatisation process of remaining public stakes in network industries, strengthening the transparency of regulatory policy in the energy sector, reinforcing competition in the retail sector, and abolishing compulsory chamber membership for professional services while maintaining required standards of professional qualifications.

Figure 10. **There is room to improve the business environment**



Source: OECD (2013), *Product Market Regulation Database*; OECD (2009), *Government at a Glance*.

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Regulatory impact assessment (RIA) is essential to avoid negative side effects, notably on the business environment. RIA provides a comprehensive framework in which policy makers can assess the consequences of reform (OECD, 2008a). Such tool, used in several OECD countries, has been introduced in 2008 and amended in 2010, when an obligation to provide information of impacts on five areas (business environment, public finance, social area, environment and information society/e-government) has been established. The authorities are aware of the importance of such a tool. Planned reforms require an obligation to consult affected entities and to identify alternative solutions (NRP, 2014). This opportunity to strengthen the analytical framework is welcome, as assessments are currently very general and not systematically based on robust analysis. There is also still room for improving RIA

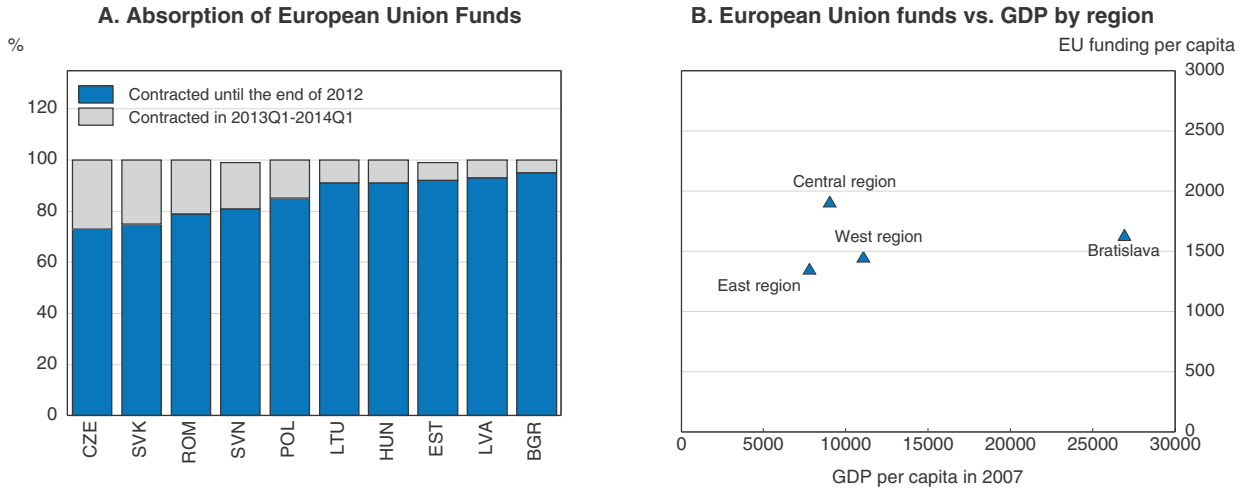
earlier in the process and for strengthening independent quality control mechanisms (see Figure 10, Panel B; OECD, 2014b). Communicating the results of RIA is also essential for improving regulatory design (OECD, 2008a). The authorities could consider establishing an experts group, which would provide statements on the quality of the assessment, as is the case in several countries. Finally, RIA should be the responsibility of a single central institution which should play a leading role in the implementation of policies concerning the co-ordination between ministries, the quality control of assessment, the choice of a unified methodology and the implementation of training and assistance to line ministries.

A slow, burdensome and uneven judicial process also hinders business activity. The cost of a trial as a percentage of the value of the claim is among the highest in the OECD and the four years needed to resolve a bankruptcy procedure is the highest among EU countries (EU, 2014). Judicial independence is also critical, by assuring the predictability, fairness and stability of the legal system. However, employers do not perceive the judiciary system as being independent (EU, 2014b). The authorities plan several reforms, including the enforcement of court decisions. They should take this opportunity to increase the capacity of the system, including by raising investments in computerisation (among the lowest in the OECD), adopting more advanced case flow management techniques and using more specialised courts (OECD, 2014c).

Tackling barriers and inefficiencies to make the most of EU funds

EU structural and cohesion funds (hereafter structural funds) have been an important source for public spending: over the 2007-13 programming period, Slovakia received EUR 11.6 billion with three-quarters of the funds spent at the regional level. This amount is equivalent to the level of public investment realised over the same period. However, Slovakia absorbed all the funds only thanks to the surge in contracting during the last quarters; and at the end of 2012, Slovakia's contracting rate at 73% was the second-lowest among CEE countries (Figure 11, Panel A). While such surge is not atypical, it might have reduced the quality of projects.

Figure 11. **Absorption of EU funds**



Source: European Commission (2014), DG for Regional and Urban Policy, Expert Evaluation Network on the Performance of Cohesion Policy 2007-2013, Synthesis of National Reports 2013, January 2014; DG for Regional and Urban Policy, European Commission Regional Policy and Statistical Office of the Slovak Republic.

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The administration of EU structural funds is very complex, and Slovakian procedures often go beyond what is required by European institutions. A simplified cost option, enabling beneficiaries to more easily claim indirect costs, was adopted only recently and with some limitations. Limited co-ordination and collaboration across government institutions also slows the process. The ongoing development of e-government would mitigate such indirect costs. Finally, high staff turnover in the public administration reduces capacity in this complex area. Almost 18% of staff in charge of EU funds management left the public service between June 2012 and June 2013 (CKO, 2013). The organisation of seminars by managing authorities and the use of external consultants do not fully compensate this loss of capacity (CKO, 2011). The authorities should implement without delay the EU Cohesion Policy recommendations. Those recommendations are in any case part of *ex ante* conditions for the release of funds (OECD, 2014b).

Lack of transparency in project selection is another area that requires action. Allegations of corruption and conflicts of interest are frequent. Poor transparency can result in low value for money, in part because it reduces the incentive for firms to participate in the selection process (EC, 2012; CKO, 2011). Moreover, frequent complaints and allegations in the area of public procurement significantly delay implementation, as they result in annulation and re-organisation of the contracting process. Weak transparency also burdens the scope for strengthening the fight against corruption (Chapter 1). The Public Procurement Act was reformed in 2013. While the reform goes in the right direction, its implementation is not fully effective; the procedure still appears lengthy, the use of e-procurement has declined and the number of complaints about decisions made by the contracting authorities has not been reduced (EC, 2014).

Slovakia has not been successful in using EU funds to reduce regional disparities. Under the 2007-13 programme, Bratislava received in 2013 more regionally specific funds in per capita terms than the eastern region (see Figure 11, Panel B). Also, the share of funds allocated to regional operational programmes (compared with the national operational programme) is lower than in other transition countries (13% compared with 18% in the Czech Republic and 25% in Poland). In the next programming period, more focus should be devoted to narrowing regional disparities, in particular by more closely involving regional authorities in the design of programmes and by building more capacity for evidence-based decision making.

Refining decentralisation

Slovakia is a unitary country with a two-tier government structure: it is divided into 8 regions and 2 926 municipalities without hierarchical relations. In 2012, subnational government expenditures accounted for 17% of general government expenditure (OECD average of 40%). Municipalities have responsibilities for pre-school and primary education (wages and maintenance), social welfare, housing, economic development and local utilities (water, waste collection). The regions have responsibility for secondary, professional and vocational education, health, social welfare, transport and regional economic development. Education and economic affairs (including transport) are the two largest spending items for regions and municipalities (OECD, 2013f). Sub-national governments have the right to raise taxes on property (municipalities) and on vehicles (regions), but they rely heavily on transfers from the central government. Debt and borrowing of sub-national governments are constrained by debt rules (Box 2).

Municipal administration is very fragmented (OECD, 2013g). Many municipalities are too small to provide effective local services. The authorities are streamlining and centralising

Box 2. **Municipal and regional fiscal rules**

Municipalities and regional budget rules prohibit deficit financing of current spending except from own reserves. Capital spending can be financed by loans up to 60%, or debt service up to 25% of the previous year's revenues.

As debt gets high relative to the previous year's revenues, progressive sanctions are imposed: when the ratio exceeds 60%, the central government can levy a fine of 5% of the difference between the debt and 60%. Of 2 926 municipalities, 514 might fall into one of the sanction zones in 2015.

Municipalities potentially constrained by the local debt rules from 2015

	Total number of cities	Number of cities with debt > 58%	Number of cities with debt > 60%	Number of cities with debt > 60% or debt service > 25%
2012	2 926	98	89	407

Source: Act No. 583/2004 about Budgetary rules for municipalities, Act No. 493/2011 about Fiscal responsibility, INEKO Dataset.

some services in order to increase cost efficiency. Merging municipalities would be a first best option. An alternative would be to provide incentives for service provisions across municipalities allowing them to retain at least some of the efficiency gains. In a first step, the current system of joint communal offices would have to be streamlined and joint provision of services across municipalities more strictly organised.

Municipalities and regions have only a low level of fiscal autonomy. For example, property taxes, their most important tax source, provide only 11% of revenues. Property tax revenues should be increased by changing the tax base from the number of square metres to the value of the property, as considered by the authorities. This would also make it more equitable. Resistance to such a reform, especially from low income households, could be reduced by allowing financially constrained owner-occupiers to accumulate the tax arrears until the property is sold.

All grants to subnational governments are earmarked in Slovakia (i.e. tied to a specific purpose), a situation which is generally associated with low flexibility and low efficiency (Bergvall et al., 2006). Increasing the autonomy of subnational government by reducing earmarking of transfers, might increase efficiency by giving them more policy discretion to match local preferences and address local needs. For instance, in secondary education, for which regions are responsible, the flexibility in allocation of spending between schools is very low while international experience suggests that decentralisation improves educational performance as measured by PISA score (Fredriksen, 2013; Blöchliger and Egert, 2013). The authorities could hence develop further the use of general-purpose grants, sometimes tied to more results-based regulation, rather than specific use (OECD, 2014d).

Sub-national government revenues also tend to be pro-cyclical, as they rely mainly on shared-revenue based on personal income tax revenues, which are sensitive to the business cycle. For instance, in 2010, shared revenue declined by 14% in real terms following the financial crisis. In 2011, government proposed to base shared revenues on a mix of taxes but this project was not realised. The government should give consideration to making a new proposal in that direction.

Recommendations for reforming the public sector

For a more efficient and effective public administration and regulatory environment for doing business

- Establish better human resource management, modernise public administration and strengthen co-ordination and collaboration across government.
- Reduce regulation in professional services and retail trade, strengthen regulatory impact assessment.
- Strengthen the efficiency and independence of the judicial system.
- Ensure that public procurement achieves the best value for money and continue with measures fighting corruption, *inter alia* by guaranteeing better transparency.

For a better use of EU funds

- Streamline administrative procedures and strengthen capacities to manage EU funds.
- Provide the poorer regions with a higher share of EU funds and stronger role in the design of programmes. Build adequate capacity for more evidence-based decision making.

For better local services delivery

- Encourage joint public service delivery for small municipalities and strengthen the revenue raising power and spending responsibility of viable local governments.

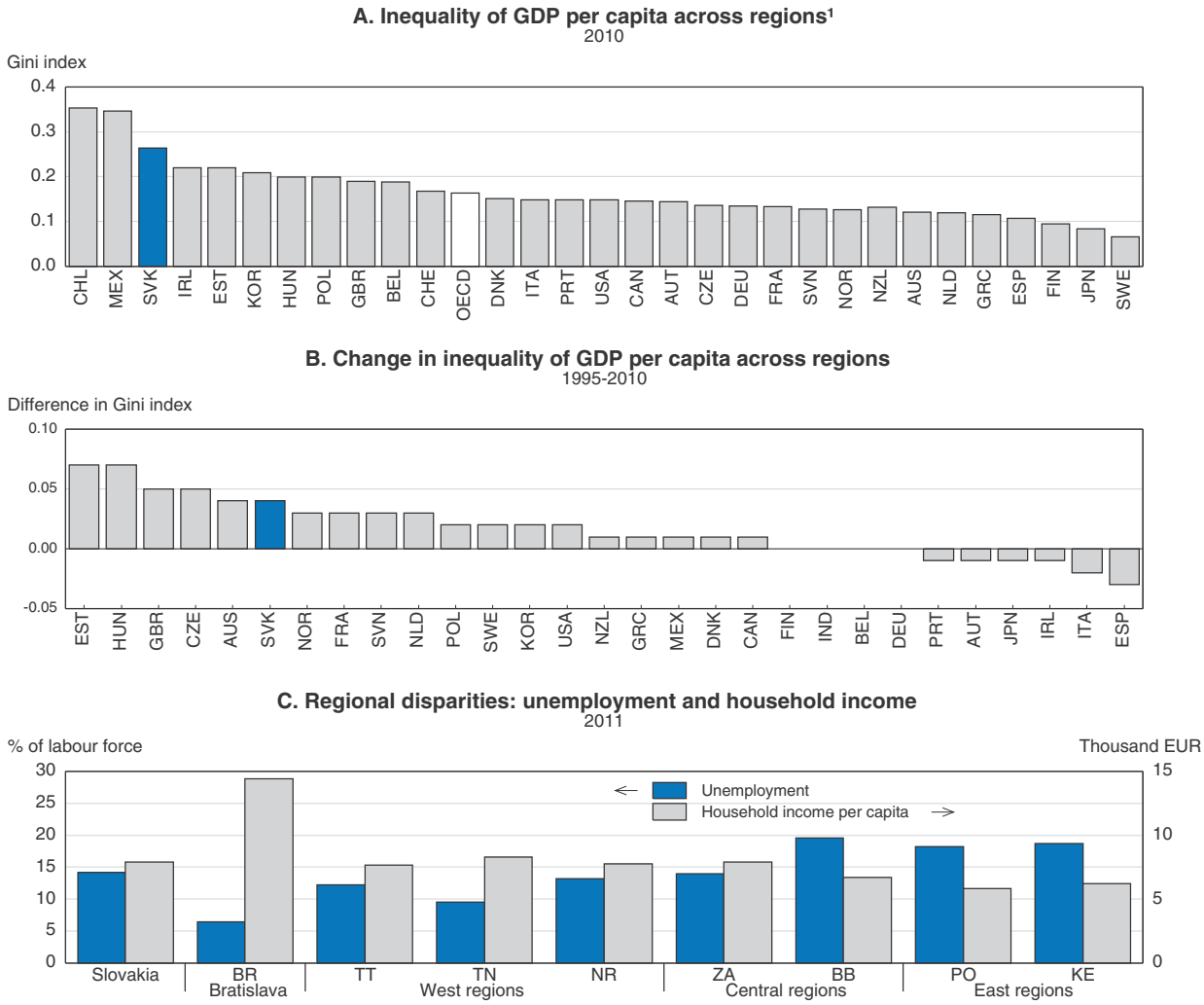
Spurring growth in lagging regions

Regional inequality is one of the highest among OECD countries and is increasing (Figure 12, Panels A and B). Regions can be divided into two broad groups: more developed western regions (Bratislava, Trnava, Trenčín, Nitra), and lagging central and eastern regions (Žilina, Banská Bystrica, Prešov, Košice). Regional differences in household income and unemployment are also high (Figure 12, Panel C). Poverty risks and benefit dependency are over-represented in the east and centre of the country.

The main reason for the significant regional disparity is the combination of low job creation in the east and central part of the country and insufficient labour mobility to the west, in particular from low-skilled workers. Increasing growth in the central and eastern regions would address the jobs shortage. Greater mobility would reduce the over-supply of labour in the lagging regions and ease some shortages in Bratislava, which is still a relatively small urban area (ranked 204 out of 275 OECD metropolitan areas in terms of population; OECD, 2013g), with high potential productivity gains linked to metropolisation (Ahrend et al., 2014). Completing the transport infrastructure network in Slovakia will be both important for both removing expansion bottlenecks in the Bratislava region and reducing obstacles for job creation in the central and eastern regions. Experiences from case studies also suggest the following lessons (OECD, 2012c):

- Growth potential in less-developed regions is high, in particular in rural regions which enjoyed, on average, faster growth than intermediate or predominantly urban regions.
- Establishing a pro-growth framework, rather than a subsidy-based policy stance, is the most beneficial and sustainable approach. It can prevent transfer dependency and rent-seeking.
- Policy packages have more impact than individual policy measures because they exploit complementarities and co-ordination across related domains.

Figure 12. **Regional disparity is high and increasing**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Regions of the OECD countries are classified according to two territorial levels: the high level (TL2) and the low level (TL3). Regions at TL2 are divided into smaller regions at TL3. TL3 level data are used except for Australia, Canada, Chile, Mexico and United States.

Source: OECD (2013), *Regions at a Glance* and Statistical Office of the Slovak Republic.

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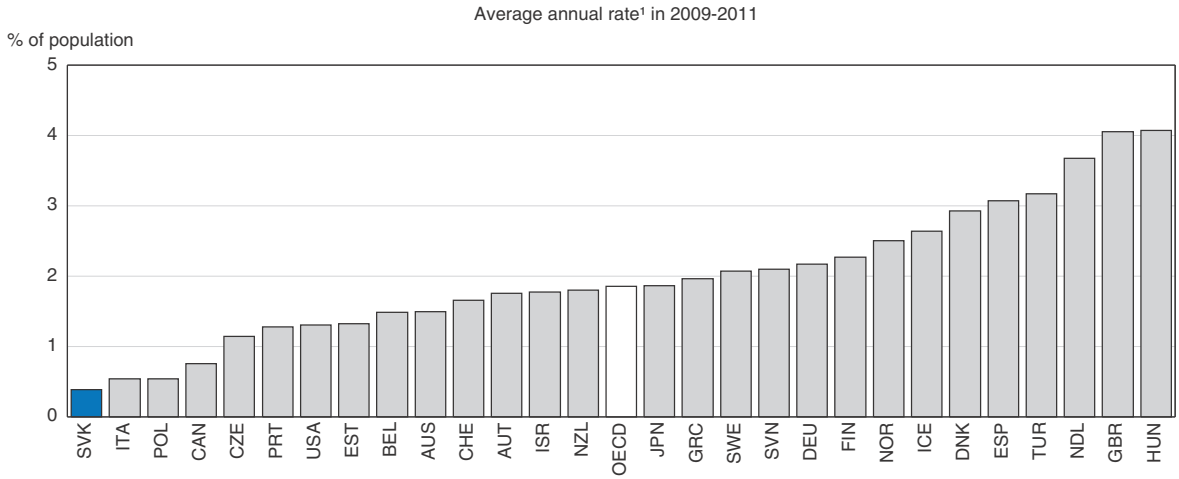
- Institutions that strengthen the region's "voice" are key to developing co-operation with other regions and countries and to creating links among the private, public and education sectors.
- Up-skilling low-skilled workers may be as important for growth as to expand higher education.
- Infrastructure can be important if investment is co-ordinated with other policies.

Strengthening labour mobility by better housing policies

Mobility of workers is low and does not respond to regional disparities in unemployment, contrary to what is suggested by international experience (Figure 13; Fidrmuc, 2004). Only 1.6% of Slovaks from age 15 to 64 moved in 2011, and of those only a quarter moved between regions

Figure 13. **Regional labour mobility is low**



1. Yearly resettlement flows of population from one TL3 region to another TL3 region (regional migration). For Australia, Canada and Israel, domestic mobility is available only across TL2 regions. Available years: Canada, Iceland, Norway and Sweden 2010-12; Germany, Netherlands and United States 2008-10; Greece only 2001; New Zealand only 2006; United Kingdom 2006-08 data do not include Scotland and Northern Ireland. Chile, France, Ireland, Korea and Mexico are not included because of missing data.

Source: OECD (2013), *Regions at a Glance*.

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(Vagac, 2013). There are also no substantial differences in mobility across age and education attainment, contrary to other OECD countries (Hüfner, 2009).

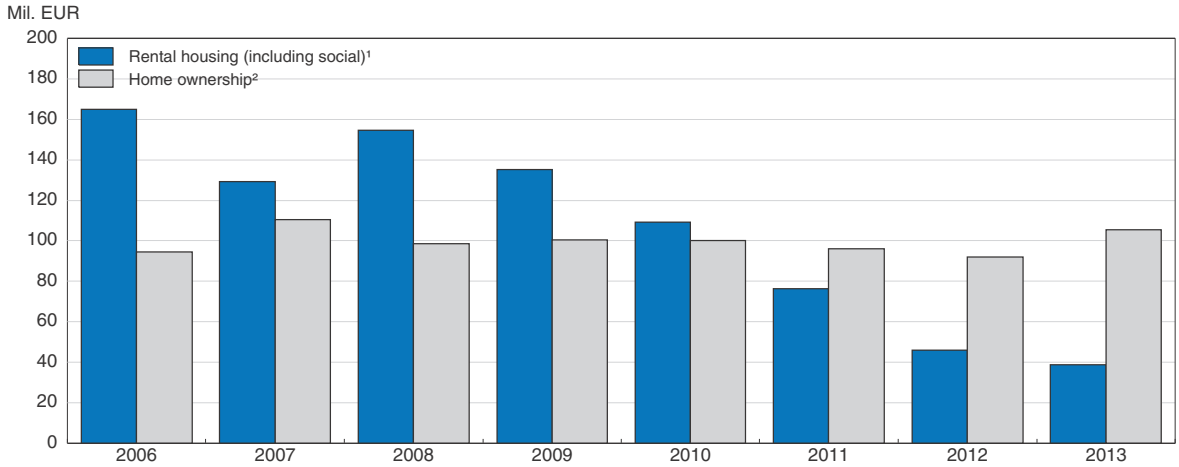
One factor hindering mobility is the lack of rental housing. Home ownership, among the highest of OECD countries – 90% of Slovaks own their home – reduces mobility due to potential capital losses (CECODHAS, 2012). Fiscal support for home ownership is higher than that for renting (Figure 14), resulting in an underdeveloped rental market. Some steps have been taken since January 2014 to promote rental housing by providing loans with subsidised interest rates to the private sector acquiring rental housing, targeted at those with low-income and in dynamic economic areas. In addition, home ownership subsidies should be reduced. A first step would be to strengthen rental demand by offering rental housing allowances to poor households. Those schemes have the advantage, compared to direct provision of social housing, of not hindering labour mobility, as allowances are not tied to a specific dwelling (ECB, 2003). Such a scheme exists in Slovakia but is only available for very poor households (those entitled to social assistance benefits). The authorities could give consideration to extending it to poor households in general, including poor workers, as done in several other countries (Andrews et al., 2011).

More balanced regulation is needed to stimulate rental housing supply. The introduction of a short term contract (2 years) in May 2014 allows parties to agree on contract termination. By contrast, permanent contracts do not offer this flexibility: landlords cannot evict a person without a court decision and must provide appropriate alternative accommodation to evicted tenants even if the reason for eviction includes serious damage of property or failure to pay rent (Vagac, 2013).

Refining and strengthening labour market policies

Active labour market policies (ALMPs) contribute to employability and mobility (OECD, 2005a). Labour market reforms were discussed in the *2012 Economic Survey*. There has been

Figure 14. **Public support is skewed to home ownership**



1. Social rental housing subsidy, substitute for rental housing and rental housing within State Housing Development Fund (SFRB).
2. State bonus, mortgage subsidy for young and housing ownership within SFRB.

Source: OECD calculations based on the data from the Ministry of Finance of the Slovak Republic.

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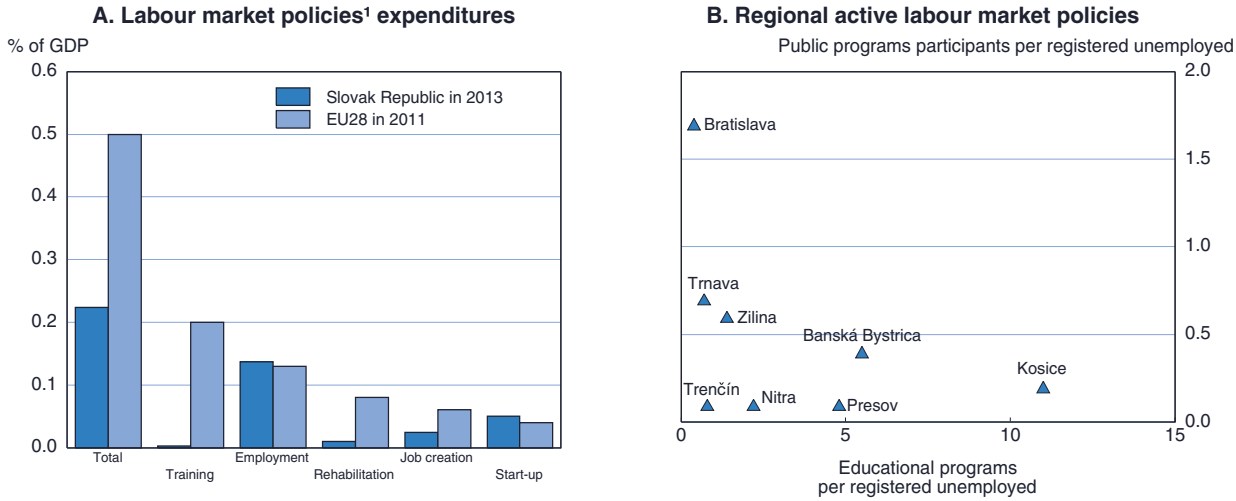
progress, but there is still scope to increase the spending on ALMPs, to improve placement services, to better target programmes on the most vulnerable and to redesign programmes (Figure 15, Panel A; OECD, 2012b). In addition, labour market policies should be further adapted to local needs given the wide heterogeneity of employment performance across regions. Programmes that improve mobility and low-skilled labour market outcomes should be strengthened, in particular in the east and central parts of the country.

Figure 15. **Active labour market policies need to be refined to strengthen mobility**



1. Total LMP measures and Training, Employment incentives, Supported employment and rehabilitation, Direct job creation and Start-up incentives.

Source: Eurostat and Central Office of Labour, Social Affairs and Family of the Slovak Republic (ÚPSVaR).

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Services provided by the Public Employment Service (PES), such as job search assistance and counselling, are critical for labour market attachment and to provide information on job offers that could boost mobility (Vagac, 2013; Kluve, 2010). With on

average 187 unemployed per officer in 2013, the caseload is very high. It is also unbalanced across the country: higher caseloads are generally found where the unemployment rate is high (except for Bratislava, where the caseload is high and the unemployment rate is low). This suggests that PES will need more resources in high unemployment district offices, including outsourcing of services. Reforms begun in May 2013 strengthened individualised help, notably by allowing officers to focus on individual meetings with the most vulnerable unemployed, rather than organising systematic mandatory meeting with all unemployed (NRP, 2014). Full implementation of the reform is planned only for 2020, and consideration should be given to accelerate the process.

Training programmes also boost mobility as skilled workers are more mobile (OECD, 2005a). Such programmes are insufficiently developed, especially in lagging regions, and account for only 1% of active labour market expenditures (Central Labour Office). The May 2013 reform tried to reorient training to regions where it is most needed. In 2013, however, training still appeared to be non-existent in lagging regions (see Figure 15, Panel B), pointing to the need for more vigorous implementation.

Wage subsidies are efficient at improving employability of low-skilled workers (Card et al., 2010; Orszag and Snower, 2003). Such scheme would benefit eastern regions in particular where the low-skilled are over-represented. Along that line, the reduction of the tax wedge for low paid workers is welcome. By contrast, the wage subsidies scheme ("Boosting job creation") targeted at youth under 29 years old (without any conditions apart from having been unemployed for three months) is likely to be associated with only small net employment increases and the authorities should target this scheme at the most vulnerable youth.

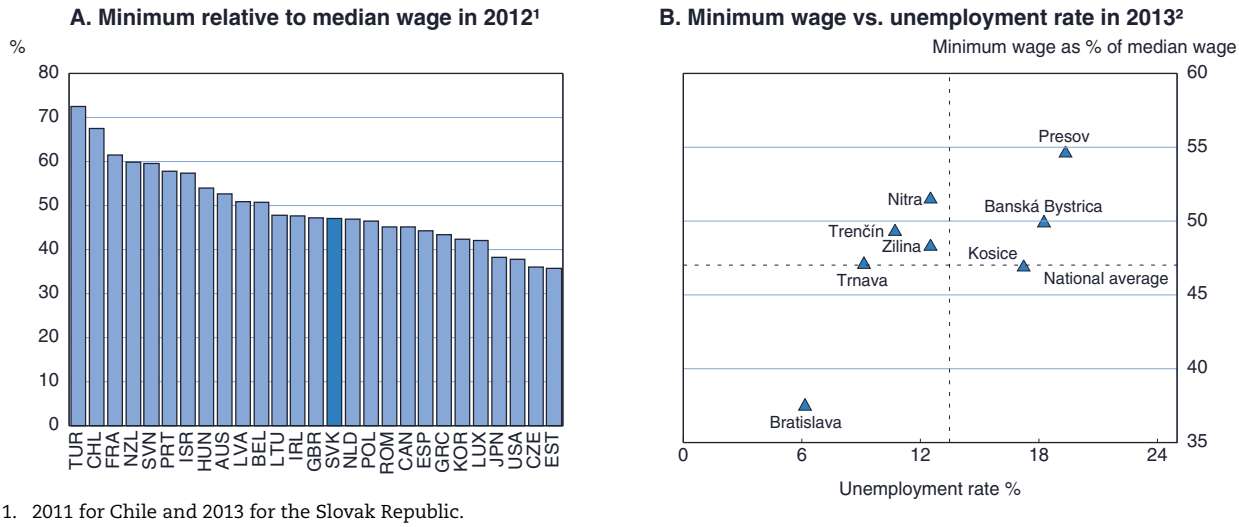
Direct job-creation programmes, more developed in the east of the country (see Figure 15, Panel B), are the least effective (Card et al., 2010) and according to evidence for Slovakia it can even worsen the chance of future employment (Harvan, 2010). In addition, they tend to lock low-skilled workers into local job-creation schemes, reducing labour mobility. Such schemes should therefore be phased out. For similar reasons, the authorities should reconsider the January 2014 reform that requires those unemployed who are eligible for social benefits, such as benefits covering material needs, to work part-time for the municipality; instead the requirement to search for work or take training should be strengthened. The authorities are considering a programme to develop in-work benefits to promote social inclusion and employment. This is in line with international best practices because it helps ensure that "work pays" (OECD, 2005b).

Making labour costs more responsive to local labour market conditions

Slovakia has six different levels of minimum wage, depending on the complexity of the job. The first two minimum wage levels relative to the median wage of the economy are at the OECD average. However, the system is uniform across the country, and therefore is likely to yield minimum wages that are too low in Bratislava but too high in the lagging regions, given sharp differences in market wages and living costs (Figure 16). The authorities should carry out a study to assess and monitor the impact of the national minimum wage legislation on labour costs and job creation in the lagging regions and explore the scope for measures which allow labour costs to respond to local conditions.

Automatic extension of collective bargaining agreements to all employers in the sector was put in place in January 2014. Collective bargaining agreements can be important for

Figure 16. **Minimum wages are not adapted to local labour market conditions**



1. 2011 for Chile and 2013 for the Slovak Republic.
2. Data on median wage for 2013 are provisional.

Source: OECD *Earnings Database* and Statistical office of the Slovak Republic.

StatLink http://dx.doi.org/10.1787/888933153871

improving working conditions and developing lifelong learning (LLL) of workers (Keogh, 2009), but extension needs to take more into account Slovakia's widely varying local labour market conditions. Extensions could distort competition if used by incumbents to prevent entry by new firms (Martin, 2014). Curbing entry also reduces incentives for incumbents to improve efficiency, reducing overall productivity. An option to consider is to establish transparent representation criteria before allowing for an extension agreement, as was done in Portugal (OECD, 2012d).

