

# **National Reform Programme of the Slovak Republic 2010**

*Better education, more jobs and better business environment*

**November 2010**



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## **General background**

*Europe 2020 is a joint EU strategy for the coming decade to ensure sustainable economic growth, including the overcoming of the economic crisis, and creation of new jobs. The strategy was finally approved by the Council in June 2010. Europe 2020 is a follow-up to the existing Lisbon Strategy that focused on economic growth and employment. Launched in 2000, the Lisbon Strategy was based on the understanding of the need to increase the productivity and competitiveness of the EU while, at the same time, reinforcing social cohesion in order for the EU to be able to face global competition, technological advancement and challenges arising from population ageing. The Lisbon agenda was revised in 2005, shifting its focus primarily to economic growth and creating more and better jobs.*

*Given the intertwined nature of EU economies, it is more effective to coordinate actions taken by all Member States with respect to structural policies from the EU level, even though these policies fall within the remit of individual Member States. Member States can also seek inspiration from examples of successful countries. A consensus exists within the EU on the general focus of the economic and employment policies of its Member States as described in the Europe 2020 Integrated Guidelines. The guidelines specify key priorities for macroeconomic and microeconomic reforms, as well as reforms in the labour market. The basic framework for the preparation of structural policies consists of the integrated guidelines and five headline targets which should be reflected in measures adopted by the Member States<sup>1</sup>.*

*As requested by the European Commission, this draft NRP mainly identifies macro-structural bottlenecks to growth and proposes measures to address them, in line with the Europe 2020 Integrated Guidelines. It was prepared on the basis of documents and information provided by individual ministries, takes into consideration short-term structural measures approved by the Slovak Government in September 2010, and in line with the Manifesto of the Government of the Slovak Republic.*

*Using the EU-wide targets specified by the Council, the Member States were asked to set their national targets reflecting their specific situations and circumstances. The Slovak Government has set the national targets based on consultations with the Commission in order to verify their compliance with the EU level headline targets (national targets proposed under the Europe 2020 strategy are included in Annex 1). With respect to the fact that the proposed targets do not exhaustively cover all factors that are necessary in order to increase economic growth, employment and living standards in Slovakia, the Government will prepare, by April 2011, a comprehensive proposal of national indicators for structural policies implemented under the Europe 2020 strategy with the focus on result indicators; the document will become part of the Slovak National Programme of Reforms.*

*In April 2011, the Slovak Government will submit a full National Reform Program to the Commission in line with the so-called "European semester" schedule, which will contain individual measures specified in more detail, along with a detailed timetable for their implementation, and funding secured for this purpose. Based on a thorough analysis, the Slovak Government will also set national targets. When drafting the measures, the Government will take into account opinions and experience from relevant experts, representatives of employers as well as employees, and the non-governmental sector, and ensure that the impacts of the proposed measures are assessed in a transparent manner.*

<sup>1</sup> The Integrated Guidelines are included in the official Slovak version of National Reform Programme of the Slovak Republic 2010 in Annex 2.



## Introduction

The Slovak economy is slowly recovering from the economic crisis. On the one hand, GDP is expected to grow at a rate of 4% this year; on the other hand, the labour market still remains affected by the crisis and is only expected to stabilise by the end of 2010. Slovakia's public finance deficit for 2010 will amount to nearly 8% of GDP, which will also be reflected in an increased public debt. In this respect, it is extremely important for Slovakia to not only overcome the current crisis as soon as possible, but to also achieve robust economic growth and better quality of life over the long-term. This requires consolidating public finances and creating new jobs.

The economic crisis has further strengthened the need to remove obstacles that are slowing down long-term sustainable economic and social development in Slovakia. Removing the barriers to economic growth and improvements in the quality of life is one of the priority objectives of the Government. Economic development and improving the quality of life represent interconnected objectives, since economic growth is also essential to the non-material advancement of a country and should remain among the key concerns of an economic policy.

