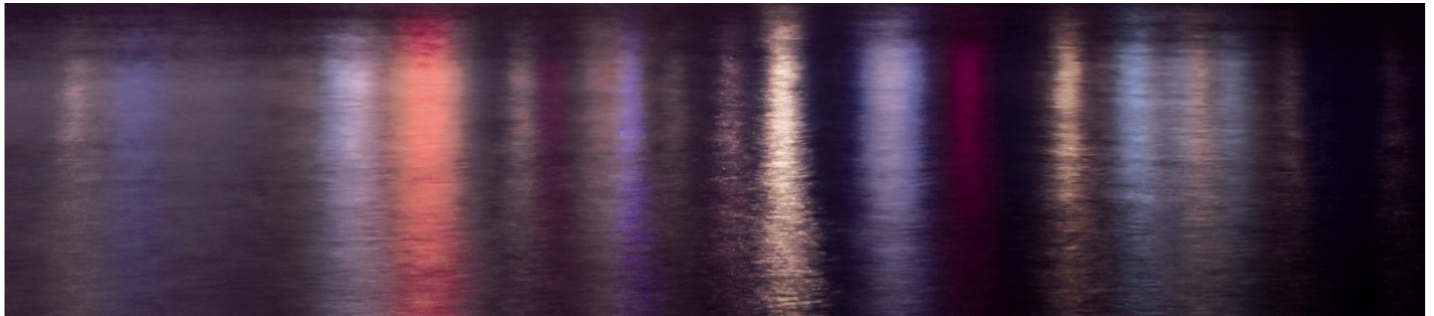




OECD Economic Surveys SLOVAK REPUBLIC

November 2014

OVERVIEW



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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.

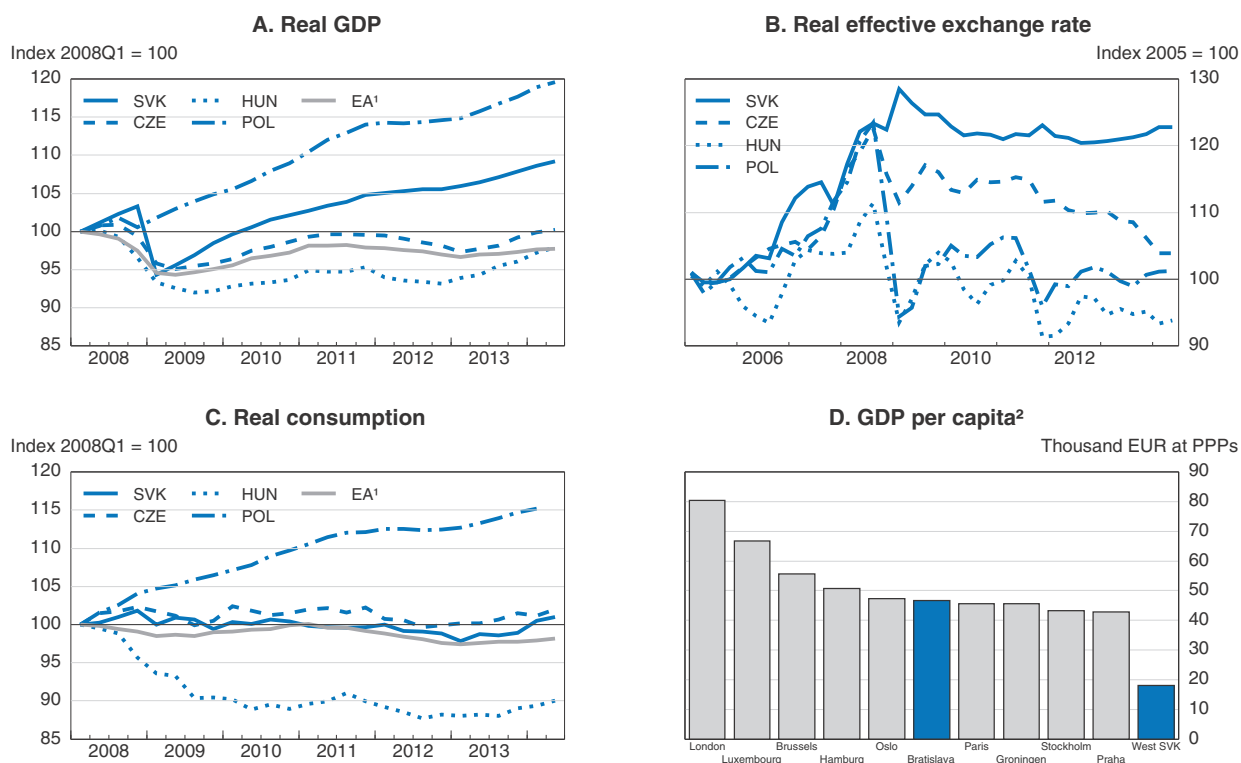
Assessment and recommendations

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

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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.

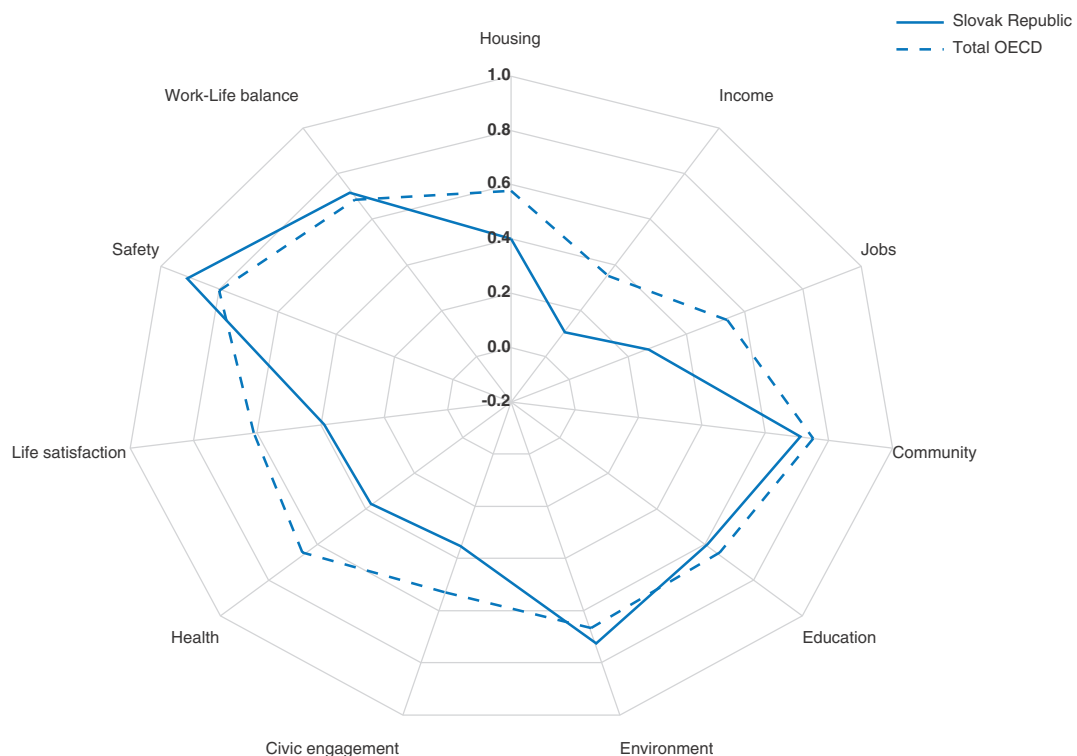
2. The ten most economically active regions in the EU. The region of Western Slovakia (without Bratislava) is ranked at 239th. These statistics are not adjusted for commuting and administrative allocation of economic activities to headquarters.

