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# **Slovak labour market in 2009**

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Economic Analysis **21**

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## INTRODUCTION

The labour market has entered one of the deepest slacks since transition and its effects are likely to last for some time. This report was written with the ambition to start a regular annual exercise in labour market analysis at the Financial Policy Institute. It looks at key developments in the Slovak labour market for the previous year providing policy relevant analysis and comparing results with previous trends and internationally. Added value of the report also comes from utilizing microeconomic data from surveys conducted and collected by the Statistical office. The second part is devoted to a special topic reflecting current issues in the Slovak labour market and allows greater in-depth focus. This year's special chapter looks at the role of self-employment, which has increased considerably in the last years and identifies a number of factors, which could be driving it.

### Key findings:

- While the percentage decrease in employment in Slovakia was larger than the EU average, after controlling for decline in economic activity (fall in GDP), the size of job losses in Slovakia is in line with the EU average. However, the decline in overall labor input was among the highest in EU27. The hours worked decreased in Slovakia more significantly compared to other EU countries, even, if we take into account the slump in the economic activity. Given the nature of the crisis, an external trade shock, the manufacturing sector was worst affected. Similar to other EU countries, youth and less educated were particularly hit by the job losses.
- Similar to GDP, unemployment response came later than in most other EU countries but the percentage point increase was above the EU average. Labour demand declined considerably partially reversing previous positive trend in flows of jobseekers out of unemployment. In addition to rising cyclical unemployment, long-term unemployment started to increase towards the end of 2009.
- Labour force participation declined by more than the EU average, even though there is considerable variation across countries and workforce groups across the EU.
- Unit labour costs have significantly deteriorated due to the fall in productivity per employee while growth of wages and compensations slowed down. However, internal flexibility in the labour market helped retain productivity per hour worked.
- The tax burden on labour decreased more than in the OECD average, as a consequence of adopted changes in the income tax base.
- The wage formation process remained largely unchanged even though the influence of government over the collective bargaining process increased. The share of minimum wage on median wage for the whole increased somewhat and the share on regional median wage is particularly high in regions with higher unemployment. OECD thus recommends considering differentiating the minimum wage in Slovakia.
- Strictness of employment protection legislation remained unchanged and stayed below the OECD average, with stricter regulation of collective dismissals.
- Self-employment in Slovakia increased substantially in the last few years, the highest increase in the EU. Its formal impact on employment growth was larger than that of dependent employment (change in numbers of employees). A number of factors increase attractiveness of self-employment including preferential tax and social contributions treatment, weak safety nets and government subsidies for new self-employed.
- Self-employed without employees (so called own-account workers), are the main drivers of increasing self-employment, which suggests that false self-employment - self-employed simply to reduce tax liabilities or employers' responsibilities - could be prevalent.

## PART 1: SLOVAK LABOUR MARKET IN 2009

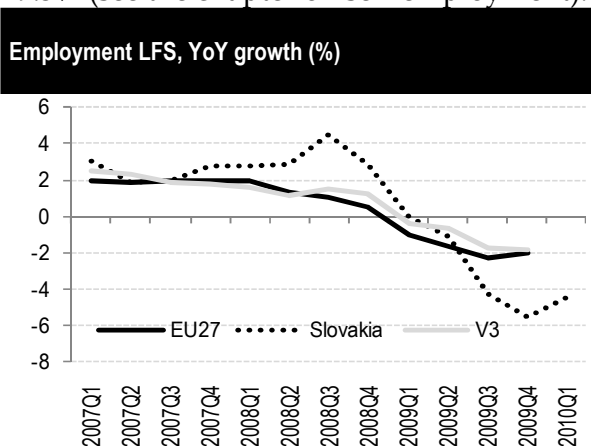
The first part of this study looks at developments in the key labour market indicators with focus on last four quarters. Positive trends from previous years have been reversed by the crisis which started to affect labour market towards the end of 2008 already. Effects of the current cyclical decline are likely to persist for some time even as the economy starts to recover. Labour policy responded to the crisis mainly by lowering the tax burden and increasing progressivity of the tax system, while employment protection legislation and the wage formation remained largely unchanged.

### 1. Labor force

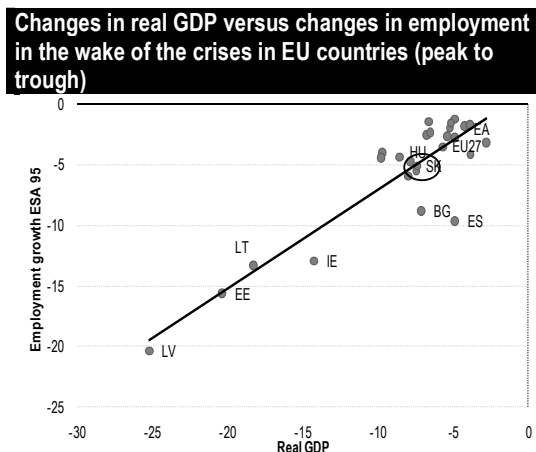
The effects of the crisis dominate the labour force developments in 2009. While the size of employment adjustment was relatively large, it is in line with other EU countries if controlling for GDP decline. In line with expectations, export dependent industry was hit most. Unemployment increased in line with magnitude of job losses, with youth and lower skilled workers most affected. As labour market persists, long-term unemployment started to increase towards the end of the year even as labour force participation decreased suggesting negative impact on structural unemployment and potential growth.

#### 1.1 Employment

The employment in Slovakia decreased significantly in the wake of the crisis. The consequences of the crisis for the real economy were fully felt in 2009 (GDP decrease by 4.7%), while the employment reacted with the usual lags. Slovakia lost more than 68 thousand jobs; the annual decrease in 2009 was according to the labour force survey (LFS) methodology 2.8%. Although the economy is recovering, the employment is still decreasing. The employment in the second quarter of 2010 decreased by 0.2% (quarter on quarter basis). The crisis year affected mostly the employees; the number of employed persons decreased by 4.8%, on the other hand the number of self-employed increased by 9.3% (see the chapter on self-employment).



Source: Eurostat



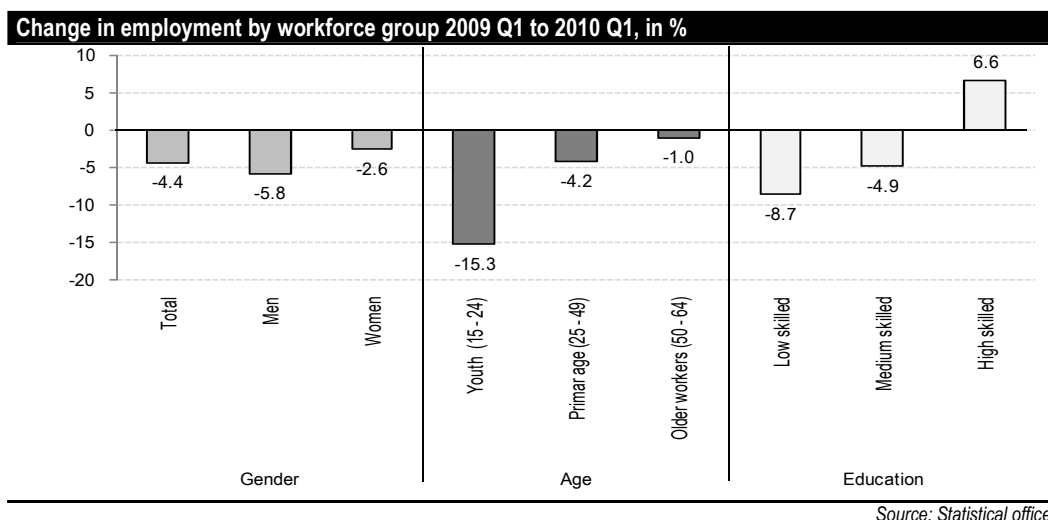
Source: Eurostat

The employment is measured by three different methodologies (see box). According to any of them, employment witnessed a significant downturn. The highest

downturn was among the registered employment (decrease by 4.5%), the employment according to the ESA methodology recorded a decrease by 2.4%.