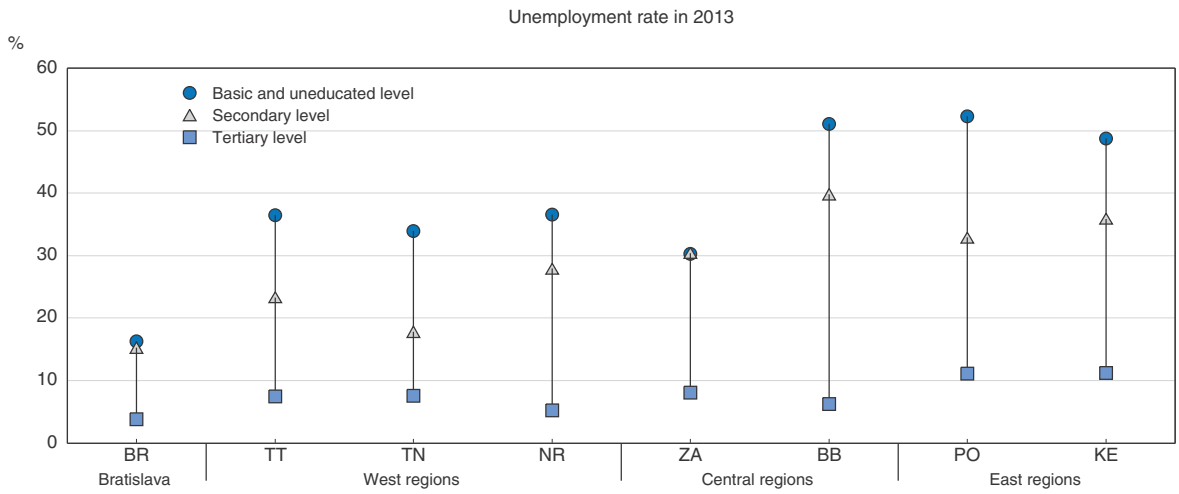
Raising the overall level of basic skills and increasing equality of opportunity

Raising the level of skills can raise labour mobility and attract firms to lagging regions. Education is critical in particular in the east where low-skilled workers have fewer job prospects than their counterparts in western regions (Figure 17). Low educational attainment results in a shortage of the basic skills needed to use new technology. For instance, in Slovakia 24.2% of the adult population report the lack of very basic computer skills – one of the highest shares in the OECD (OECD, 2013h).

Increasing LLL is essential to boost adaptability of workers to structural change, especially in the east where such change is particularly needed (Bassanini et al., 2005). Significant gains could therefore be achieved by raising LLL in Slovakia, where only 3% of all workers (2% in the east) participated in LLL in 2013, compared with 10.4% on average in European countries (Eurostat). Recommendations made in the *2012 Economic Survey* in that area are still valid (OECD, 2012b).

Improving school-to-work transition is a critical challenge in lagging regions, where 23% of youth is not in education, employment or training (compared with 9% in Bratislava). The weak link between VET and business has been identified by employers as an important barrier for regional development (PAS, 2013). The authorities should expand current pilot projects for vocational education including on-the-job training, in particular in lagging regions, as international experience suggests that they improve labour market outcomes by

Figure 17. **The low skilled have worse labour outcomes in lagging regions**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).
Source: Statistical Office of the Slovak Republic.

StatLink http://dx.doi.org/10.1787/888933153889

providing the skills needed in the labour market (OECD, 2010a). To provide sufficient incentives for offering workplace training, the authorities plan to provide tax exemptions to companies, in line with international best practices (NRP, 2014; OECD, 2010a; OECD, 2007).

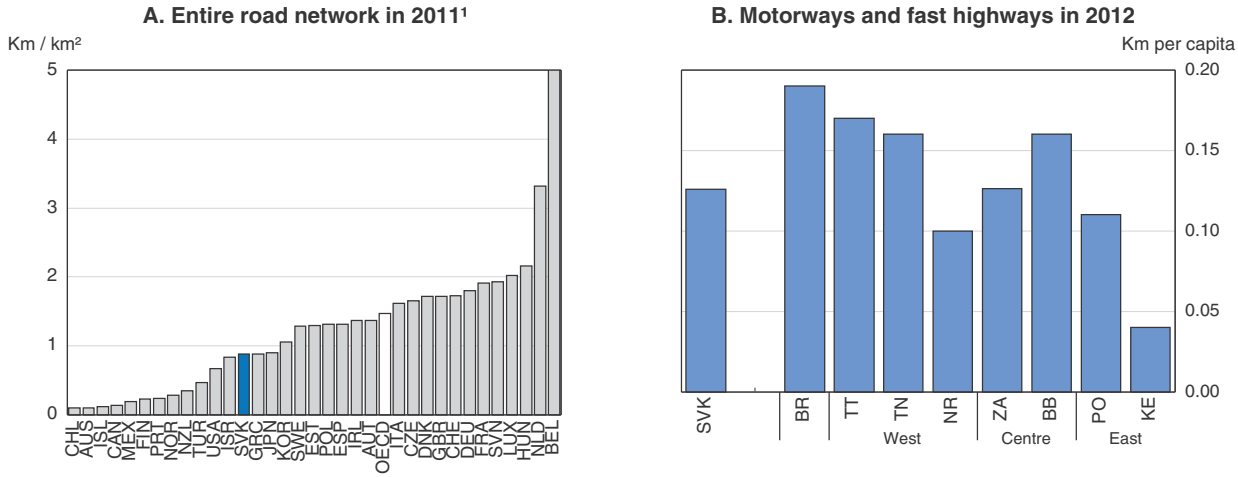
The educational outcomes of students from disadvantaged socio-economic backgrounds are among the worst in the OECD (OECD, 2013c), particularly so in the east of the country. The poor educational outcomes of the Roma, who mainly live in the east of the country and are over-presented in special-needs schools, is a specific source of concern, (OECD, 2012b; World Bank, 2012). Good quality early childhood education has a positive impact on future education outcomes and reduces the probability of enrolment in a special needs school (World Bank, 2012). Overall, the Slovak Republic devotes 0.2% of GDP to pre-primary education compared with 0.6% on average in OECD (OECD, 2013c), and only 77% of children participated in pre-primary education in 2011 compared with 93% on average in European Union (Eurostat). At only 20%, the participation of Roma children is dramatically lower (UNDP, 2012).

Efforts are ongoing to develop further the capacities for pre-primary education (NRP, 2014). These efforts should be further stepped up to raise the participation of socially disadvantaged children. An option is to provide more in-kind benefits together with free pre-primary education for all children from the age of three. Recent positive steps to increase the number of assistants ("all-day project") should also contribute to better integrating Roma pupils in standard schools. Support targeted at that population should be further developed. However, the monitoring, implementation and evaluation of those programmes is particularly difficult in the absence of reliable statistics; these too should be better developed.

Improving transport infrastructure

The unequal distribution of infrastructure contributes to regional disparities. The density of motorways per capita is much lower in the eastern and central parts of the country (Figure 18). As a result, eastern regions do not have easy access to the large

Figure 18. **Raising infrastructure is key**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Road density is the ratio of the km length of the total road network per square km. The road network includes all roads. Data refer to 2010 for Ireland, 2009 for Canada, 2005 for Italy and 2004 for Luxembourg.

Source: World Bank (2014), *World Development Indicators* (WDI); and Statistical Office of the Slovak Republic.

StatLink *http://dx.doi.org/10.1787/888933153897*

Bratislava market, and Dijkstra et al. (2011) estimate the costs of reaching other EU countries from the east to be among the highest among EU regions. Building such links is a prerequisite to tapping the growth potential of the lagging regions (Sutherland et al., 2009). A positive development is the fact that nearly all missing parts of the D1 highway between Bratislava and Košice are now under construction. Specific attention also needs to be paid to road quality, which is relatively low (WEF, 2013).

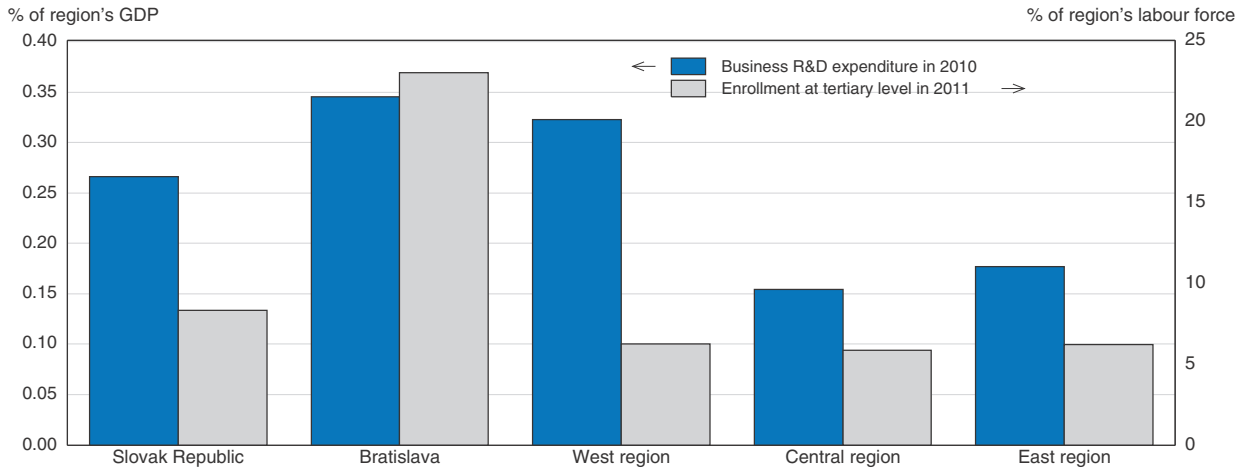
The development of rail transport could also contribute to reduce emissions. Rail transport suffers from obsolescence and depreciation, equipment, bridges and culverts, many of which are at the end of their technical lifetime. Steps have been recently taken to develop railways infrastructures, in particular the electrification, interoperability and modernisation of tracks to accommodate higher speed trains, in particular on the TEN-T network (OECD, 2013i). A comprehensive reform of the absorption of EU funds (see above), could also accelerate the development of transportation infrastructure.

Boosting the adoption of new technology

In the Slovak context, there is a need for policies to support innovation in the advanced west and to support the adoption of new technology in lagging regions (OECD, 2012c). The lack of capacity for firms to adopt new technology is striking in the east and central regions, where hiring of those with tertiary education and the resources devoted to R&D activities are very low (Figure 19). The implementation of a tertiary vocational education programme, including on-the-job training, would provide the technicians needed to use new technology. While the authorities are providing incentives for hiring youth workers, these incentives could be targeted to firms that provide internships to students from those programmes.

The capacity to adopt technology depends also on specific knowledge, including monitoring of technological development, which may require hiring researchers (Cohen and Levinthal, 1989). Moreover, the benefits of innovation depend on the resources devoted

Figure 19. **The capacity of central and eastern firms to absorb technology is weak**



Source: OECD *Regions and Cities Database.*

StatLink http://dx.doi.org/10.1787/888933153903

to R&D (Van Pottelsberghe de la Potterie and Lichtenberg, 2001; Griffith et al., 2004). The authorities could therefore give more consideration to widening the R&D tax credit for firms in less developed regions to hire researchers or engineers and make the tax credit refundable for firms which not yet make profits (OECD, 2013j).

The promotion of clusters in lagging regions could improve knowledge and technological transfers between firms and create a local labour market (OECD, 2009b). The objective of those programmes is not to create clusters from scratch but to help latent clusters emerge and expand. Co-operation between firms and research centres and, between SMEs and large firms, could especially be an important channel of productivity growth in the region. Steps have already been taken. For instance, the Košice region hosts two clusters in the area of Information Communication and Technology (ICT). However, such initiatives lack support from the central government (RIS3, 2013). Going forward, different actions could be taken to promote and strengthen existing clusters:

- Technology vouchers, in addition to innovation vouchers that are currently under consideration, would provide incentives for firms, in particular SMEs, to consult a knowledge provider (like a research or technology centre) to identify and implement new technology (OECD, 2010b).
- Promoting cluster facilitators to develop co-operation between firms and to help apply for EU funds. The *Klastry* programme in the Czech Republic could be of interest (OECD, 2008b).
- Launching competitive selection processes to allocate funds to the best organised clusters to support excellence and co-operation with research centres. Such programmes have been developed in Sweden (*VINNVÄXT*) and France (*Les pôles de compétitivité*).

The local authorities should be more involved in the design of innovation policy. International experience suggests this would better cater for local needs and identify investment opportunities and bottlenecks (OECD, 2014f and 2013k). The Smart Specialisation Strategy is meant to be based on self-identification of regional and local comparative advantages, but has been implemented only at the national level. The authorities could give consideration to launching a new version of regional innovation centres.

Recommendations for spurring growth in lagging regions

Boost the capacity to adopt new technology and reduce transport barriers

- Develop professional tertiary education and support for co-operation with employers.
- Provide financial incentives for adopting new technology and innovation spending.
- Improve national road and rail transport infrastructure and international connections.

Strengthen mobility and employability to reduce unemployed and inactive labour

- To develop the rental housing market, phase out support to home ownership and expand means-tested rental housing allowances.
- Develop training as well as job-search support and phase out public works programmes.
- Make sure minimum wages and legal extension are implemented without damaging employment prospects, especially in lagging regions.

Reduce skills mismatch and better integrate disadvantaged groups, especially the Roma population

- Implement a dual vocational education and training system and give specific attention to school-to-job transition in eastern regions.
- Develop the provision and quality of early childhood education and ensure wide access to low socio-economic background children, especially Roma children.

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ANNEX A1

Progress in structural reforms

This annex reviews action taken on recommendations from previous Economic Surveys of the Slovak Republic. *They cover reforms in the following areas: labour markets, education, product markets, public sector efficiency and the fiscal framework. Each recommendation is followed by a short note of actions taken since the* 2012 Economic Survey of the Slovak Republic.

Labour market

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Ensure that further increases in the minimum wage do not have negative impacts on employment opportunities. Take into account advice from an independent expert commission. Phase out the differentiation of minimum wages by degree of work difficulty and consider differentiation at the regional level.	No action taken.
Remove barriers to higher female labour participation: reduce the tax wedge on second earners in two-earner households by lowering the marital income allowance. Consider introducing a surcharge on health insurance for non-working spouses.	No action taken.
Encourage job search activities and participation in Active Labour Market Policy (ALMP) by all benefit recipients with some ability to work by making their registration in placement services mandatory.	Activation centers were established in January 2014 to activate social assistance benefit recipients. A significant number of additional officers are to be hired.
Ensure adequate public employment service (PES) capacities by allocating more resources and creating one-stop shops. Establish an effective online collection of job offers and increase resources allocated to collect information on labour market developments.	The 2013 PES reform allowed: i) streamlining activation programmes; ii) lowering the administration burden for PES; and iii) increasing flexibility through a reduced number of obligatory measures. The launch of a web portal and development of a back office IT system are improving PES capacities.
Implement systematic evaluations of ALMP and increase spending on programmes whose effectiveness has been demonstrated. Test new programmes with pilot projects before implementation at the national level.	A central database has been established in order to gradually allow a regular monitoring of ALMPs. Three pilot projects targeted at very long term unemployed are ongoing.
Better target the measures to those who may not gain a lot from taking up a job. Develop employment incentives targeted towards long term jobseekers with low productivity. Propose job creation programmes when no other options are available. Increase spending on training measures. Strengthen eligibility criteria and the monitoring of start-up incentives.	Since November 2013, long-term unemployed hired on a low-paid job (67% of the average wage) under a standard contract form, are exempted from social security contributions for 12 months (except accident insurance contribution and guarantee insurance contribution). Since May 2013, eligibility of start-up incentives has been stricter and depends on the credibility and sustainability of the business plan.
Make tertiary education more attractive to technical secondary school graduates: develop short (2-3 years) occupationally oriented programmes. Introduce tuition fees coupled with income contingent repayments, facilitate entry of new institutions. Make budgetary allocations to universities more dependent on outcomes.	PES has established since 2013 a non-formal internal training system.

Education

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Make tertiary education more attractive to technical secondary school graduates: develop short (2-3 years) occupationally oriented programmes. Introduce tuition fees for full-time students at state universities coupled with income contingent repayments, facilitate entry of new institutions, replace budgetary allocations to universities with competitive research grants or at least make them rely more on outcomes.	A new Act on Higher Education, including short-term tertiary professional programmes, is prepared.
Enhance incentives for employers to allocate more resources and time to training. Pursue initiatives aiming at easing the recognition of non-formal education.	An amendment of the Act on Lifelong Learning in 2012 widens the range of certifying institutions.
Increase the wages of teachers together with structural measures increasing the efficiency of the system. Improve the use of available evaluations to identify dysfunctional schools as well as best practices.	In 2013 and 2014, the teachers' pay was increased. Maximum class size was increased and minimum limits introduced. Since 2013, additional funding for schools has been conditioned on rationalisation measures.

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Foster acquisition of professional experience during studies and work-based vocational education and training by creating a legal framework for a dual apprenticeship system.	A new Act on Vocational Education and Training is planned for December 2014.
Remove premiums to eight-year grammar schools as planned and strengthen incentives for the integration of pupils with special needs in the standard system. Raise support to disadvantaged pupils. Further encourage participation of children from low-income families and Roma in pre-primary education and the integration of Roma in mainstream education.	Premiums to eight year-grammar schools were removed in 2013. Full day's schooling is being implemented in 200 elementary schools, a new pre-school educational programme is being tested in 110 kindergartens and educational support projects at all levels of the Roma population will be supported by EU funds.

Product markets

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Resume the privatisation process. Privatise the remaining government shares in the telecommunications incumbent. Pursue further entry of private capital in companies active in electricity generation and trade as well as in gas trade.	An amendment of the Act on Privatisation is under consideration to simplify the process of privatisation. A memorandum on further privatisation of Slovak Telekom has been signed.
Make the disbursement of subsidies to the railways industry more conducive to competition. Subsidies should be used to lower network access prices or be made contestable through the public tendering of public service obligations.	No action taken.
Foster the spread of e-business and e-commerce. Consider the involvement of business and industry associations in order to gain economies of scale and to better tailor the services to the needs of specific industries.	No action taken.
Reassess the current regulatory framework on consumer protection to ensure a sufficient protection of consumers participating in e-commerce activities industries.	A June 2014 Act contributes to protect consumers in e-commerce.
Identify administrative burdens and establish a timetable for measures aimed at tackling the identified business barriers.	A webpage for businesses to report compliance problems has been created in 2013.
Strengthen competition in network industries, Ensure that the price regulation does not deter the entry of new competitors in the energy market. Reduce delays in the introduction of remedies to foster competition in fixed line telecommunications services. Strengthen the independence of the telecommunications regulator.	Implementing the third EU Energy package will strengthen competition.

Public sector efficiency

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Make sure that e-government is implemented by the target date of 2013 and ensure a training of employees in computer and internet skills.	The Act on e-Government became effective in November 2013.
Encourage greater use of results and performance information in the budget process in all government departments.	No action taken.
Fully enforce the provisions of the laws fighting corruption.	A code of ethics for civil servant was partly adopted in April 2013. A draft law on criminal liability of legal person is being drafted.
Introduce market mechanisms in the provision of public services.	No action taken.
Continue efforts to improve tax collection by implementing the transition towards an integrated tax collection system. Proceed quickly with approving the second stage of the unified collection scheme reform (UNITAS II). Further combat tax evasion.	Implementation of an integrated core system of Financial Administration should be completed in 2015. The second phase of UNITAS reform will resume afterward. Since 2012, the first and second stages of the Plan to fight tax evasion, in particular VAT, were implemented.

Fiscal framework

Recommendations from previous *Surveys*	Action taken since the December 2012 *Survey*
Increase the scope for monitoring and evaluation of spending programmes. Widen the use of performance elements in promotion, contract renewals and compensation of public staff. Establish a robust system of internal controls and include appropriate performance and results information in annual budget documentation. Allocate more resources to ex-post audit and take into account evaluation outcomes in budget allocation.	A new civil service law is being prepared to enhance the stability, professionalism and neutrality of civil service. Human resources policies were centralised end of 2013.
Regularly issue policy briefs on the fiscal policy. Publish a citizen's guide to the budget.	A web portal displays the general government budget, budgets of different public entities and state budget.
Give ministries more freedom in the allocation of funds between agencies and programmes. Reduce the number of line-items in the budget and allow carry-forward of current spending items.	No action taken.
Provide an adequate degree of transparency throughout the entire public procurement cycle. Amend the Public Procurement Act to ensure that the tender achieving the best value for money is selected. Systematically record problems with public procurement and implement a task force to provide recommendations on how procurement rules could be made easier to apply without undermining the fight against corruption.	An amendment of the public procurement (PP) act modifies the selection process to strengthen the quality of projects and establishes a PP office.
Further strengthen the medium-term spending framework by introducing spending ceilings as planned, and adhere to them.	Spending ceilings, established in 2013, can be activated by the government in case the country deviates from medium-term objectives
Reform the structure of taxation to make it less harmful to growth notably by increasing real estate and environmental taxes and lowering labour taxes paid by employers at lower wage levels to encourage greater labour demand.	Since November 2013, long-term unemployed hired on a low-paid job (67% of the average wage) under a standard contract form, are exempted from social security contributions for 12 months (except accident insurance contribution and guarantee insurance contribution). An amendment proposal of cadastral act is currently in legislative process to allow assessing the value of particular properties.
Direct more resources towards growth enhancing areas such as education, research and development, and infrastructure. Establish an effective framework for assessing and selecting infrastructure projects, using tools such as cost-benefit analysis. Follow the OECD recommendations for the public governance of PPPs.	Expenditures on education, R&D and transport infrastructures increased since 2011 and are planned to rise further according to the 2014 Slovak Stability Programme.
Stabilise the functioning of the pension system: Refrain from any opening-up of the two pension pillars. Consider making participation in the DC pension pillar mandatory for all persons joining the labour market for the first time.	No action taken.
Ensure the long-term sustainability of the DB pillar: Increase the statutory retirement age in line with gains in life expectancy and index pensions on inflation only.	2012 pension reform has increased the long-term sustainability of the public pension system was improved by changing indexation and automatic increasing of the statutory retirement age (since 2017). The pension system of police and armed forced was reformed in 2013 by increasing the number of years in service and changing the indexation of pension.

Thematic chapters

Chapter 1

Reforming the public sector

Improving public sector efficiency can help to meet two conflicting objectives: ensuring fiscal consolidation and maintaining room for growth-friendly spending. However, the public sector, lags on the application of e-government and e-procurement, insufficiently prioritises spending, and suffers from budget fragmentation, lack of co-ordination between ministries and perceived corruption. The regulatory framework could also be more business friendly and the judicial system more efficient. Boosting public sector efficiency requires broad based reforms. Sequencing will be important for the effectiveness of this comprehensive reform effort, and therefore the government should put an initial emphasis on human resource management and the improvement of administrative capacity.

Improving public sector efficiency is rightly among the key government priorities. Two of the five key areas in the National Reform Programme (NRP) 2011-14 relate to "continued fiscal consolidation aimed at economic growth" and the "modernisation of the public administration". These two objectives are complementary. The need for continued fiscal consolidation can stimulate government efficiency in all its dimensions: budget planning, programme allocation and prioritisation of resources, and administrative and managerial effectiveness. In that way, welfare reducing programme cuts or tax increases can be avoided. At the same time, the public sector should become an instrument for stronger, more inclusive and diversified growth, which by helping to strengthen the domestic production – and tax – base, also adds to longer-run budget sustainability.

The structure of the chapter is as follows. In the first section, the issues of budget planning efficiency are discussed, the integration of longer-term budget constraints into short-term budget decision-making being critical to sustainability. In the second section, allocative efficiency is discussed in terms of the spending priorities of a catching-up economy. The third section then discusses issues of institutional co-ordination determining the ability to address priorities *ex ante*, including issues related to the allocation of structural funds. The fourth section looks at the potential for efficiency gains as the administration is modernised. The final section addresses the issue of tax, regulatory and administrative burdens imposed on the private sector, the efficiency of the interface between public and private sectors being crucial to growth and employment performance.

Budget planning efficiency: Anchoring the budget process in longer-term perspective

Greater continuity is necessary in budget-making

The efficiency of the budget planning framework is a key determinant of public sector efficiency, as it can ensure continuity, consistency and stability in policy making. Fiscal rules are important here. In response to the requirements of the Treaty on Stability, Co-ordination and Governance, Slovakia introduced a balanced structural budget rule in November 2013, with the commitment to decrease the structural budget deficit to 0.5% of GDP by 2017. This is a more demanding sustainability constraint than the criterion of stabilising debt at the 60% debt ceiling (Table 1.1). According to the 2014 Budget – which expects the structural budget deficit to increase to around 4% of GDP in 2014 – further structural measures worth 3.5% of GDP will be needed by 2017 to meet the 0.5% target. While a balanced structural budget may not be optimal for a catching up economy like Slovakia, where public investment is crucial to growth, from a financial market perspective it helps to put the debt ratio on a downward path (towards the upper limit of 50% by 2027) and gives more room for automatic stabilisers to operate than is currently available under the operational debt ceilings. However, the credibility of the structural budget target has yet to be fully established which may, in part, be due to the fact that the sources of the expenditure cuts have yet to be identified and neither have the means of maintaining structural balance through to 2027.

Table 1.1. **Sustainability requirements**

	Consolidation[1]	Consolidation over 2016-30 to stabilise debt at 60%[2]		Financial balances[3]			Gross financial liabilities[4]			Long-term real interest rates[5]		
	2010-13	Average	Peak	2013	2020	2030	2013	2020	2030	2013	2020	2030
Slovak Republic	**4.5**	**1.1**	**1.6**	**-2.8**	**-1.3**	**-1.1**	**59**	**62**	**60**	**2.0**	**2.0**	**2.2**
Euro area	3.6	1.4	2.6	-3.0	1.7	0.2	107	92	61	1.6	2.2	2.1
OECD	3.2	2.1	3.8	-4.9	-0.6	0.1	109	103	77	1.1	2.6	2.5

1. Consolidation is measured as the change in the underlying primary balance, as a percentage of potential GDP.
2. Over the projection period, countries with gross government debt ratios in excess of 60% of GDP are assumed to gradually reduce debt to this level, whereas other countries stabilise debt ratios at their current levels. Consolidation requirement from 2015 to achieve these objectives are measured as the difference between the underlying primary balance in 2015 and its average or its peak over the period to 2030 (or until the debt ratio stabilises).
3. General government fiscal surplus (+) or deficit (-) as percentage of GDP.
4. Includes all financial liabilities as defined by the system of national accounts (where data availability permits) and covers the general government sector, which is a consolidation of central, state and local governments and the social security sector. The definition of gross debt differs from the Maastricht definition used to assess EU fiscal positions.
5. Nominal 10-year government bonds adjusted by the GDP deflator.

Source: OECD Economic Outlook 95 Long-Term Database.

Anchoring expectations that medium-term consolidation goals will be fulfilled, while also allowing for short-term fiscal flexibility, requires reinforcement of the medium-term budgetary framework. Credibility is currently compromised by the fact that in the past there has been substantial slippage from the long-run adjustment path due to a failure to exert discipline and run an adequate surplus during recovery years (Horvath and Odor, 2009). Safeguards against a recurrence of this tendency to fiscal slippage need to be put in place. While the debt ceiling rules and the establishment of a Fiscal Council help, debt controls and sanctions are very much *ex post* devices which only come into play when rules have been breached and confidence needs restoring. The budgetary framework has been strengthened by the introduction of expenditure ceilings in 2013 which have the advantage of restraining expenditure increases in boom periods, but also allow the automatic stabilisers to work in downturns. Spending ceilings are, however, not binding each year but would only be activated in the case of a significant deviation from the medium-term objectives (MTO) or the correction path towards it. This design reduces the constraints imposed on expenditures in good times, when such ceiling is likely to make the most for fiscal consolidation. The commitment to medium-term objectives could also be strengthened by making budget targets binding on a multi-year basis while they are currently binding only for the first year of the budget, the two following years being only indicative. Medium-term expenditure ceilings, anchored by realistic budget fundamentals, would allow for the identification of the priorities behind the needed consolidation measures and help create the confidence that such measures would be lasting.

Longer-term sustainability issues have to be dealt with

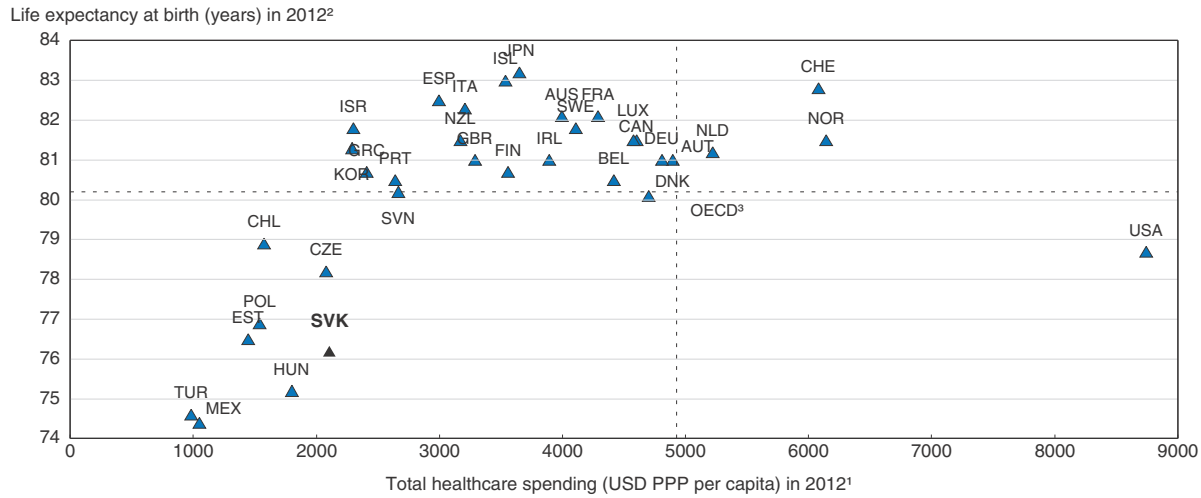
Efficient forward planning of ageing related programmes, such as pensions and health, which make up around half the budget, is essential for budget consistency and credibility. Demographic spending pressures are due to rise considerably, as Slovakia will have the steepest increase in the old-age dependency ratio of all EU member states up to 2050: spending will rise by 3.5% of GDP, of which 1.5% of GDP to meet public pension commitments and 2% to health care – the second highest projected increase in health care expenditure of all the EU member states (EC, 2012a, 2013a). The total consolidation effort required to maintain the budget at close to structural balance is thus of the order of 7% of GDP.

As a step towards longer-term sustainability, major changes to the public pension system were adopted in 2012 and to the armed forces pension system in 2013, which should reduce the projected increase in pension expenditures in the 2010-60, (SP, 2014). However, short-term economies have been made partly at the expense of reducing the future contribution from the funded pillar, which could add to the longer-term sustainability problem, and with the exception of low earners, the changes in the calculation and indexation of pensions are likely to reduce the replacement rate in the long run. Even though, new pensioners with low pension (who earn up to 1.25 of the average wage) will not be affected by this decline, this may raise political pressures to increase the pension funding from general budget sources. Given that the scope for increasing social contributions is very limited (see below), ensuring sustainability rests on increasing the efficiency of the old-age income replacement system. One way to do so is to further adjust the pension age which will require major improvement in the employability of older workers. Furthermore, increasing the employment rate and productivity would create room for financing public pension obligations. In that context, and taking account of possible future pressures to raise the replacement ratio, the reforms have not yet fully addressed all problems of sustainability within the public pensions system.

Compensating for the implicit liabilities built into the health system requires action. Slovakia commits less resources to health than the EU average (6.2% of GDP versus 7.1% of GDP in 2010, respectively) and public expenditure on hospitals, both as a share of GDP and as a share of the overall public healthcare budget, is one of the lowest in the EU. But healthcare expenditure has been growing rapidly as a proportion of total government spending and hospital debt has been rising, with overdue liabilities that almost doubled from 2011 to 2012 (NRP, 2014). Moreover, rapidly increasing spending does not necessarily lead to better health outcomes, which in Slovakia are rather below-average for the amount of resources committed (Figure 1.1). Inefficiencies are, for instance, evident in a high number of facilities and acute care beds and a high average length of inpatient stays (OECD, 2012a; EC, 2014a). Inefficiencies are compounded by inadequate accounting, an absence of effective monitoring of hospital activity. Without increased planning, institutional and management efficiencies, the health sector will continue to be a source of budgetary disruption. Demographic pressures on the health service will not subside, but Slovakia could achieve better results if it reached the frontier of best performance.