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

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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: $(\text{indicator value} - \text{minimum value}) / (\text{maximum value} - \text{minimum value})$. Each well-being dimension is measured by one to three indicators from the OECD Better Life Indicator set.

Source: OECD Better Life Index Database.

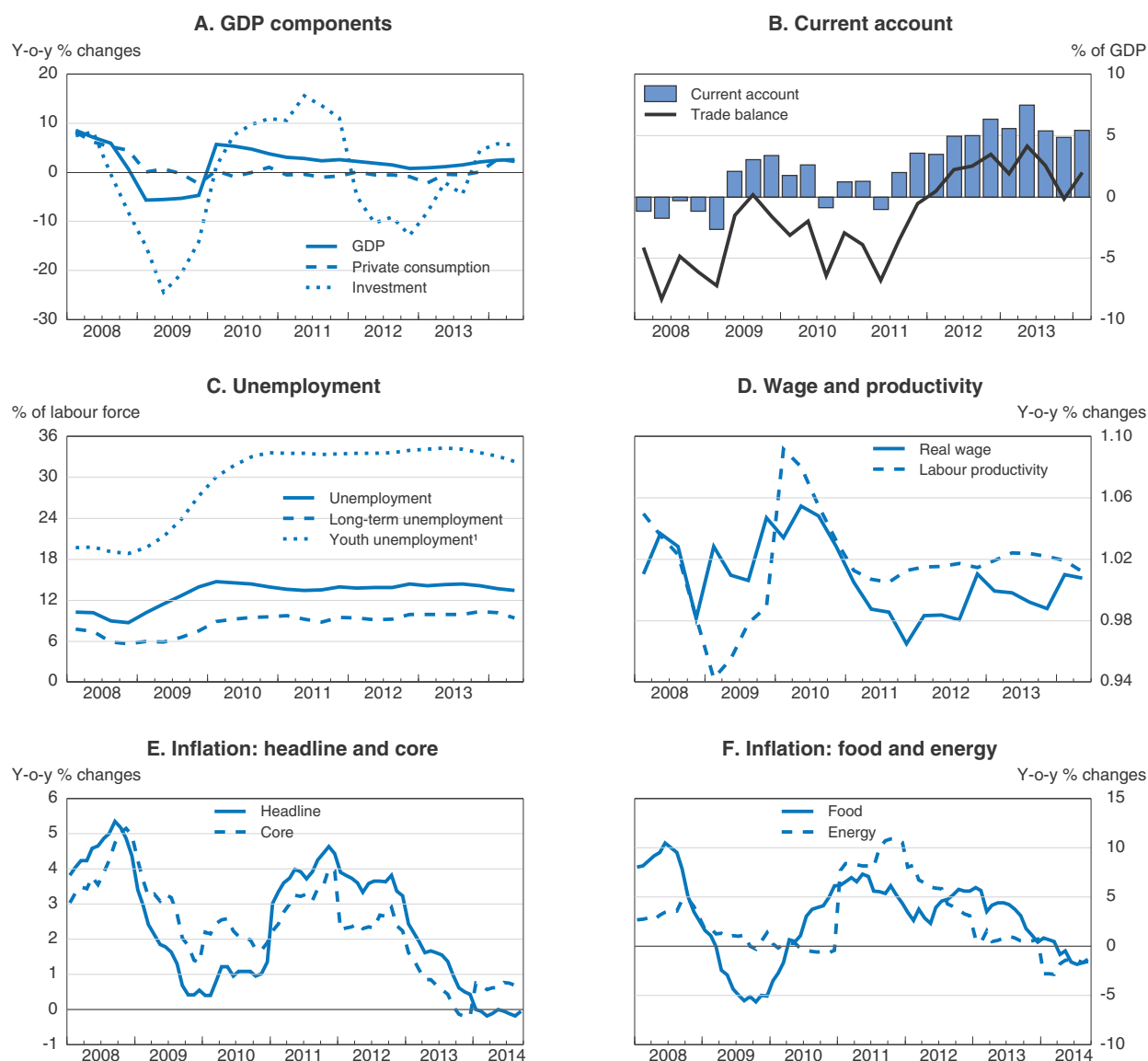
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Short term economic challenges and fiscal policy

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.

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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.

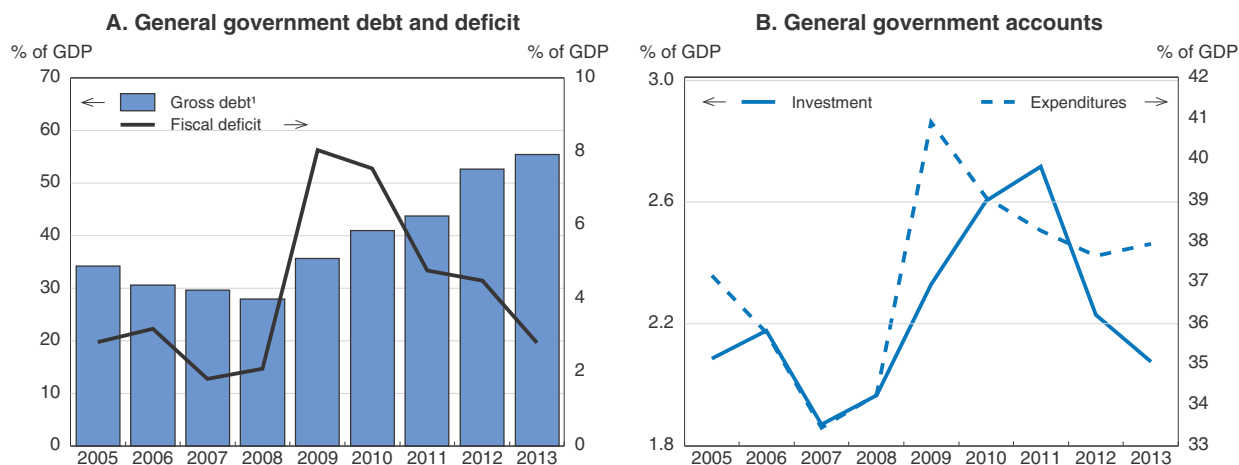
costs. The fiscal deficit will continue to narrow thanks to higher revenues. The debt-to-GDP ratio is projected to remain above the constitutional debt ceiling of 55% of GDP over the projection period, but to stand below the 57% debt ceiling (based on Maastricht definition).