Targets such as higher employment, productivity and social cohesion have also been defined at the EU level. The performance of structural policies that fall within the competence of the Member States was in the past coordinated under the so-called Lisbon Strategy, and is now covered by the Europe 2020 strategy. Yet, the political will to implement necessary measures is even more important than the institutional framework. The Government therefore commits to create conditions to ensure that the real convergence of the Slovak economy will be in the long run based on economic growth and promote social cohesion. This requires creation of new knowledge and subsequent efficient application in practice. It is necessary to increase the quality of education, research and development, reduce the long-term unemployment rate, and remove barriers in order to facilitate more effective utilisation of business sector potential. With respect to the growth in productivity, it is equally important to gradually increase spending on education and R&D both in the public but, in particular, the private sector. Effective allocation of funds requires institutional reform in both of these areas.

The National Reform Programme of the Slovak Republic 2010 (NRP) contains measures to be implemented by the Slovak Government in the upcoming period in order to enhance economic growth and improve the quality of life in Slovakia.

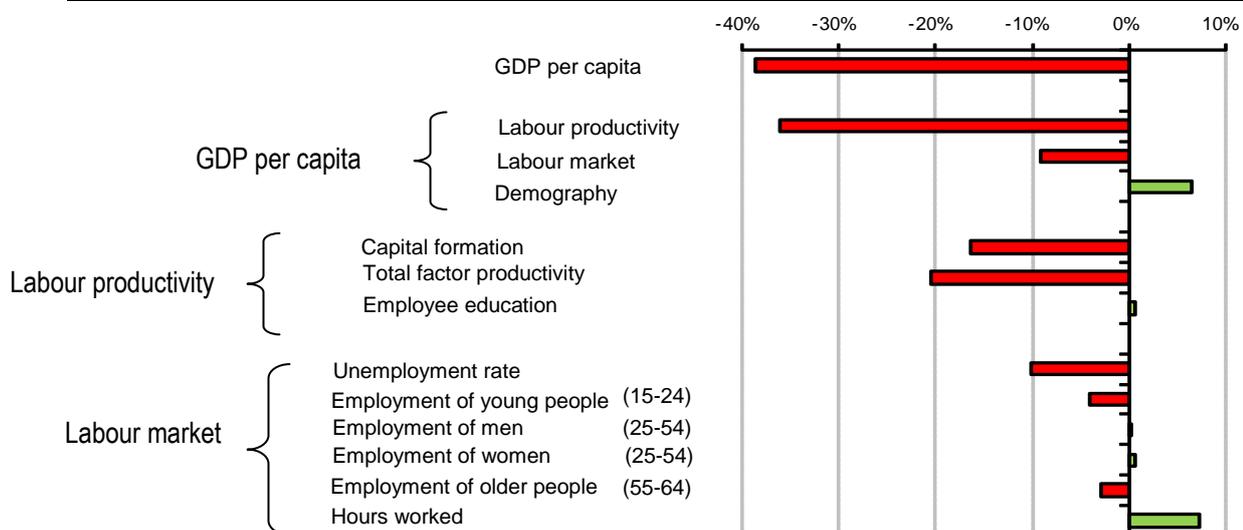
## 1 Identifying priority areas

Economic development measured by GDP growth and improvements in the quality of life are mutually interconnected objectives, because economic growth is also essential to facilitating the non-material sustainable development of countries. To that end, NRP priorities were largely identified by comparing decomposition of Slovak GDP with that of the EU-15 average. On the other hand, there are many other aspects of life which should be monitored more closely and, where necessary, corrected by public policies; hence, NRP priorities also take into account additional factors which do not necessarily contribute to a higher GDP growth, but improve the quality of life.

GDP was broken down in two steps. Firstly, GDP per capita was divided into three basic components: (1) labour productivity; (2) labour market; and (3) demography. Secondly, two of the basic components - labour productivity and labour market - were further subdivided. Consequently, GDP per capita was broken down into ten components. Comparing the level of these components against advanced EU Member States enables us to identify those production factors in which the Slovak economy shows the largest lag and which, therefore, represent the greatest potential for future GDP growth in Slovakia.

Slovakia's GDP per capita is considerably lagging behind the EU-15 average. The difference is, to a large degree, caused by lower labour productivity in Slovakia (64% of the EU-15 level). Similarly to other new Member States, the difference in labour productivity reflects lower capital input per employee and a lower level of total factor productivity. The labour market represents the second factor, with a negative impact on GDP per capita, though to a lesser degree than labour productivity (91% of the EU-15 level). The demography component has a positive impact on total GDP per capita (107% of the EU-15 level) due to an above-average share of population at the productive age.