The NRP proposes a comprehensive effort to make the health budget more sustainable (NRP, 2014). It envisages the introduction of an integrated model of health care provision where the position of general practitioners will be reinforced to reduce unnecessary and expensive treatment in hospitals, and by specialist physicians, enhanced information systems, improved hospital management, centralised procurement and the introduction of diagnosis-related groups (DRGs); hitherto, remuneration of hospitals has been on a *per diem* basis, encouraging a high number of in-patient cases. The government has also enhanced transparency on the healthcare market and information awareness of patients by obliging health insurance companies to publish all contracts with healthcare providers. There are also plans to unify health insurers into one public provider, to alleviate comparatively high administrative costs. In December 2013, the government adopted a 2014-30 Strategic Framework for Health to improve cost-effectiveness, which is an important complement to better control mechanisms in hospitals and now requires detailed implementation. The extent to which the health budget will be easier to control and predict is unclear and the

Figure 1.1. **Resource inputs and outcomes in the health sector**



1. 2011 for Australia, Netherlands, New Zealand, Portugal and Spain; 2011 for Canada and United States.
2. 28 countries for which both of health spending and population are available. The following countries are excluded: Australia, Mexico, Netherlands, New Zealand, Portugal and Spain.

Source: OECD Health Database and *OECD National Accounts Database.*

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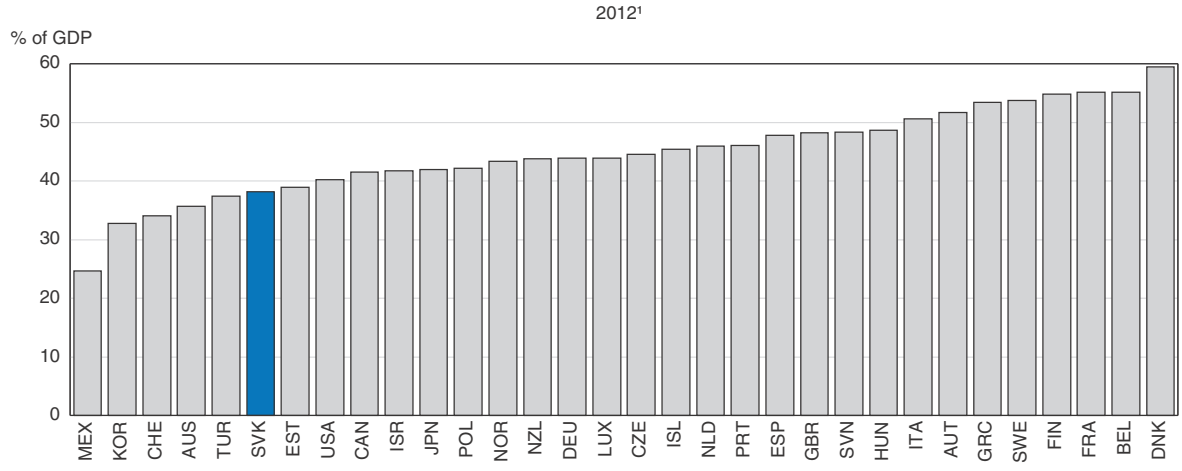
situation will require constant monitoring, but better-designed incentive structures allied to cost-containment should help significantly in that regard.

Allocative efficiency: Spending should address priorities more effectively

Spending patterns do not reflect the priorities of a catching-up economy

Slovakia has a relatively small general government sector (Figure 1.2) and hence relatively small public spending per head. As income per capita converges and the population ages, it would be expected that the resource demands made by some income-

Figure 1.2. **General government spending**



1. 2011 for Turkey.

Source: OECD Economic Outlook 95 Database.

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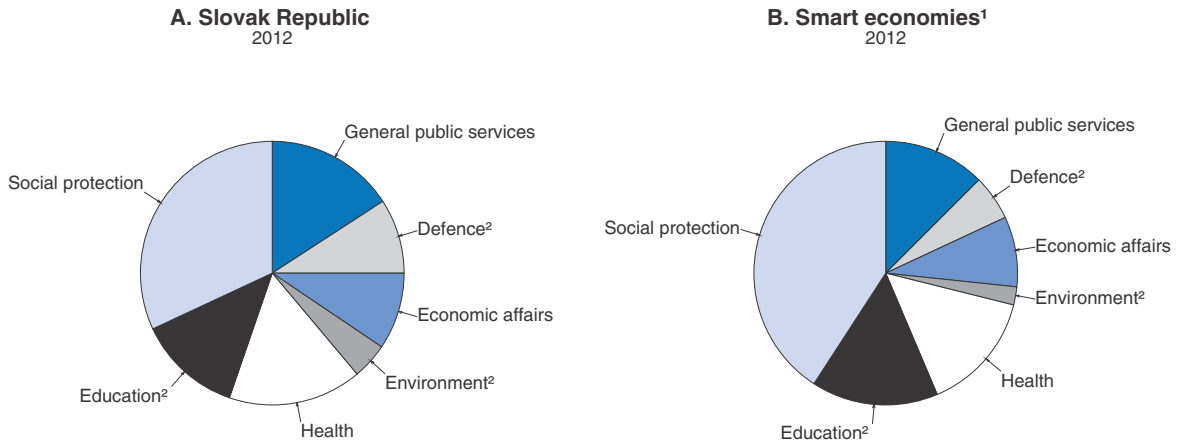
elastic and demographically driven programmes would tend to expand. The emphasis thus needs to be on controlling and reducing wasteful public expenditures.

The composition of spending is markedly different than is typical in the OECD (Figure 1.3). As noted in the 2012 *Economic Survey*, social transfers in general are smaller but more effectively targeted than the OECD average (OECD, 2012a). However, general services and public order account for a relatively high 22% of government spending, while education and economic affairs (including transport and communication, industry, R&D) spending is low (Figure 1.3). These are areas where spending needs to be expanded. This is reflected in the prioritisation in the current Budget to areas of spending promoting economic growth; state expenditure on education, R&D and the development of transport infrastructure are all scheduled to rise relatively fast (SP, 2014). The necessary prioritisation of spending towards these growth-enhancing areas was discussed in the 2012 *Survey*; this section elaborates on the instruments available for effecting such prioritisation.

Figure 1.3. **Composition of general government spending**



1. Smart economies comprise the top five European economies according to OECD Better Life: Netherlands, Denmark, Sweden, Norway and Switzerland.
2. Sectors based on the Classification of the functions of government 93 (COFOG) at 2-digit level of which three sectors are aggregated: Defence including public order and safety; Education including recreation, culture and religion; and Environment including Housing and community amenities.

Source: OECD General Government Accounts Database.

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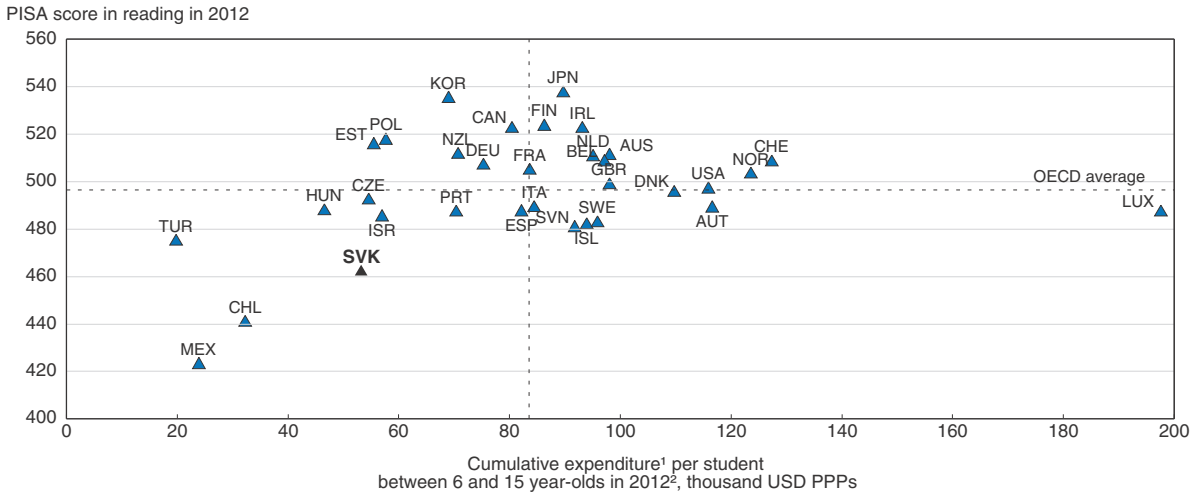
More resources and better performance in education

Higher spending on education offers the prospect of high rates of return and reductions in income inequalities. The net present value for an individual with upper secondary education is high compared with the OECD average (OECD, 2013a). Conversely, levels of long-term and youth unemployment are worryingly high and pose a significant potential problem for future growth if this segment cannot acquire employable skills. Around 60% of the unemployed have a low level of education and the increased risk of unemployment for Slovaks without upper secondary education is particularly strong. This disadvantage appears to be self-perpetuating, since children in homes with an unemployed parent are at far greater educational risk than on average in the OECD (OECD, 2013a). Educational disadvantage is also linked to regional disparities. While there is a greater degree of income equality in the Slovak Republic compared to in the majority of

OECD countries, there is a particularly high concentration of poor households in the eastern regions, which means that regional disparities are much more pronounced than in other OECD countries (see Chapter 2).

Slovak educational performance is below average, in the secondary sector at least, as evidenced by PISA results, and international comparison suggests some room for efficiency gains (Figure 1.4). High youth unemployment partly reflects the low quality of the education and training systems and their limited relevance to labour market needs (Chapter 2). But relatively low public expenditure in education and the poor attractiveness of the teaching profession probably also help explain this problem (OECD, 2012a).

Figure 1.4. **Education outcomes in secondary education and spending per student**



1. Public institutions only for Hungary, Ireland, Italy, Poland, Portugal, Slovenia and Switzerland.
2. 2009 for Chile and Germany; 2011 for Canada.

Source: OECD (2013), *Education at a Glance* and *OECD PISA Database*.

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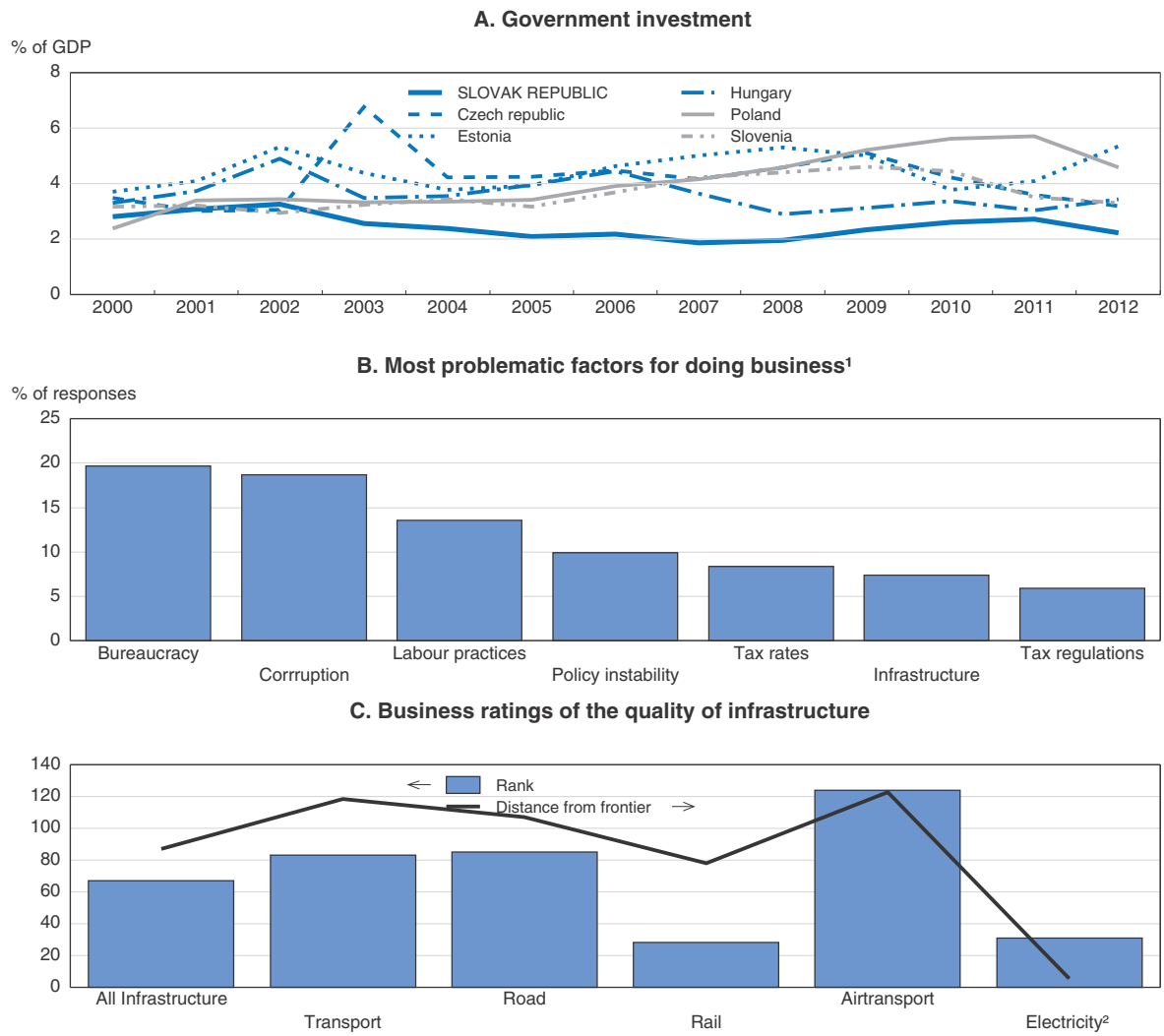
Recently adopted and proposed reforms attempt to correct these deficiencies. Notably, the NRP sets the objective of gradually increasing public expenditure on education to 6% of GDP – the average of EU countries – by 2020. At the same time, the wages of pedagogic and professional staff in education are being increased, making teaching financially more attractive, following recommendations of the *2012 Economic Survey of the Slovak Republic* (OECD, 2012a). The remuneration of teaching staff is generally positively linked with teaching outcomes (Sutherland et al., 2007). Efforts to improve the attractiveness of educational careers should be continued, given the gap between the teachers' salaries and the average wage of tertiary-educated individuals in Slovakia; 44% in 2010, as against 82%-90% on average in OECD countries (OECD, 2013a). To improve the attractiveness of teaching careers and the quality of education, the NRP is to improve initial training of teachers and implement continuous monitoring of the recently introduced career system for teachers.

The higher education reform adopted in December 2012 also aims to improve internal quality assurance systems and the quality of part-time studies and teaching, while increasing the incentives to increase the internationalisation and business relevance of higher education institutions. A comprehensive new law on higher education institutions is under consideration, as is a revised funding mechanism that would link the financing of education more closely to the overall quality of education.

Infrastructure investment is below normal

Public investment has declined over the past few years to relatively low levels compared to other catching-up economies (Figure 1.5, Panel A). Certain elements of infrastructure – electricity and telephony infrastructure for example – compare well; other important areas, particularly transport, do not according to World Economic Forum (WEF) indicators. Employers identify transport as one of the main barriers for doing business (Figure 1.5, Panel B). Developing infrastructure in Slovakia could be highly beneficial to growth (Sutherland et al., 2009), business ratings of the distance from the best-practice frontier being in particular substantial for transport infrastructure (Figure 1.5, Panel C).

Figure 1.5. **Government investment and infrastructures are low**



1. Inefficient government bureaucracy, Corruption, Restrictive labour practices, Policy instability, Tax rates, Inadequate infrastructure and Tax regulations.
2. Quality of electricity supply.

Source: OECD Economic Outlook 95 Database and World Economic Forum (2013).

StatLink http://dx.doi.org/10.1787/888933153958

The focus is currently on modernising the road transport system, particularly motorways and expressways, one aim being to link regions with a lower economic performance and a high unemployment rate into the system (Chapter 2). For any infrastructure investment drive to be effective, clear rules are needed for setting priorities. The Slovak government is considering introducing an Act on Traffic Authority to ensure smooth, functional and economical strategic planning of transport, but so far no budget for such measure has been prepared. The financing mechanism could be based on fees received from market participants. Public-private partnerships (PPPs) also offer the possibility of reducing the budgetary burden of infrastructure projects. With this objective, PPP projects are for instance under preparation for the construction of the expressway R1, a section of highway D4 and the first three sections of the expressway R7. Such schemes should be closely monitored such that they do not create hidden contingent liabilities and risk between public and private sectors is fairly distributed (OECD, 2012b). That has not always been the case and two out of three PPP highway projects have been cancelled in Slovakia in 2010 due to non-transparent procedures and high cost of financing, compared to a financing based only on EU and public funds (OECD, 2012a).

Government investment in R&D could be selectively increased

As is the case for education, public investment in research and development is low by OECD standards. Over time, investment in domestic company-level research has declined while technology imports have risen, via branches of multinational companies. Otherwise, the state of the knowledge economy remains rather backward, not just compared to the most advanced OECD countries (OPKE, 2011), and Slovak small and medium enterprises (SMEs) and the few large domestic-owned companies typically have low productivity levels and low R&D intensity. Total Slovak Gross Expenditure on R&D (GERD) and Business Expenditure on R&D (BERD) as per cent of GDP being respectively about 40% and 25% of EU27 levels in 2012 (Erawatch, 2014).

The 2011 Innovation Policy acknowledged "disproportional reliance on the European and international financial assistance" and called for increased national funding for innovation (EC, 2014b). National innovation funding accounts for a limited part of overall funding and lacks a clear thematic focus. In response, the *2013 National Reform Programme* sets 2020 targets for gross domestic expenditure on R&D and business expenditure on research and development at 1.2% and 0.8% respectively. The intention is to concentrate state support for R&D on selected priority areas, where Slovakia has comparative advantage, such as material research and/or information and communication technologies. The goals for innovation development are elaborated further in the national *Smart Specialisation Strategy*, which identifies key areas of economic specialisation and presents far-reaching plans for institutional reforms in the public sector (higher education institutions, Slovak Academy of Sciences, research funders). To increase the share of private resources in R&D, the government intends to promote development and innovation capacities in companies via the strengthening of various financing incentives, including R&D tax credit and venture capital schemes (NRP, 2014). However, frequent changes in policy directions do not help and prioritisation is also important. It may be particularly important to encourage the transition of companies, especially subsidiaries of multinational corporations, from assembly and production to the development of their own products and technologies, which could be supported through clustering and other forms of networking at the local, regional, national and macro-regional level (Chapter 2).

Institutional efficiency: Reducing budget fragmentation and improving co-ordination

Towards a more holistic approach to policymaking

Achieving a more efficient resource allocation in public spending will necessitate more effective co-ordination. The focus of the ongoing administrative reform process, launched in 2012, is thus to create a more holistic approach to policy-making, first by creating greater cohesion among administrative institutions and second by ensuring more effective collaboration between the state and sub-national entities. Part of the problem has been that Slovak public administration tends to be relatively fragmented and organised around strong ministerial silos, with rigid departmentalism making it difficult to ensure that synergies across policy areas are fully exploited and duplication is avoided (OECD, 2014a). Many strategic priorities are cross-sectoral and the strict sectoral approach hinders their effective implementation.[1]

The success of reform effort depends on robust planning and co-ordination mechanisms, within a framework which allows strategic priorities to be set, via budget goals that are transparently defined and clearly aligned with budget instruments, while allowing systematic *ex ante* and *ex post* assessment and appraisal based on the promotion of evidence-based policy-making (like regulatory impact assessment and policy evaluation). Most notably, the following strategic weaknesses need to be addressed:

- *Collaboration on cross-cutting projects is inadequate*. There is a wide network of advisory boards, usually attached to specific ministries; the line ministries lead on their policy areas and the Council of Ministers takes final decisions on key issues. This leaves a gap, where complex policies and reforms that cut across traditional ministerial lines of command need to be addressed more collectively before they can be put to the Council of Ministers (OECD, 2014a).
- *Strategic planning is difficult*. There is a range of processes for different purposes, including short and much longer term strategic plans, additional to the Programme Declaration of the government. As line ministries are often in charge of these, timelines and methodologies can vary, which makes it particularly hard to align strategy with budget. Moreover, processes and institutions for ensuring the quality of impact assessment throughout the decision-making process are not yet well developed (OECD, 2014a).
- *Analytical capacity is limited*. Experience shows that the ministries responsible for the implementation of structural policies may not always have sufficient in-house expertise in relevant areas (Slovak government, 2013). Conceptual thinking is often absent and the quality of proposed solutions is compromised.
- *Monitoring and evaluation processes are undeveloped*. There are relatively large differences in the use of performance measurement across sectors. There is a tendency to focus on inputs and tasks rather than outputs and outcomes (OECD, 2014a).
- *Problems of central-local co-ordination*. A further set of problems arise from difficulties of central-local co-ordination, seen in the reluctance of national ministries to delegate control over the EU funds to lower governance levels. Slovak ministries are, for example, sceptical of the ability of municipalities and regional authorities to implement EU funds efficiently and on time (Bucek, 2011).

Correcting these weaknesses would make forward budget planning and prioritisation easier, achieving greater consistency and continuity. To some extent, better co-ordination

needs to come from the centre. For instance, the creation of the position of the Deputy Prime Minister for Investments, whose portfolio also includes co-ordination of preparation and implementation of the Partnership Agreement of the Slovak Republic for 2014-20, should improve co-ordination and prioritisation of public infrastructure investment. Institutions and incentives that support this position could help ensure that co-ordination and prioritisation is sustained over time (OECD, 2014a). There is also an ongoing effort to set a planning horizon that goes beyond the electoral term of the government in office and this needs to become established practice, in conjunction with the expenditure ceiling approach discussed above. To improve analytical capacity, analytical units are being set up by key social and economic ministries[2] and their effectiveness will depend on attracting sufficient expertise into the civil service: policy and strategy development, impact assessment, budget programming, monitoring and evaluation all require the building of a skilled and professional corps of civil servants. This needs to be fostered via civil service reforms (discussed below) which would help set a dividing line between political and non-political functions.

Getting the most out of EU structural funds is a key co-ordination challenge

Co-ordination problems have been most serious with respect to absorbing EU structural funds. At the end of 2012, Slovakia's contracting rate at 73% was the second lowest among CEE countries. It then increased abruptly in an attempt to fully absorb EU funding prior to the deadlines of 2007-13 programming period, though such a massive surge might have resulted in deteriorating project quality and so should best be avoided. This acceleration comes also with higher risks of irregularities and hence suspension of payment by the EU. In addition, it imposes tight deadlines to declare costs, as all the expenditures on projects that have to be reimbursed by the EC must take place by the end of 2015. Overall, several programmes had to speed up the absorption by more than 50% in 2013.

The incapacity of local administration to absorb the funds efficiently is linked to an extremely burdensome national system of structural funds administration, based on complicated rules and requirements; at the same time there is some evidence that the quality and the transparency of the selection process of certain projects have been low:

- The complexity of EU structural funds administration often goes beyond what is required by European institutions. Two important lost opportunities have been the slow adoption of simplified cost options, which would enable beneficiaries to claim indirect costs through a fixed formula, and of a simplified application process, which would postpone the need to gather all official verification after the application is accepted (CKO, 2011; EC, 2011).
- Administrative capacity has been inadequate, with an insufficient use of e-government, and human resource problems, including high staff turnover linked to political cycles. Almost 18% of administrative staff in charge of EU funds management left between June 2012 and June 2013 (CKO, 2013). However, on a more positive note, a unified organisational structure with training for the administration of EU funds has been introduced.
- There has been a marked lack of transparency in the project selection process and in public procurement. This is a key barrier to the efficiency of the EU structural funds absorption and poses a significant threat to the quality of projects and their cost efficiency (CKO, 2011; EC, 2012b). The situation contributes and aggravates the corruption problem in Slovakia, which is discussed below.

- There is a lack of instruments to measure and evaluate work performance. Over the years 2009-11, less than one half of planned evaluations of operational programs were implemented. With respect to the evaluation of individual projects, enlarging the toolkit remains a challenge; for example, projects could be evaluated based on the deviation from proposed measurable objectives.

On a positive note, some steps have been already taken to improve the administration of EU funds, such as the semi-annual publication on the implementation of EU funds that allows the authorities to react promptly in case of identified problems regarding absorption of the funds. Administrative procedures have also been simplified and allow the managing authority to request only partial project documentation upon the application submission, the rest of the documentation being required only after projects are selected. Some measures have also been taken at the European level to reduce the administrative burden for the next programming period, including the extension of simplified cost options to other types of costs. This extension will be challenging for Slovakia which has almost no experience with these options, compared with other countries. As part of the simplification measures, requirements for audits will be reduced. But to ensure that this will not be associated with greater corruption, simplification needs to be supported by transparent project selection and public procurement.

Better absorption is critical because the European Union structural funds offer Slovakia an opportunity to tackle its regional disparity problem while strengthening the development of the country as whole. Slovakia has been among the countries with the highest funding per capita and this high level of funding will continue in the forthcoming 2014-20 programming period. The current year is pivotal as the work on the 2014-20 programming period needs to be finalised: operational programmes have to be submitted to the European Commission by the end of September and signed by the end of December 2015. Insofar as governance has been an issue in the amount and distribution of funds, there is a need to address early the administrative impediments to the take-up and efficient implementation of EU structural funds (EC, 2013). In particular, guidance for the preparation and the selection of projects should be improved to raise the quality of projects applications, the transparency of the selection process should be increased and the assessment time of the certification authority should be reduced. Capacity for more evidence-based decision making should be built. With past deficiencies in mind, a key *ex ante* condition attaching to the EU Cohesion Policy, and the release of funds, has been that the Slovak Republic adopt a strategy for reinforcing administrative efficiency including public administration reform and modernisation (OECD, 2014a). To tackle those challenges, the authorities have hence launched a separate operational programme to support the building of an effective public administration (OP EPA).

Improving central-local co-ordination

While Slovakia is highly centralised in terms of revenues and spending autonomy (see Assessment and recommendations), it is also characterised by a large transfer of responsibilities to local units of the central government (Box 1.1). One crucial defect of this system has been the disintegration into specialised structures which are territorially and organisationally miscellaneous and difficult to manage. To correct these defects, the administrative reform programme has taken steps to make central direction more effective, the first stage having being completed in October 2012, when parliament approved a law replacing the system of so-called "specialised" state administration with a

Box 1.1. **Decentralisation in Slovakia**

There is a dual system of: 1) decentralisation that is meant to ensure the autonomous functioning of regional and/or local state administration; and 2) "deconcentrated" state administration that refers to the transfer of responsibilities to local units of the central government.

1. The framework of self-government is organised into two main levels without hierarchical ties between them but which function on the basis of mutual co-operation:
   - *The local level* represented by 2 926 municipalities.
   - *The regional level* represented by eight self-governing regions. The Constitution refers to the eight autonomous regions (*samosprávne kraje*) as "higher territorial units" (Article 64) and since 2002, they have been responsible for specific competences in several areas, and also for carrying out competences delegated by the central level of government.
2. The framework of "deconcentration" of state administration is subdivided into two aspects:
   - *The general state administration;* it is decentralised from the central level (Government Office, Ministry of the Interior) to the district level (district offices of general administration). This scheme applies, for instance, to administration procedures linked to entrepreneurship, general interior affairs, civil security or citizenship.
   - *The specialised state administration;* it is decentralised from the central level (government, ministries except for the Ministry of the Interior) through the regional level (regional offices of specialised state administration) to the district level (district offices of specialised state administration).

more centralised, integrated system. With this, the regional specialised public administration offices have been integrated into district authorities. The aim is to improve both the administrative and allocational efficiency of the Slovak public administration system. Rationalisation has indeed begun to have benefits: the merger of local government offices has also brought savings: for example, expenditures on operation and administration of buildings and costs of public procurement have already dropped, while further efficiency savings are expected from the non-replacement of posts in closed regional state offices.

The risk of current streamlining of local services is that "top-down" decision-making will become more dominant and the potential for local initiatives and regional development led directly by local stakeholders will be limited in the interests of ensuring a more efficient administration – of cohesion funds for example. To preserve the benefits of local democracy, while reaping efficiency gains, the reform could go further, embracing not just the rationalisation of the regional/district organisations but also bolstering the autonomy of the excessive number of municipalities, via a process of merger and consolidation or inter-communality as discussed in the Assessment and Recommendations. Merging municipalities and reducing the number of administrative intermediaries could generate significant efficiency gains, while also helping to prevent a recurrence of the central/local co-ordination problems thrown up by the crisis, which saw local governments running into debt. Such merging process has been implemented for instance in Canada, Denmark, Japan or Turkey. An alternative to merging would be to

provide incentives for co-operation by allowing retaining some of the efficiency gains. The need to reduce administrative fragmentation is generally acknowledged. Municipalities can already co-operate or even establish joint communal offices: there are 233 such offices in Slovakia covering almost all of the 2 926 municipalities, which could form a basis for joint provision of services across small municipalities. In a first step the current system of joint communal offices would have to be streamlined and joint provision of services across municipalities organised in order to maximise efficiency gains.

Management efficiency: Modernising the public administration

Modernising the public administration is the key enabling policy for improving performance of the public sector. It is an essential plank of the public administration reform as set out in *the Strategic Framework of Public Administration Reform* and the *National Reform Programme,* which was motivated by the perception that the Slovak public administration continues to underperform in terms of both quality and efficiency. For example, bureaucratic inefficiencies are cited as the most important impediment to business expansion (see below). Problems appear to be systemic, focused on the following areas:

- *Performance measurement is undeveloped*. Currently, there are relatively large differences in the use of performance measurement across sectors and there is a tendency to focus on inputs and tasks rather than outputs and outcomes.
- *E-government is underused*. One of the means to achieve greater efficiency is through a wider use of electronic means and reinforced analytical capacities in the state administration; IT systems are an essential interface between citizens and governments.
- *Human resource management needs to be improved*. Problems associated with a high turnover of civil servants are aggravated by a low use of strategic human resource practices such as planning, performance assessment and predictable career paths.
- *The integrity of the civil service is compromised by corruption*. Corruption raises costs and reduces the quality of public services, while undermining the trust in the government.

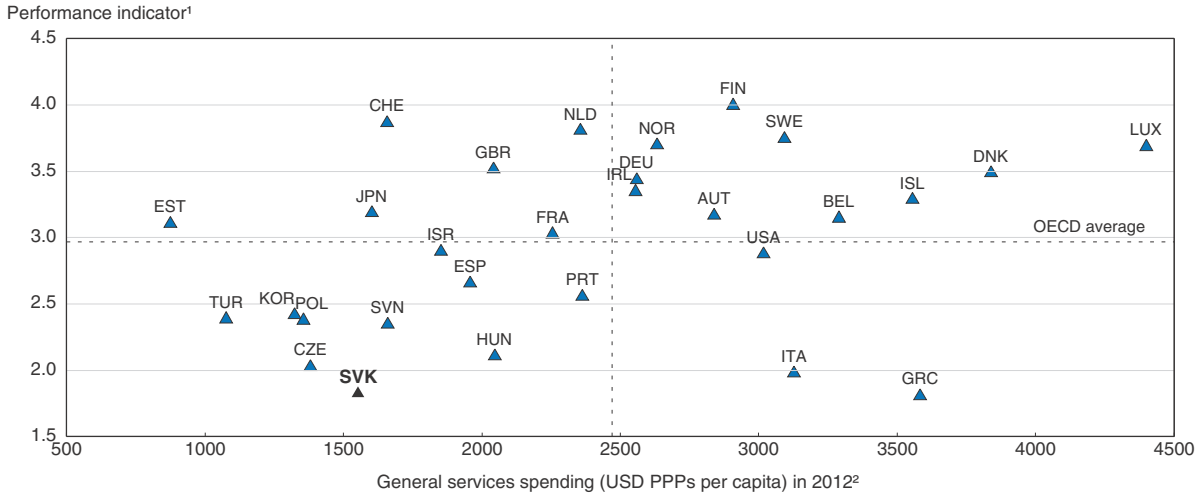
Results-oriented budgeting would improve administrative efficiency

Within the scope of binding expenditure ceilings, where high-level budgetary allocations are made centrally, budgets need to be implemented flexibly to ensure efficiency and service quality, based on results. Typical elements in a programme to devolve decision-making include increasing end-of-year flexibility (carry forwards). This requires a degree of "top-down" budgeting, which would involve each ministry being allocated funds (typically ring-fenced into economic categories), but being given more freedom in allocating them among agencies and programmes. In this respect, Slovakia already implements top-down budgeting and responsibilities delegated to line ministries broadly accord with international standards. While, as in most other OECD member countries, line ministries cannot decide on the allocation of the budget envelope between payroll and other expenses, or on the number and types of posts in organisations, capital expenditures are allowed to be carried forward and carry-forward for current expenditure is allowed within limits. However, consideration should be given to expanding these responsibilities further to increase managerial flexibility.