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.

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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.

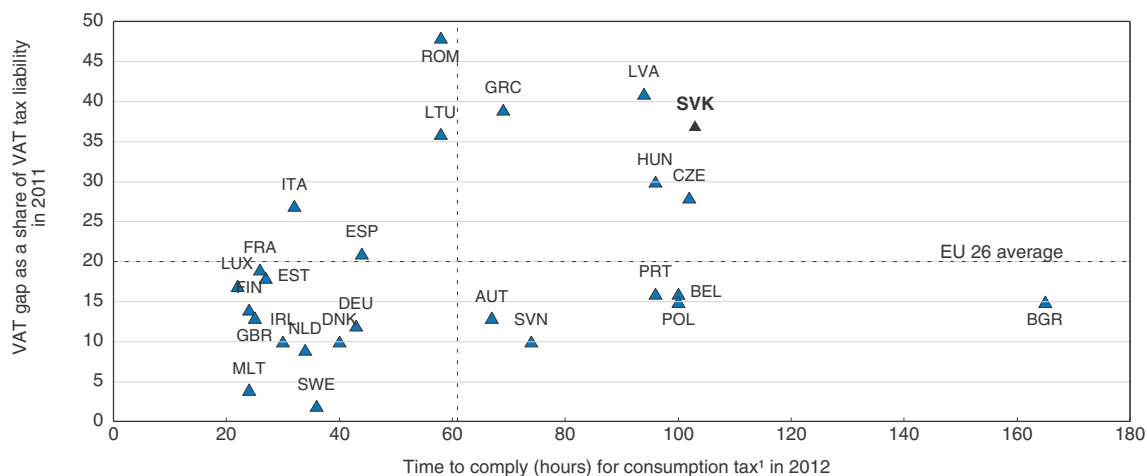
Between 2018 and 2028, the thresholds are to be gradually lowered by 10 pp.

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*.

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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

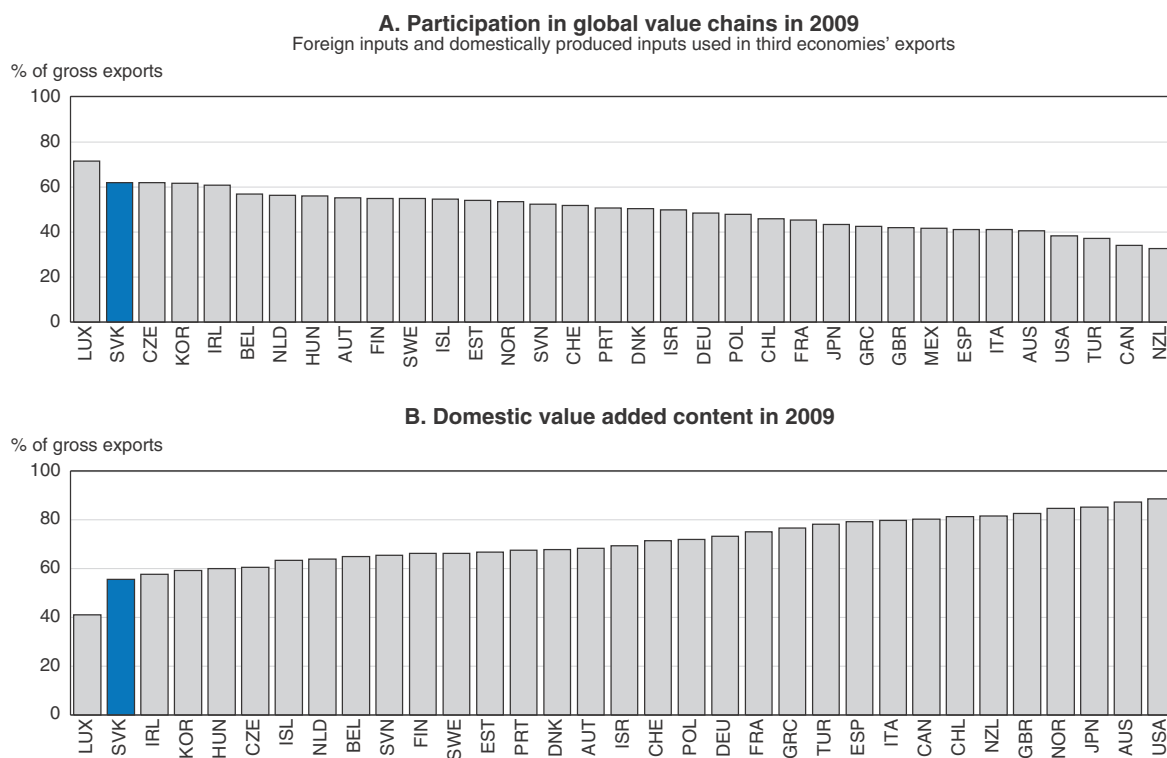
Source: OECD Labour Market Statistics.