**Decomposition of GDP per capita (Slovakia against the EU-15, 2007)**



Source: European Commission, Ministry of Finance of the Slovak Republic

This GDP decomposition has helped us identify five components which show the largest potential for GDP per capita growth in Slovakia:

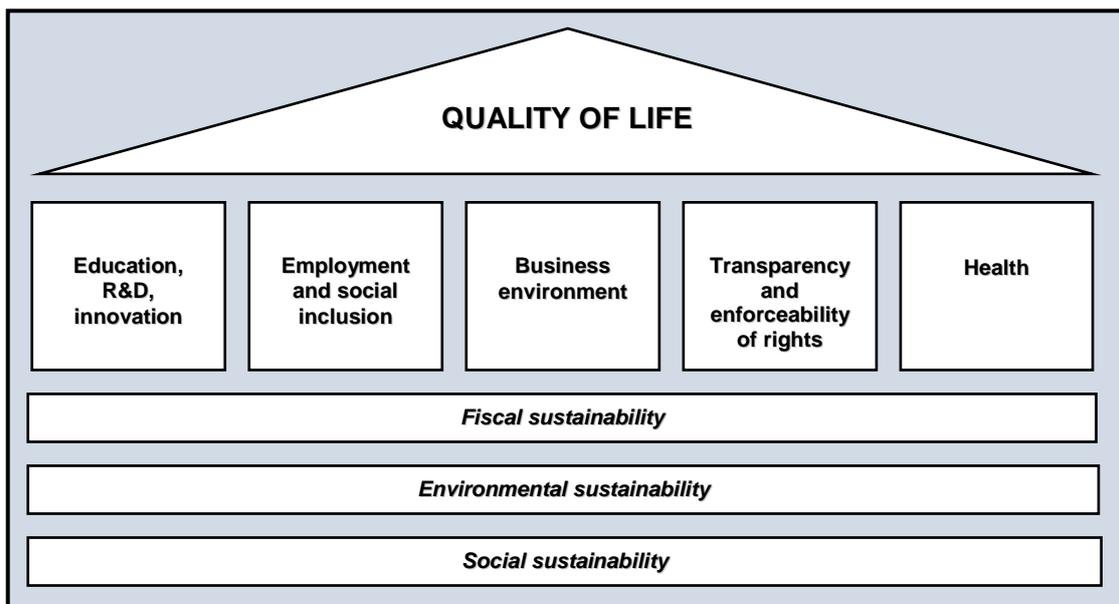
- under labour productivity, the components crucial to the convergence of the Slovak economy include *total factor productivity* and *capital formation*. Despite considerable progress, they are still significantly lagging behind the EU-15 level.
- under the labour market, two components require special attention. The first one, *employment rate of young people*, fell noticeably between 2001 and 2007, having moved even further away from the EU-15 average. This development is, however, more than compensated for by their growing participation in tertiary

education, which will have a positive effect on labour productivity in the future. The second important component is *the employment rate of older people*, which has increased due to an increase in the retirement age, but still remains significantly below the EU-15 average. The third component is *the unemployment rate*, which still remains relatively high, even though it has dropped considerably in recent years.

- the demography component is important from a long-term aspect, i.e., in the moment when the share of population in the productive age starts decreasing, thus negatively influencing overall economic growth. Therefore, it is absolutely necessary to focus on problems related to, for example, the fiscal sustainability of the pension system. Currently, the share of the productive-age population in Slovakia is above the EU-15 average, which means that the demography component does not adversely contribute to a relatively lower GDP per capita in Slovakia.

The GDP decomposition has expressly indicated the need to increase overall productivity in the economy, increase employment of older people, and cut the unemployment rate. In a small, under-capitalised economy, it is extremely difficult to increase total factor productivity without the involvement of foreign capital and know-how. From a medium-term perspective, Slovakia needs to create conditions for enhanced innovation development. Innovation potential is driven by quality higher education on the one hand, and by a suitable business environment on the other. The GDP decomposition thus indirectly, through low labour productivity, draws attention in particular to such areas as education, business conditions, innovation, and information technologies.