A focus on performance and results is the necessary accompaniment to greater managerial flexibility and a robust system of internal and external controls needs to be in place to prevent abuse. Administrative capacities and related follow-up assessments are

currently too weak to ensure that public spending programmes are implemented efficiently (Figure 1.6). To help correct this, the government has started to develop evaluation practices in each line Ministry and the Council for Budgetary Responsibility (CBR) is in charge of assessing the fiscal impact of policy proposals in parliament. The public sector has inadequate capacities and infrastructure for the creation and evaluation of policies, and there is little emphasis on customer satisfaction and the factors determining it – waiting time and length of the administrative process, for example. The role of the civil society organisations in public policy making and monitoring of policy implementation is also currently undeveloped.

Figure 1.6. **Resource inputs and performance in government general services**



1. Composite performance indicator for public administration outcome based on OECD's Product Market Regulation Indicator (for 2008) to proxy the levels of bureaucracy and results of the 2012 WEF survey on the quality of justice, level of corruption and government inefficiency (data for 2010).
2. 2011 for Austria, Korea, Luxembourg and Turkey. Data unavailable for Australia, Canada, Chile, Mexico and New Zealand. OECD aggregate across countries for which data in 2012 are available.

Source: Calculations based on *OECD Product Market Regulation Statistics* and WEF (2012), *The Global Competitiveness Index 2012-2013 Data Platform*, World Economic Forum; and *OECD National Accounts Database*.

StatLink http://dx.doi.org/10.1787/888933153965

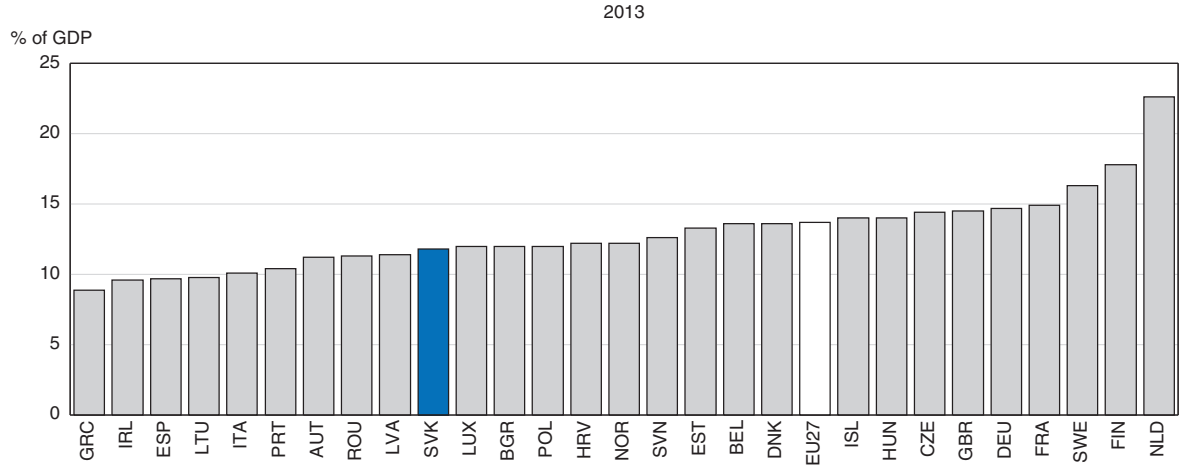
To make monitoring effective, appropriate performance and results information should be included in the annual budget documentation. Such indicators should offer an understanding of how the goals of various governmental policies and spending programmes are being achieved and could be used to assess spending effectiveness. Performance reporting should be carried out in a transparent manner and in a user-friendly format to avoid a useless swelling-up of budget documentation. The Slovak authorities could draw on OECD countries' experience in conducting their own performance evaluations. For example, Australia's Productivity Commission publishes an annual review of government programmes that is used in the budgetary formation process.

With its Public Finance Management reform, important progress has been made notably in respect of standardising accounting procedures, shifting from the cash principle to accruals and improving the content of budget documents. The Supreme Audit Office provides value-for-money audits, though the outcomes of these audits are not yet used in budgeting procedures. The *ex post* audit processes should be improved by allocating more resources to the monitoring of programmes and evaluation outcomes should be taken into account in budget

allocation. Budgeting procedures could make better use of international benchmarking by identifying best practices in this regard. Also, publishing a citizen's guide to the budget is good practice in international fiscal transparency initiatives by increasing accountability for individual spending areas (IMF, 2007). The current project of the authorities to create a website with user friendly information on the budget goes in the right direction.

Achieving greater transparency in public procurement is an essential element in cost reduction, especially given that the Slovak Republic spends around 11% of GDP on procurement, more than the EU average (Figure 1.7). Important progress has been made in this direction. Since the second half of 2010, the government has operated a mandatory electronic central registry of contracts on its central procurement website for the whole public administration, in which the dissemination of tenders, tender documents, the submission of bids and the publication of notification of awards is done publicly through a single portal. Contracts signed by general government organisations and municipalities, as well as any contracts involving public funds, become effective only after their publication. The single-entry procurement website is one of the few in the OECD that allows users to track the outcomes of contracts, an important functionality for making the public procurement transactions more transparent, increasing the scope of oversight by the civil sector. Nevertheless, there are still gains to be made by lowering barriers further, by ensuring that data is made available in more suitable and machine-readable formats (Fernas, 2013).

Figure 1.7. **Public procurement**



Source: Eurostat.

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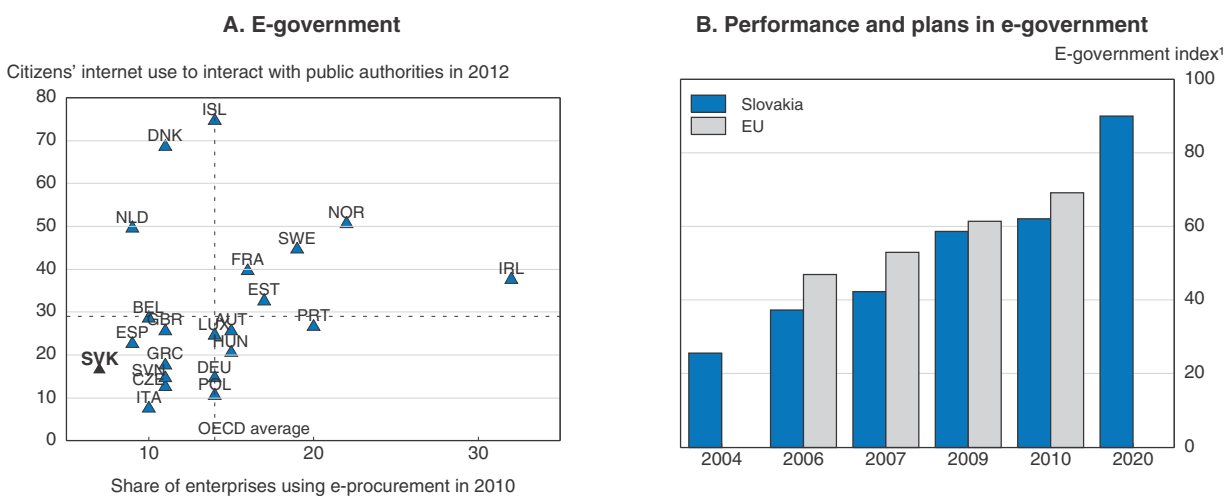
Manipulation of public procurement occurs either before or after the awarding of the bid, rather than during the decision process itself, which is now heavily regulated. Prior to the submission of bids, procuring authorities can limit competition and manipulate the results of the tender process by custom tailoring a contract or setting unreasonable conditions on who can submit a bid in the first place (Fernas, 2013). In that respect, public procurement still lacks some important elements of transparency insofar as Slovakia does not publish justifications for awarding a contract, which 40% of OECD member countries already do (OECD, 2012c).[3] Furthermore, formal mechanisms and institutional means of sanction are also not currently very effective (Fernas, op. cit.). Efficiency is also impaired because procurement rules restrict the choice of evaluation criteria, so that state

institutions are discouraged from making decisions on the basis of procurement quality. The 2013 Public Procurement Act reform, goes in the right direction, notably by allowing that not only cost but also quality considerations are taken into account. However, complaints have not reduced since the reform, pointing to the need of closely monitoring the implementation of this reform (Chapter 2). Also, procurement authorities should ensure that the Competitive Dialogue procedure – a more flexible procedure defined by the EU Commission and consisting in a pre-selection of candidates followed by a dialogue with bidders with the aim of developing suitable solutions to meet procurement requirements – is used for complex projects. In some areas current procurement rules are also perceived to be too difficult to apply. A task force should be implemented to provide recommendations as to how procurement rules could be made easier to apply without undermining their original intentions of fighting corruption and increasing efficiency. Slovakia is similarly lagging behind in term of e-procurement (Figure 1.8, Panel A), which not only reduces transaction costs and improves timeliness, but also enhances transparency and hence reduces the risk of corruption. For example, over half of OECD countries provide contract management tools via their portals, such as tracking contract outcomes or statistics related to past procurements.

E-government is underused

Slovakia has a relatively low level of online interaction between the public and government (see Figure 1.8, Panel A). For example, while citizens widely use government websites to find information, they very seldom use it to send forms. This increases the pressure on administrative resources, for example in the tax, administration and judiciary systems. A survey by the United Nations shows that in 2012, Slovakia ranked fourth worst among EU countries in the evaluation of e-government maturity, the areas furthest behind

Figure 1.8. **E-government**



1. For any given country, the index is calculated as a weighted average of the following three indicators: e-Government availability (50% weight), individual e-Government usage (25% weight) and business e-Government usage (25% weight). The e-Government availability measures the share of 20 basic e-Government services available via the Internet and the e-Government usage measures the percentage of people/businesses who have, in the last three months, used the Internet in communication with public institutions.

Source: OECD (2011, 2013), *Government at Glance* and European Commission (2013), "National Reform Programme of the Slovak Republic 2013".

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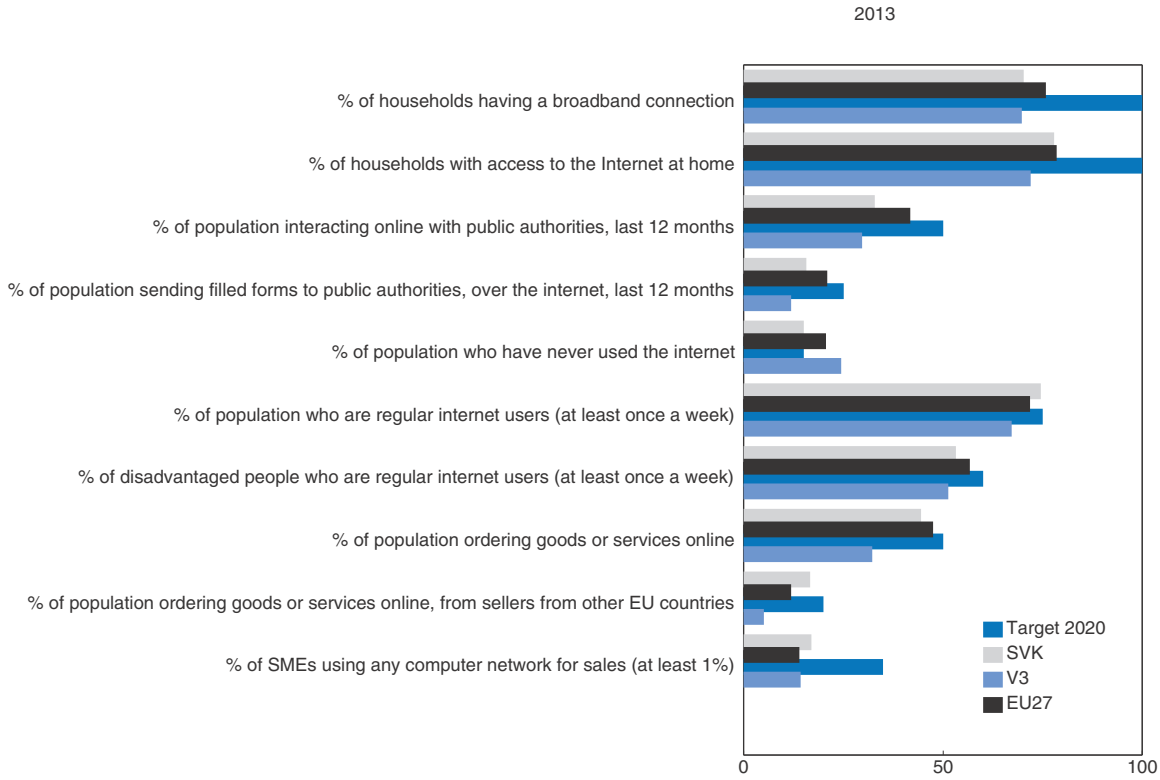
being online services and telecommunications infrastructure (UN, 2012). The Slovak Republic is also among countries with the lowest level of openness in terms of availability of public data, including reference data administered in public administration registers, which are needed for the exercise of public authority (State of Open Data, 2012). On the positive side, more recently, VAT payers, tax advisors and attorneys are required to communicate with the financial administration using online services.

The National Reform Programme (NRP) is quite ambitious in its plans for extending e-government (see Figure 1.8, Panel B), which will require a catch-up across a wide range of elements making up the "digital agenda" (Figure 1.9). Full achievement will not be possible without further investment in skills, both within the public service and among the wider population. For instance, in Slovakia 24.2% of the adult population report no prior experience with computers or lack of very basic computer skills – one of the highest shares in the OECD (OECD, 2013b). Low broadband penetration, particularly in rural areas, is obviously also an important barrier. As for the measures implemented so far in the area of modernisation and electronisation of public administration systems, these are often solved separately by different organisations without any interconnectivity of systems, through which individual public administration bodies could exchange information. The adoption of measures to facilitate the effective development of an integrated public administration information system and to improve the interoperability of its services is thus essential, in addition to simplifying administrative procedures to facilitate the use of ICT tools and using ICT tools to meet the individual objectives of the administrative reform programme (Box 1.2).

Figure 1.9. **Digital agenda**



Source: EC Digital Agenda Scoreboard Key Indicators.

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Box 1.2. **Using e-government to make reforms effective**

The projects being implemented should facilitate the provision of e-government services at the transaction level:

- The new e-ID card is designed to enable on-line authentication and authorisation of citizens, while the central e-government portal will serve as a single point of access to all e-government services.
- The Strategy for the computerisation of public administration aims to provide the public with the necessary ICT and transaction e-services through suitable entry channels as well as by creating preconditions for their effective management and distribution, in line with the National Strategy for the growth of digital services.

In addition, ICT tools will help achieve the individual specific objectives of the administrative reform programme:

- Strengthening analytical capacities of the public administration – analytical computerisation systems will be put in place in the areas such as the simulation of policy impacts, risk analysis and the uncovering of fraud and the solving of specific needs of individual analytical institutions. A system of central e-learning will also be put in place, which will enable the implementation of employee education and training courses online.
- Support human resources management – through the means of a complex information system for the management of human resources in e-government cloud and related applications for quality management.
- Effective public procurement and transparency – open data in the area of public administration, central tools for public procurement and services in the e-government cloud will be implemented and central e-learning will be used in the educational processes.

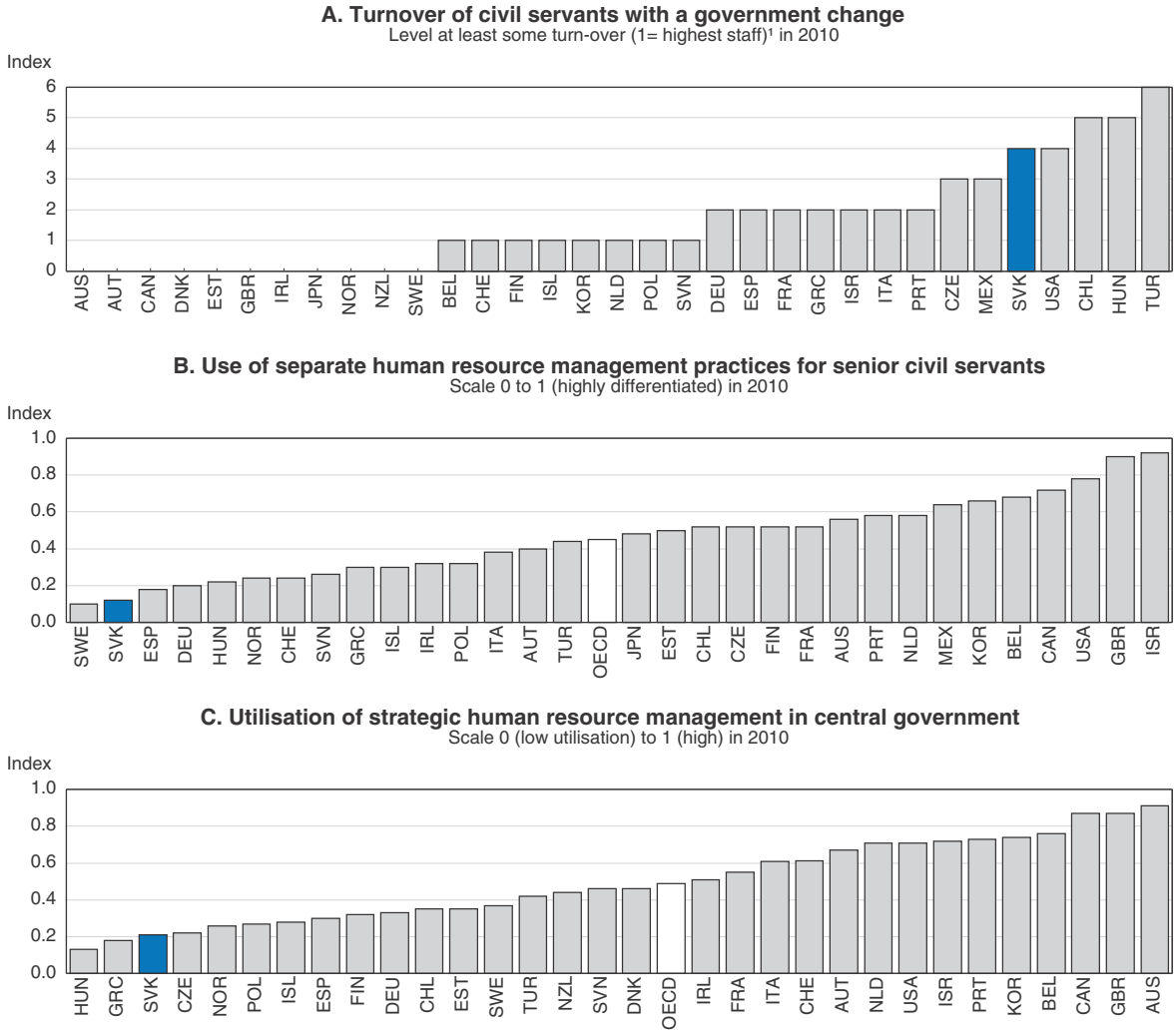
Improving human resource management

Modernisation should embrace reforms to human resource management. Slovakia is characterised by one of the highest turnover across OECD countries, including at the junior level (Figure 1.10, Panel A), in part as a result of the electoral cycle. High turnover reduces the incentive for skill and qualification accumulation and undermines the analytical, strategic and operational capabilities within the government. These problems are aggravated by a low use of strategic human resource practices such as planning, performance assessment and predictable career paths (Figure 1.10, Panels B and C). Ongoing administrative reform efforts seek to address these problems and key human resource responsibilities were centralised at the Government Office at the end of 2013. To be fully effective, this needs to be accompanied by an amendment to the Act on Civil Service, to increase the independence of the public service along with merit-based, transparent rules for career growth and higher remuneration.

The quality of public service is undermined by corruption

Slovakia is afflicted with a high degree of corruption, which raise costs and reduces the quality of public services. For example, according to a survey by Eurobarometer, 86% of respondents in Slovakia agreed that there is corruption in public institutions, which is well above the European average (EC, 2013b). Slovakia is among worst OECD performers in the Transparency International Corruption Perception Index (2013). Corruption is perceived as particularly high in the health sector, but also at the central government and, most

Figure 1.10. **Human resource management needs to be improved**



1. The bar shows to what extent there is a change of positions at different levels of civil servants when the government changes. The level (y-axis) ranges from 1 (most senior, i.e. highest level of career in civil services) to 6 (lowest). In the countries with no turnover, the first eleven countries in the figure, a change of government does not directly affect the employment of staff of public servants. The small number of public servants employed in Ministerial offices on an event-based contract, with the event triggering the termination of their contract being the conclusion of their relevant Minister's term in office is ignored. Data for Luxembourg does not exist and data on turnover in level 5 and 6 are not available for all countries.

Source: OECD (2011), *Government at a Glance*.

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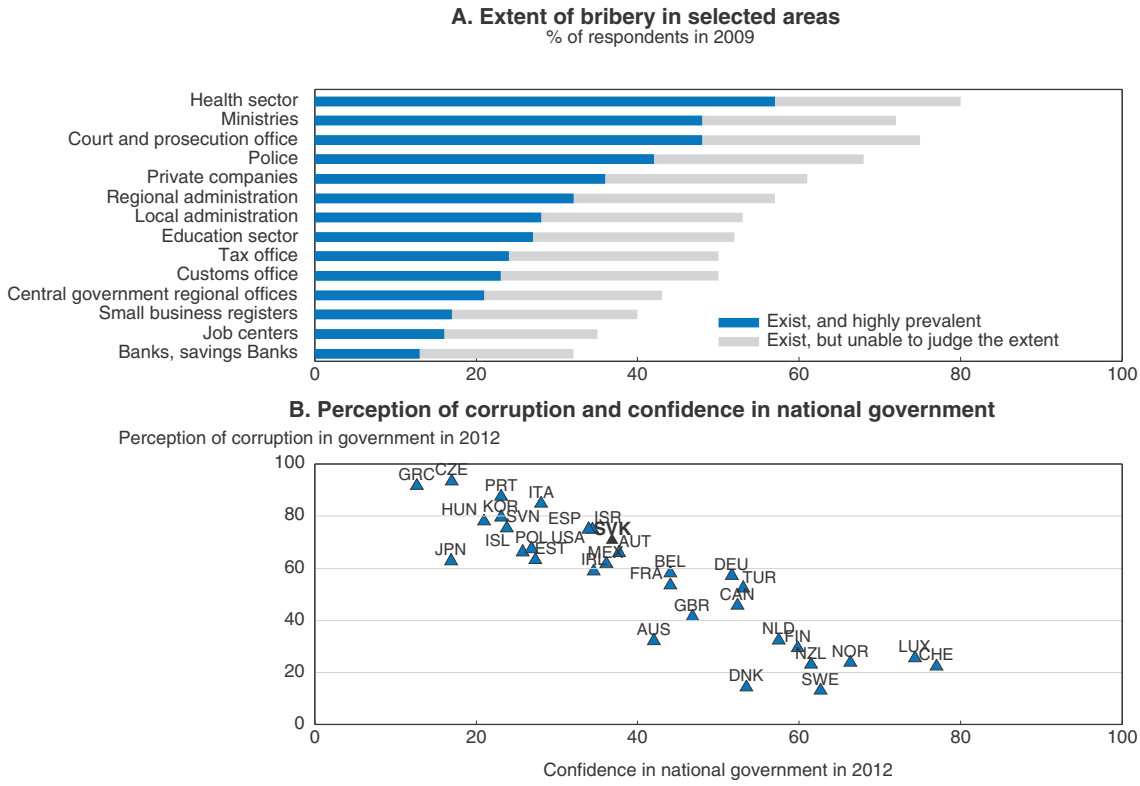
worryingly, in the judiciary and law enforcement systems (Figure 1.11, Panel A). Slovakia scores also the worst in the public procurement assessment by EBRD. Indeed, corruption and the perception of corruption undermine trust in government (Figure 1.11, Panel B).

A comprehensive strategic national plan for fighting corruption was adopted in August 2011 as an amendment of earlier strategic document. The implementation evaluation prepared in 2014 showed that close to 80% of planned legislative, institutional and operational measures have been implemented by key institutions. The greatest progress has been achieved in the areas of defining clear criteria for issuing licences, franchises, permits, loans and state subsidies, that allow limiting the discretion when making such decisions at all levels of the government. Increased transparency has also

Figure 1.11. **Extent of bribery and corruption perception in selected areas**



Source: Transparency International Slovensko; World Economic Forum (2014), *Global Competitiveness Index Database.*

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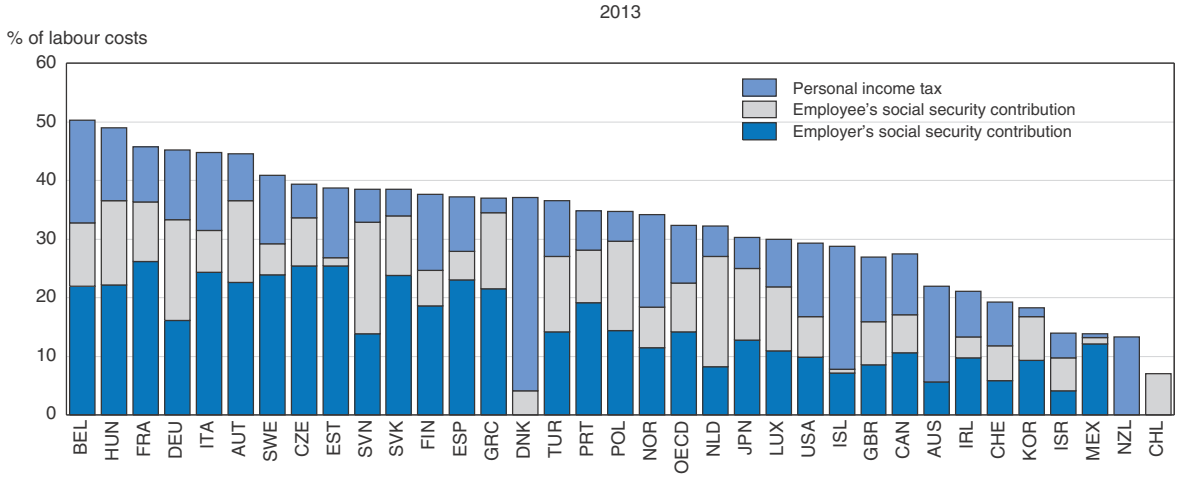
been introduced in the area of public procurement. This work is, however, not completed. Also, a code of ethics for civil servants was adopted in April 2013. Several practical solutions for encouraging and protecting whistle blowers have introduced, including an anti-corruption hotline. No assessment of the success of the strategic plan is yet available, and investigations of high-profile political corruption cases, have not been completed despite clear public concern. The degree of forward momentum on anticorruption efforts is thus difficult to judge, but perceptions remain poor, calling for continued ongoing commitment to anti-corruption initiatives.

Economic efficiency: Reducing the burden on the private sector

Improving the efficiency of the tax system

Consolidation has resulted from revenue as well as expenditure measures, a by-product of which is that the share of the revenues with a higher negative impact on growth, namely direct taxes and social contributions, is increasing. A feature of the tax system is the relatively high reliance on social security charges, in particular charges paid by employers (Figure 1.12). Also, the time firms spend complying with tax legislation in Slovakia is 15% greater than the EU average and double that in the best-performing European economies; this is linked to the extremely high number of payments which have to be made in respect of smaller taxes and fees. It is thus important to address both the

Figure 1.12. **The tax wedge is high**



Source: OECD Taxing Wedge Database.

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possible adverse effects of tax on businesses and the administrative burden of compliance. In particular, there is evidence of over-complication, which is likely to be associated with more corruption and less investment (World Bank, 2013).

The structure of the system is also distortive in several respects and reforms offer the opportunity for some rebalancing in the tax burden. In particular, distortions in the taxation between different types of employment need to be removed, real estate taxation should be updated by linking the tax base to the market value of property and greater use needs to be made of environmental taxation. Action may in particular improve allocational efficiency and assist growth in three areas:

- Self-employed workers have benefited from a lower tax wedge compared to standard workers, which has encouraged firms to avoid social security contributions by substituting self-employed for regular employees. Measures have been taken to make the tax treatment of self-employment income less favourable, which should alleviate the burden on dependent work (EC, 2013a). However, the effective tax on self-employed income is still significantly smaller than that on employee income, so further progress towards neutrality could be made.
- Slovakia has relatively low receipts from recurrent taxes on immovable property (1½ per cent of total revenues compared with 5½ per cent for the OECD area). Political obstacles in this area are compounded by institutional problems: in particular, reform would require a better land registry. The authorities are currently considering broadening the taxation by changing the tax base from the number of metres to the value of the property (NRP, 2014).
- Removing non-neutralities with respect to energy taxation, including phasing out tax exemptions on energy would allow taxes on other activities to be reduced. Such exemptions have adverse environmental effects, lead to a misallocation of resources, encourage wasteful consumption and impede investment in clean energy sources (OECD, 2009).

Better tax administration would reduce costs and raise revenues

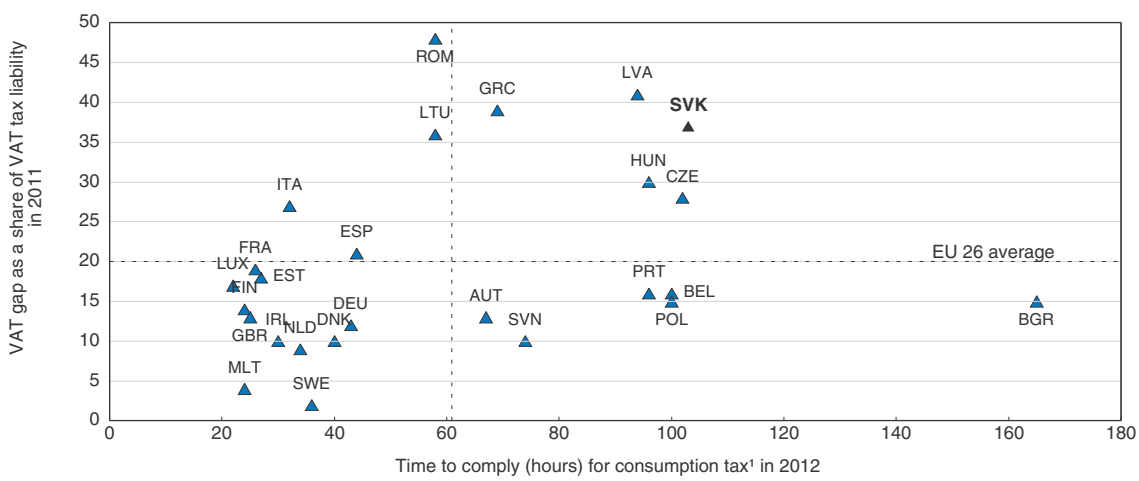
The current tax system is also characterised by number of administrative inefficiencies. The "cost of collection ratio", which compares annual administration costs with the total revenue collected, is the highest in the OECD. In particular, Slovakia needs to improve the efficiency of tax collection (Table 1.2), especially with respect to the VAT where revenues fall significantly short of what a standard rate would produce (Figure 1.13). Bringing the efficiency of VAT revenue collection up to the OECD average would raise revenues equivalent to 0.6% of GDP. Compliance is low, associated with high VAT compliance costs, in part reflecting its complexity. There is also a problem related to the high proportion of VAT refunds – more than 50% of gross collections of VAT were refunded in 2010 (OECD, 2013c). This mainly reflects high exports, but there is a need both for systematic processes for granting timely VAT refunds to compliant taxpayers and robust compliance checks for the detection of fraudulent refund claims.