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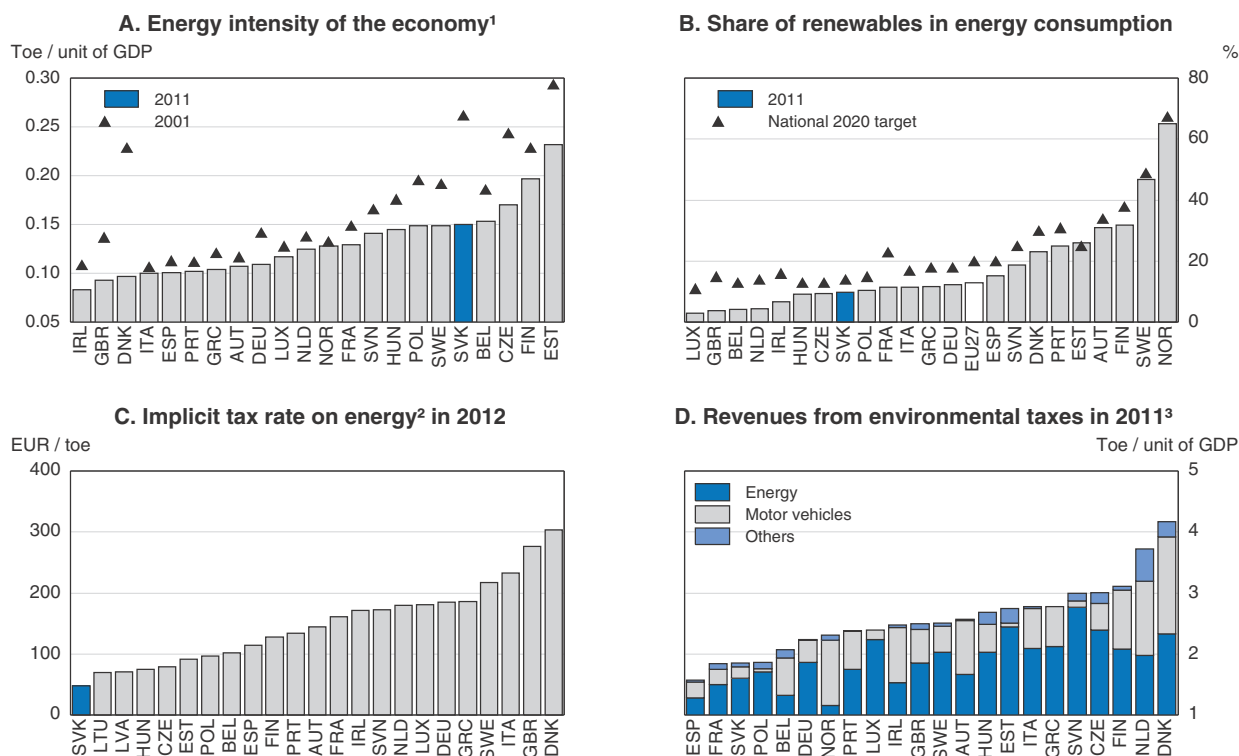
on the Services Trade Restrictiveness Index (STRI) is better than the OECD average in 14 out of 17 service sectors, pointing to the relative liberal regulatory regime applicable to foreign entry in services (OECD, 2014a).

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.

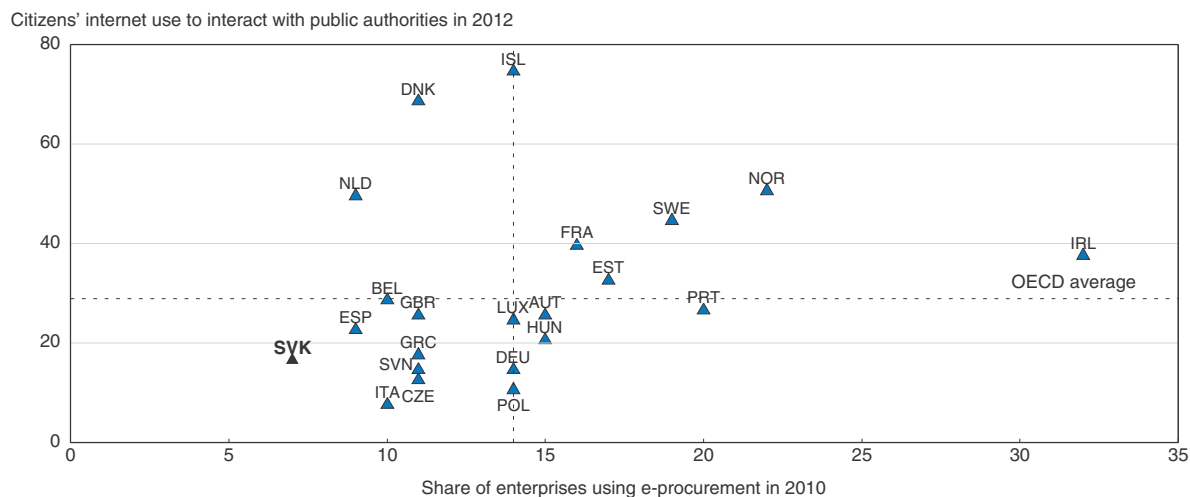
Strengthening public administration efficiency and effectiveness

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.

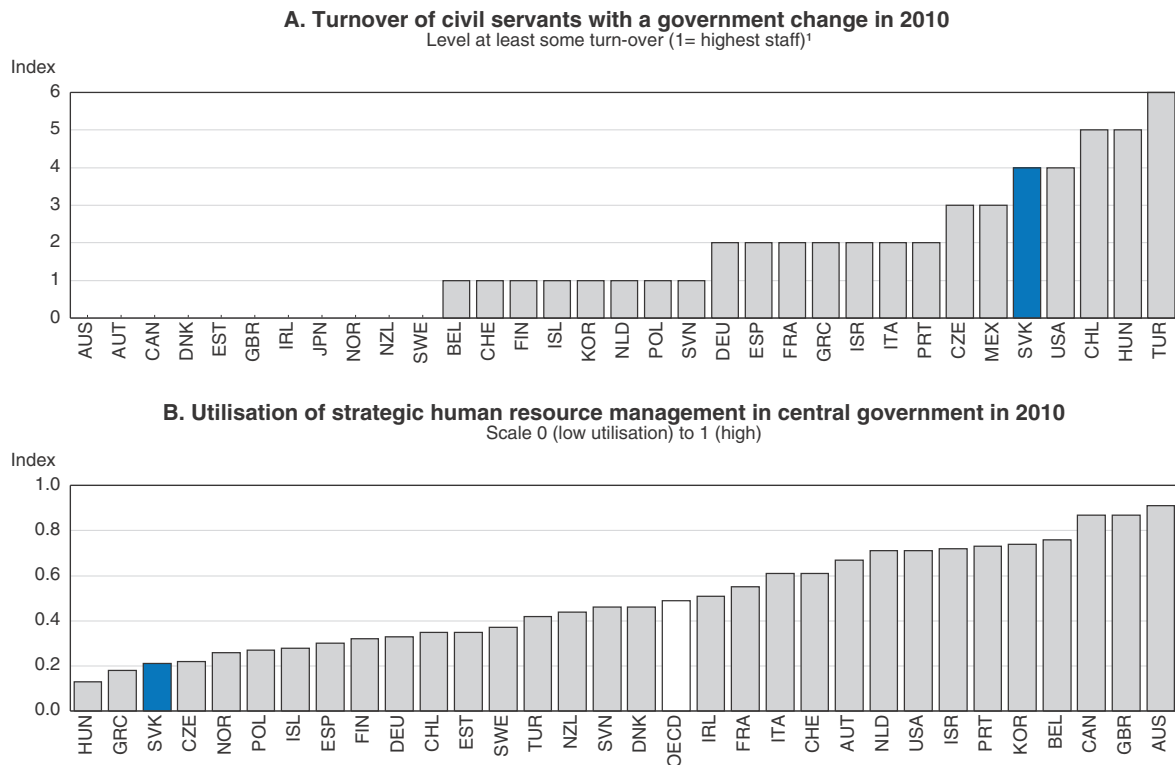
Figure 8. **The public administration lags behind in developing e-government tools**