The decrease in employment in Slovakia was more significant compared to other countries, in EU27 the decrease was 1.7%. On the other hand, if we take into the account the significant slump in economic activity in Slovakia, we realize that the labour market response in terms of the numbers of jobs lost inside the country to the negative output shock was in line with EU average (chart above). This chart shows the significant negative association between real GDP growth and changes in employment growth, where Slovakia is on the regression line. The GDP and employment decrease refers to period from peak to the trough of the crises. This is, however, not true for the total labour input (see 2.2 Utilization).

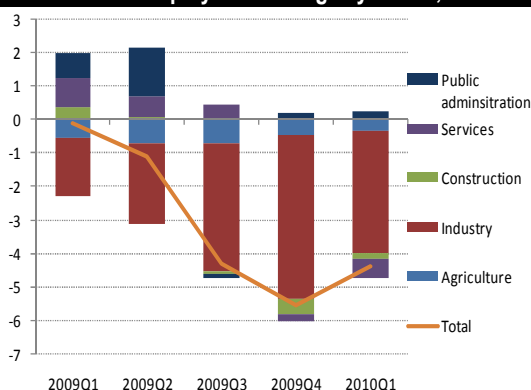
Job losses have been relatively larger for some workforce groups than for others. Youth and low skilled workforce have been hit particularly hard by the current recession. This is in line with historical recessions patterns, where youth and low skilled showed greater cyclical sensitivities (OECD 2010a). Employment loses were also above average for men and medium skilled workers. This reflects the sectoral composition of the negative shock to aggregate demand, which particularly affected the manufacturing industry and mining. The number of persons working in the manufacturing sector decreased by more than 15% YoY. The greater than usual impact on jobs in manufacturing is related to the trade collapse. The employment grew in 2009 in IT (2.3%) and communications (1.2%) sectors.



Improving condition in the world economy should help to stabilize the labour market in Slovakia. While employment should decrease by 1.8% according to LFS methodology in 2010, it should start rising by the end of 2010 and grow by 1% in 2011. Severe economic downturns, like the recent crises, have durable adverse effects on the labour market reducing potential output over medium term. They persist even once GDP has fully recovered. According to the latest forecast of the Ministry of Finance (june 2010),

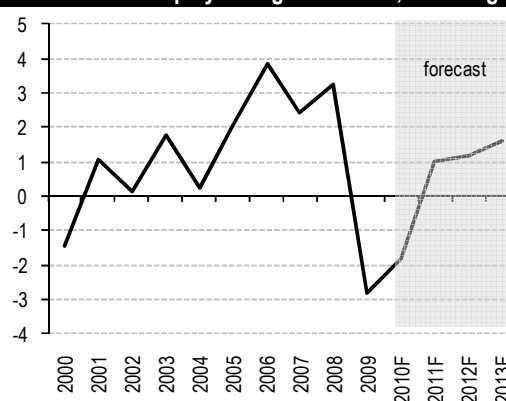
the Slovak economy should not reach the level of employment from the pre crises period even in 2013.

**Contribution to employment change by sector, %**



Source: Statistical office

**Forecast of the employment growth - LFS, % change**



Source: Statistical office, MoF SR

### BOX - Employment methodologies

The employment can be measured by three different methodologies

- Labor force survey
- Registered employment
- ESA 95

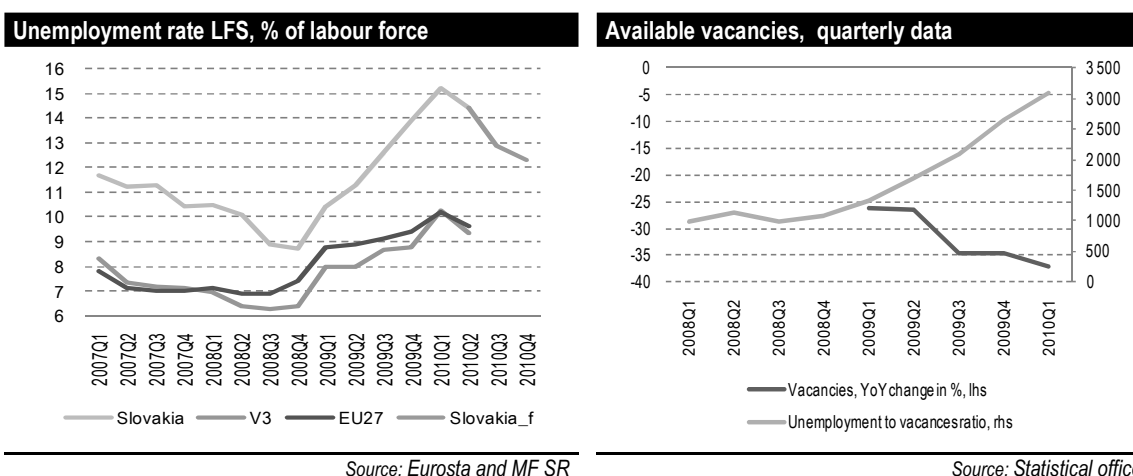
**Labor force survey** is conducted by statistical office of SR and it is monitoring the labor force on the basis of a direct surveying in selected households. The survey covers all persons aged 15 and over living in the households of selected dwellings regardless of permanent, temporary, or unregistered stay. Each selected household remains in the sample for 5 subsequent quarters. All surveyed data is rescaled by the current data on the SR population taken from statistical survey about population movement. Data includes residents working abroad - national concept.

**Registered employment** is monitoring of employment on the basis of quarterly sampling survey in entrepreneurial organizations with 20 and more employees or up to 19 employees, who have annual receipts of own output and goods of 5 mill. EUR and more. Data for other small enterprises with the number of employees up to 19 are gained from the quarterly sampling survey.

**ESA 95** is a constructed indicator of labor accounts and it is published quarterly. It harmonizes data from enterprise surveys with the data from the labor force sample survey in households to meet the ILO and ESA 95 definitions. According to ESA 95 total employment is expressed in domestic concept. In this concept the data is acquired from the enterprise survey. For the sake of comparability, the data from the Labor force survey is adjusted by the number of residents working abroad, non-residents coming from abroad, employees of collective households, women on maternity leave and others.

## 1.2 Unemployment

After a gradual decline in the previous years, unemployment increased significantly in 2009. The unemployment rate began to rise in the 1Q2009 and reached 12.1% for 2009, increasing by 2.5 pp compared to 2008. It is projected to peak in the first half of 2010 and decline only gradually afterwards.



Similar to GDP, unemployment response to the crisis was more lagged in Slovakia, as the unemployment rate increased later than in other EU countries. Companies first adjusted by cutting working hours (per worker) and productivity rather than jobs (OECD 2010a or graph), suggesting internal flexibility played a greater role in Slovakia when compared to other countries. Moreover, early employment declines translated into a fall in participation rather than higher unemployment. Students, who qualify as inactive in LFS methodology after losing work, were particularly affected and number of working students declined by 7.4 ths in 1Q2009 compared to a year ago (12.4% YoY).