Table 1.2. **Costs of tax collection**

Cost of collection ratio in 2011	Countries (by level of tax/GDP in 2011)[1]		
	20-30%	30-40%	Over 40%
0.61-0.80	United States	Iceland	Austria,[1] Denmark, Finland
1.01-1.20		Hungary, Ireland	France[1]
Over 1.41	Japan[1]	Poland,[1] Slovak Rep.[1]	Belgium

1. For these countries, SSC are collected by separate agencies, not the revenue body.
Source: OECD, 2013c.

Figure 1.13. **Efficiency of tax collection is low**



1. Time taken to complete the tax compliance process of preparation, filing and payment of the consumption tax. Time is in hours per year. Consumption tax refers to value added tax or sales tax.
Source: PwC (2014), *Paying Taxes 2014* and European Commission (2013), *Study to Quantify and Analyse the VAT Gap in the EU27 member states*.
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The fragmentation of tax collections has been one of the main reasons for these negative cost and compliance features. On 1 January 2012, the separate Tax and Customs Directorates were amalgamated within a new Financial Directorate and the office network rationalised. Although the integration of social security contribution was planned to be

effective from 1 January 2014, it was delayed, and it is uncertain when it will finally happen. Slovakia has also rationalised its network of Tax Offices, reducing 101 Tax Offices to 8 on 1 January 2012, which should improve efficiency of tax system. Reform at the headquarters level also took effect at this time – the Customs Directorate of the Slovak Republic and the Tax Directorate of the Slovak Republic merged into the Financial Directorate of the Slovak Republic.

At the same time, strategies for managing taxpayer services, hitherto significantly underdeveloped in comparison with other OECD economies, have needed to be upgraded. Electronic services for the basic tax returns filing (for all the major taxes) were extremely under-developed as of end-2011. Arrangements for electronic tax payments have since been improved and a dedicated call centre was established in 2013; but strategies for supporting tax professionals in aspects of tax administration (e.g. with flexible return filing arrangements, online access to client records) are as yet undeveloped, although it should be acknowledged that many countries are deficient in this area. Some steps are currently taken to increase legal certainty for tax payers who have the possibility from September 2014 to ask for information at the Financial Directorate (against fees). Finally, as elsewhere in the public administration, staff attrition rates have been high, at almost double the OECD average, pointing to possibly substantial efficiency gains from better work and job design, and enhanced training and developmental opportunities.

Significant progress has also been made fighting tax evasion. Many measures to fight tax evasion were adopted in the 2012 action plan, focusing mainly on improving VAT collection. They are already bringing important outcomes, the gap between VAT collection in the EU and Slovakia having shrunk considerably from 40% in 2012 to 36% in 2013 (NRP, 2014; SP, 2014). New measures include in particular the "tax cobra" scheme to fight major fraud in co-operation with the police and prosecution services and a lottery encouraging customers to request a receipt to promote the payment of tax (NRP, 2014). Efforts should be continued by implementing the third stage of the action plan aimed at improving tax collection, in particular through the introduction of an Electronic Registry of Insolvent Entities (NRP, 2014).

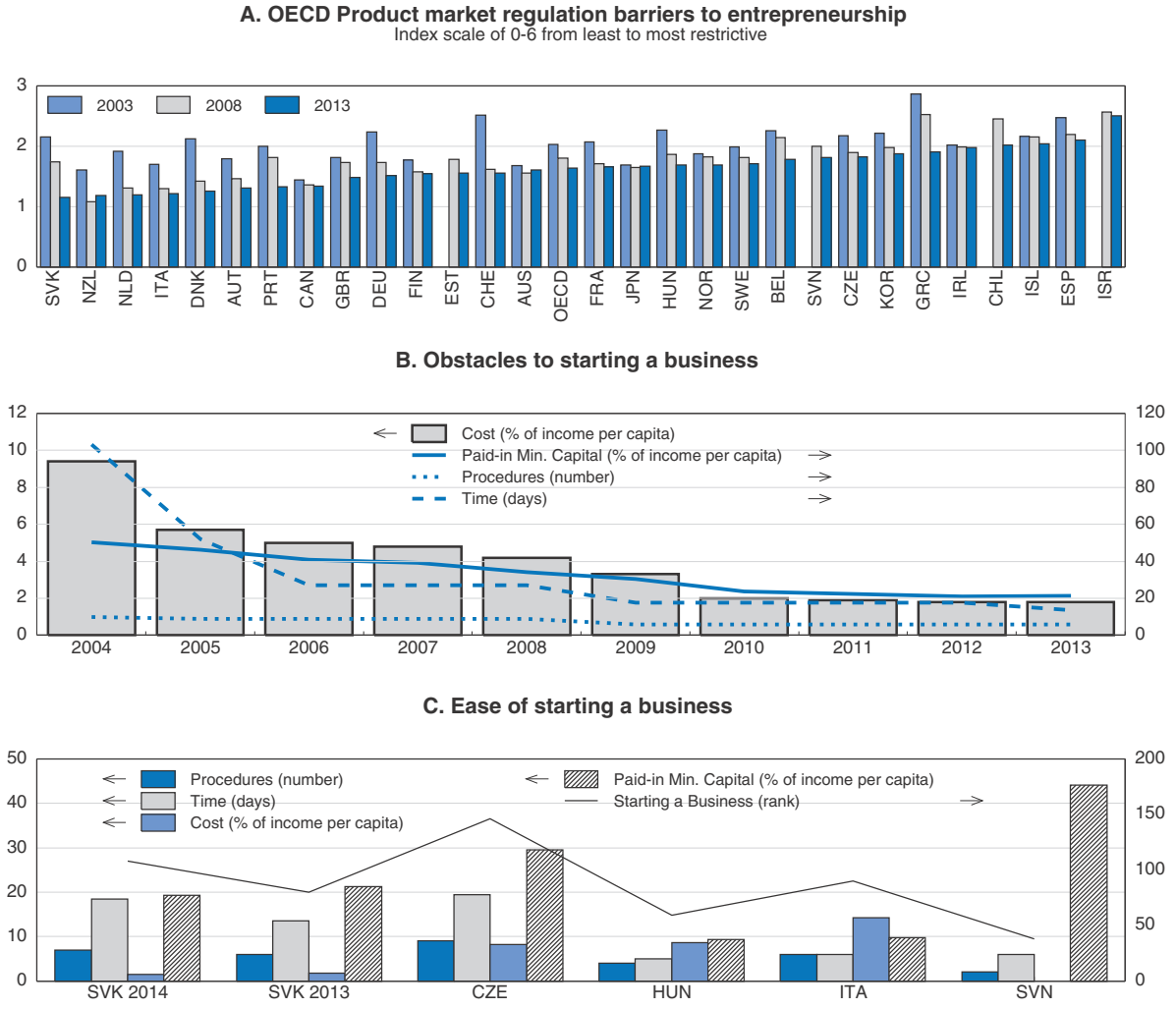
Regulatory and compliance burden on business are excessive

According to OECD product market regulation (PMR) indicators, Slovakia made good progress in reducing barriers to entrepreneurship over the 2008-13 period. Beginning from a relatively high level, the overall measure of entrepreneurial impediments is now the lowest of all OECD countries (Figure 1.14, Panel A). However, in some areas the reform impetus has been falling behind and current regulation is far behind best practice (World Bank, 2013). Equally important, weaknesses in the functioning of the public institutions which administer the business environment and ensure law enforcement need to be removed. Slovakia has made little progress in improving the efficiency and transparency of its judicial system and continues to score poorly in international indicators of corruption and e-government (see above).

Making it easier to do business

Time needed for starting a business is important and Slovakia's ranking has been slipping (World Bank, 2013; Figure 1.14, Panels B and C). On the positive side, a "silence is consent" procedure has been introduced, which has significantly simplified the process of opening and operating a business. Another improvement has been the creation of single

Figure 1.14. **Barriers to entrepreneurship have been reduced**



Note: OECD refers to the average of the OECD countries for which data are available in 2013.
Source: OECD (2013), *Product Market Regulation Indicators* and World Bank (2013), *Ease of Doing Business*.

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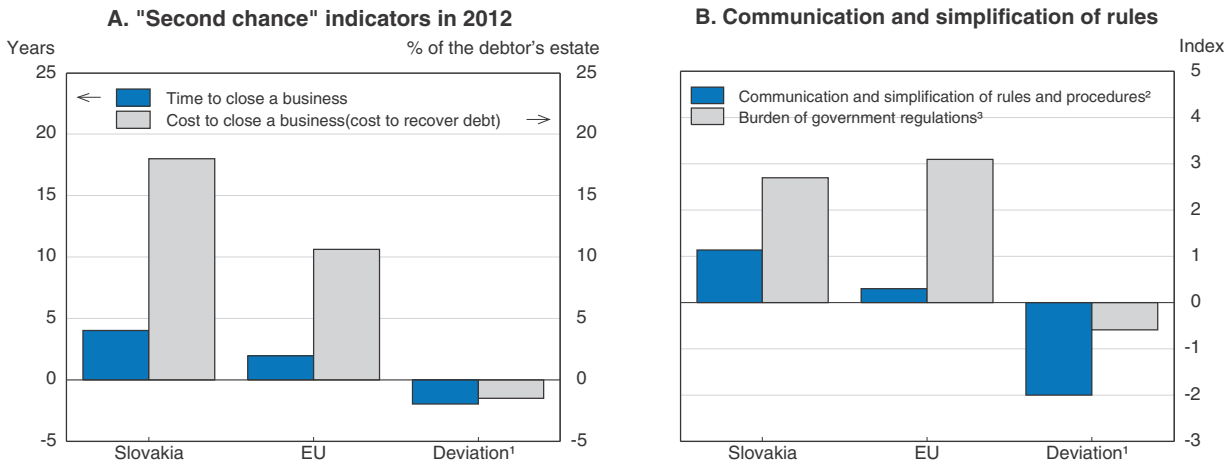
contact points that can issue or collect all the notifications and licences via the Internet. Under a "one-stop shop" process, Trade Licensing Offices have been created for trade licences, income tax and health insurance with one application form. However, despite progress, the number of procedures for start-up is still relatively high, and even increasing with respect to establishing a limited liability company (Figure 1.14, Panel C), indicating red tape. Overall, the Slovak Republic needs to make further efforts to improve the business environment.

Since 2008, Slovakia has been responding to EC recommendations aimed at eliminating barriers to SMEs while setting up an "ideal" environment for them. In 2009 and 2010, laws covering a wide range of areas were assessed, including accounting, bankruptcy and restructuring, market regulation. In June 2011, the Agenda for Better Regulation and the Action Programme for Reducing Administrative Burden for 2007-12 featured a commitment to reducing the administrative burden by 25% by 2012, a goal with

respect to which no *ex post* assessment is available. According to the more recent information acquired through the latest round of estimating the OECD PMR Indicator, legislation in this area has improved, in particular regarding administrative burden on corporate start-up (OECD, 2013d). Legislation should be closely monitored in how far these welcome reforms are implemented in a way which allows reducing the time and costs of closing a business (Figure 1.15, Panel A), and simplifying the administrative burden on firms interacting with government (Figure 1.15, Panel B).

Figure 1.15. **Regulatory burden on SMEs**



1. Slovakia deviation from EU average.
2. Scale from 0 (max) to 6 (min). The communication and simplification indicator is calculated using the country's self-reported answers in 2008.
3. Scale from 1 (burdensome) to 7 (not burdensome). The burden of regulation refers to 2011.

Source: European Commission (2012), *SBA Fact Sheets*.

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The EC identifies a range of tools to ensure the effective implementation of the "better regulation" principle, including the application of an "SME test" for legislative proposals, the use of SME-specific provisions in legislation to avoid inadequate regulatory/administrative burden on SMEs, and consultation of SME stakeholders (EC, 2012c). However, in Slovakia the regulatory framework has been frequently changed without sufficient analysis of its impact on the private sector via regulatory impact assessments. The processes and the institutions for ensuring the quality of impact assessments throughout the decision-making process do not seem to have been adequate to prevent continued excessive regulatory and administrative barriers and until the latter years of the last decade were well away from best practice (Jacobzone et al., 2007). Against this background the rules and institutions of Regulatory Impact Assessment (RIA) had to be re-formulated. A unified methodology was introduced in 2008 and updated in 2010, stipulating the obligation to evaluate the impact of new legislation on 5 areas, including on the business sector (Box 1.3).

This process is now in need of strengthening: the national reform agenda includes a promise to increase the quality of the legislation creation process, by updating the methodology used for assessing the selective effects of legislative and non-legislative proposals, including the introduction of obligatory consultations with the affected entities as well as obligatory analysis of alternative solutions (NRP, 2014). The authorities could

Box 1.3. **Regulatory impact assessment in Slovakia**

A unified methodology was introduced in 2008 and updated in 2010, stipulating the obligation for evaluating the impact of new legislation on five areas: business, public finance, social area, environment and information society/e-government.

Intergovernmental comments proceedings

Since 2010, an obligation to provide an Annex has been established where the expected impact in each area is presented. This annex is mainly based on assumptions but is supplemented by deeper analysis in case the initial assessment identifies either a positive or a negative impact. Such an annex is required for all legislative or non-legislative materials and is discussed in the context of intergovernmental comments proceedings, which is settled prior to the submission to the government session.

The intergovernmental comments proceedings last from 5 to 15 days, depending on urgency and nature of a proposed material. Exceptions are possible if a material is of an informative nature and does not contain a draft decision of government.

Pre-comments proceedings

Prior to intergovernmental comments proceedings a pre-comments proceedings is performed, which requires submitting the proposed material to four supervising ministries in charge of evaluating the quality and accuracy of the impact analysis. Since 1 September 2011, this step is no longer mandatory but just an option for legislative material.

Regulations resulting from implementation of EU directives are excluded from the pre-comments proceedings.

The pre-comments proceedings last from 5 to 20 days, depending on the urgency.

Impact on business environment

This includes the type and number of subjects affected, the range of costs and contributions, the amount of administrative costs, the effects on the functioning of markets, and the socio-economic impact. This has contributed to improve the efficiency of regulation and reduce the negative impacts of regulation on the business environment.

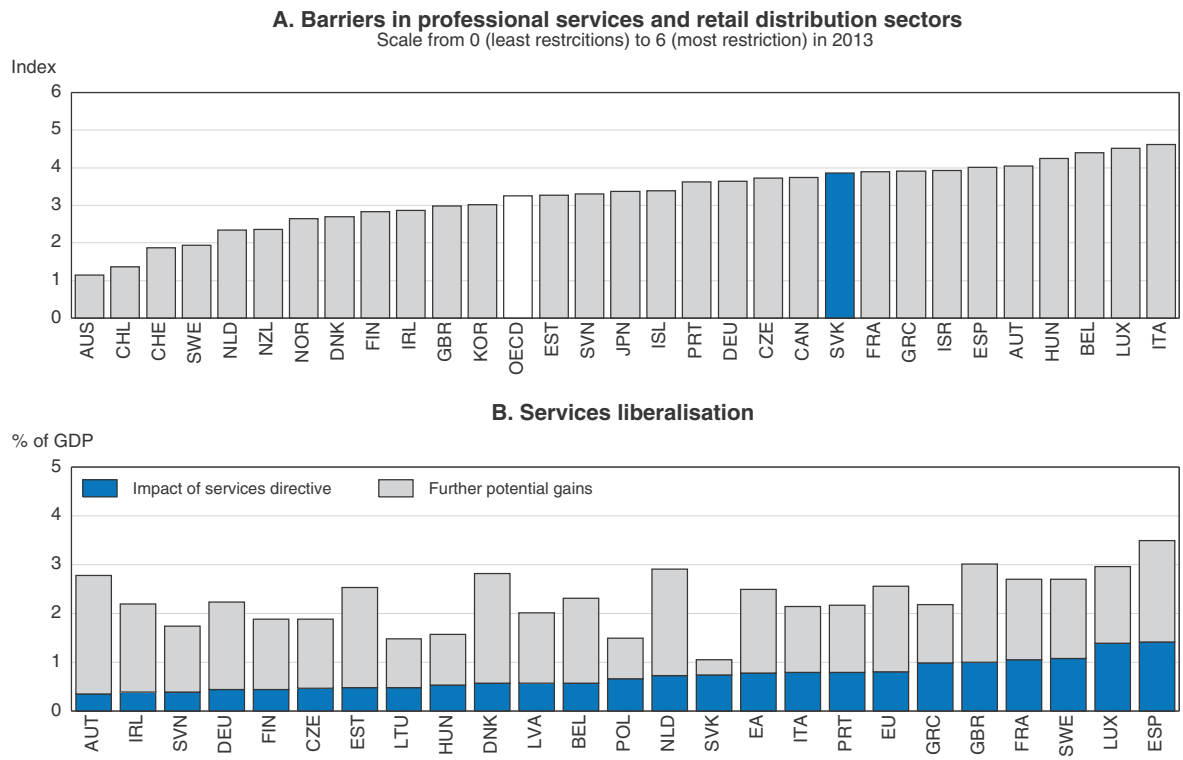
take this opportunity to design the RIA methodology in line with international best practices identified in the review on Regulatory Compliance Cost Assessment (OECD, 2014b). Communicating the results of the RIA is also essential for improving regulatory design (OECD, 2008). Going forward, an independent group of experts which would provide statements on the quality of impact assessments would also contribute to strengthening the quality of regulatory assessment process. The Dutch *Actal*, the German *Normenkontrollrat* or the Czech *RIA Board* can be used as examples. Finally, RIA process should be under the responsibility of a single central institution which should play a leading role in the implementation of policies, the co-ordination between ministries, the quality control of assessment, the choice of a unified methodology and the implementation of training and assistance to line ministries.

Further progress needs to be made in liberalising services

Many of the regulatory barriers to entry into services, as defined under the EU Services Directive (in force since end-2009), have been abolished.[4] Fees charged by the engineering and architecture professions have been deregulated, for instance. However, in some areas, there is a trend towards tighter regulation. For example, the number of years of practice for

the legal profession has increased, and in the retail sector there is still a maximum limit on the value of the discount for products. Overall, as measured by the OECD PMR indicator for professional and retail services, Slovakia still has much progress to make (Figure 1.16, Panel A). Some of the gains will be locked in under the EU Services Directive. According to EU calculations, full implementation of the services directive is projected to yield benefits of 0.75% in terms of GDP, a figure which is quite close to the EU average gain (Figure 1.16, Panel B) (EC, 2012d). The gains would be somewhat larger if the Slovak Republic were more ambitious and move to the level of restrictions of the five best countries in the EU per sector which is *de facto* close to a full elimination of barriers; that would bring additional gains amounting to almost 0.35%.

Figure 1.16. **Services liberalisation**



Source: OECD (2013), *Product Market Regulation Database* and *EU Single Market Regulated Professions Database*.

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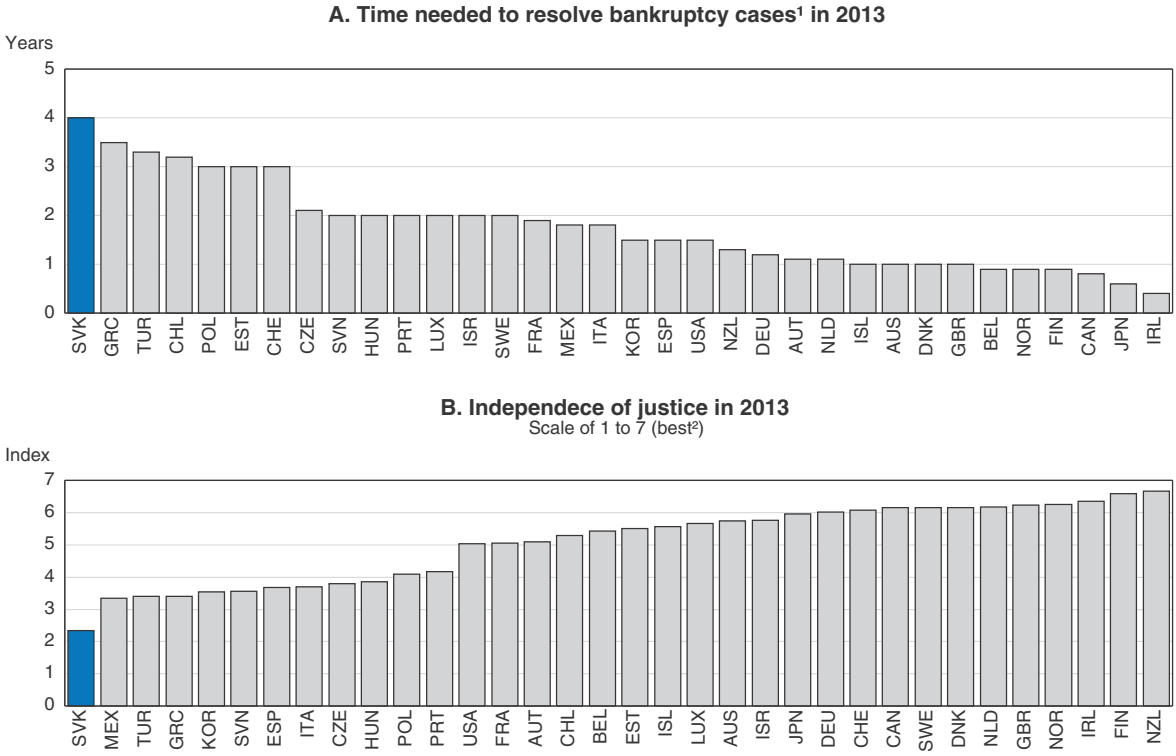
An inefficient justice system is holding back the economy

The judicial process in Slovakia is slow, burdensome and unreliable, limiting access to judicial settlement, complicating business activity and adding to business costs (Figure 1.17). According to the World Economic Forum indicators, Slovakia ranks in the bottom 2% of surveyed countries with respect to the efficiency of the legal system in settling disputes and in challenging regulations (WEF, 2013). The time required resolving the bankruptcy procedure is four years, much higher than the OECD average and higher than would be required for the system to act as filter for ensuring the survival of economically efficient companies, or reallocating the resources of inefficient ones (World Bank, 2013). Contract enforcement takes 545 days, costs 30% of the value of the claim and

Figure 1.17. **Indicators of judicial process**



1. Time to resolve insolvency is the number of years from the filing for insolvency in court until the resolution of distressed assets.
2. The highest value means better perception.

Source: World Economic Forum and World Bank Doing Business (2013).

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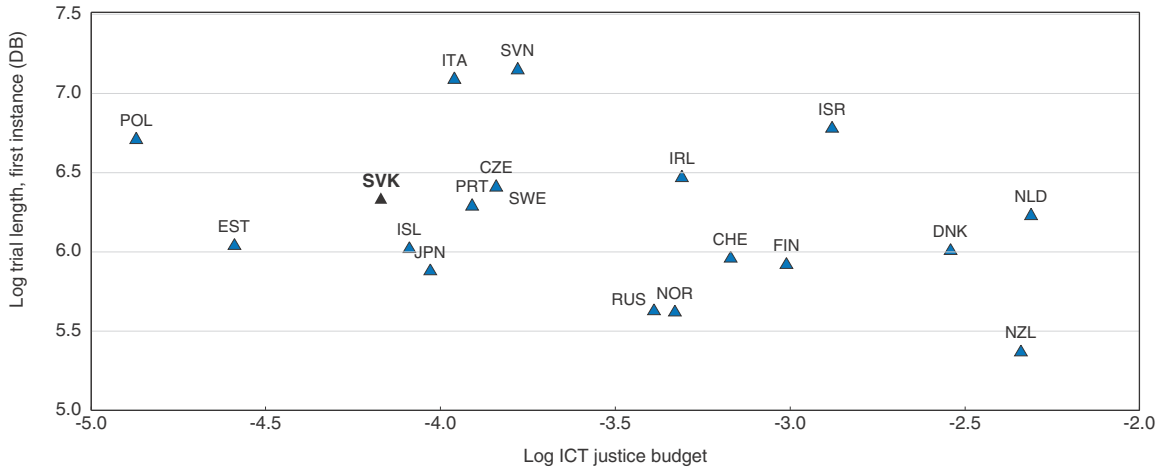
requires 32 procedures (ibid.). Securities regulations, company law and court rules of evidence also point to a weaker degree of investor protection than the OECD average.

The judicial system is also perceived as globally one of the least independent (WEF, 2013), which discourages the pursuit of justice. Where cases are pursued, justice is rather slow. While it allocates around 0.2% of GDP to the courts' budget, similar to Switzerland and the Czech Republic, the average trial duration is 2.7 times longer and the cost of trial as a percentage of the value of the claim is among the highest in the OECD and several times higher than in best performing countries (Figure 1.18). Thus the judicial system needs streamlining if the modernising of the public administration is to have full effect on the business environment.

Progress towards reform is slow. The Slovak Republic has recently improved its insolvency processes and contract enforcement, intended to simplify and speed up proceedings and limit obstructive tactics by parties to a case. However, the court infrastructure needs modernising, and the judiciary needs to be more transparent. To help achieve this, greater priority could be given to policies that increase the capacity of the system to meet the demand for justice, such as computerisation, which is currently among the lowest across the OECD, the adoption of more advanced case-flow management techniques and the enhancement of the degree of court specialisation. Judicial appointments also need to be made completely transparent. As part of the strategic policy framework, significant reforms are planned to modernise the judiciary, to eliminating

Figure 1.18. **ICT justice budget and judicial performance**



Note: The share of the justice budget allocated to informatisation (ICT justice budget) is computed as the ratio of annual public budget allocated to computerisation to the public budget allocated to the functioning of the courts (excluding financial resources devoted to legal aid and public prosecution services). Trial length is taken from the World Bank *Doing Business*. The share of budget allocated to ICT may under-estimate the effective amount of resources devoted to ICT for it does not include co-financing by supranational bodies (e.g. EU structural funds).

Source: OECD (2013), "Judicial Performance and its Determinants: A Cross-Country Perspective", *OECD Economic Policy Papers*, No. 5.

StatLink http://dx.doi.org/10.1787/888933154066

delays in court procedures and to increase the quality of court decisions and court staff, and promote alternative dispute resolution mechanisms. So far most of the proposed legislative changes have not been fulfilled, but it is important that the target deadlines through to end-2016 be met.

Recommendations for reforming the public sector

Key recommendations

Refining fiscal consolidation

- Implement multi-annual binding spending ceilings to reinforce budget discipline in upturns.
- Continue strengthening revenue collection, and increase taxation on property and environmentally harmful activities.

For a more efficient and effective public administration and regulatory environment for doing business

- Establish better human resource management, modernise public administration and strengthen co-ordination and collaboration across government.
- Reduce regulation in professional services and retail trade, strengthen regulatory impact assessment.
- Strengthen the efficiency and independence of the judicial system.
- Ensure that public procurement achieves the best value for money and continue with measures fighting corruption, *inter alia* by guaranteeing better transparency.

Recommendations for reforming the public sector *(cont.)*

For a better use of EU funds

- Streamline administrative procedures and strengthen capacities to manage EU funds.

Further recommendations

Ensuring efficiency of public spending

- Re-prioritise spending towards investment.
- Modernise management, via performance budgeting, e-government, and more open public procurement.

Refining the role of state in the economy

- Improve the efficiency of tax administration
- Reduce bureaucratic costs and delays and make regulations more business-friendly.
- Increase judicial capacity in particular through investment in IT systems.

Notes

1. An example of this is climate adaptation with anti-flood measures which, in the case of ecosystem-based solutions, require the co-operation of the Ministry of Environment and its organisations that deal with water, biodiversity or climate, the Ministry of Interior Affairs that deals with the adaptation agenda, and the Ministry of Agriculture and Rural Development that has responsibility for agriculture, soil management and forestry. In this area, if co-ordination is lacking – and unfortunately it is – simple fast-track solutions with questionable adaptation effects, such as dam building, will be preferred.
2. For example, the job of the newly created Educational Policy Institute EPI is to prepare analysis, to forecast, and to give expert advice concerning strategic policy decisions in education, in co-operation with relevant ministry's departments (Šiškovič, 2013).
3. As of 2012, information on the justification for awarding contracts was available in thirteen OECD member countries and contract modifications were publicised in eleven members; however, only six countries provided information that allowed the tracking of procurement spending (OECD, 2012c).
4. The scope of the Act includes: travel agencies; hotels; construction/building companies; real estate agents; tourist guides; small retail shops; restaurants; large retailers; certification service in the area of construction; crafts businesses in construction sector; engineers; tax advisers; architects; legal services; accountants.

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Chapter 2

Spurring growth in lagging regions

Regional inequality in Slovakia is among the highest in the OECD and is increasing. The main reason for regional disparity is the combination of low economic growth and job creation in the eastern and central part of the country and insufficient labour mobility to the west, in particular by low-skilled workers. As a result, jobs shortage and lack of technological capacities in the central and eastern regions persist alongside skills shortages in the Bratislava regions. Boosting convergence requires a multi-pronged approach involving innovation, labour market and educational policies. Completing the transport infrastructure network in Slovakia will be both important for removing expansion bottlenecks in the Bratislava region and reducing obstacles for job creation in the central and eastern regions.

Individual income inequality in Slovakia is low, but regional inequality is high, which means that low income earners are regionally concentrated. Regional inequality is apparent in terms of GDP per capita, income, employment and poverty indicators (OECD, 2013a). The life satisfaction index is also significantly below the OECD average and regional disparities are striking; more than 80% of the population in the east believe that their situation and chances for improvement are worse compared with the rest of the country, while only 13% share this thinking in Bratislava (Figure 2.1). Higher and more inclusive growth facilitating regional convergence is needed to counter the geographical dualisation.

Figure 2.1. **Slovakia has high regional inequality and low life satisfaction**

Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Regions of the OECD countries are classified according to two territorial levels: the high level (TL2) and the low level (TL3). Regions at TL2 are divided into smaller regions at TL3. TL3 level data are used except for Australia, Canada, Chile, Mexico and United States.
2. The indicator is measured as a weighted-sum of different response categories based on people's rates of their current life relative to the best and worst possible lives for them on a scale from 0 to 10, using the Cantril Ladder.
3. Percentage of responses to the following question: "Do you think the situation and chances of the population living in your regions are 'worse' compared to the average of Slovakia?"

Source: OECD (2013), *Regions at a Glance*, *OECD Better Life Index Database* and Institute for Public Affairs.

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The main reason for regional disparity is the combination of low economic growth and job creation in the eastern and central part of the country and insufficient labour mobility to the west, in particular by low-skilled workers. Promoting regional growth requires the adoption of a multi-pronged approach, which combines personal and regional aspects. Such a comprehensive programme needs to focus on developing the rental housing market, stepping up ALMPs, making education more employment-focused, completing transport infrastructure and targeting innovation policies to regional needs (discussed in this chapter), together with public sector reform (discussed in Chapter 1). Some issues were already

identified as essential challenges in former *Economic Surveys of the Slovak Republic* (2012, 2009). A new look at those questions is provided in light of regional challenges.

The chapter begins with an assessment of regional disparities leading to a clear picture of a booming west and a lagging east. It then discusses barriers to the regional mobility of workers, which could help in adjusting the labour market at the national level, but which is among the lowest of OECD countries due to the absence of a rental housing market and insufficient transport infrastructure. Labour market performance of low-skilled workers is one of the worst among OECD countries, and the picture is even more dramatic in the east. Stepping up the ALMPs, strengthening job-search support and containing labour costs would improve their job prospects. Increasing the education level and improving the school-to-work transition would also increase the employability of eastern workers and productivity, spurring the attractiveness of the east for firms. Similarly, developing transport infrastructure and technological capacity would attract more investment and job creation in less-developed regions.