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.

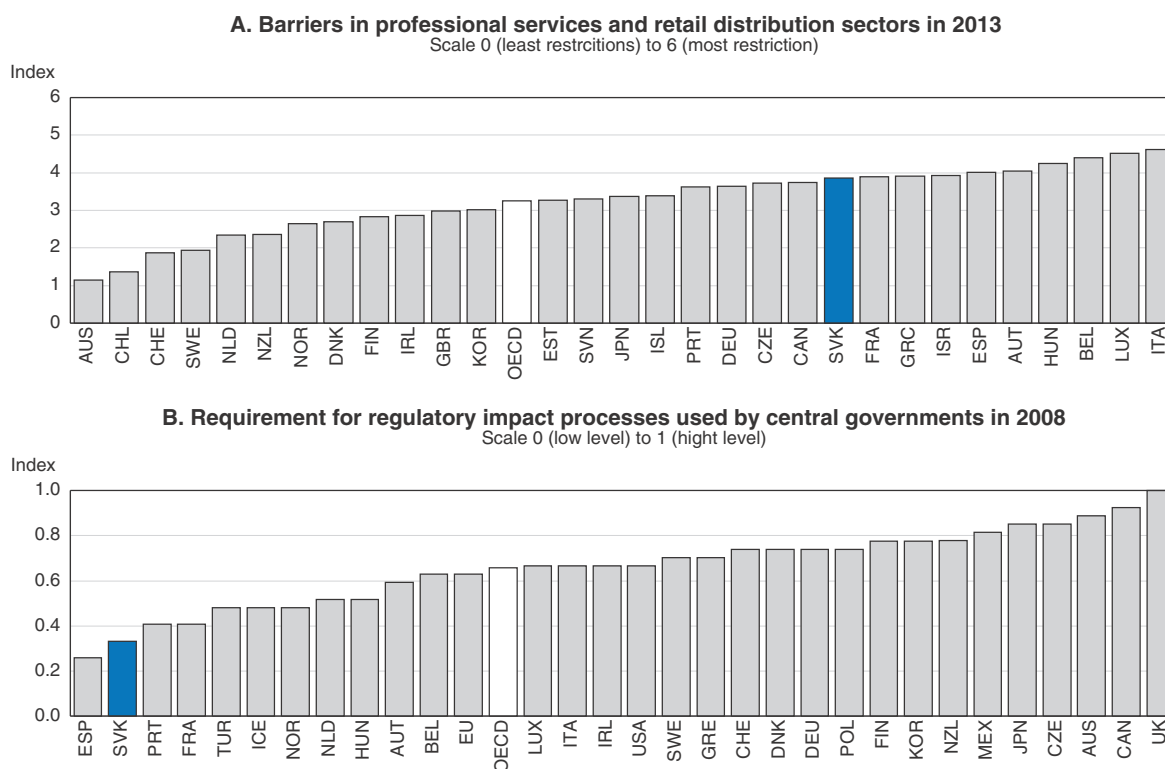
Around 86% of respondents in Slovakia believe corruption exists within public institutions – well above the European average (EC, 2013b; EC, 2014b). Slovakia is also among the worst OECD performers in the 2013 Transparency International Corruption Perception Index. Corruption undermines trust in the 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

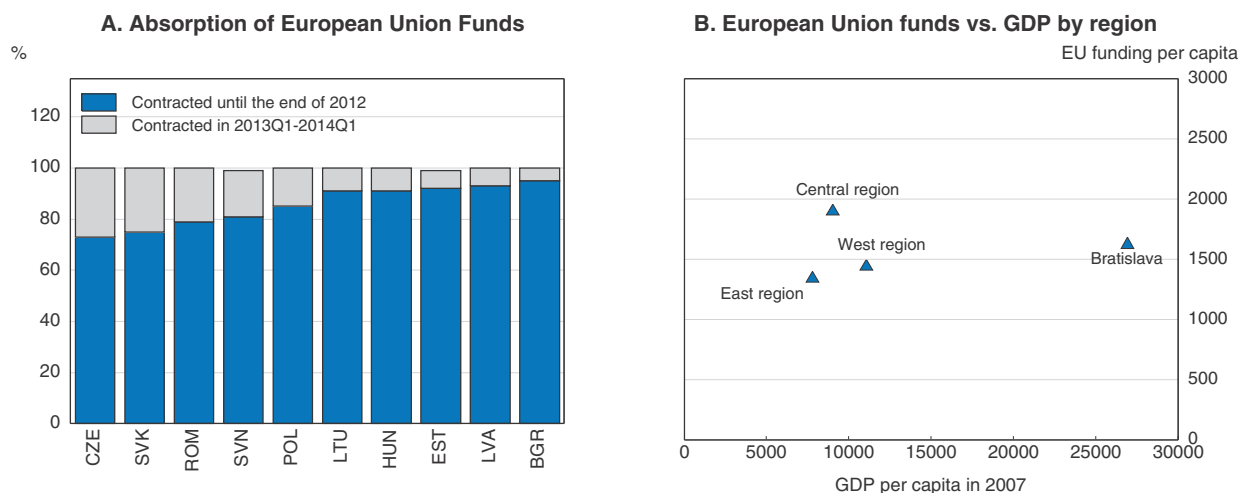
earlier in the process and for strengthening independent quality control mechanisms (see Figure 10, Panel B; OECD, 2014b). Communicating the results of RIA is also essential for improving regulatory design (OECD, 2008a). The authorities could consider establishing an experts group, which would provide 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 annulment 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