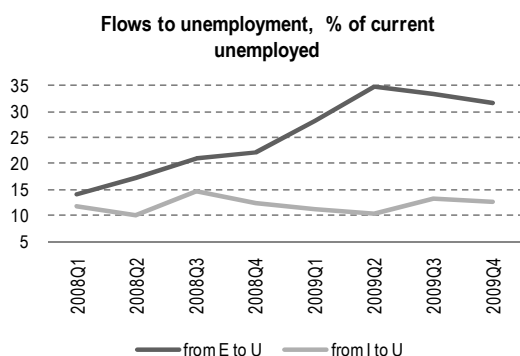
However, once unemployment started to increase, it was rising faster than the EU average. The unemployment rate in Slovakia increased 6.5 pp, twice as much as the EU average of 3.3 pp (peak to trough). This was due to relatively larger job losses (see section on employment above) when looking at the whole period.

Rising unemployment was driven by increased job losses and falling demand for labour. Availability of dependent employment significantly worsened, as the number of available vacancies<sup>1</sup> declined by almost a third (see graph right above). With lower labour demand, flows from unemployment to employment fell by 5.9 pp YoY as a share on the number of previous year's unemployed. With falling vacancies and rising unemployment, the number of job seekers per vacancy almost doubled.

<sup>1</sup> The data on available vacancies is published by the Statistical office and based on voluntary reporting of job opening by employers to labour offices in the regions. Due to the voluntary nature of data submission, the numbers are likely to be significantly underestimating the number of available jobs.

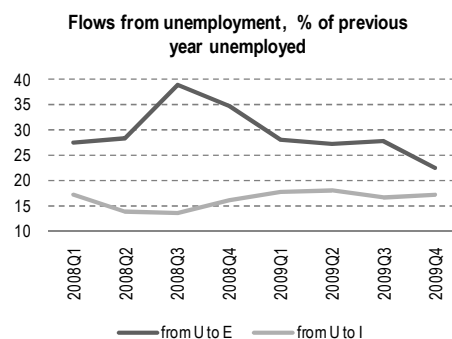


### Flow to unemployment<sup>2</sup>, % of current unemployment



Source: Statistical office and own calculations

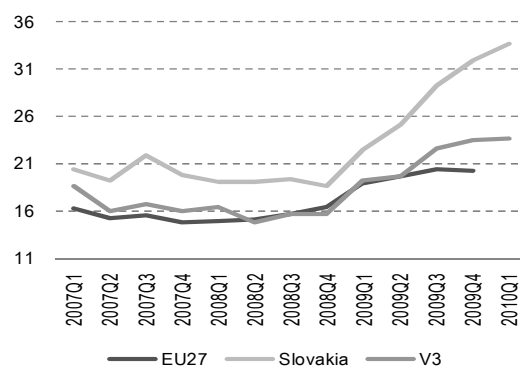
### Flow from unemployment<sup>2</sup>, % of previous year unemployment



Source: Statistical office and own calculations

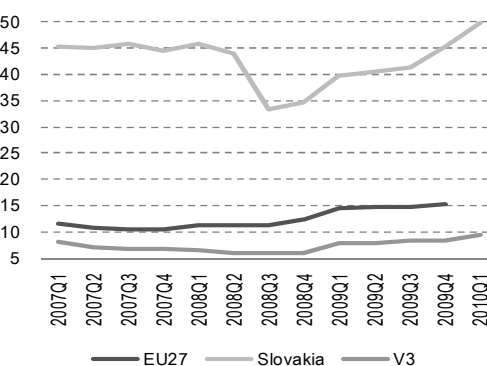
The impact on unemployment varied across the workforce groups. Similar to decline in employment workgroups (see discussion above) and previous recessions in other countries, youth (15-24) and less educated (primary and lower secondary education) were hit relatively more strongly. However, unemployment rate of these groups increased by more than the EU average (see graphs below) suggesting that these groups are more at risk of being unemployed during labour market downturn in Slovakia.

### Youth unemployment rate, % of labour force (15-24)



Source: Eurostat

### Unemployment rate of the low skilled, % of the labour force with pre-primary, primary and lower secondary education



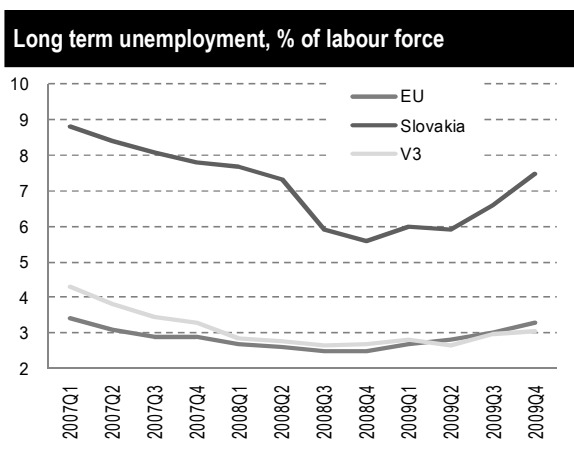
Source: Eurostat

In addition to rising cyclical/short-term unemployment, **long-term unemployment** (LTU) started to grow as well. While the long-term unemployment rate had been previously falling, it increased by 1.9 pp, more than double the EU average of 0.8 pp during the crisis<sup>3</sup>. Lower availability of new jobs slowed down flows into employment and after an early increase in short-term unemployment (see graph right below) prolonged unemployed spells. In addition to an increasing number of unemployed becoming LTU, the outflow from LTU slowed down significantly and

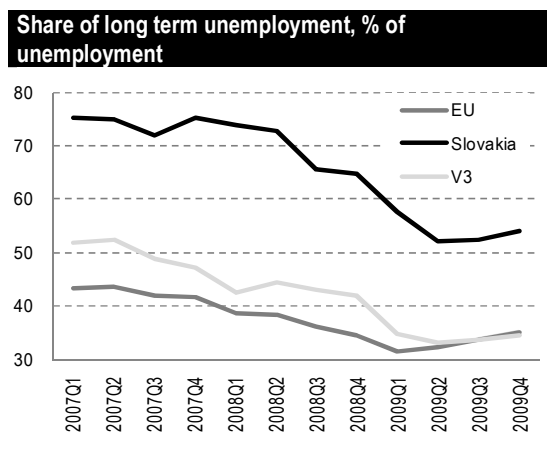
<sup>2</sup> Flows are calculated from the LFS microeconomic data and compare economic status in a given quarter with a year ago.

<sup>3</sup> Lowest to highest quarterly value of the long-term unemployment rate (2008-2009).

decreased by 0.9 pp to 2.6% as a share of total number of LTU in the previous quarter (graph below). Slovakia has a relatively high pass through from unemployment to LTU (OECD 2010c) and in the past, LTU continued to increase even as the economy and employment started to recover, suggesting that LTU is likely to continue increasing and remain high for some time.