Regional inequality is high, increasing and associated with poor quality of life

Regional disparities in Slovakia are among the highest in the OECD countries. GDP per capita in the Bratislava region is more than twice the national average, while in the east (Prešov), GDP per capita is less than 60% of the national average. More than half of the population lives in less-developed regions where GDP per capita is below the median estimated at EUR 11 150 in 2011 (Figure 2.2, Panel A).

Regional disparities are also apparent in income and labour utilization (Figure 2.2, Panel B). The average income in the east is less than half of that in Bratislava. The difference between the highest regional unemployment rate (19.6%) and the lowest (6.4%) is high. On the basis of unemployment rates, regions can be divided into two broad groups: richer western regions comprising Bratislava, Trnava, Trenčín, and Nitra, and poorer eastern regions comprising Žilina, Banská Bystrica, Prešov, and Košice, hereafter called also lagging regions (Figure 2.3). Overall, two thirds of the unemployed live in the eastern regions. Among the Roma, who mainly live in the east of the country, only 20% of men and less than 10% of women participate in the formal labour market (World Bank, 2012). As a result of low job prospects, almost 17% of people in the east are below the at-risk-of poverty threshold (60% of median income) compared with only 6% in Bratislava. People entitled to benefits that cover material needs are about eleven times more numerous in the east compared with the Bratislava region (Central Labour Office).

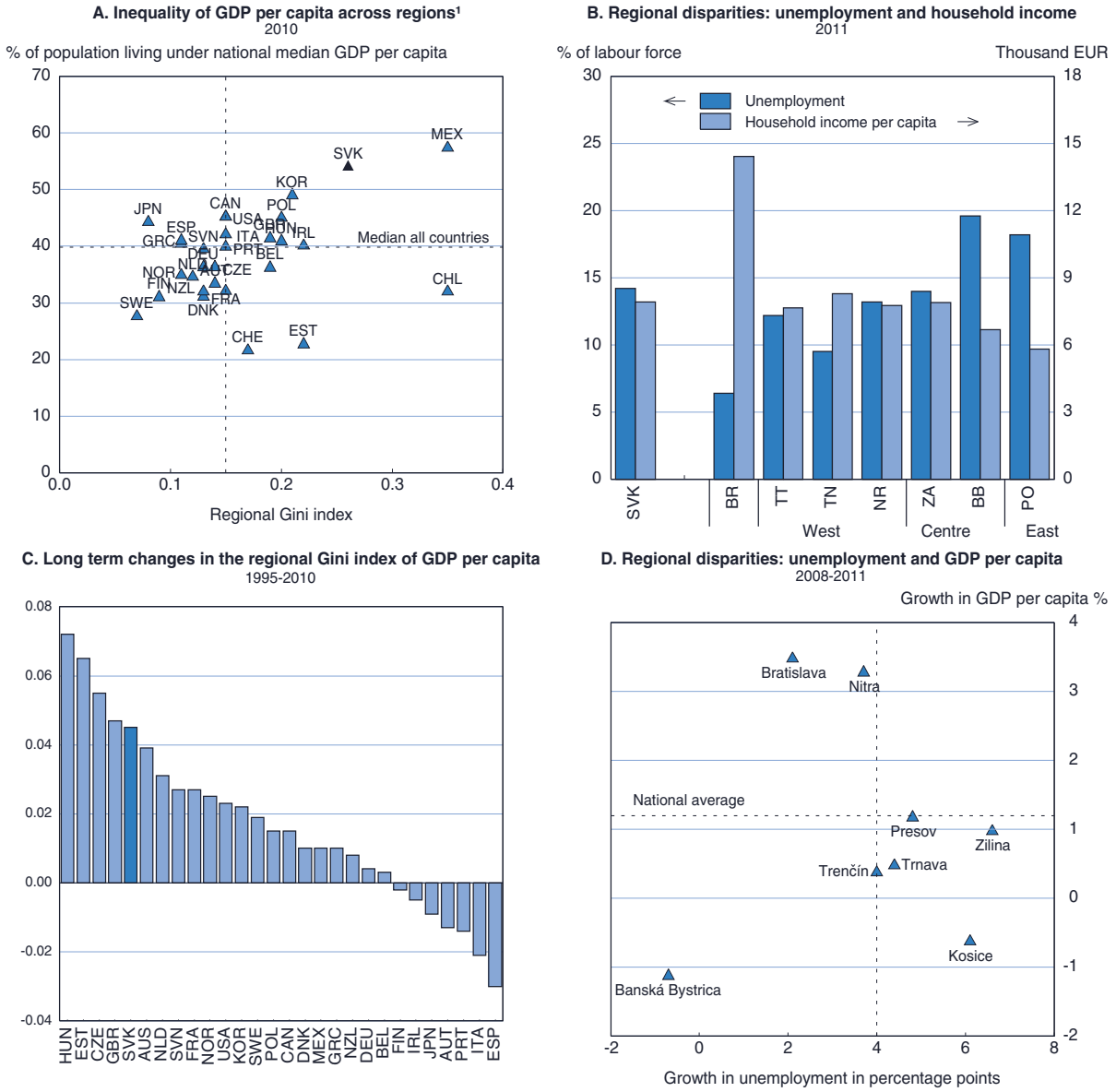
Regional disparities are persistent and rising over time (Banerjee and Jarmuzek, 2009). The increase in the regional Gini coefficient has been one of the highest among OECD countries since the transition and it has accelerated since the economic crisis. Almost 40% of the unemployment increase since 2009 was concentrated in the eastern regions and long-term unemployment accounts for 70%, while western regions benefit from strong economic growth and labour market performance (Figure 2.2, Panels C and D).

Developing a housing rental market

Low labour mobility hampers economic growth

Bratislava has scope to expand its agglomeration, which is relatively small. Higher growth in the economically successful regions would help reduce the unemployment rate in the east and stimulate productivity in the west by a better matching process as well as

Figure 2.2. **Regional disparities are persistent and rising**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Regions of the OECD countries are classified according to two territorial levels: the high level (TL2) and the low level (TL3). Regions at TL2 are divided into smaller regions at TL3. TL3 level data are used except for Australia, Canada, Chile, Mexico and United States.

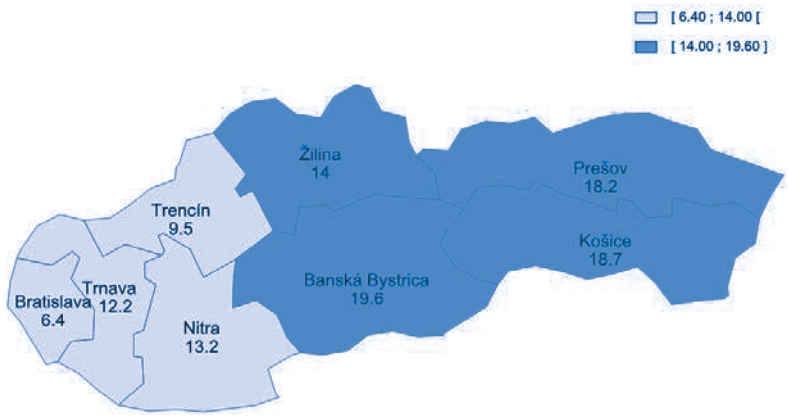
Source: OECD (2013), *Regions at a Glance* and Statistical Office of the Slovak Republic.

StatLink http://dx.doi.org/10.1787/888933156609

agglomeration effects (Ahrend et al., 2014). International experience suggests that doubling the size of an agglomeration could increase productivity by 2-8%, depending on the sector (Rosenthal and Strange, 2004; Combes, 2008).

Mobility of workers is very low in Slovakia, however, and the adjustment of the Slovak labour market via migration has been weak (Fidrmuc, 2004). Less than 2% of Slovaks from 15 to 64 moved in 2011, and of those only a quarter moved between regions (Vagac, 2013). There are no substantial differences in mobility across age and education attainment, contrary to other OECD countries, implying that a common factor explains low

Figure 2.3. **Regional disparity in unemployment, 2013**

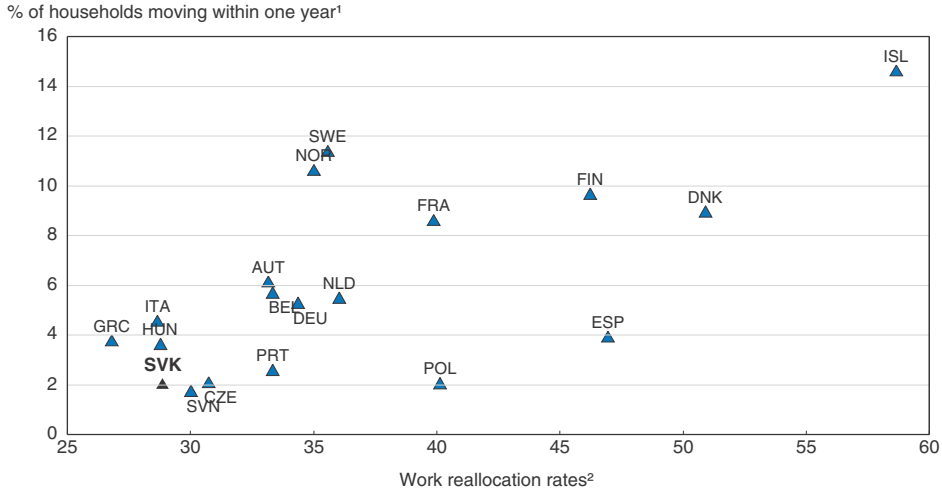


Source: Statistical Office of the Slovak Republic.

StatLink http://dx.doi.org/10.1787/888933154089

regional mobility (Hüfner, 2009; OECD, 2005a). Low residential mobility is associated with low labour turnover, suggesting that barriers to residential mobility hamper the reallocation of workers to adjust to job opportunities (Andrews et al., 2011; Figure 2.4).

Figure 2.4. **Geographical and occupational mobility of workers is low**



1. Mobility rates are annualised. The low mobility rate in some Eastern European countries cannot be verified independently.
2. Work reallocation rates (hiring and firing rates) are expressed in percentage of total dependent employment. See OECD.

Source: OECD (2011), *Economic Policy Reforms: Going for Growth*; *OECD Employment Outlook 2010*.

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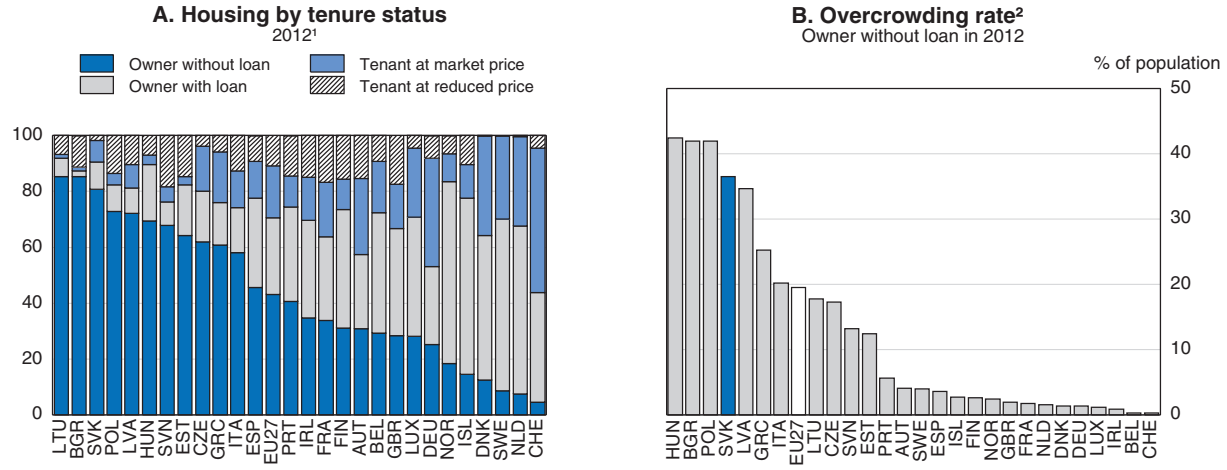
Home ownership is a barrier to labour mobility

In general, home ownership reduces residential mobility of workers due notably to potential capital losses (OECD, 2005a; von Ommeren and Leuvensteijn, 2005). Empirical evidence suggests that a 10 percentage point rise in the owner-occupation rate may be associated with an increase in the unemployment rate up to 2 percentage points due to lower mobility (Oswald, 1996; Nickell, 1998). With 90% of Slovaks owing their own home, ownership is among the highest in OECD countries (Figure 2.5, Panel A). Moreover, a very

Figure 2.5. **Home ownership is high**



1. 2013 for Austria, Czech Republic, Finland, Hungary, Iceland, Latvia, Norway and Spain.
2. This indicator is the population living in an overcrowded household, i.e. without at its disposal a minimum of rooms. The definition of minimum rooms depends on the age and sex of the individuals living in the dwelling.

Source: Eurostat SILC.

StatLink http://dx.doi.org/10.1787/888933154101

large majority of owners do not have any loans to pay as they bought their flats after the transition from communism at a discounted price. This contributes to lowering further labour mobility as owners with a monthly mortgage have a greater incentive to avoid unemployment and hence to move to improve their labour market perspectives (Andrews et al., 2011). On average in OECD countries, an owner without a mortgage is estimated to be 13% less likely to move every year than a private renter, while a mortgage owner's yearly mobility rate is some 9% lower than that of a renter (OECD, 2011a).

The absence of a functioning rental market is accompanied by poor living conditions. The share of residents that live in crowded conditions has reached 40% in Slovakia, one of the highest rates observed in European countries (Figure 2.5, Panel B). Overcrowding suggests that dwellings are insufficient and demand for rental houses is potentially high (CECODHAS, 2012; Vagac, 2013).

Public policies should further encourage the development of a rental market

Public support is biased in favour of home ownership (Table 2.1). Support includes grants allocated to youth for housing purchases; a state bonus on saving devoted to housing purchase, and subsidised interest rate mortgages (Box 2.1).

Although the share of public support to rental housing has fallen (Table 2.1), some steps have been taken to promote rental housing. Under a recent regulation, loans with subsidised interest rates are provided to the private sector acquiring rental housing under the conditions that the house is rented for at least 30 years; it is rented to a low-income tenant and it is built close to an industrial park. In addition to municipalities and self-governing regions, NGOs are eligible for subsidies to provide standard rental housing for low-income households. Moreover, subsidies have been increased by 10 percentage points (covering 30-40% of average costs against previously 20-30%).

Table 2.1. **Distribution of public support between home ownership and rental housing**

Housing support in Slovakia (mil. EUR)	2006	2013
SFRB		
Housing ownership	38.3	35.5
Rental housing	94.3	12.7
Restoration, insulation and other	23.5	106.5
State bonus within the "Housing Saving Scheme"	34.7	39.1
Mortgage subsidy for young	21.6	31.0
Social Rental Housing Subsidy (Act 443/2010)	70.9	23.9
Substitute Rental Housing Subsidy (Act 261/2011)	0	2.3
	283.1	**250.9**

Source: Ministry of Finance.

Box 2.1. **Housing market support in Slovakia**

State Housing Development Fund (SHDF)

In 2013, the total budget of SFRB reached EUR 155 million and the majority of the funds were devoted to insulations and restorations. Individuals can benefit from a subsidised long-term loan for property acquisition or reconstruction with a fixed interest rate for the whole period. The purchased flat or apartment should be new (2 years old or less), with a maximum area and the eligibility depends on age (less than 35 years old) and income (below 3.5 times the subsistence level, i.e. EUR 693 in 2014). The maximum loan amount is EUR 65 000 and must not exceed 80% of the property value. Support is also provided to municipalities and legal entities for developing social rental housing.

State bonus on saving

Everyone who deposited at least EUR 781 in 2014 in the Housing Savings Scheme is eligible for a state premium of EUR 66. During the six first years of entering the scheme a condition applies on the use of the funds (for purchase or reconstruction of a property), but it disappears afterward, The state premium is not income-tested.

State funded subsidised mortgages

People under the age of 35 are eligible for a subsidised mortgage with the interest rate reduced by 3% for five years if their income does not exceed 1.3 times the average wage of the last two quarters (for instance EUR 1 043 at the beginning of 2014). The maximum loan is EUR 50 000 and must not exceed 70% of the property value. Subsidised mortgages are also eligible for couples.

Social Rental Housing Subsidy (Act No. 443/2010)

A municipality, a self-governing region or an NGO are eligible for a social rental flats construction or purchase subsidy. Subsidies vary, according to the type of flat, from 30% to 70% of total construction costs. Built social flats must comply with maximum area requirements and rental status of the property must be kept for at least 30 years. To assure the social character, tenants are income-tested.

Substitute Rental Housing Subsidy (Act No. 261/2011)

Owners of restituted houses (returned to their original owners in 1990) have the right, according to 2011 legislation, to terminate a contract with tenants whose rent was regulated and substantially below market price. Tenants, usually older people living there for many years, have the right to ask a municipality for substitute housing and must leave

Box 2.1. **Housing market support in Slovakia** *(cont.)*

the property before 2017. For this purpose, the state subsidises mainly the construction of substitute housing, which should be ready by 2016.

Housing allowance (Act No. 417/2013)

Housing allowance is provided as a social support to persons in material need to cover housing-related costs. The support amounts to EUR 55.80 for a single person, for households with at least 2 members it equals to EUR 89.20. Eligible beneficiaries of the allowance have to be owners or co-owners of a dwelling, or tenants.

On the other hand, some broad based programmes provide home ownership public support:

- The Housing Saving Scheme that provides a state bonus to anyone who has saved at least EUR 781 has several drawbacks including that it is not income tested; the bonus can be used after six years for any purpose, and it distorts market competition as banks involved in it make extra profits by offering a lower interest rate than the market rate.
- The state subsidised mortgage and subsidised long-term loans provided for property acquisition by the State Housing Development Fund (SHDF) are regressive; they distort the allocation of resources; and they have perverse economic effects, in particular at a time of very low interest rates (Andrews et al., 2011).

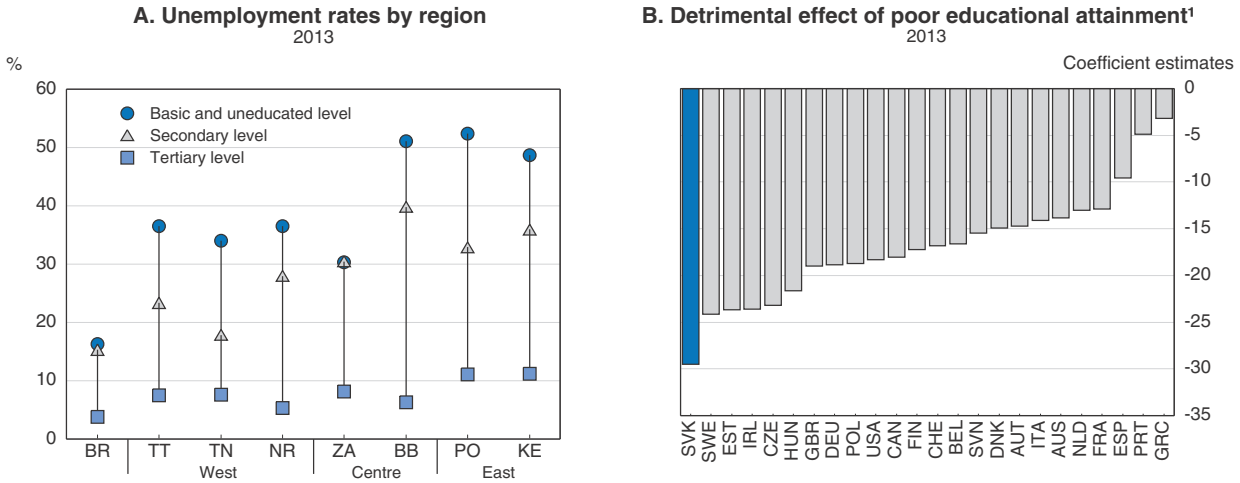
The lack of support for renting, targeted at low-paid workers, adds to the problem as their income does not allow them to cover the cost of moving and inhabiting dwellings in most economically dynamic regions. In that regard, international experience suggests that housing rental allowances are preferred to social housing because they do not seem to hinder mobility as allowances are not tied to a home (ECB, 2003). Such a scheme exists in Slovakia but is weakly developed, with only very poor households entitled to social assistance benefits who are eligible (Hüfner, 2009). The authorities could consider extending it to poor households in general, including poor workers, as has been done in Ireland, the United Kingdom and some Nordic countries (Andrews et al., 2011).

Regulations covering rents and tenant-landlord relationships have a strong impact on rental supply. Rental regulation is close to the EU average. However, some specific characteristics of Slovak regulation reduce incentives to rent. In particular, landlords cannot evict a person without providing him appropriate alternative accommodation even if the notice reasons include serious damage of property or failure to pay rent (Vagac, 2013). Since May 2014, a short-term contract (maximum two years) can be established, with possible agreement on a shorter notice period or reasons for contract termination, including the non-payment of rent. This should be pursed further by allowing more flexibility for indefinite contracts and reducing their use in favour of extendible fixed-term contracts. Improvement of the efficiency of the judicial proceedings could also improve rental market potential (Chapter 1).

Improving the employability of low-skilled workers by stepping up active labour market policies

Low-skilled workers have job prospects that are worse than their counterparts in other countries. The employment rate of the low-skilled is only half that of the average observed in OECD, although that for the tertiary-educated is not significantly different (OECD, 2013b). Controlling for age and gender, failing to reach the upper-secondary level in Slovakia diminishes the employment rate by almost 30 percentage points (Figure 2.6).

Figure 2.6. **Low skilled unemployment is the main challenge for Slovakia**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).
1. Primary and lower secondary education.
Source: Statistical Office of the Slovak Republic; and OECD calculations (for details, see the publication *OECD Economic Surveys Poland*, 2014).

StatLink http://dx.doi.org/10.1787/888933154119

Regional disparities in low-skilled unemployment are also high; more than half of the lower educated (below upper secondary education) are unemployed in the east compared with less than 20% in Bratislava. To make the most of potential growth and to ensure a better integration with less-developed regions, addressing the challenge of the low-skilled is likely to be more important than expanding higher education (D'Costa et al., 2013; OECD, 2012a).

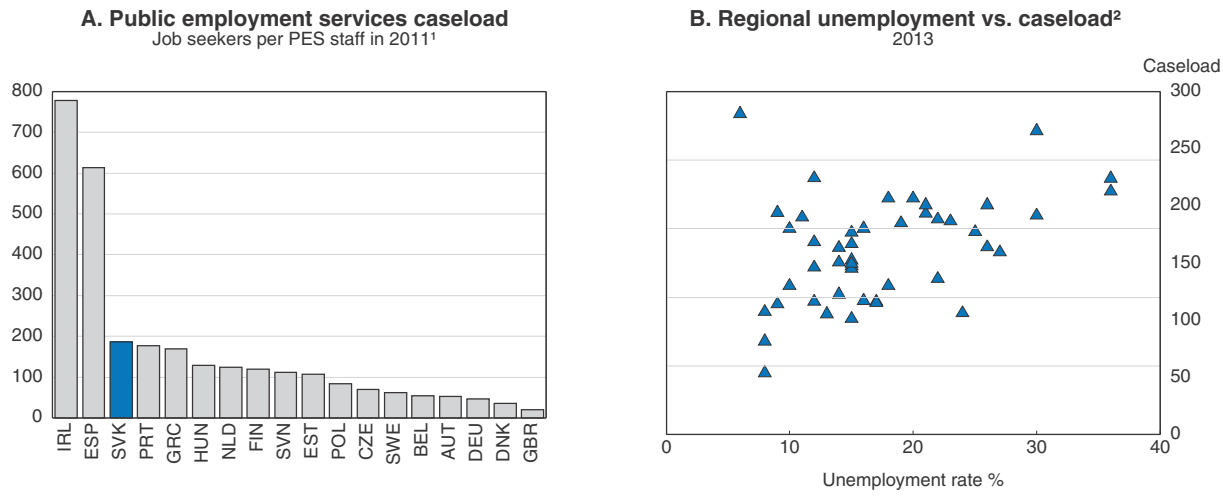
Tackling low-skilled unemployment requires efficient labour market policies at the national and regional level. As a first step, there is a need to increase overall resources devoted to ALMPs, especially in the east (OECD, 2012b). With 0.2% of GDP, spending in that area is the second-lowest among OECD countries. There is also room to make job-search support more effective, to refine activation policies, and to ensure that labour costs do not prevent low-skilled workers from being hired.

Effectiveness of job search support could be raised

Public Employment Services (PES), such as counselling and job search support, are the most effective programmes for reducing unemployment and, in particular improving labour market performances of low-skilled (Card et al., 2010; EC, 2013). They also contribute to maintaining labour market attachment and to providing information on job offers that may boost labour mobility.

However, the limited capacity of the PES hinders its effectiveness. With on average 187 unemployed per one labour office employee in 2013, the Slovak caseload is about twice as high as in other Visegrad countries (Figure 2.7, Panel A). The difference is even stronger when taking into account front-line local staff only (OECD, 2012b). While there is a strong need to increase resources, significant staff cuts were experienced in 2011. Eight hundred and forty new staff members will be hired in 2014 but they will mainly be in charge of new tasks related to the activation programmes of social benefit recipients (discussed below). The authorities should increase overall resources to PES to meet the demand created by high unemployment. Outsourcing part of job-search support activities to private providers, which the authorities are considering, could also supplement the weak capacity of PES (OECD, 2013c).

Figure 2.7. **There is room for higher resources and efficiency in public employment services**



1. 2013 for Slovak Republic.
2. 46 labour offices of Slovakia. Bratislava is an outlier with a caseload of 285 and an unemployment rate of 6%.

Source: PES staff numbers from European Commission, Employment, Social Affairs and Inclusion, Public Employment Services (*http://ec.europa.eu/social/main.jsp?catId=105&langId=en*); Slovakia EK and Central Office of Labour, Social Affairs and Family.

StatLink *http://dx.doi.org/10.1787/888933154121*

Unbalanced caseload distribution across the country adds to the problem. The caseload ranges from less than 100 unemployed for an officer in Pezinok to a peak of almost 300 unemployed per officer in Bratislava. While Bratislava could be viewed as an outlier with a large share of unemployment of short duration (Table 2.2), on average, labour offices with higher caseloads have to deal with high local unemployment rates (see Figure 2.7, Panel B). Efficiency and service quality gains could be achieved, therefore, by redistributing personnel based more on local needs.

A comprehensive reform of PES that would enhance the quality and cost-efficiency of services is ongoing, in line with some recommendations made in the previous *Economic Survey* (Box 2.2). The reform is planned to be fully applied by 2020 and the government should consider accelerating the pace of its implementation. Key changes include (NRP, 2014):

- The individualised treatment of the unemployed has been strengthened by suppressing the mandatory meeting for each unemployed. This initiative brings additional flexibility and allows officers to focus on specific groups.

Table 2.2. **Duration of unemployment by region**

Per cent

	Less than 6 months	From 6 to 12 months	From 1 to 2 years	From 2 to 4 years	More than 4 years
Bratislava	38	19	17	18	7
Trnava	9	15	21	30	25
Trenčín	29	23	18	19	11
Nitra	18	11	15	28	28
Žilina	23	17	17	19	24
Banská Bystrica	15	7	16	15	47
Prešov	18	8	17	22	36
Košice	17	9	15	24	35

Source: LFS 2013.

Box 2.2. **Ongoing reform of public employment services**

The reform aims at increasing the flexibility, capacity and quality of services and should be fully implemented by 2020.

Strengthening the responsibility and autonomy of the Central Office of Labour

The general directorate and branches of labour offices will be integrated in January 2014. The Central Labour Office will be fully responsible for the management of individual labour offices and their staffing.

Integrating active and passive labour market policies

Labour offices will have responsibility for:

- Front-office tasks (professional first-contact services, applications and data processing, career counselling).
- Back-office tasks (job offers search and interviews, active labour market policies).
- Automatic payments processing of benefits.

Adapting the budget to local labour market needs

The budget of labour offices will depend on labour market needs (e.g. unemployment rate) and outcomes (e.g. number of job-seekers hired that remained in the job, adequate offer of ALMP programmes).

Increasing motivation of public employment officers

The existing financial remuneration of employees is below the average for public administration (80%). Based on the outcome indicators, employees providing professional and information-counselling services will receive wages corresponding to the average wage in public administration.

Monitoring ALMPs

A central database of the labour market office was established and would allow monitoring of ALMPs by the Ministry of Labour, Social Affairs and Family and the Central Labour Office. A methodology for assessing the efficiency of active labour market measures was developed and approved by the Ministry of Labour in early 2012.

Improving efficiency and modernising services

A new web portal was launched in November 2013, which enhances back office IT system. It gathers job vacancies, implements matching of occupational classifications with clients' profiles, and provides services to inform clients about job vacancies.

Administration and bureaucracy in the PES have been lowered.

- The quality of services provided by employees depends on their skills and motivation. The national project "Improvement quality and accessibility of PES" aims to train about 2 700 PES employees and to develop their IT skills.
- The future integration of job-search support and payment of benefits would also contribute to achieve efficiency gains (OECD, 2001).

Active labour market policies need to be refined to meet regional needs

The May 2013 reform of activation policies has likely generated some efficiency gains by i) suppressing some redundant and ineffective programmes; ii) reducing administrative burdens when implementing programmes; and iii) establishing clear criteria for programme eligibility (age, qualification, duration of unemployment and local labour market conditions). There is still room for efficiency gains by re-allocating spending toward the most efficient programmes. The regional allocation of programme needs also to be refined to ensure that support reaches those in needs.

Developing training programmes, and phasing out public works, especially in the east

With only 1% of ALMP spending devoted to training, the resources devoted to such programme is insufficient insofar as it is one of the most efficient activation programmes according to international experience (Card et al., 2010). Training contributes to strengthening the employability of jobseekers by improving their ability to match labour market needs and raise the quality of the job that they obtained *ex post*. Training may also boost the mobility of workers by raising skills, since skilled workers are more mobile (OECD, 2005a). The authorities should consider allocating further resources in that area (Table 2.3).

Table 2.3. **Allocation of resources among activation programmes: National and regional**

Per cent

	Training	Employment incentives	Direct job creation	Start-up incentives	Supported employment and rehabilitation
2013	1	61	4	11	22
		Region			
Bratislava	77	1	2	5	5
Trnava	4	6	4	5	7
Trenčín	2	11	5	10	15
Nitra	1	11	8	12	12
Žilina	7	14	7	13	13
Banská Bystrica	6	15	22	16	16
Prešov	1	23	17	19	16
Košice	2	19	35	20	17

Source: COLSAF.

Training programmes are best developed in the west and Bratislava regions but are non-existent in lagging regions (Table 2.3). This contrasts with the objective of the May 2013 reform which strengthens the regional dimension when allocating actives policies. The authorities should monitor closely the regional allocation of training programmes to ensure that these programmes reach the most vulnerable in the east.

The training design is essential for effectiveness. International experience suggests to i) promote market-oriented training, including in the workplace; ii) develop intensive programmes on a small scale (with high cost per head) rather than extensive programmes; and iii) provide some formal certification (Martin and Grubb, 2001; BIS, 2013). Some progress has been made regarding certification of skills and the recognition of non-formal education, and a new Act is under preparation (NRP, 2014) which could contribute to further mobility by allowing job seekers to have their skills recognised countrywide.

By contrast, public work programmes are not effective at improving employability (Card et al., 2010) and Slovak evidence confirms that it can even worsen the chance of future employment due to stigmatisation effects (Harvan, 2010). They hamper the mobility of workers as they tend to lock low-skilled workers into local job-creation schemes and they are used mainly in lagging regions, which contrasts with the need to promote labour mobility in those regions. Such schemes should therefore be phased out or targeted at the hardest-to-place jobseekers and made only temporary (OECD, 2009a). This could be for instance the case of long-term inactive people who need specific support to gain some work habits.