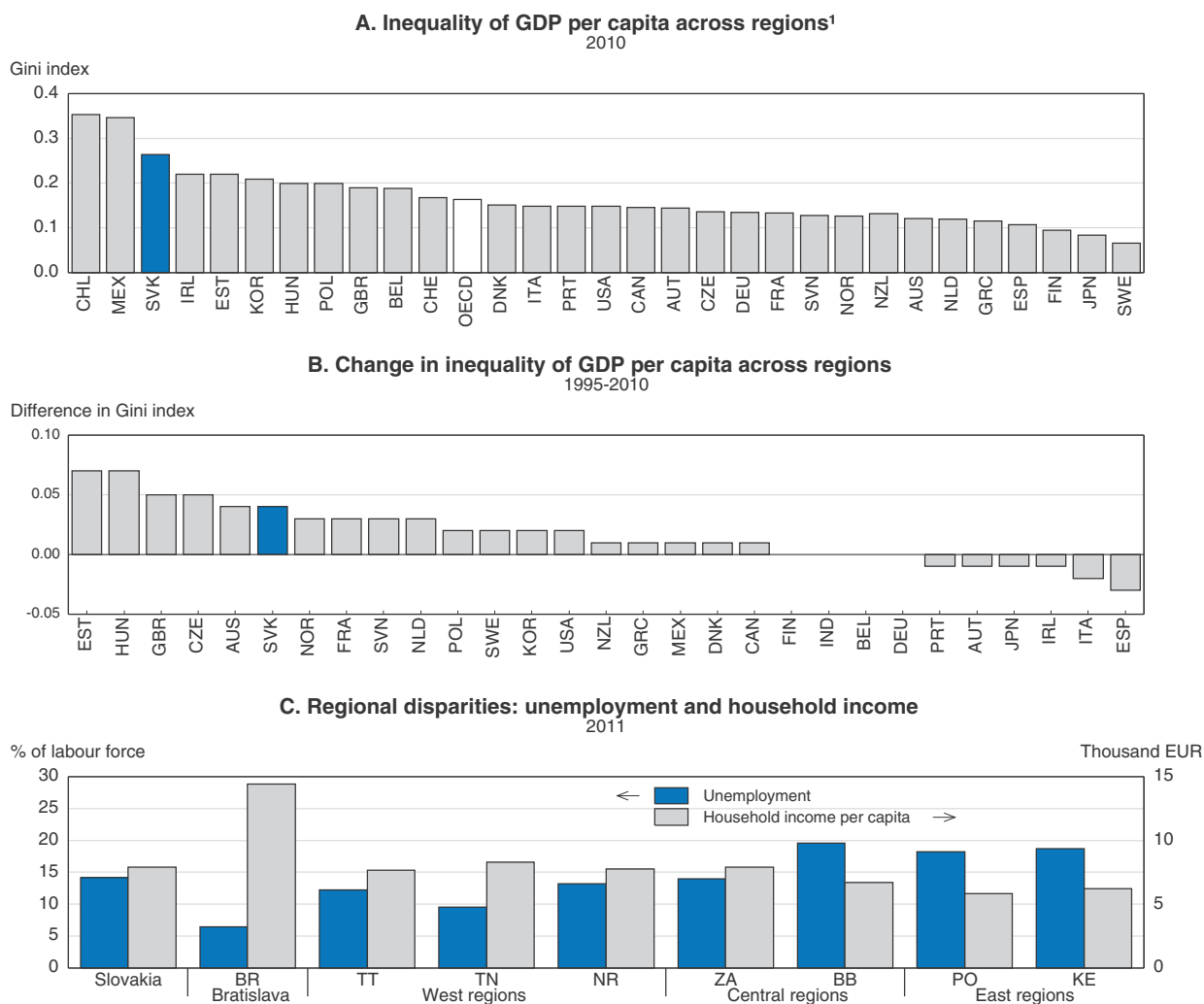
- Encourage joint public service delivery for small municipalities and strengthen the revenue raising power and spending responsibility of viable local governments.

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.

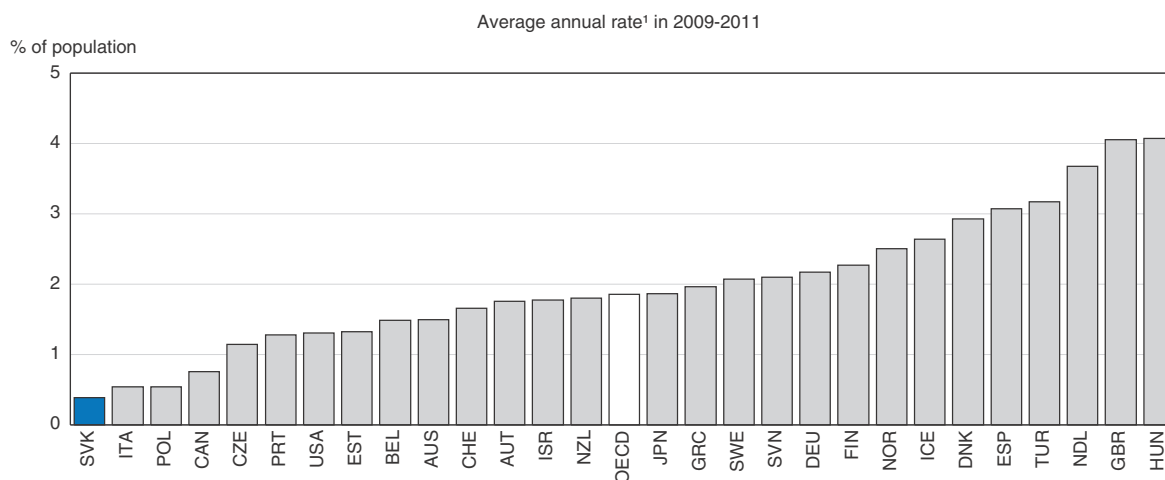
Source: OECD (2013), *Regions at a Glance* and Statistical Office of the Slovak Republic.

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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).