#### Approach to improving the quality of life in Slovakia



The priorities were identified using an approach introduced in a study prepared by the National Bank of Slovakia<sup>2</sup>. The study also takes into account additional areas which have only an indirect effect on GDP growth but contribute to a better quality of life. Such areas are identified on the basis of research in welfare economics and the subjective perception of welfare. Welfare economics has the largest number of practical applications in the area of education and health. The priority of ensuring high-quality education thus stems not only from material indicators, but also from the need to ensure equal opportunities. As far as the subjective perception of welfare is concerned, attention should primarily be paid to the need to enhance confidence in the economy and ensure the enforceability of judicial protection of rights and reduction of corruption; these goals may better be accomplished through effective and transparent public administration. The subjective perception of welfare is closely related to health, employment and social relations. While the role of economic policy is clearly evident in the first two areas, it has only a limited application in the case of family relations.

<sup>2</sup> [Structural Policy Challenges in Slovakia. Discussion paper 1/2010. National Bank of Slovakia.](#)



Recommendations made by the European Commission also focus on these areas<sup>3</sup>. According to the Commission, Slovakia should improve its public finances and reallocate public spending towards education, research and development, and infrastructure. It should also increase the effectiveness of education and R&D systems, as well as improve the business environment and reduce unemployment. All Commission recommendations are included in a separate box.

Structural policies often miss out on the limits of public policy. Therefore, it is necessary to underscore that efforts towards a better quality of life must also take into account long-term fiscal, environmental and social sustainability. Sound public finances are the cornerstone of prosperity in any society. On the one hand, they ensure macroeconomic stability, thus contributing to more robust economic growth; on the other hand, they promote inter-generational justice in that they do not overburden subsequent generations. The need to have long-term sustainable public finances is now underscored by population ageing.

Environmental sustainability is most frequently associated with global warming and reducing the energy intensity of the economy. It is increasingly important to ensure the good quality of the environment; therefore, economic policy should pay more attention to environmental costs, especially in the case of major projects.

Social sustainability is generally linked with income gaps, where Slovakia, along with the Czech Republic and Slovenia, ranks among the most egalitarian Member States. It is therefore necessary to instead concentrate on the effectiveness and efficiency of redistribution policies, mainly with respect to addressing the problems of marginalised social groups. The most effective instrument to ensure the growth of income of the population is to increase employment; therefore, social inclusion and poverty reduction are discussed in a sub-chapter on employment and social inclusion.

In addition to the three essential prerequisites briefly discussed above, the following areas were also identified by the Slovak Government as important for long-term strong economic growth and improvement in the quality of life in Slovakia:

- education, R&D, and innovation;
- employment and social inclusion;
- business environment;
- transparent conditions and enforceability of rights;
- health.

#### **European Commission: Macro-Structural Bottlenecks to Growth in Slovakia**

*Reducing the high general government structural deficit and ensuring long-term sustainability of public finances in view of the population ageing.*

The significant structural deficit persisted during good times and increased further during the crisis, also taking into account some uncertainty regarding potential output. Expected growth of age-related expenditure, especially in the health sector, poses an additional challenge in the longer term.

*Ensuring reallocation of public spending towards growth-enhancing items, including education, R&D and infrastructure.*

The share of spending in growth enhancing items, in particular R&D, education and capital expenditure is low in Slovakia compared to its peers. Increasing their share would support real convergence of the economy, given diminishing scope for technological catch-up.

*Implementing the necessary reforms to ensure better quality of public spending and in particular that the additional expenditure for education and R&D are used efficiently.*

There are inefficiencies in Slovakia's education and R&D systems. Addressing them, in particular by strengthening links between research and business sectors, and refocusing education towards labour market needs would support potential output.

<sup>3</sup> [European Commission \(2010\), Macro-Structural Bottlenecks to Growth in EU Member States.](#)



*Ensuring wage and price adjustment to sustain competitiveness, while improving the business environment.*

The rapid appreciation of the Slovak REER over the recent years points to a need for careful monitoring of relative prices and costs vis-à-vis Slovakia's competitors. Improvements in the business environment would help maintain competitiveness..

*Ensuring full utilisation of the economy's labour potential, by tackling the long-term unemployed and marginalised groups.*

Unemployment, including long-term unemployment, remained high even during the economic boom. Structural problems on the labour market need to be addressed..