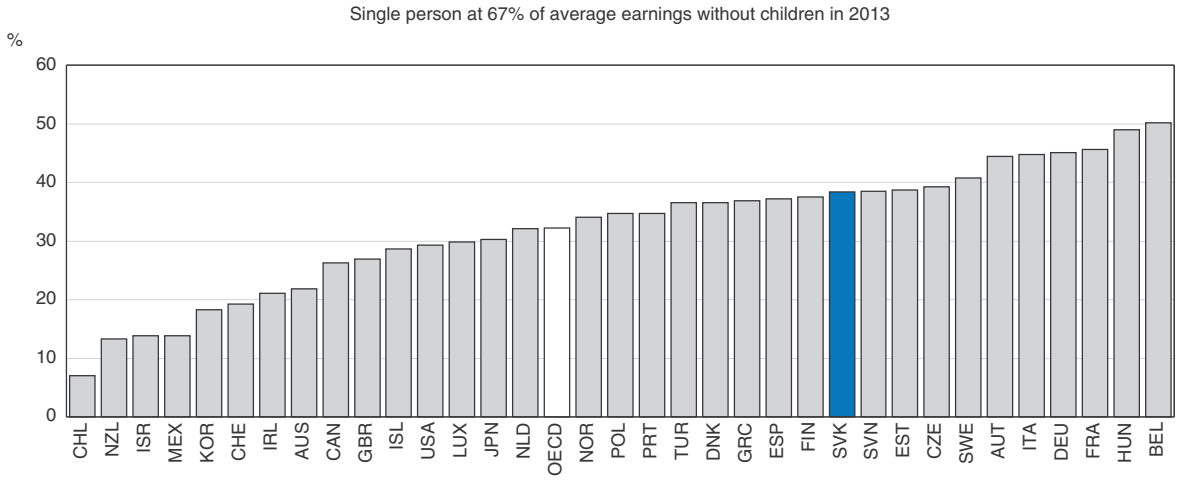
Wage subsidies could be more targeted

Active labour market programmes in Slovakia are mainly focused on wage subsidies (61% of spending). While they are effective at bringing people into employment, they come with the risk of deadweight losses (hiring could have occurred even without the subsidy) resulting in only small net employment increases and a short-term effect (Martin and Grubb, 2001; Boone and van Ours, 2004; Kluve, 2010). Those schemes need to be closely targeted to provide a cost advantage to low productive workers who would not be employed otherwise, given their low level of productivity (Orszag and Snower, 2003). In line with this principle, wage subsidies schemes are more used in less-developed regions where low-skilled workers are over-represented (Table 2.3).

Since November 2013, long term unemployed who have found a low paid jobs (67% of average wage) under a standard labour contract, are exempted for 12 months from social security contribution paid by employees and employers (except accident insurance contribution and guarantee insurance contribution). By reducing the tax wedge, this scheme would raise incentives to work by increasing the net income of workers as well as the incentives to hire low-paid workers by reducing their labour cost (Figure 2.8). However, as of February 2014 it has supported only 1 900 people, although 15 000 participants per year were expected and the high share of long-term unemployed suggests a large potential. The authorities should closely monitor it to be sure that specific barriers do not hinder its use by employers. Going forward, the authorities should consider making this scheme permanent to ensure a lower tax wedge for low skilled. The current plan to exempt permanently low paid jobs (paid below EUR 494) from health insurance contribution goes on the right direction.

There is also room to improve the efficiency of wage subsidies targeted at youth. The scheme "Supporting Job Creation" benefits youth under 29 without any conditions but having been unemployed for three months. This programme has been successful with 11 500 jobs created since December 2012. However, it comes with the risk of high deadweight losses given the soft eligibility criteria. Without conditions on the level of education, employers might use this scheme to hire youth with better educational profiles

Figure 2.8. **The tax wedge for low-paid jobs is high**



Source: OECD Taxing Wages Database.

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who would have been hired in any case. This scheme should hence be reformed to be targeted at the most vulnerable youth.

Start-up incentives have been reformed

Start-up incentives have been reduced, in line with the recommendations made in the previous *Economic Survey,* and reformed to better adapt to local needs. Evidence regarding their effectiveness is mixed, notably because of the lack of entrepreneurial skills of some recipients (Martin and Grubb, 2001). Eligibility for those programmes is stricter since the May 2013 reform. The start-up incentive is also now provided in two stages: the first stage of 60% within 1 month after the conclusion of the agreement providing start-up incentives, the remainder after submission of a report after 12 months of self-employment. In addition, the regional employment committee is now involved in the decision evaluating the effectiveness, efficiency and credibility of the business plan. This holds the promise of matching start-ups to local needs, but also adds another layer to the approval process.

Activation programmes for social assistance recipients could be refined

Progress regarding the activation of social assistance recipients is mixed. New activation centers, under the responsibility of PES, were established in January 2014 and are responsible for activating recipients of benefits covering material needs. This goes in the right direction as international experience and in particular the *Hartz*-reforms implemented in Germany suggest that a more integrated approach of social policies and labour market policies would increase the prospect of recipients of social assistance benefits to find a job (OECD, 2010a).

An unattractive feature of the activation scheme is the mandatory work (32 hours a month in municipalities) imposed on recipients of material needs benefits. As discussed above, the effect of public work on future employability is limited: it may even be stigmatising in the labour market and reduce regional labour mobility. Stronger job search support and participation in activation programmes are preferred, such as training which contributes to raising skills and employability. Moreover, the activation programme could

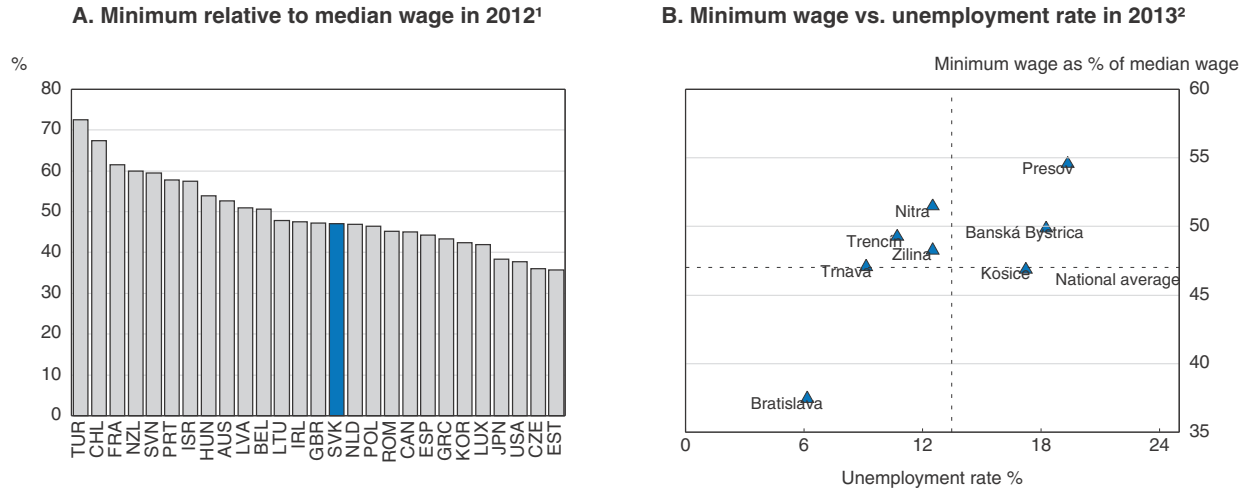
further contribute to regional disparities by increasing poverty for those who do not take a job and experience a cut in benefits. The authorities should therefore reconsider this measure. An alternative, more in accordance with international best practices, is to develop in-work benefits (OECD, 2005b). This helps promote social inclusion and employment by making work pay. Along this line, the authorities would consider providing stronger additional income support for low-paid workers and for recipients of material needs benefits engaged in training and educational activities.

Containing labour costs increase in less-developed regions

Regionally differentiated minimum wage or social security contribution may be needed

A minimum wage set at a high level can hinder employment prospects of the low-skilled by raising their labour cost above their productivity. The minimum relative to the median wage of the economy is at the OECD average and the share of employees earning the minimum wage is estimated at between 2% to 6% in Slovakia, which is close to the median value observed in European countries (Eurostat, 2010; INESS, 2013; Figure 2.9). However, the system is uniform across the country, and therefore may yield minimum wages that are too low in Bratislava but too high in the lagging regions, given sharp differences in market wages and living costs. Recent estimates confirm regional disparity as the share of minimum wage earners could be twice the national average in lagging regions such as Prešov and Banská Bystrica (INESS, 2013).

Figure 2.9. **Minimum wages are not adapted to local labour market conditions**



1. 2011 for Chile and 2013 for the Slovak Republic.
2. Data on median wage for 2013 are provisional.

Source: OECD Earnings Database and Statistical Office of the Slovak Republic.

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The recent reform of the non-standard labour contract could make the minimum wage more binding for lagging regions. Until January 2013, a non-standard work contract ("work performance agreement") could be used by employers and was not subject to a minimum wage requirement or a social security contribution payment. They had been widely used, with 450 000 individuals under those contracts in 2013, and their number decreased strongly after the reform (by 200 000). The authorities should carry out a study

to assess and monitor the impact of the national minimum wage legislation on the labour cost and job creation in the eastern regions and explore the scope for measures which allow labour costs to respond to local conditions.

The legal extension of collective bargaining should be reformed

Collective bargaining agreements are important for improving working conditions and developing LLL of workers (Keogh, 2009), but an automatic extension to all firms impedes adaptation to Slovakia's widely varying regional labour market conditions. To improve the flexibility of wages and hours worked according to economic conditions, the employers had until January 2014 the possibility to opt out of collective bargaining agreements. While this option has been suppressed, employers have still the possibility to raise comments on the agreement at the Tripartite Commission, which can then decide to exempt them from the extension. The Ministry of Labour, Social Affairs and Family takes in particular into account a set of criteria before allowing an extension, including the representativeness of the agreement and the economic conditions of the sector (Box 2.3). Going forward, to ensure that extension of collective bargaining adapt to regional diversity, an option to consider is to establish transparent representation criteria before allowing for an extension agreement, as done in Portugal in 2011 when the authorities added the requirement that the employers subscribing to the agreements employ at least 50% of the workers in the relevant economic sector, in the geographic, firm size and occupation domains requested (OECD, 2012c).

Box 2.3. **Extension of collective agreements**

Collective bargaining in the Slovak Republic takes place at both the industry and company level. Legal extension has existed in the Slovak Republic since 1991, but was relaxed in 2004 by granting employers the effective right to veto an extension to their company.

Since 1 January 2014, any party to a higher-level collective agreement, negotiated between trade union organizations and employers' associations, may propose to extend the agreement to all other employers in the same industry. This extension may cover employers who did not participate in negotiations. The following conditions apply:

- Agreements at a higher level are superior to collective agreements at the company level and individual employment contracts. If higher-level collective agreements propose more favourable conditions for employees, employers must take them into account.
- It is not possible to extend a collective bargaining contract to other companies that are already covered by one collective agreement.
- The agreement can be extended only if it covers a larger number of employees in the industry than any other agreement.
- The government makes the final decision.
- Firms that employ less than 20 employees are not subject to extension.

Aligning educational policies with employment objectives

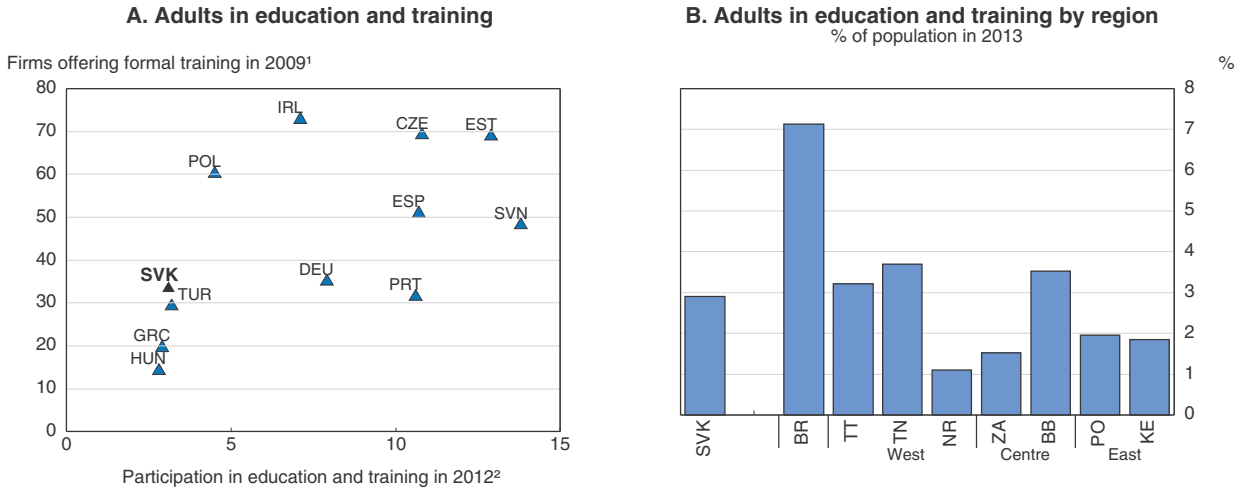
Regional disparities are also apparent in education, with Bratislava ranked 15th out of 265 EU regions in terms of educational performance and the eastern region (Východné) ranked 211th (EU, 2012). Increasing the quantity and quality of education would improve employability of jobseekers in lagging regions where the low level of education is an important obstacle. Remedying this would raise productivity of workers make eastern and central regions

more attractive for firms. Policies need to focus on improving the skills of workers, providing the employable skills for graduates and reducing inequality of opportunity.

Improving the adaptability of workers through lifelong learning

Lifelong learning (LLL) contributes to improving labour market outcomes and productivity by raising the level of skills and improving matching. Empirical evidence suggests that a 10% increase of participation in LLL increases the probability of being active by 0.4% on average and decreases the probability of being unemployed by 0.2% (OECD, 2004; Bassanini et al., 2005). There are therefore significant gains that could be achieved by raising LLL in Slovakia, where only 3% of workers participated in LLL in 2013, compared with 10.4% on average in European countries, and where participation has even declined in the past few years, from 4.6% in 2006 (Figure 2.10, Panel A).

Figure 2.10. **Lifelong learning is almost non-existent in lagging regions**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Firms offering formal training programmes to their permanent, full-time employees. Data refer to 2008 for Turkey; 2005 for Germany, Greece, Ireland, Portugal and Spain.
2. Participation in formal and non-formal education and training by 25-64 year-olds. Per cent of population in same age group.

Source: Eurostat (2013), *Population and Social Conditions: Lifelong Learning – LFS data*; *Eurostat Database*, December; and World Bank (2013), *Enterprise Surveys*, *www.enterprisesurveys.org*.

StatLink http://dx.doi.org/10.1787/888933154148

The low participation of workers in lagging regions adds to regional disparities (see Figure 2.10, Panel B). Retraining workers make them more mobile across occupations and more adaptable to structural and technical change. It is hence particularly needed in eastern regions where occupational and regional labour mobility is low and the need for structural change high. The authorities should ensure that workers from less-developed regions participate sufficiently.

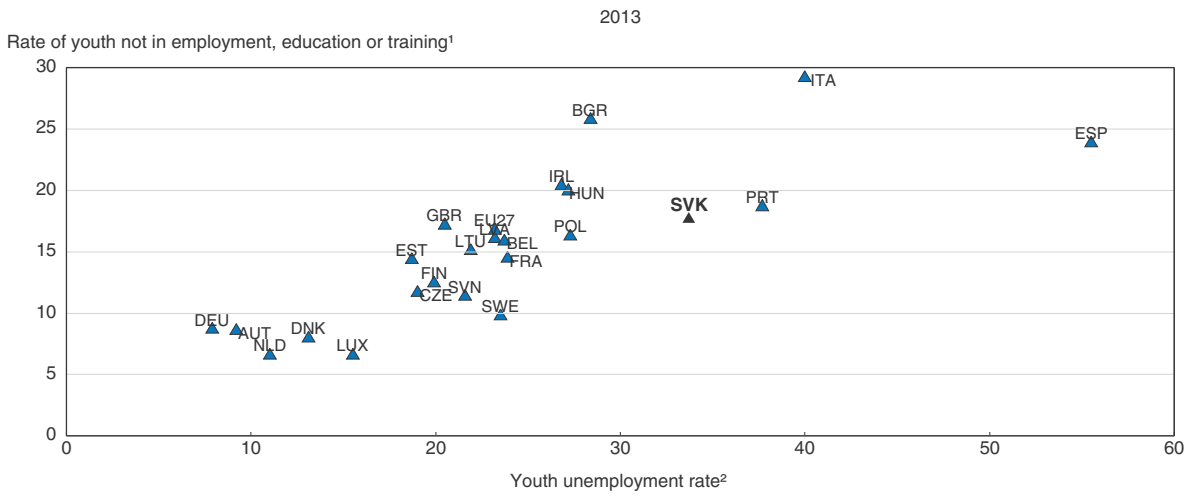
Market failures contribute to low incentives for companies and workers to invest in LLL, including: i) a lack of provisions in educational programmes; ii) a lack of information about the rewards from training; iii) insufficient recognition of informal learning; and iv) the fear of poaching from other firms (Ok and Tergeist, 2003). Steps have already been taken by the authorities to promote LLL. Better recognition of informal education and training and the establishment of 25 counselling centres for adults should stimulate the incentives for

employees. More could be done to support workers and companies financially with, for instance, vouchers which are effective at raising LLL participation (OECD, 2005c).

Ensuring a better matching of skills with labour market needs for vocational education

Youth suffer from weak labour market, with an unemployment rate of 34%, which is among the highest among OECD countries. The fact that about 19% of youth are not in employment, education or training (NEET) reflects poor school-to-work transition (Figure 2.11). This is even more striking in the east where the share of NEET is twice that of Bratislava (23% against 9%).

Figure 2.11. **Youth labour market performance is weak**



1. As a percentage of the population aged from 18 to 24 years.
2. As a percentage of the active population aged from 15 to 24 years.

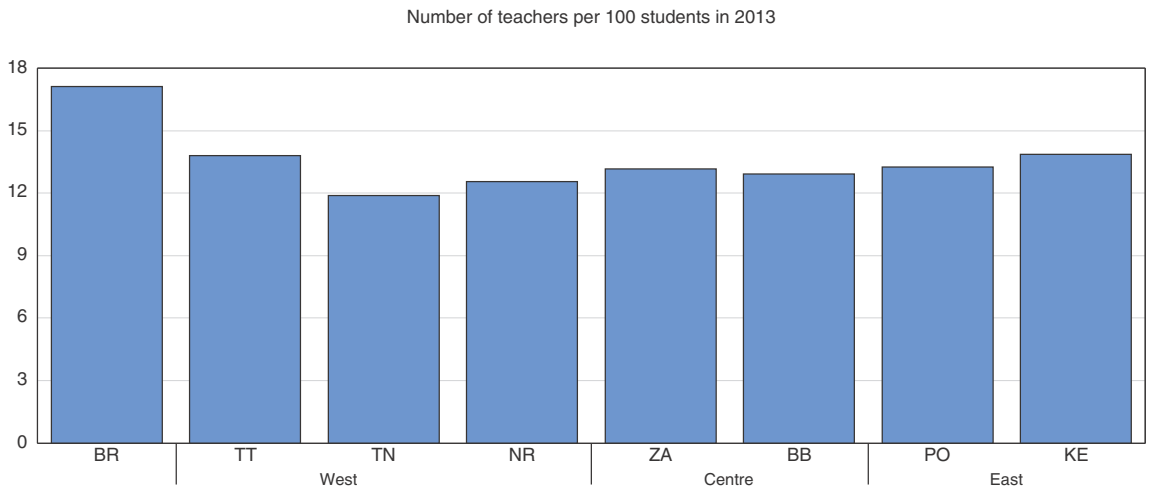
Source: Eurostat.

StatLink http://dx.doi.org/10.1787/888933154156

The vocational education and training (VET) system fails to provide adequate skills for the labour market (OECD, 2012b; Grubb, 1999; OECD, 2007). According to surveys from automotive industry employers, only 6% of secondary VET graduates are trained appropriately and ready for work (Cedefop, 2013). Weak school to work transition is notably due to insufficient co-operation between firms and VET schools, and has been identified by employers as an important barrier (PAS, 2013). The authorities have implemented some pilot projects, including apprenticeships, to tackle these challenges (NRP, 2014). Their expansion at the national level next year, with the objective of training 2 000 youth in 2015, is welcome. Special attention should be given to less-developed regions when implementing the new dual system and the allocation of resources across schools should take account of educational challenges. Currently Bratislava gets more resources in terms of teachers per 100 students (Figure 2.12).

The efficiency of the dual system to improve labour market outcomes for youth depends on the availability of sufficient workplace training of good quality. To provide sufficient incentives for companies, the authorities plan to exempt them from taxes. The authorities should accompany those schemes with strict quality control to ensure a

Figure 2.12. **Uneven resources of vocational education and training should be avoided**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).
Source: Staff calculation based on INEKO data.

StatLink http://dx.doi.org/10.1787/888933154164

balance between the skills acquired by the trainee, the productive work that she realises, the wage paid and the subsidy provided (Westergaard Nielsen and Rasmussen, 1999). Regionally differentiated support could be considered to increase incentives for firms to locate their activities in the east and central part and ensure that sufficient workplaces training are supplied.

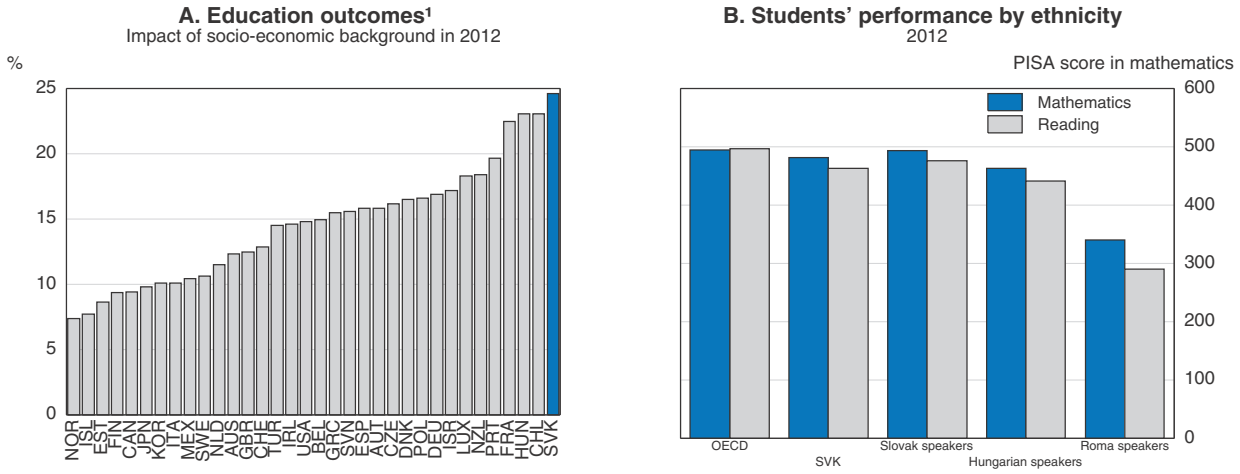
Forecasting labour market needs and supporting areas with stronger potential for job creation is also essential for the success of the VET institutions. To that end, the authorities have set up a forecasting committee. In January 2014, a black list of redundant professions and a white list of dynamic professions with stronger jobs potential were identified. Those lists were supposed to be established based on unemployment rates of graduates following the two years of their graduation and the forecast of labour demand. Several drawbacks from the white list have been identified: 15 out of 39 professions from the white list did not have any graduates in the two past years, and 24 of them had an unemployment rate of 27%. Given the public debate generated by this list, the methodology used should be made transparent and labour market experts involved.

Raising the overall level of basic skills and increasing equality of opportunity

The educational outcomes of students with low socio-economic backgrounds are among the worst in the OECD, a disadvantage that is even more striking in the east (Figure 2.13, Panel A; OECD, 2013b). Variation among schools appears much higher than what is observed on average in OECD countries, due to the poor performance of schools with a predominance of students with low social economic status (OECD, 2013d).

International experience suggests that good quality early childhood education has a positive impact on future educational outcomes and reduces inequality of opportunity. Potential education gains from wider pre-primary education could be especially high in Slovakia; they are estimated at 40 additional PISA points, which is higher than OECD average (OECD, 2011b). However, Slovak participation in ECE is among the lowest in the European Union (77% compared with 93% on average). For instance, in Belgium, Hungary,

Figure 2.13. **Inequalities of opportunity in education are high**



1. Percentage of variance in student performance explained by the *Programme for International Student Assessment* (PISA) index of economic, social and cultural status (ESCS), R-square*100.

Source: OECD (2013), *PISA 2012 Results: Excellence through Equity* (Vol. II).

StatLink http://dx.doi.org/10.1787/888933154172

and the Netherlands, pre-primary education is nearly universal, with more than 90% of students reporting that they had attended pre-primary school for more than a year. This is in line with best practices in that area (OECD, 2011b). Suitable measures should be taken to raise the participation of children in pre-primary education, in particular those from poor socio-economic and Roma backgrounds, who tend to participate less (UNDP, 2012). Recent positive steps have been taken to develop the quality of pre-primary education and should be continued in line with the recommendations made by the OECD review on ECE quality (OECD, 2012e). The authorities plan to introduce by 2015 free pre-primary education for children aged over 3 years and from socially vulnerable groups, including the Roma children (NRP, 2014). This goes in the right direction and the participation rate should be closely monitored.

The motivation of teachers and teaching quality are also essential determinants of educational outcomes. Attracting the best teachers in schools where there are more students in need has proven to be effective. A recent increase in wages of teachers (by 5% in 2013) goes in the right direction, but more is needed considering the Slovak gap; the wage of a teacher is about 44% of the average wage of tertiary educated individuals compared with 82-90% on average in OECD countries (OECD, 2013b). Further efforts should be made in that direction, including implementing a bonus for teachers teaching in schools where students with poor socio-economic backgrounds and Roma students are over-represented.

The poor educational outcomes of the Roma population is a specific source of concern, as is their overrepresentation in special schools (see Figure 2.13, Panel B; OECD, 2012b; World Bank, 2012). Good quality early childhood education would reduce the probability of enrolment in special schools (World Bank, 2012). An alternative to mandatory pre-school education discussed above is to provide more in-kind benefits together with free pre-primary education for all children from the age of three. Financial incentives to parents of that sort have been provided for instance in Brazil with the programme *Bolsa Familia* targeted at primary-age school children (OECD, 2013e). The increase in the number of

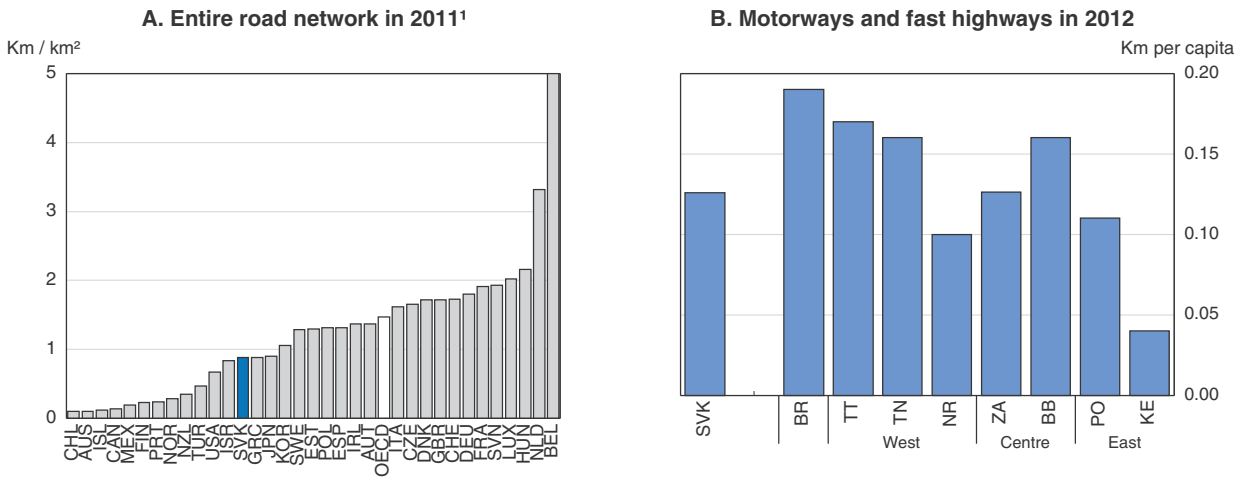
assistants ("all-day project") should contribute to better integrating Roma pupils in standard schools by providing tailor-made support for integrating those students, including a Roma-speaking assistant. While support targeted at that population should be continued, the monitoring, implementation and evaluation of programmes is difficult in the absence of reliable statistics; these too should be developed.

Improving transport and innovation infrastructures

The connection between lagging regions with the core economic centre needs to be improved

Improving the quality and quantity of transport infrastructure is key to improve the development of lagging regions. Employers in the eastern and central regions view weak transport connections as the most significant barrier to regional development (PAS, 2013). Regional differences of road density are large (Figure 2.14). Completing the transport infrastructure network in Slovakia will be both important for removing expansion bottlenecks in Bratislava regions and reducing obstacles for job creation in the eastern region.

Figure 2.14. **Rising infrastructure is key**



Note: Bratislava (BR), Trnava (TT), Trenčín (TN), Nitra (NR), Žilina (ZA), Banská Bystrica (BB), Prešov (PO) and Košice (KE).

1. Road density is the ratio of the km length of the total road network per square km. The road network includes all roads. Data refer to 2010 for Ireland, 2009 for Canada, 2005 for Italy and 2004 for Luxembourg.

Source: World Bank (2014), *World Development Indicators* (WDI); and Statistical Office of the Slovak Republic.

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There is still no completed highway between the east and west. However a positive development is the fact that nearly all missing parts on D1 between Bratislava and Košice are now under construction. The road infrastructure between Košice and Budapest and to Poland and Ukraine is also of poor quality (OECD, 2012a). Improving the availability of road infrastructure is a priority for the authorities, whose key objectives are to modernise first-class roads and to upgrade the road network, especially on corridors of the TEN-T network. Along those lines, the completion of the motorway D1 connecting Bratislava and Košice is planned for 2019 and the connection with Poland and the Czech Republic is under construction. Other progress recently made include the finalisation of expressway between Košice and Hungarian borders and the preparation work on infrastructure projects towards the Polish and Ukrainian border. Such steps would contribute to growth (Sutherland et al.,

2009) by reducing the currently large costs of access to Bratislava and to other EU countries (Dijkstra et al., 2011).

Disputes related to public procurement decisions have been an important determinant of delays in road construction. The recent reform of the public procurement procedure should contribute to raising cost-efficiency of infrastructure investment as well as quality. Major aspects of the reform include a change in the selection process to strengthen quality-based decisions, the establishment of an independent Council of Public Procurement, and the establishment of a registry of reference to record the quality of providers (Box 2.4). While the reform goes in the right direction, its implementation is not

Box 2.4. **Main characteristics of the Public Procurement Act reform**

Selection process

- The one-stage tender process has been replaced by a two-stage tender. In the first stage, offers are considered according to technical criteria. The second stage concerning the price is opened only after evaluation of the first stage. This new process should ensure that the price does not influence the technical evaluation of the bid, which used to have a negative impact on the quality of procurement in Slovakia (OECD, 2012b).

Explicit definition of extraordinarily low bid (ELB)

- ELB is defined as a bid i) below 70% of the average of the other bids and; ii) below 85% of the second higher bid and; iii) below 85% of the expected bid. The procurer can exclude ELB from the competition if the clarification for the low price is not satisfactory or it is not provided.

Establishment of a Council of the Public Procurement (PP) Office

- It considers appeals against the PP Office's decision. Having the right to appeal is supposed to raise the quality of the PP Office decisions and to shorten the resolution of disputes by reducing claims brought to court, which has a lengthy resolution process.

Creation of a registry of references

- Upon the expiration of the contract, the procurer must issue a reference and grade the supplier. In the case of three subsequent references with very low grades, the supplier is suspended from all PP for one year.

Simplified procedures for some procurement

- It can be used for the procurement of legal services and in the case of low value. Previous experience with the bidder can be used as a criterion for the evaluation of the bids. The contracting authority is not obliged to award the contract to the bidder which has not made the best offer, to the extent that the awarded bidder is not more than 20% higher.
- The electronic marketplace can be used only for procurements below EUR 200 000.