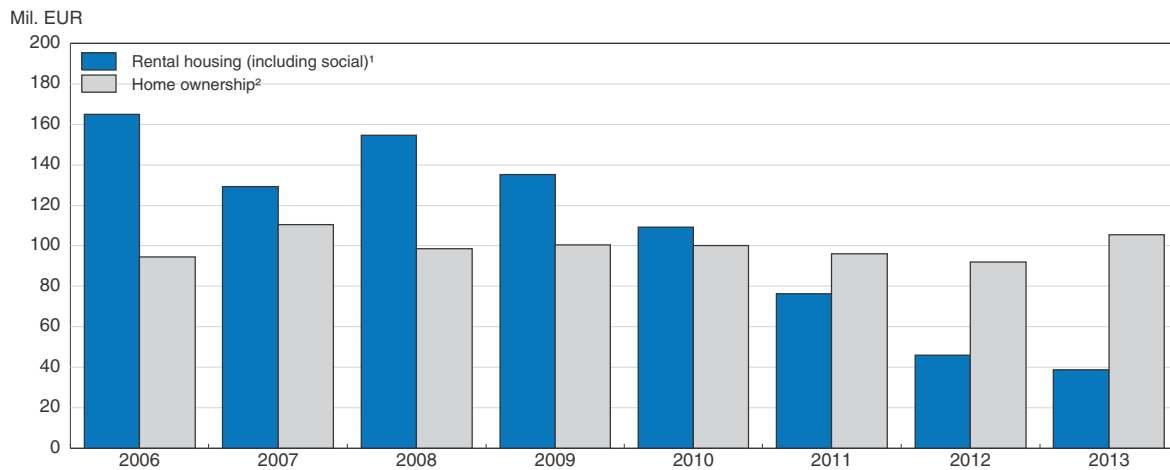
One factor hindering mobility is the lack of rental housing. Home ownership, among the highest of OECD countries – 90% of Slovaks own their home – reduces mobility due to potential capital losses (CECODHAS, 2012). Fiscal support for home ownership is higher than that for renting (Figure 14), resulting 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



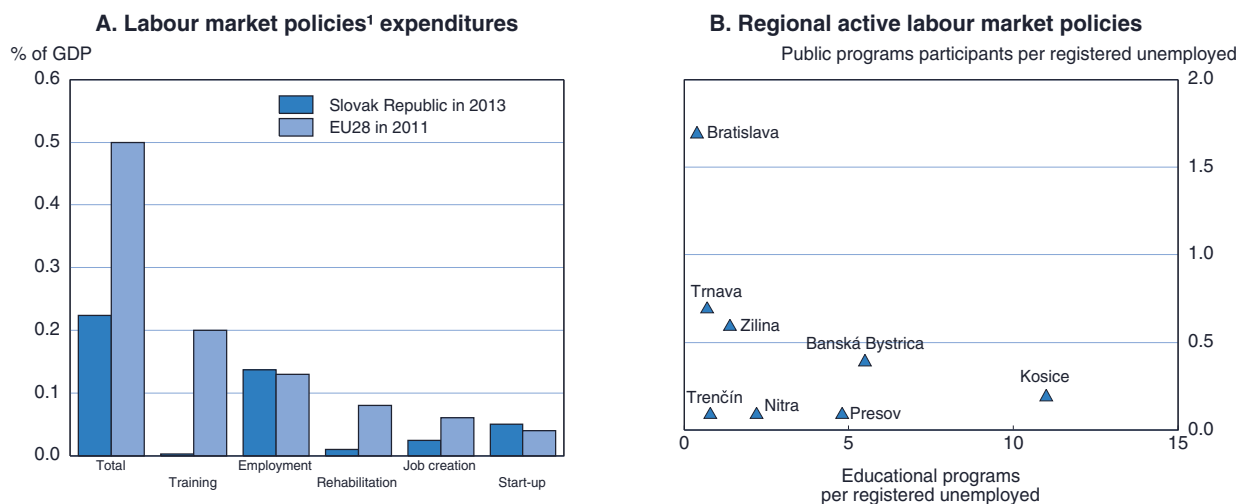
1. Social rental housing subsidy, substitute for rental housing and rental housing within State Housing Development Fund (SFRB).
2. State bonus, mortgage subsidy for young and housing ownership within SFRB.

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; Kluge, 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.

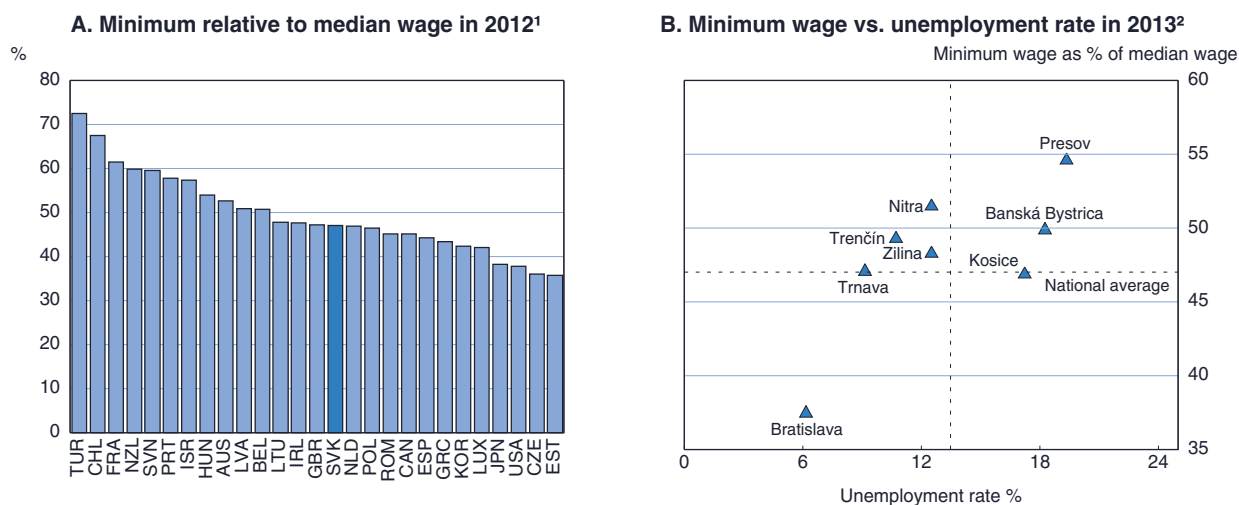
Wage subsidies are efficient at improving employability of low-skilled workers (Card et al., 2010; Orszag and Snower, 2003). Such scheme would benefit eastern regions in particular where the low-skilled are over-represented. Along that line, the reduction of the tax wedge for low paid workers is welcome. 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.