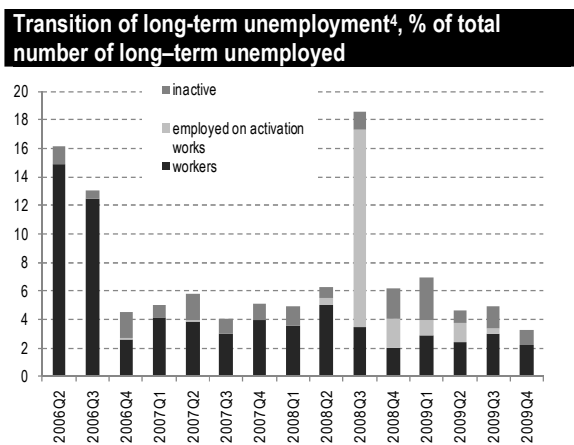


Source: Eurostat

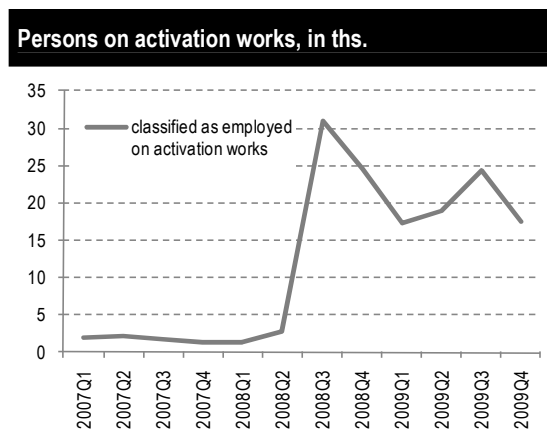


Source: Eurostat

Moreover, the role of activation works as a factor reducing LTU decreased somewhat in 2009. While the total number of unemployed on activation works classified as workers increased by 31% in 2009 (see graph right below), the share of LTU become workers on activation works decreased by 3.4pp to 0.7% (a decrease by 83%). Short-term unemployed are likely to be more successful in qualifying for the contribution and could be crowding out the long-term unemployed.



Source: Statistical office and own calculations

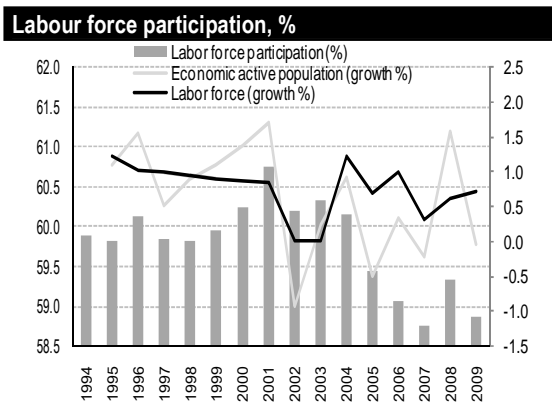


Source: Statistical office

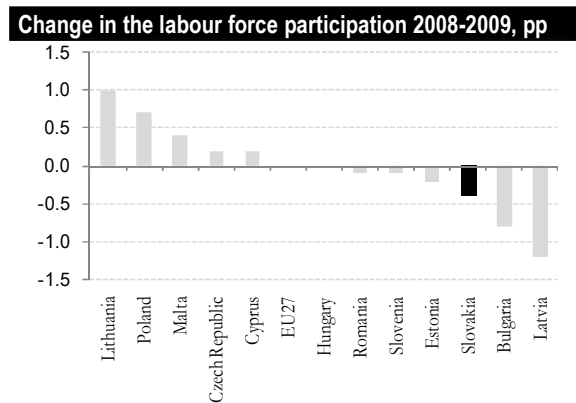
4 Calculated using the Labour Force Survey microeconomic data and comparing economic status of long-term unemployed in one quarter with their status in the following quarter.

### 1.3 Labour force participation

Economic downturns have usually ambiguous effects on the labour force participation. There are two opposite forces behind the change in the participation rate in response to the crises. On the one hand, there is the discouraged workers effect, that is, the workers tend to remain on maternity leaves, continue with study etc., hence outside the labour market, while on the other hand, loss of family income may also induce those previously outside the labour force to seek employment to support family income. The labour participation response varies across the countries. In Slovakia, an adverse effect of the crisis on participation suggests that discouraged worker effects are dominant. Hence, Slovakia is one of the countries among the new EU member states, where labour participation decreased due to the crisis. The participation rate dropped from 59.3% in 2008 to 58.9% in 2009.

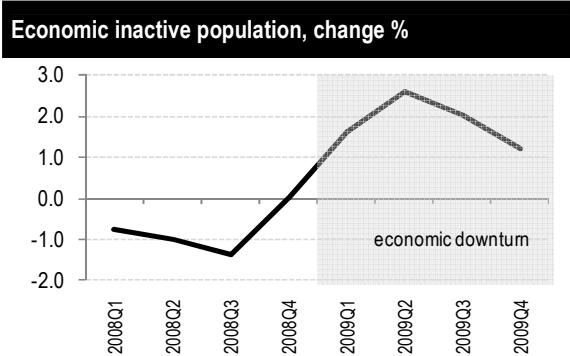


Source: Statistical office

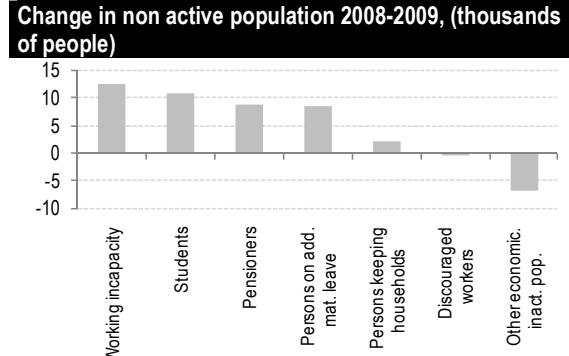


Source: Statistical office

The labour force increased by 0.7% in 2009 as the number of persons in productive age and in post-productive age increased by 23.9 thousands and by 9.2 thousand respectively. Slovakia also witnessed a significant increase of economic inactive population, which was the main driver of the labour market participation decrease. The number of economic inactive people aged 15 years and more increased by 34.4 thousands (YoY growth rate 1.9%) in 2009. Most of all – persons with working incapacity, students and pensioners increased significantly.



Source: Statistical office



Source: Statistical office

Due to the slight overheating in the labour market in 2008 (Sramkova 2010) more students and pensioners were able to find job before the crisis. In 2009 these group were dropped out of the labour market and ended up in inactivity. This was significant especially in the first two quarters of 2009, therefore the peak of the increase of the economic inactive population was in the first half of the year. The other reason of the increase of inactivity was the significant increase of persons on sick leave (working incapacity). Due to the crisis the employees were motivated to take the sick leave in order to receive benefits (Social security agency is providing contribution on sick leave, which equals 55% of gross wage) or to postpone the lay-off. The number of persons on sick leaves in 2009 increased by 12.8 thousands. If adding these extra sick leaves, the unemployment rate in 2009 would have increased by 0.4 p.p. to 12.5%.

## **2. Labour costs and utilization**

The impact of the crises on labour costs and utilisation became apparent in the last quarter of 2008 and more pronounced in the course of 2009. The wage and compensation growth slowed down, while the productivity decreased significantly. Together with the employment adjustment, companies in Slovakia used changes in the working hours as a tool to adjust labour input. The working hours reduction in the SR was one the highest among other European countries.

### **2.1 Wages and compensation**

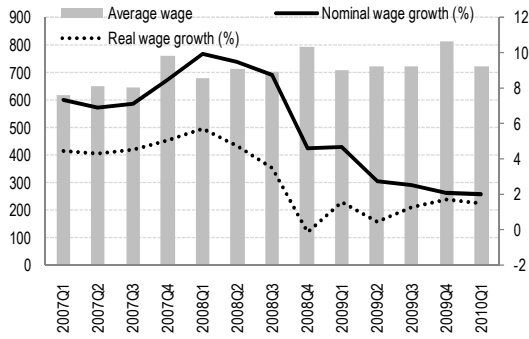
As the labor market conditions in Slovakia have deteriorated significantly, it has consequently affected the labor costs. The decline in the employment and increase in the unemployment rate translated into slower wage growth. On the other hand, in the first stage of the crisis, the low skilled labour and labour with lower wages were mostly affected; positively affecting the average wage growth. The average wage in 2009 was 745 EUR and increased by 3% in nominal and 1.6% in real terms.