*Source: European Commission (2010), Macro-Structural Bottlenecks to Growth in EU Member States.*

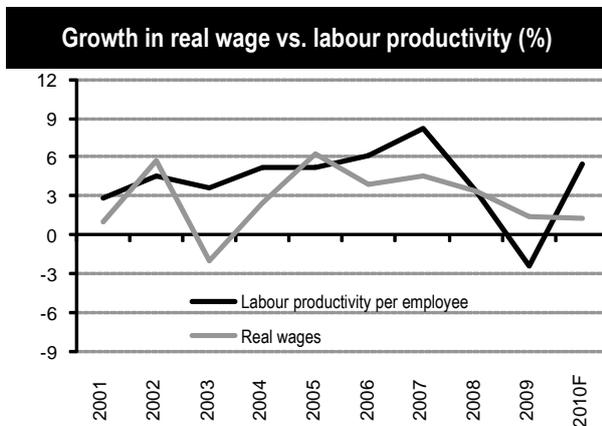
## 2 Macroeconomic and fiscal policy

The Slovak Government considers a stable macroeconomic and fiscal policy fundamental to healthy economic development and a better quality of life. The following chapter describes the underlying macroeconomic and fiscal framework, as well as measures to ensure the healthy and sustainable development of public finances. Slovakia's economy was significantly affected by the economic crisis last year. The economy has started to gradually recover this year, but the situation in the labour market remains negative. A consolidation package is required to stabilise public finances. The Slovak Government will establish several fiscal institutions and increase the effectiveness in the collection of taxes and social contributions in order to provide better conditions for long-term sustainability of public finances.

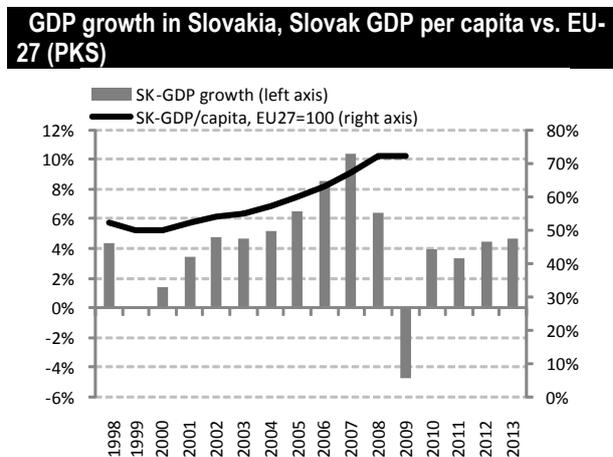
### 2.1 Macroeconomic framework and medium-term forecast

Following the period of extreme economic growth from 2005 to 2008, driven mainly by the massive inflow of foreign direct investment and related growth in exports, the Slovak economy was hit, similarly to a majority of other countries, by the largest economic crisis since the end of WWII. In Slovakia, the crisis was most felt in the noticeable decline in foreign demand and consumer confidence. Since Slovakia has a small export-oriented economy, the slump in foreign demand had a considerable effect on its economic growth. Slovakia's real GDP, growing at rates from between 8-10% in previous years, fell by 4.7% in 2009. Almost all GDP components fell, be they household consumption, investments, stocks or foreign trade.

The first signs of recovery occurred in the second quarter of 2009. Driven by increasing foreign demand, Slovakia posted one of the largest quarter-on-quarter economic growths in the EU, though its GDP was still decreasing year-on-year. GDP grew at a rate of 4.7% in the first half. This recovery was mainly driven by a growth in net exports and stock building. However, the unfavourable situation in the labour market is still fuelling a downturn in domestic consumption; investments also remain in negative figures.



Source: Eurostat, own calculations



Source: Eurostat, own calculations

The adverse effect of the crisis on the labour market occurred with a delay, as expected. Since 2004, the unemployment rate continuously decreased, having fallen under the 10% threshold in 2008 (as per the Labour Force Survey). The unemployment rate started increasing in 2009 and hit the 14.4% level in 2Q2010. The unemployment rate reflects developments in employment, which fell 2.8% year-on-year in 2009, and keeps falling, despite the economic recovery. The growth of the average nominal wage slowed down due to the crisis from 8.1% in 2008 to 3% in 2009. Conversely, low inflation kept real wages growing.