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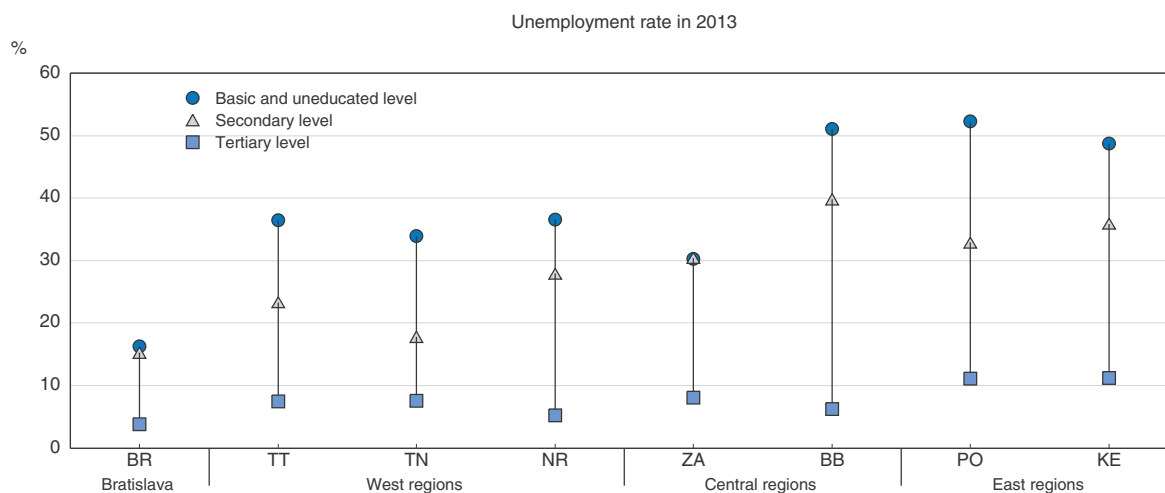
improving working conditions and developing lifelong learning (LLL) of workers (Keogh, 2009), but extension needs to take more into account Slovakia's widely varying local labour market conditions. Extensions could distort competition if used by incumbents to prevent entry by new firms (Martin, 2014). 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.

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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).

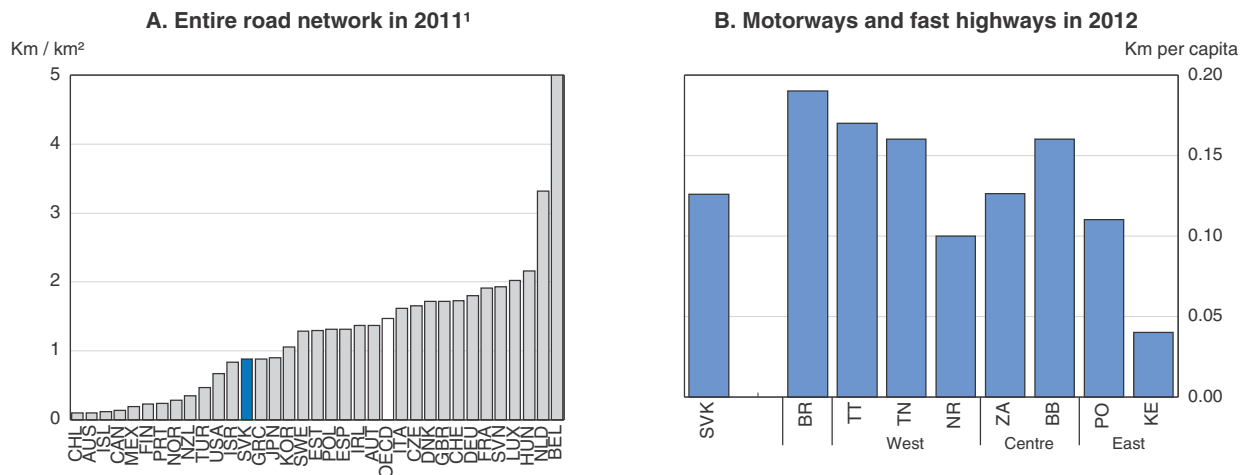
The educational outcomes of students from disadvantaged socio-economic backgrounds are among the worst in the OECD (OECD, 2013c), particularly so in the east of the country. The poor educational outcomes of the Roma, who mainly live in the east of the country and are over-presented in special-needs schools, 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.

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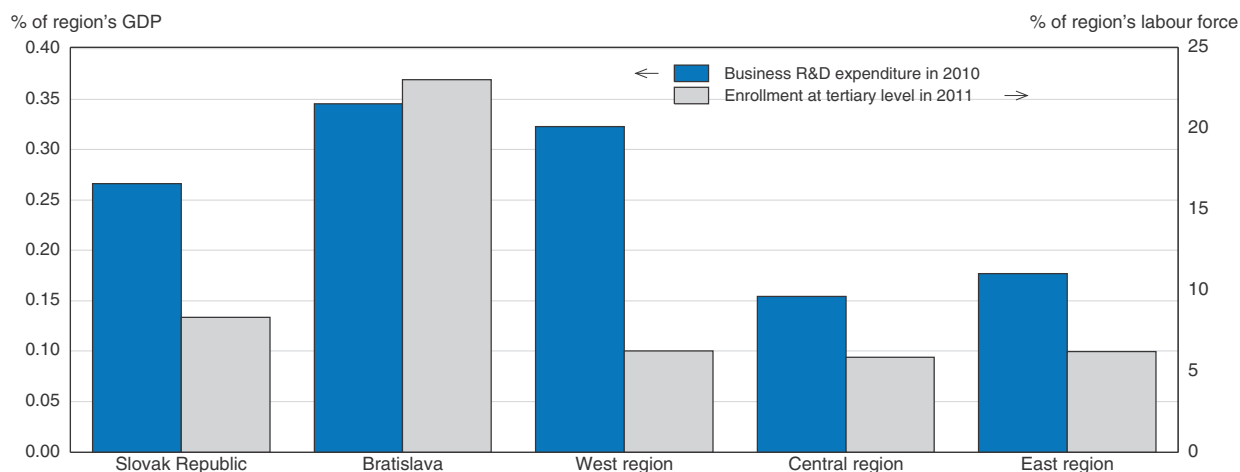
Bratislava market, and Dijkstra et al. (2011) estimate the costs of reaching other EU countries from the east to be among the highest among EU regions. Building such links is a prerequisite to tapping the growth potential of the lagging regions (Sutherland et al., 2009). A positive development is the 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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
Resume the privatisation process. Privatised 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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
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 <i>Surveys</i>	Action taken since the December 2012 <i>Survey</i>
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 forces was reformed in 2013 by increasing the number of years in service and changing the indexation of pension.

Chapter summaries

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 prioritizes spending, and suffers from budget fragmentation, lack of coordination 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.

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.

This Survey is published on the responsibility of the Economic and Development Review Committee 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 and editorial assistance was provided by Seung Hee Koh. Arthur Radziwill and Yana Vaziakowa 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.

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