Also compensation per employees<sup>5</sup>, which are mainly driven by the wage growth, decreased just slightly compared to V3 countries. Other factors which helped to cushion the effects of the crisis on wage growth were indexation of wages and public sector wage growth. The wage indexation in collective wage bargaining process is usually based on the inflation in the previous year, which was relatively high in 2008 (4.6%). The public sector wages were approved in the budget in October 2008 and the wage tariff growth in public sector set up on 5%.

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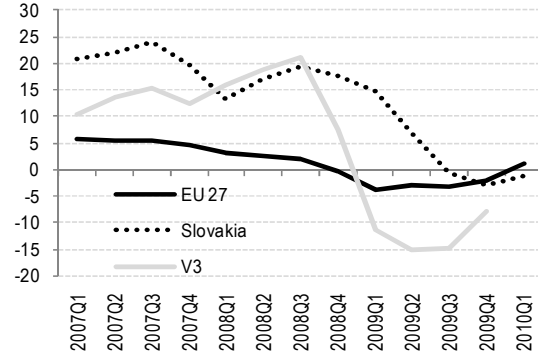
<sup>5</sup> The main difference between the wages and compensation is the social security contribution paid by the employer, which is included in compensation, but is excluded from wages.

**Growth and level of average wage, 2007Q1-2010Q1**



Source: Statistical office

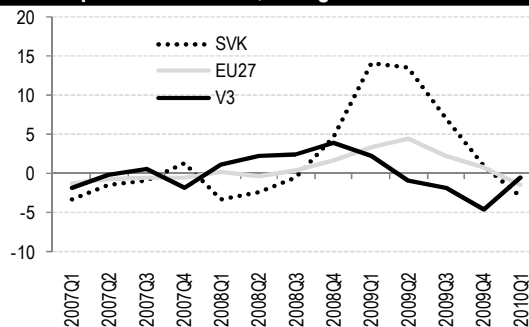
**Compensations (yoy growth %)**



Source: Statistical office, MoF SR

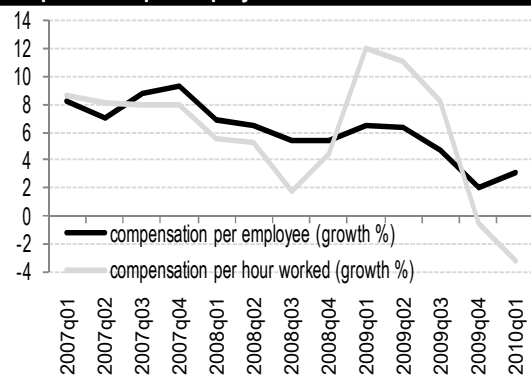
Unit labour cost (ULC) measures compensation per employee with productivity per worker and it is a widely used competitiveness indicator of labor costs. The real ULC in Slovakia increased on average by 7.2% in 2009. This was driven by sharp falls in productivity and the slow reaction in the dynamic of compensation per employee, while the inflation was subdued since the local currency could not depreciate. The ULC increased significantly compared to other countries which means that the labor costs in Slovakia increased even if we take into the account the productivity growth. However, when we are explaining the labor costs we have to take into account the significant reduction in hours worked (see the part on utilization). The compensation per employee increased significantly, while the increase in the compensation per hour worked was much lower. Also the decrease of productivity per hour worked was on a much lower scale than the decrease of productivity per employee. Hence, due to the significant reduction in hours worked the competitiveness hasn't been affected by the crises on the scale as the ULC data would suggest.

**Development of real ULC, change in %**



Source: Eurostat

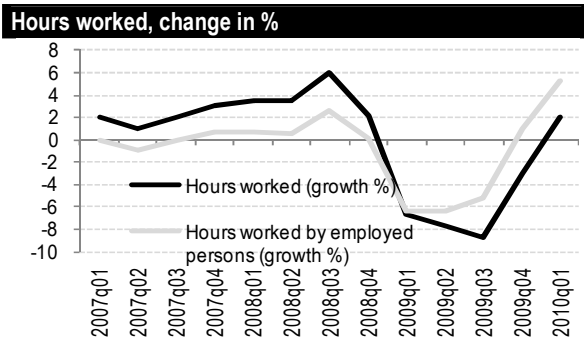
**Compensation per employment and hour worked**



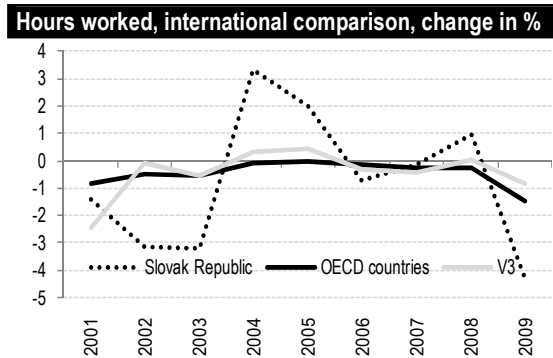
Source: Statistical office of SR

## 2.2 Utilization

Firms have responded to lower demand for labour by cutting the number of hours worked per employee. In 2009, the working hours per worker decreased by more than 4.3%. In a regional comparison, the working hour's reduction in the SR was the highest among the V4 countries. Also in relative terms, taken to account the employment decrease, the working hour's reduction was higher compare to V4 countries. Lowering the number of hours worked allowed the companies to adjust for the lower labour demand and thereby contribute to their ability to retain more workers. Moreover, further factors that help explain the large reduction are the newly adopted government policies in the labour market. In particular, this includes the short-time working scheme and a measure increasing internal flexibility of firms which gave firms the possibility to shift hours not worked as part of the regular working time to the next year without additional financial costs.

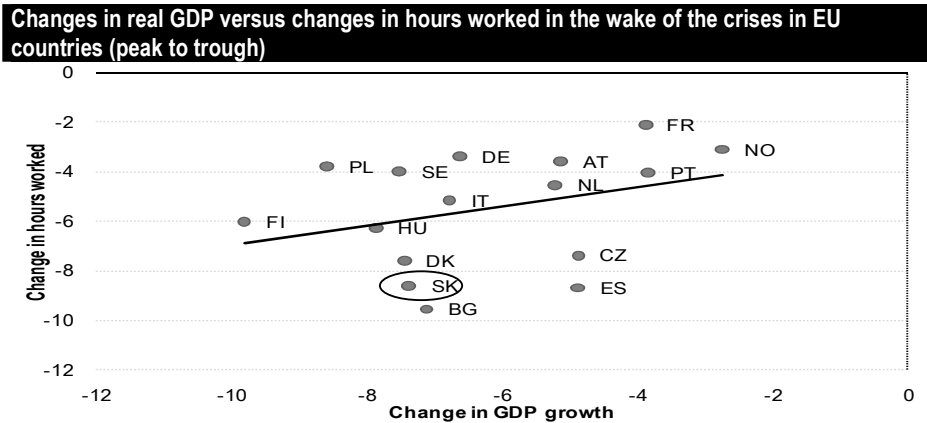


Source: Statistical office



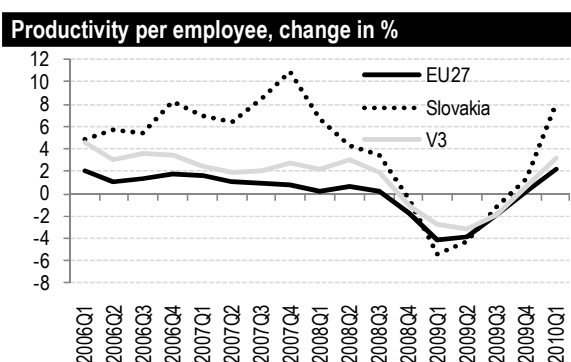
Source: OECD

The decline in overall labor input (hours worked) in Slovakia was more significant compared to other countries. Even, if we take into the account the significant slump in economic activity in Slovakia, the decline in hours worked was among the highest in EU27 (chart below). This chart shows the significant negative association between real GDP growth and changes in hours worked, where Slovakia is below the regression line. The GDP and hours worked decrease refers to period from peak to the trough of the crises.