Others

- A new institute of *ex ante* review of public procurement documents has been introduced and is available only to "above-limit" contracts financed from European Union funds.
- Governments can ask the contractor to procure without PP in certain cases.
- Regulation of subcontracting: the law defines how much of the contract must be executed by winning suppliers.

fully effective and the procedure still appears lengthy, the use of e-procurement has declined and the number of complaints about decisions by the contracting authorities has not been reduced (EC, 2014). An effective implementation of this reform would also address the transparency challenges discussed in Chapter 1.

There are important barriers to road construction, including i) gaps in compliance with EU rules regarding the implementation of impact environmental assessments; ii) irregularities in the declared costs submitted to the EC; and iii) inefficiencies in planning procedures (Box 2.5). A comprehensive reform of the public sector, discussed in Chapter 1 should address these obstacles, which would contribute to accelerating the pace of transportation infrastructure construction.

Box 2.5. **Main barriers that have slowed highway construction**

Transparent public procurement

Disputes regarding public procurement decisions have resulted in long delays in the implementation of projects, and in some cases bidders with very low prices were excluded. For example:

1. Svrčinovec-Skalité (D3): Planned for 2012 but contracted only in June 2013;
2. Ruskovce-Pravotice (R2): Planned for 2012 but contracted in December 2013;
3. Zvolen, východ-Pstruša (R2): Planned for 2012 but contracted in July 2014.

Independent environmental and feasibility studies

The connection between Bratislava and the east has suffered from delays related to the treatment of the ecological impact of the planned highway on the sites that are part of the Natura 2 000 ecological network. The Turany-Hubová connection (D1) was delayed for more than two years due to discussion between the commission and the authorities regarding the need for a new impact assessment that follows the EC methodology in that area. The Slovak authorities did comply. However, a new evaluation is ongoing after the modification of the project.

Landownership process

The process that requires purchase of land prior to the start of construction has slowed down the implementation of some projects: for instance, Čadca and Bukov-Svrčinovec (D3) initially planned for 2013.

Administrative issues

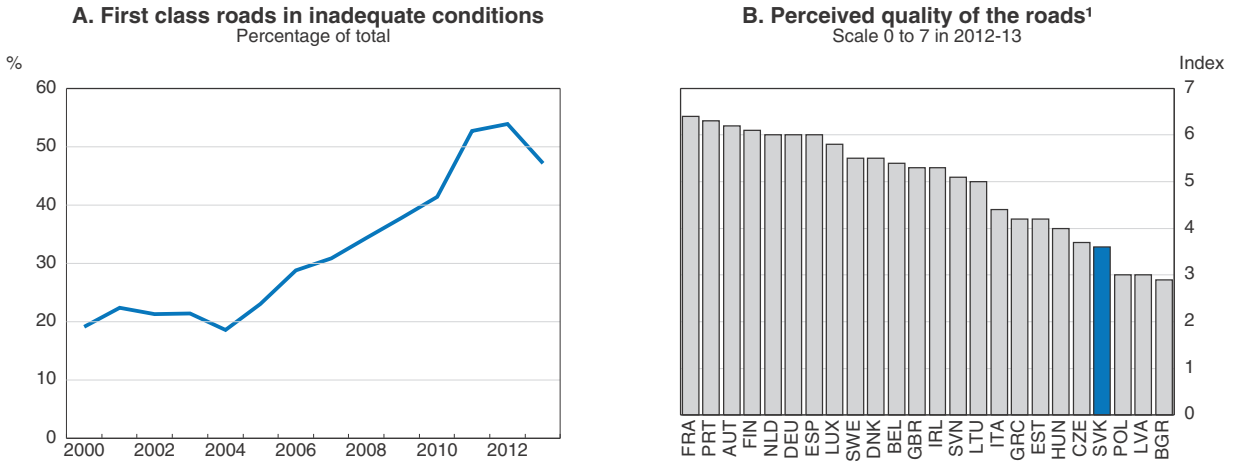
The EC's payments through Operational Programme Transport were suspended between August 2011 and June 2012 due to irregularities in declared costs submitted to the EC.

Changes in planning certificates have delayed the connection Žilina with Brodno-Kysucké Nové Mesto (D3), initially planned for 2013.

Source: UVO; NDSAS; Roth (2012).

Specific attention needs to be paid to road quality, which is perceived as one of the lowest in the EU (Figure 2.15). First-, second- and third-class roads suffer especially from low quality while most of the motorways and fast highways are relatively new. The quality deterioration has peaked recently with half of the first-class roads labelled as in inadequate condition compared to less than 20% in 2010. The trend is similar for second-class roads.

Figure 2.15. **The quality of roads is weak**



1. Weighted average. In your country, how would you assess the railroad transport infrastructure? (1 = extremely underdeveloped among the worst in the world; 7 = extensive and efficient among the best in the world).

Source: Ministry of Transport, Posts and Telecommunications and *World Economic Forum Executive Opinion Survey.*

StatLink *http://dx.doi.org/10.1787/888933153871*

Since 2014, the electronic tolling system charging trucks over 3.5 tons has been broadened to more first-class roads. This may have contributed to slowing down road degradation.

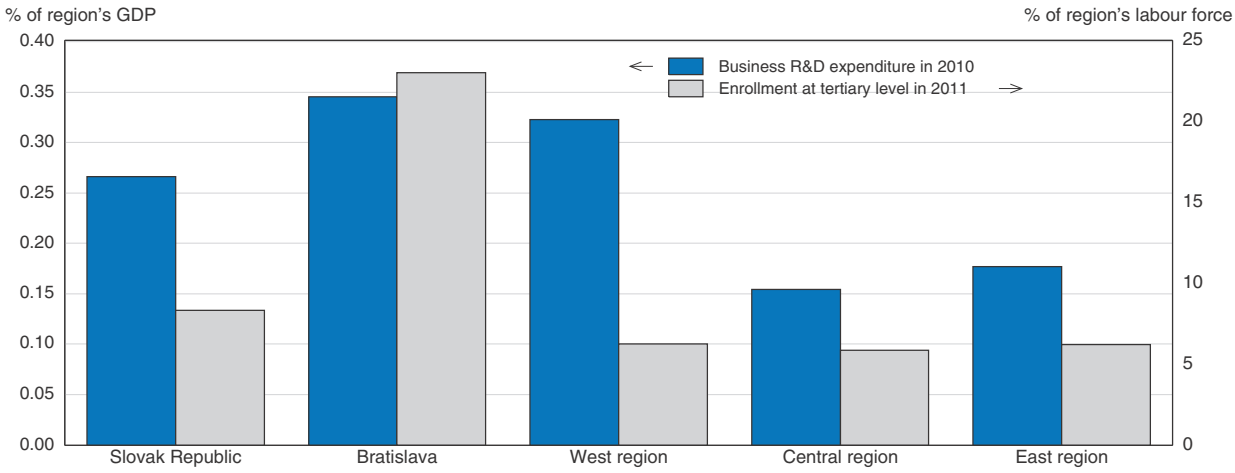
Development of rail transport could ease road transport and reduce emissions in the transport sector. Rail transport infrastructure suffers from obsolescence and depreciation. The non-operability of railways with other neighbouring countries is also a barrier to the development of freight transport (PUSR, 2011). The authorities specified investment priorities for 2014-20 and have recently paid increased attention to the electrification, interoperability and modernisation of tracks to accommodate higher speed trains, in particular on the TEN-T network (OECD, 2013f). High regulated railway access fees in Slovakia until 2011 have also contributed to enhancing road transport compared to rails. Their reduction to the EU average level in 2011 was an important step and should be continued, along with raising fees for using road transport (PUSR, 2011).

Spurring technology adoption in lagging regions to increase competitiveness

The resources devoted to research, development and innovation activities are weak in international comparison (OECD, 2013fg). Slovakia ranks 20th out of 27 EU countries on EU innovation (EU, 2014). As a result, the technological capacity of domestic firms is weak and they are positioned in downstream activities in the Global Value Chain, involving mainly assembly or manufacturing of components (OECD, 2013h). The attractiveness of FDI involving R&D activities is also weak compared with peers (RIS3, 2013). Going forward, strengthening the innovation framework is a national challenge for drawing more benefits from globalisation.

The regional disparity adds to the challenge as knowledge-based resources are almost non-existent in the eastern and central regions (Figure 2.16). This hampers the capacity of firms to use and copy technology, which may require researchers and engineers (Cohen and Levinthal, 1989). Along the same lines, empirical evidence suggests that knowledge transfers, and related productivity gains, depend on own resources devoted to R&D (Van Pottelsberghe de la Potterie and Lichtenberg, 2001; Griffith et al., 2004). As a result, weak

Figure 2.16. **The capacity of central and eastern firms to absorb technology is weak**



Source: OECD Regions and Cities Database.

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investment of private sector in R&D contributes to lowering the scope for productivity growth and the attractiveness of eastern regions for economic activity.

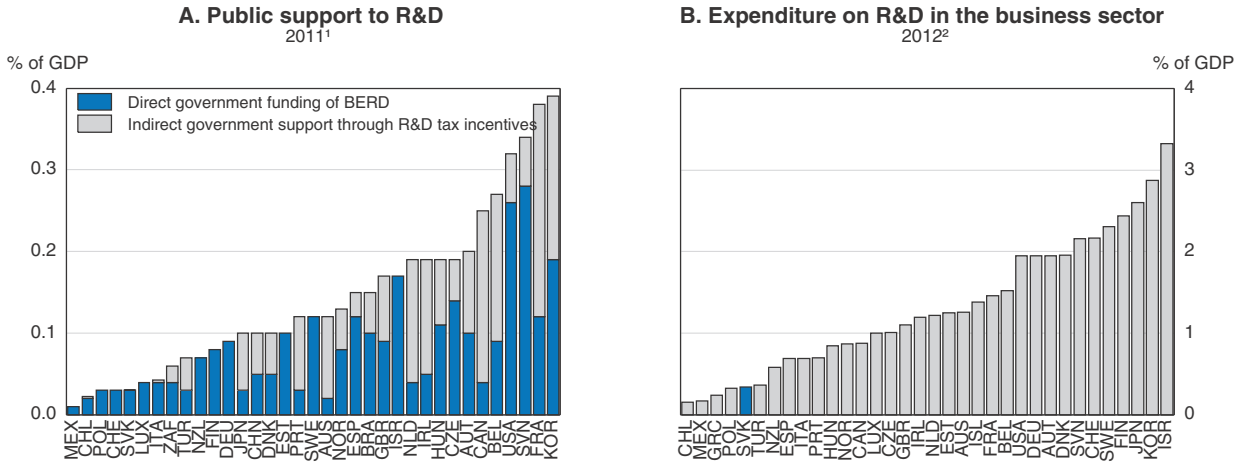
Given the weak innovation framework, public policies are essential to trigger the move towards a knowledge-based society in Slovakia. The Innovation Strategy has rightly identified a set of challenges to be tackled for more evenly balanced growth based on knowledge-based resources, including the need to strengthen public sector research, clusters, an R&D tax credit scheme, venture capital, incubators, and to focus resources in specific areas of specialisation, which are related to local comparative advantages (RIS3, 2013). Some of those issues were discussed in the *2009 Economic Survey of Slovakia*, and its main recommendations remain valid (OECD, 2009b). An additional element to be considered is the regional design and impact of public policies. Policies to support innovation are more critical in regions near the technological frontier while lagging regions should rather implement policies to support the adoption and imitation of new technology (OECD, 2012a). To promote regional convergence, attention should in particular be given to policies that stimulate the investment in R&D and the supply of skills needed for innovation and technology adoption. Greater development of clusters would help strengthening technological transfers between firms and with universities and research centres.

R&D tax incentives could be refined to further support technological adoption

Public support for R&D is low in international comparison (Figure 2.17). Horizontal tools, such as R&D tax credits, are widely used by OECD countries as they tend to be more neutral and have more limited administrative burden than direct support (Andrews and Criscuolo, 2013). Substantial benefits could be achieved by raising and better designing such support. Empirical evidence suggests that reducing R&D costs through incentives by 1% would increase R&D by 1% in the long run (Westmore, 2013).

The authorities have appropriately revised the R&D tax credit. Slovak's R&D tax credit was introduced in 2009, allowing a firm to apply for tax relief. The tax relief is fixed at 19% of private R&D spending – the level of the corporate income tax rate – and can be claimed for at most three consecutive taxation periods. This scheme, however, was not popular due

Figure 2.17. **Public support to business R&D is insufficient**



1. 2010 for Australia, Belgium, Brazil, Chile, Ireland, Israel and Spain; 2009 for China, Luxembourg and South Africa; and 2008 for Switzerland.
2. 2011 for Australia, Iceland, Japan, Korea, Mexico, New Zealand and Turkey; and 2010 for Chile.

Source: OECD (2013), *Science, Technology and Industry Scoreboard* and *OECD Science, Technology and Patents Database*.

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to the imposition of a high threshold above which R&D costs are eligible. This level, which varies by firm size and the type of research, was substantial: in case of basic research (applied research), the lower limit was fixed at EUR 0.25 (1.5) million for micro and small, EUR 0.5 (2.5) million for medium and EUR 1 (3.5) million for large entrepreneurs. These criteria resulted in practice in the exclusion of a large majority of micro and small entrepreneurs, but were abolished in December 2013.

The design of R&D tax incentives is essential to contain fiscal costs and to achieve net effects (Criscuolo et al., 2009). R&D tax incentives based on volume may have large deadweight losses when they support spending that would occur anyway (Andrews and Criscuolo, 2013). This kind of scheme tends also to mainly benefit to larger and incumbent firms. The authorities should consider implementing a hybrid scheme, including a tax relief based on the volume of R&D below a certain threshold and on the increase in R&D spending above this threshold. This incremental component would reduce the deadweight losses but comes with additional administrative burden (Andrews and Criscuolo, 2013) and requires significant steps to be taken regarding public sector efficiency (Chapter 1). The authorities could in particular consider the Irish experience, as the country has implemented such a hybrid system recently (Haugh, 2013).

The current R&D tax credit scheme could also be made more effective in stimulating technological adoption in small and new firms. Firms, in particular young technological start-ups and SMEs, may not make profits the first years following their creation and hence cannot benefit from the support. To ensure that R&D tax credits are effective, the authorities could make the tax credit directly refundable (OECD, 2013i). Other directions for reform favourable to SMEs are to make eligible the cost related to sub-contracted R&D.

Even if R&D tax incentive schemes are refundable and contain carry-over provisions, young firms may not fully benefit from such schemes if they lack the upfront funds required to start an innovative project. Direct support is in that context complementary to tax incentives but needs to be well designed to reduce administrative costs (Andrews and

Criscuolo, 2013). Such support can also act as a certificate of the quality of the investment that helps young innovative firms to access external financing (Busom et al., 2012). Finding a right balance between R&D tax credits and direct funding will be essential.

Professional higher educated students are needed

Hiring more tertiary graduates is essential if firms in less-developed regions are to use new technology. However, in Slovakia only 19% of those aged 25 to 64 have attained tertiary education, compared with 32% in OECD countries. The picture is more favourable when looking at the share of tertiary graduates among the young generation, although the difference between Slovakia (26%) and the OECD (39%) remains the same. While this is still low in international comparison, the gap is expected to close as the demography of new graduates is more favourable in Slovakia (OECD, 2013b).

The tertiary vocational education programmes (type 5B) which focus on practical or technical education and provide occupation-specific skills designed for entry into the labour market are barely existent in Slovakia: in 2011, only 1.2% of students are enrolled in such programmes against 13.2% on average in the EU (EC, 2014). Developing short tertiary programmes, as currently considered by the authorities, that include on-the-job training and employable skills could provide the workers needed to use new technology. Such a programme should also include a robust level of general knowledge that provides students with the adaptive capacities necessary for technological change (Handel, 2012). While a new law on higher education is in the pipeline, the authorities should pay specific attention to this challenge.

Clusters could spur technological transfers

Promoting relationships among firms and innovation actors could help spur technological adoption and innovation activities by creating a local labour market, taking advantage of the proximity of actors for ensuring diffusion of knowledge, and by using common infrastructure (OECD, 2011c, 2009c). Public policy can help public and private actors collaborate and share knowledge. For instance, promoting collaboration between university, industry and government has inspired cluster programmes in several OECD countries such as Finland, France, Norway and Sweden (OECD, 2008). The objective of those programmes is not to create clusters from scratch but to help latent clusters emerge and expand. Several clusters already exist relatively evenly spread throughout the country (Table 2.4).

Table 2.4. **Regional distribution of clusters**

Industry	Region				
	BA	West	Central	East	Total
Technology	3	7	2	4	16
Tourism	0	2	5	2	9
Hunting and forestry	0	0	1	0	1
Construction	0	1	0	0	1
Total	3	9	8	4	27

Source: Union of clusters (*www.uksk.sk/*) and the Slovak Innovation and Energy Agency (*www.siea.sk/klastre-na-slovensku/*).

Innovation vouchers are successful instruments for promoting knowledge diffusion (OECD, 2011c). They give firms the opportunity to consult an innovation service provider of

their choice who could help them identify and implement their technological projects. This can be particularly useful for SMEs who may face barriers in approaching research centres because of the small size of their projects. Moreover, innovation vouchers have the advantage of being more flexible than the current procedure of administrative selection of firms and the inherent difficulties picking winners. International experience suggests that a simple lottery or transparent eligibility criteria can be set out beforehand, in case the number of demand for vouchers is superior to the number of vouchers available (OECD, 2010b).

Cluster facilitators are critical to developing co-operation between firms (OECD, 2008). They notably take the form of individuals, private consultants or government agencies and their objective is to improve the conditions for co-operation. To that end, they can especially organise training activities, provide support services and promote a cluster (Ingstrup and Damgaard, 2012). They also support clusters as a whole when applying for public funds, in particular EU funds. The experience of the *Klastry* programme in the Czech Republic is of interest: it helps to develop sectoral competencies and networking, mainly among firms, in all regions outside of Prague with support from EU structural funds. Providing training and information to cluster facilitators would also contribute to strengthening existing clusters.

Launching competitive selection processes to allocate funds to the best organised clusters could also help to support excellence. Such programmes have been developed in Sweden (*VINNVÄXT*) and France (*Les pôles de compétitivité*). They are also extended to lagging regions such as the *InnoRegio* programme in Germany. International experience allows identifying best practices to assess the quality of clusters that could help authorities to implement similar schemes (Kocker and Rosted, 2010).

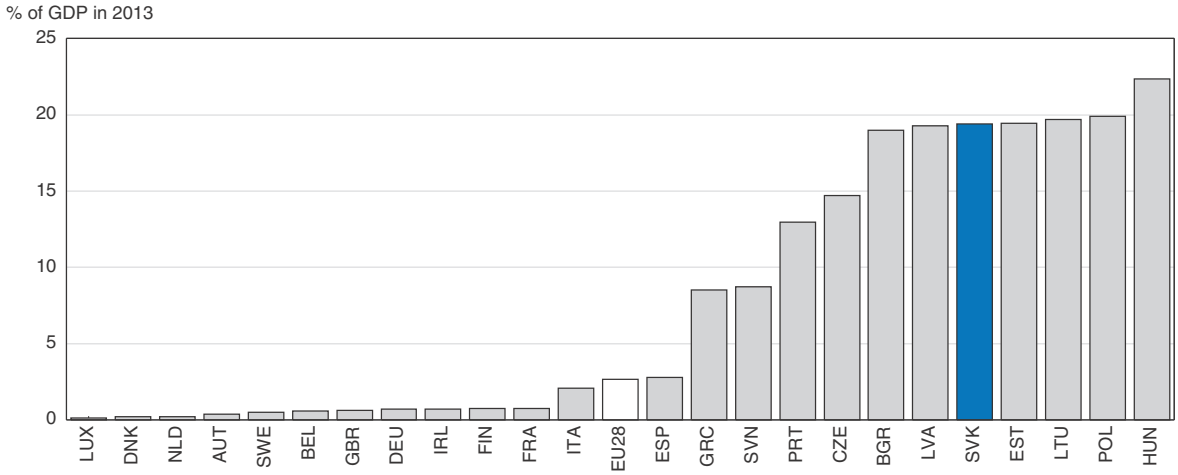
Improving co-ordination among authorities in innovation policies

Co-ordination and co-operation are essential to make the most of investment, to better cater for local needs and identify investment opportunities and bottlenecks (OECD, 2014a and 2013j). There is room for progress regarding the co-ordination and co-operation between the different institutions as discussed in the *Public Governance Review of Slovakia* (OECD, 2014b; and Chapter 1). Co-ordination between regional and central authorities is also essential in designing and implementing innovation policies. For instance, in Slovakia, the Smart Specialisation Strategy has been implemented only at the national level while it was meant to be based on self-identification of regional and local comparative advantages. This is explained by the small size of the country and the weak technical capacities of regions. However, the smart specialisation strategy in France demonstrates that technical capacity can be centrally provided and combined with regional ownership, which has led to an improved assessment and consistency across regions (OECD, 2008). The case study launched in Východné Slovensko in June 2014, aim at applying the OECD principles on Effective Public Investment across levels of Government (OECD, 2014a) and would also help identifying key remaining bottlenecks to local investment.

Making the most of EU funds

Slovakia is among the main beneficiaries of EU funds which represent a substantial source of Slovak public funding (Figure 2.18). Over the 2007-13 programming period, EU funds for Slovakia reached EUR 11.6 billion. This amount is equivalent to the level of public investment. In the next programming period (2014-2020), the amount of EU funds allocated to Slovakia will increase to almost EUR 14 billion, i.e. almost 20% of GDP in 2013 (Figure 2.18). In terms of funds received per capita, Slovakia is the second main beneficiary

Figure 2.18. **Slovakia is a main beneficiary from EU cohesion and structural funds in 2014-20**



Source: DG Regio (*http://ec.europa.eu/regional_policy/index_fr.cfm*) and Eurostat.

StatLink *http://dx.doi.org/10.1787/888933156637*

of EU funds, following Estonia. EU funds offer Slovakia a great opportunity to tackle its regional disparity problem while strengthening the development of the country as a whole.

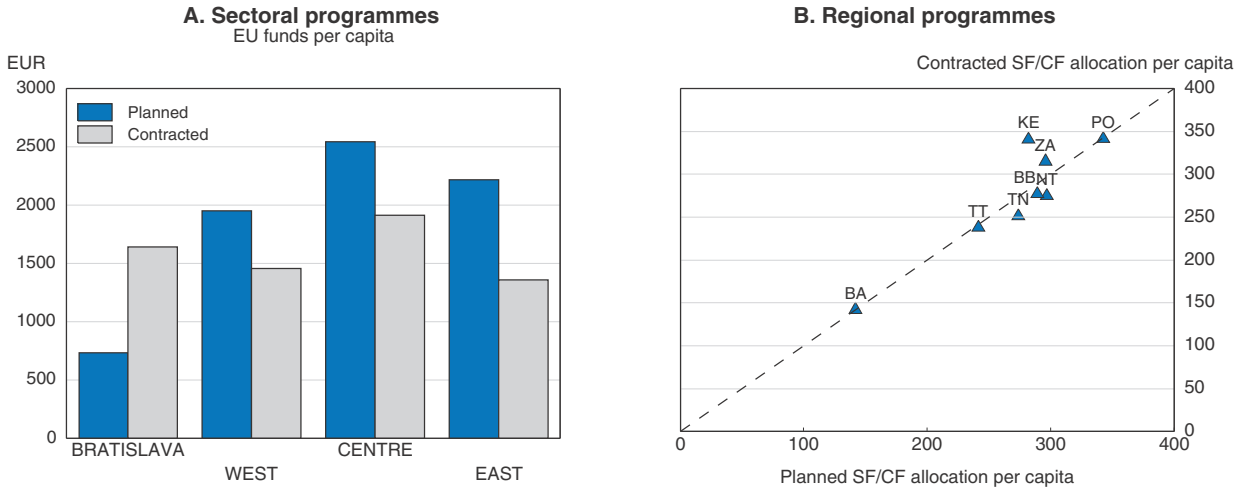
The impact of EU funds for future growth depends on their efficient absorption and implementation, including at the regional level. Institutional barriers in the previous programming period included i) the administrative burden; ii) the lack of administrative capacity; iii) the lack of transparency in project selection and public procurement; iv) corruption; and v) the insufficient involvement of regional authorities (Chapter 1). To strengthen the impact of EU funds on regional convergence and better use them in line with local needs, poorer regions should receive a greater portion of the EU funds and regional authorities be more involved in the design of programmes.

There is room to strengthen the impact of EU funds on regional convergence

Devoting a larger share of EU funds to poorer regions is essential to promote regional convergence. In theory, the allocation of funds across the Slovak regions is meant to favour less developed regions. Accordingly, during the 2007-13 programming period, the Bratislava region was expected to receive about one third of the average funding of the other three regions in per capita terms, but contracted funds were similar in all regions (Figure 2.19, Panel A). In the next programming period, the difference between the Bratislava region and the other regions is supposed to be stronger; the per capita funds planned for all regions but Bratislava have increased on average by one fourth, and those planned for the Bratislava region decreased by 8%.

Regional operational programmes (OPs), also play a critical role in tackling regional disparities given that the main factors constraining growth may vary considerably among regions at different levels of development (D'Costa et al., 2013). Moreover, such regional programmes are less subject to a reallocation of funds between regions (Figure 2.19, Panel B). However, they are insufficiently developed in Slovakia where there are nine sectoral but only two regional OPs, representing only 13% of the all received EU funds (Table 2.5). Other Visegrád countries operate separate regional OPs for each of their regions. No changes are planned in that regard in the next programming period.

Figure 2.19. **Lagging regions tend to receive less EU funds than planned**



Source: National Strategic Reference Framework and Regional Operational Programmes.

StatLink http://dx.doi.org/10.1787/888933156642

Table 2.5. **Share of EU funds allocated to regional programmes**

Poland	Hungary	Czech Republic	Slovakia
25%	23%	19%	13%

Source: National Strategic Reference Framework 2007-2013 (EC, 2008; MDVRR, 2007).

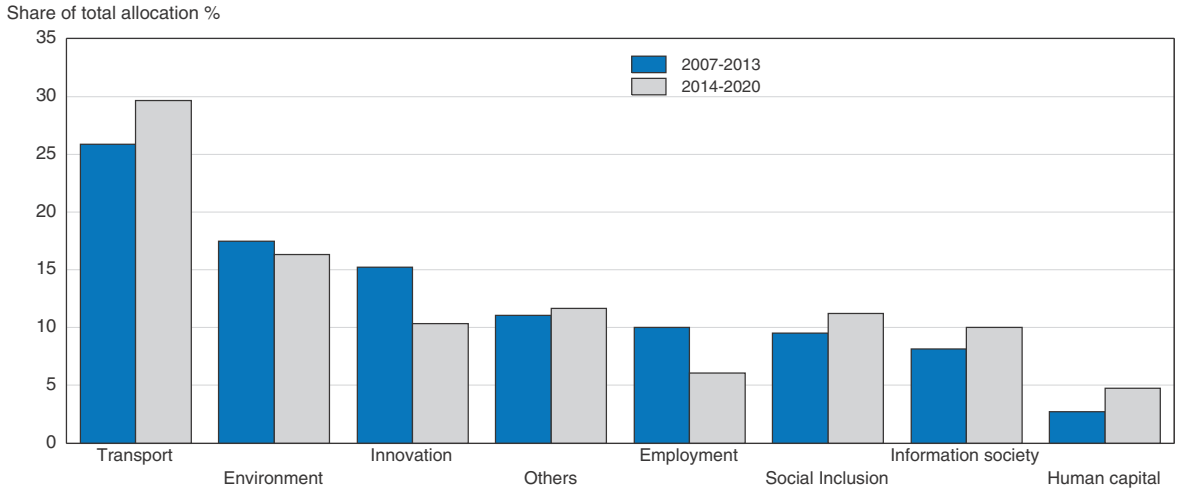
Further involving regional authorities in the the design of programmes would increase the likelihood that funds match with local needs. During the 2007-13 programming period, self-governing regions were not involved in the preparation stage of the regional OPs because of their lack of capacity (Bucek, 2011). They became involved afterward once their capacity improved through technical assistance (MPRV, 2011). In the next programming period, the particular needs of each region will be addressed through regionally integrated strategies that will be designed by the self-governing regions in co-operation with other regional partners. Self-governing regions will be also responsible for the selection of projects under the Integrated Regional Operational Programme. Such an initiative goes in the right direction and should be continued while providing further technical assistance to regions to develop their capacity.

The allocation of funds among priorities is consistent with the main Slovak challenges

Priorities of cohesion policy of Slovakia for the 2014-20 programming period are in line with main challenges identified in this survey for spurring growth throughout the country: i) infrastructure for economic growth and jobs; ii) human capital growth and improved labour market participation; iii) innovation-friendly business environment; iv) modern and professional administration; and v) sustainable and efficient use of natural resources. Transport infrastructure development will continue to receive the largest proportion of the funds (MoF, 2014). Support for Innovations and R&D will increase by 50%, which will bring it to the level of other Visegrád countries in the 2007-13 programming period. The development of the ICT infrastructure remains a priority, which is in line with the plans to expand e-government services (MoF, 2014; MV, 2014). The funding support to employment is, rightly

targeting long-term unemployment, labour mobility and young people's integration into the labour market (MPSVR, 2014). It was raised by four percentage points, but it remains low in comparison with other European countries. A source of concern is the decline in the share of funds allocated to employment and innovation programmes, although they are identified as essential challenges for improving employability and productivity of workers, together with attractiveness of the country for investment (Figure 2.20).

Figure 2.20. **Sectoral allocation of EU funds are in line with growth challenges**



Source: DG Regio and Operational programmes for programming period 2014-2020.

StatLink http://dx.doi.org/10.1787/888933156657

Recommendations for spurring growth in lagging regions

Key recommendations

Boost the capacity to adopt new technology and reduce transport barriers

- Develop professional tertiary education and support for co-operation with employers.
- Provide financial incentives for adopting new technology and innovation spending.
- Improve national road and rail transport infrastructure and international connections.

Strengthen mobility and employability to reduce unemployed and inactive labour

- To develop the rental housing market, phase out support to home ownership and expand means-tested rental housing allowances.
- Develop training as well as job-search support and phase out public works programmes.
- Make sure minimum wages and legal extension are implemented without damaging employment prospects, especially in lagging regions

Recommendations for spurring growth in lagging regions *(cont.)*

Reduce skills mismatch and better integrate disadvantaged groups, especially the Roma population

- Implement a dual vocational education and training system and give specific attention to school-to-job transition in eastern regions.
- Develop the provision and quality of early childhood education and ensure wide access to low socio-economic background children, especially Roma children.

EU funds

- Provide the poorer regions with a higher share of EU funds and a stronger role in the design of programmes.

Further recommendations

Housing

- Suppress grants allocated to youth for housing purchases; the state bonus on saving devoted to housing purchase, and subsidised interest rate mortgages.
- Allow more flexibility for rental contracts and develop the use of extendible fixed-term contracts.

Labour Market

- Increase the overall resources devoted to activation programmes and public employment services (PES). Reallocate resources across PES offices according to local unemployment rates. Accelerate the pace of implementation of PES reform. Outsource part of job-search support activities to offset weak capacities.
- Narrow the eligibility of wage subsidies to youth. Make permanent the reduction of tax wedge for low-paid jobs. Suppress the mandatory work in municipalities for social assistance recipients. Make work pay by implementing in-work benefits.

Education

- Establish training vouchers to boost participation in Lifelong Learning.
- Implement financial incentives, such as tax deductions, for offering apprenticeships, with strict quality control.
- Develop statistics to monitor the effectiveness of support to the Roma population.

Transport and Innovation

- Ensure the effectiveness of the public procurement reform.
- Develop innovation vouchers and reform R&D tax credit to make it refundable. Promote cluster facilitators and a competition-based funding process.
- Provide technical assistance to regional authorities to develop capacities such that they can be involved further to assess and steer innovation policies at the regional level.

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