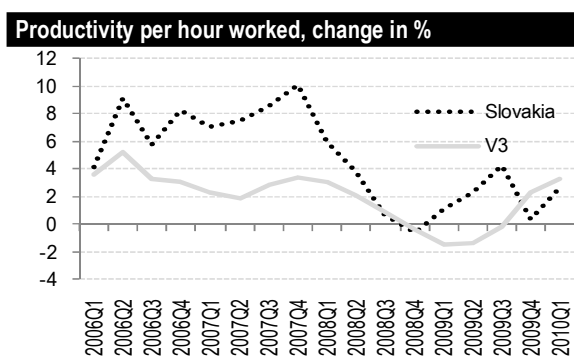


Source: MF SR, Eurostat

The economic impact of the global crises in Slovakia has been large, with GDP declining from peak to trough by more than 7%, yet the employment decreased by 5%. The relative weak response of employment to the decline in aggregate demand reflects the higher degree to which Slovak companies have held on their workers during the downturn. This explains the significant decrease in productivity per employee in 2009. After a record low in the first quarter 2009, the productivity per employee showed a clear upward trend in subsequent quarters, reflecting both adjustment in labour force and lower falls in output. Although recovering in subsequent quarters, productivity remained negative throughout 2009. It decreased by 2.4% and it was the highest decrease among the V4 countries. However, the productivity per hour worked gives us a rather different picture. Due to the significant decrease in working hours the productivity per hour worked has not decreased during the crisis, though the growth slowed down significantly since the beginning of 2008. The productivity per hour worked in 2009 increased by 2% and was higher than the average of V3 countries.



Source: Eurostat



Source: Eurostat

### 3. Labour policy

Labour market policy is an important factor affecting labour market outcomes. Labour taxation affects both labour demand and supply through change in labour costs of firms and take home wages of employees. Institutional framework of the wage formation process and minimum wage level regulation can affect wage growth and employment in the economy. This section also covers employment protection legislation, which determines the costs of hiring and firing workers.

#### 3.1 Labour taxation

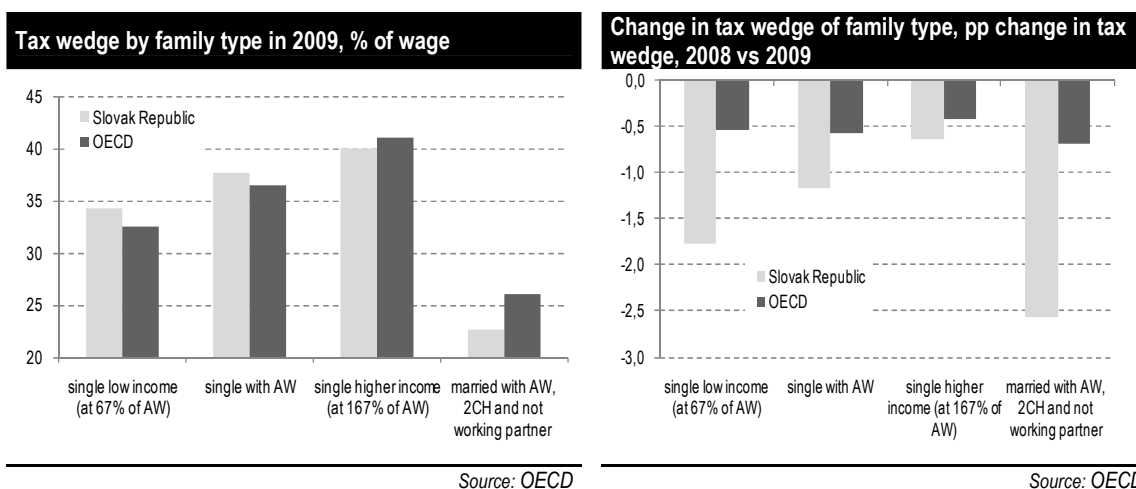
**Tax burden on income decreased** more than in the OECD. The tax burden, as measured by OECD's tax wedge indicator, has decreased for all family types. For the average worker<sup>6</sup> tax wedge fell by 1.17pp in 2009 (OECD 2010b) making Slovakia one of the countries with the biggest fall in tax and social contributions burden among OECD countries<sup>7</sup>. This was due to an increase in the basic and spouse allowance as non-taxable

<sup>6</sup> worker with average wage (AW) and no children (CH).

<sup>7</sup> For additional details see also commentary at <http://www.finance.gov.sk/Default.aspx?CatID=7565>

part of tax base affecting all taxpayers, while the single income tax rate remained unchanged for all groups.<sup>8</sup>

**Progressivity of the tax system increased due to changes in the tax base and an increase in the employee tax credit.** As a consequence of changes in the tax base, tax burden on families with income below average wage fell by more than higher income families (see graph right below). Moreover, a temporary increase in the employee tax credit, implemented as part of the anti-crisis measures, decreased the tax wedge for low income workers (at the level around of the minimum wage) without impact on higher income workers.



### 3.2 Wage formation system

State authorities play a role mainly in defining the rules for collective bargaining and setting the minimum wage<sup>9</sup>. The **wage bargaining system** remained largely unchanged in 2009. It is a mixture of different approaches with existence of both collective and individual level wage bargaining. Approximately 30% of all employees are covered by collective agreements with majority of them in the public sector (EC 2008). In the private sector, collective bargaining is predominant at the sectoral level, but can also take place at the company level. Under the 2009 legislation, nation-wide sectoral wage agreements may be automatically extended to other firms in the sector which do not participate in the collective wage bargaining but firms can request exoneration from legal extension on grounds of firm characteristics or local labour market conditions.

**Minimum wage (MW)** increased strongly in 2009. Its share on median wage for the whole economy increased by 3pp and reached 47% but remained around the OECD average of 46% for 2008<sup>10</sup>. However, the share of minimum wage on median wage is

<sup>8</sup> For a full overview of the tax and social contributions system in Slovakia see Financial policy institute webpage at <http://www.finance.gov.sk/Default.aspx?CatID=7431> [Slovak only] and OECD (2010b), pp. 411-421

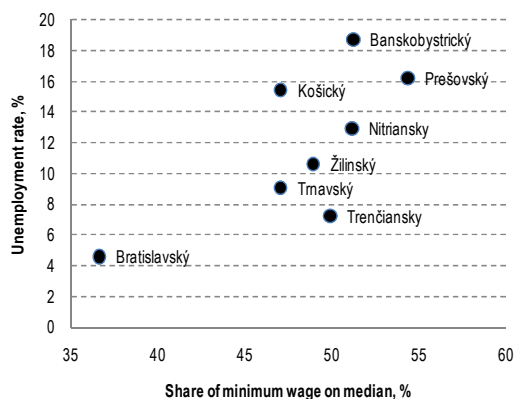
<sup>9</sup> See also Law on collective bargaining and Law on minimum wage

<sup>10</sup> OECD average is not yet available for 2009.



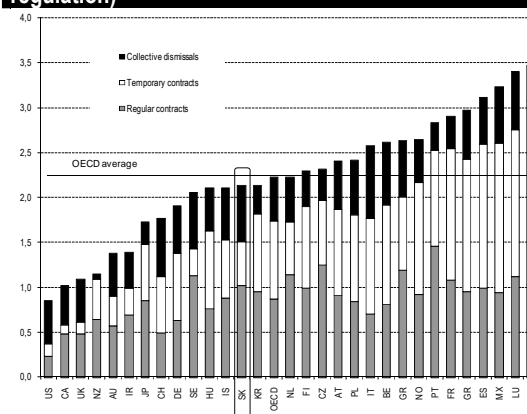
higher in Prešovský region (54%) where unemployment rate is among the highest. OECD (OECD 2010d) thus suggests that significant increases in the minimum wage should be avoided and their regional impact on labour market conditions should be taken into account, for example by considering a regional differentiation.

**Share of minimum wage on median wage and unemployment rate in regions in 2009, %**



Source: Statistical office and MFSR forecast

**Employment protection legislation indicator (v3) in OECD countries, (0 being least and 6 most restrictive regulation)**



Source: OECD

### 3.3 Employment protection

Strictness of employment protection remained below the OECD average<sup>11</sup>. The strictness of employment protection legislation, as measured by OECD's employment protection legislation index (Venn 2009), increased in 2008 mainly due to stricter regulation of regular contracts. The severance pay was increased to two months of pay.

The overall EPL indicator remained below the OECD average with relatively stricter regulation of collective dismissals and regular contracts than in the OECD (see table below). EPL index for regular contracts was pushed up by long notice periods and relatively high severance payments for workers with short job tenure (EC 2008). EPL index for regulation of collective dismissals is above the OECD average due to additional notification requirements and delays in notice start.

**Employment protection legislation by sub-indicators (v2)**

Year	Regular contracts	Temporary contracts	Collective dismissals	Overall EPL
2001	2.47	1.13	4	<b>2.17</b>
2003	2.31	0.38	3.75	<b>1.74</b>
2008	2.5	0.38	3.75	<b>1.82</b>
2008 (OECD)	2.27	1.82	2.59	<b>2.13</b>

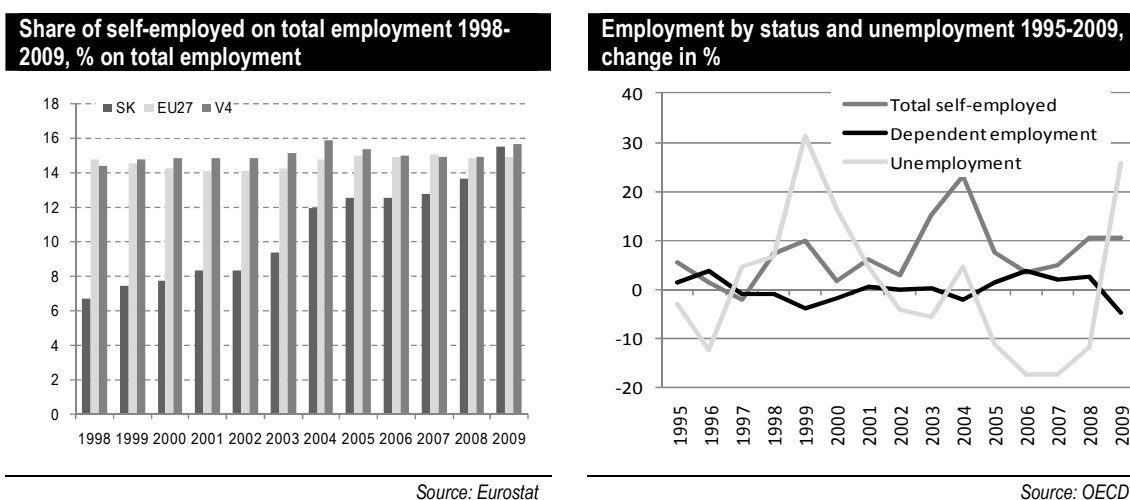
Source: OECD

<sup>11</sup> See also IFP commentary <http://www.finance.gov.sk/Default.aspx?CatID=7428>

## PART 2: SELF-EMPLOYMENT IN SLOVAKIA

The role of self-employment<sup>12</sup> in the Slovak labour market increased rapidly in the last few years, as a growing number of workers are becoming employers or own-account workers. While self-employment, as a sign of entrepreneurship and growth of small businesses, should be viewed positively, the risk of rising false self-employment<sup>13</sup> as a form of tax and employment regulation evasion also needs to be considered.

Self-employment increased substantially in the last few years and its growth further accelerated during the crisis. Its share on total employment has more than doubled since 1998 and increased by 2.3pp since the beginning of the crisis reaching 16.3% in 1Q2010. It has increased much faster than in the EU reaching 15.5% and was above the EU27 average of 14.9% by share on total employment in 2009. In contrast to the EU, self-employment growth in Slovakia accelerated during the crisis suggesting that cyclical decline has a positive effect on self-employment growth in Slovakia which could be due to a different institutional framework. Their share on total employment also increased, as the number of employees declined sharply.

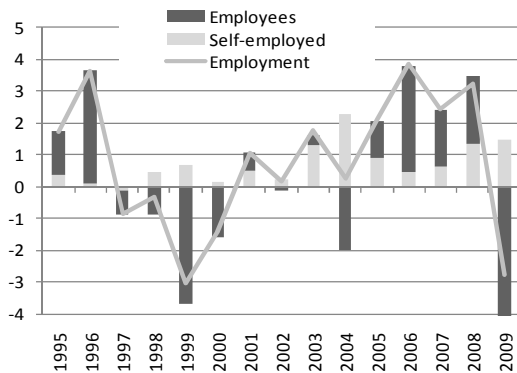


Self-employment was formally a bigger driver of employment growth than dependent employment. The average contribution of self-employment to total employment growth is three times bigger than that of dependent employment over 2004-2009. This is likely due to higher negative sensitivity of dependent employment to business cycle conditions and thus greater volatility of its response. While dependent employment creates more jobs during growth, it declined sharply even as self-employment continued to increase during labour market slack (figure below).

<sup>12</sup> Self-employed include entrepreneurs with employees (employers), entrepreneurs without employees (own-account workers) and unpaid working household members, with the last being a very small workgroup in Slovakia. (OECD 2000: 191)

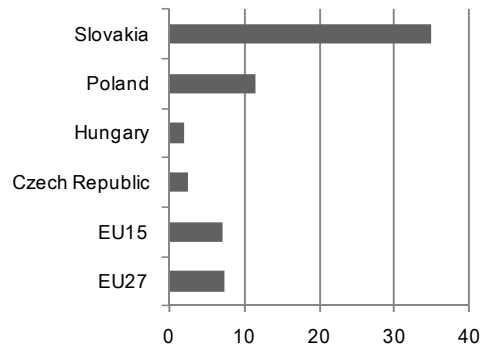
<sup>13</sup> False self-employed are persons who are self-employed simply to reduce tax liabilities or employers' responsibilities (OECD 2008).

**Contribution to employment growth by professional status 1995-2009, in pp**



Source: Eurostat

**Share of start-up incentives on total active labour market policy expenditure in 2007, %**



Source: Eurostat

A number of factors increase attractiveness of self-employment compared to dependent employment and likely help explain its high and persistent growth. Lower relative tax and social contributions burden of self-employed compared to dependent workers increases financial attractiveness of self-employment. Self-employed can lower their income tax base by deducting 40-60% of their income as business costs (Antalicova 2006) thereby lowering their effective income tax rate. Social security contributions are significantly higher for dependent workers when also including payments by the employer (Antalicova 2006). Moreover, new self-employed are not required to pay social contributions in the first year after establishing their business and unemployment insurance is voluntary for all self-employed, which further increase their real wages.

Relatively stricter employment protection is likely to makes employers more reluctant to use labour contracts. Employment protection in Slovakia, as measured by OECD's EPL -indicator, was only slightly below OECD average<sup>14</sup>. While this doesn't seem too high, higher firing costs increase incentives for relying on self-employed by firms particularly in a downturn. Slovakia is among seven OECD countries which have severance pay in the first year of service (OECD 2008: 105). This is likely to have a pro-cyclical effect on self-employment, which was observed in 1999, 2004 and 2009, when self-employment and unemployment increased sharply in Slovakia.

Relatively weaker safety nets make dependent work less attractive for workers in Slovakia. Long qualification period for unemployment benefit entitlement and low share of unemployed receiving unemployment benefits, only 9% in 2006, makes the Slovak unemployment insurance scheme relatively stricter when compared other OECD countries (OECD 2008), suggest relatively strict unemployment benefit conditionality. In addition, as already mentioned unemployment insurance is voluntary for self-employed in Slovakia.

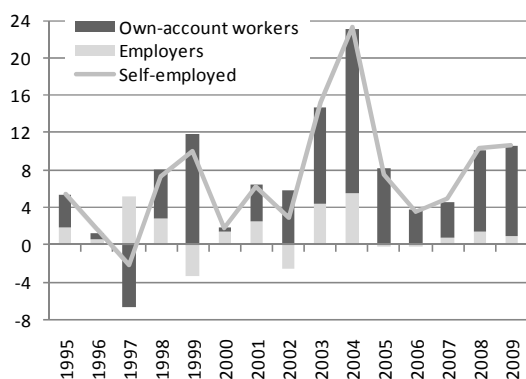
Government self-employment subsidies further distort the incentives for self-employment, increasing their financial attractiveness. The contributions are granted to

<sup>14</sup> See also IFP commentary <http://www.finance.gov.sk/Default.aspx?CatID=7428>

qualifying job seekers providing that they continue performing self-employing activities for at least two years (Eurostat 2009). The share of start-up incentives on total ALMP expenditure was above 10% for almost every year since 2002. It was almost 3 times higher than EU average in 2008 (figure above) suggesting a significant role of this program in the ALMP budget. The conditionality of the subsidy was further relaxed during the crisis by reducing the necessary length of unemployment period for applicants. The number of supported new self-employed persons reached 12 thousand in 2009 according to the Labour office.

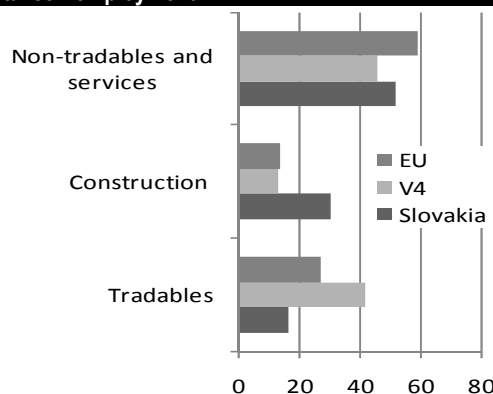
As consequence of the preferential treatment described above, dependent workers have an incentive to become self-employed for financial benefits rather than entrepreneurial reasons. Own-account workers - self-employed without employees - are the main drivers of increasing self-employment. They accounted for 83% of new self-employed on the average between 2000 and 2009 and as a consequence their share on total self-employment increased strongly, reaching 77.3% in 2009 significantly above the EU average of 57%. A rising number of own-account workers with only weak growth in self-employed with employees likely suggests that more workers are becoming self-employed not to start their own businesses but rather for tax or other economic benefit, as explained above. They effectively become or are forced to become false self-employed - persons who are self-employed simply to reduce tax liabilities or employers' responsibilities (OECD 2008). For obvious reasons, exact estimates of false self-employment are difficult to obtain.

**Self-employed by type 1995-2009, contribution to growth in pp**



Source: Eurostat

**Self-employment by share in sectors in 2008, in % of total self-employment**



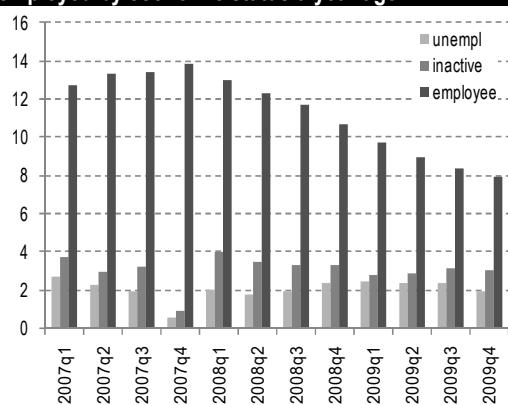
Source: Eurostat

Self-employment is relatively more persistent in the construction and services sectors. While majority of self-employed work in the non-tradeables and services sector, with similar share on total self-employment as in other EU countries, the share of self-employed in the construction sector was relatively high and reached double the EU average in 2008 (graph above). A high share of own-account workers in the construction industry in Slovakia (OECD 2005) could suggest that the difference from EU average could be due to prevalence of false self-employment.

While majority of new self-employed come from dependent employment, it is unclear whether push or pull factors are driving the flows. Between 2007 and 2009, around 10% of self-employed came from dependent employment, with less than 5% from inactivity and unemployment combined (see graph left below). LFS data for 2008 suggest that self-employed are relatively more satisfied with their income situation than wage workers, however, it is unclear whether they would prefer dependent work if available. Contrary to expectations of higher cost pressure in firms and thus bigger incentive to rely on financial more attractive self-employed workers, flows from dependent work decreased during the crisis (see graph below).

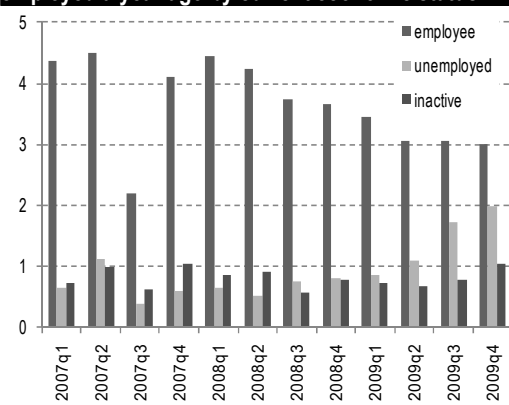
The impact of self-employment on unemployment level is limited. The inflow from inactivity to self-employment is higher than from unemployment suggesting that, similar to results for other OECD countries in the 1990s (OECD 2000), self-employment has only limited direct positive or, once outflow numbers are considered (see graph below), negative impact on unemployment. Self-employment subsidies seem to have only a limited influence on flows from unemployment, given the low numbers.

**Flows into self-employment, % share on current self-employed by economic status a year ago**



Source: Statistical office and own calculations

**Flows from self-employment, % share on self-employed a year ago by current economic status**



Source: Statistical office and own calculations

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