Following the euro changeover in Slovakia, inflation development continued to be influenced by developments in an external economic environment. The global economic crisis, along with growing unemployment, a slump in



domestic demand and a fall in commodity prices, caused a considerable decline in inflation. The inflation rate kept falling throughout 2009 and, in the first two months of 2010, reached a low of 0.4% (using CPI methodology). It is the lowest inflation rate ever since CPI methodology was implemented to measure price development in Slovakia. Having reached this low, the trend in the development of overall inflation has since reversed, and the average price level has been moderately growing since March 2010. The annual inflation rate stood at 1% in August 2010.

An updated macroeconomic forecast prepared by the Ministry of Finance of the Slovak Republic in September 2010 expects Slovak GDP to grow at a rate of 4.0% in 2010. This high growth is projected to be driven by a faster economic recovery of Slovakia's major trading partners; however, planned fiscal consolidation will slow down economic growth next year. The main reasons include a decline in domestic demand and a rising inflation rate. The planned cut in the public finance deficit, from 7.8% to 4.9% projected for 2011, will be inhibited by the envisaged increased drawing of EU funds, which should facilitate growth in investments. The overall negative effect of fiscal consolidation on the growth of GDP was quantified at a percentage point level of 0.5. Sustaining GDP growth in the coming years also shows a degree of risk in the segment of foreign demand. It is associated with the fading effect of incentive packages and savings measures adopted by Slovakia's major export partners.

The negative development on the labour market is expected to stop at the end of 2010, with the employment rate expected to resume growth in 2011. On the back of this positive development in employment, the unemployment rate will gradually fall. Even though the average nominal wage will again start growing, higher inflation projected for 2011 will hold back growth in real wages. Higher inflation in 2011 will be driven, from two-thirds, by global price factors (rising food prices and rising prices of commodities affecting fuel and regulated prices) and, from one-third, by the planned increase in indirect taxes required due to fiscal consolidation.

Projected development for selected economic indicators in Slovakia (September 2010, %)					
Indicator	Actual	Projected			
	2009	2010	2011	2012	2013
GDP, real growth	-4.7	4.0	3.3	4.5	4.7
Final household consumption, real growth	-0.7	-0.2	0.4	3.5	4.0
Gross fixed capital formation, real growth	-10.5	1.8	3.5	6.5	4.0
Exports of goods and services, real growth	-16.5	13.2	5.5	7.0	8.6
Imports of goods and services, real growth	-17.6	11.8	3.5	6.8	8.2
Average monthly wage for the entire economy, nominal growth	3.0	2.7	3.7	5.8	6.1
Average employment growth, pursuant to ESA95	-2.4	-1.4	0.6	1.2	1.3
Average unemployment rate, pursuant to Labour Force Survey	12.1	14.1	13.6	13.2	12.4
Consumer price index, average growth	1.6	1.4	3.7	3.5	3.9
Harmonised index of consumer prices	0.9	1.0	3.5	3.4	3.7
Current account balance, share of GDP	-3.2	-2.2	-2.3	-2.1	-1.3

Source: Ministry of Finance of the Slovak Republic

## 2.2 Fiscal policy and public finance

Slovak fiscal policy was affected by the economic crisis in 2009; in an effort to mitigate its impact on the economy, the Government let automatic stabilisers operate freely and adopted anti-crisis measures. Driven by the permanent loss of potential output, the structural deficit also worsened. The headline general government deficit amounted to 7.9% of GDP in 2009. Despite the economic recovery in the course of 2010, the Ministry of Finance of the Slovak Republic estimates this year's deficit at a level of 7.8% of GDP. The primary reason is the structure of economic growth which is driven by growing exports, while negative developments remain present in



the labour market, having an adverse effect on household consumption. The low tax and social contribution intensity of exports subsequently translates into a negative development in tax revenues and social contributions of the budget. The gross general government debt is estimated to rise from 27.7% of GDP posted at the end of 2008 to 42.1% of GDP at the end of 2010.

Relatively high values of general government deficit and the rise in government debt necessitate consolidation in the medium run. The primary medium-term fiscal goal pursued by the Government is to cut the deficit below 3% of GDP in 2013 in compliance with the recommendations made under the excessive deficit procedure, which requires that ambitious consolidation objectives be set, given the unfavourable initial fiscal position in 2010.

A draft general government budget for 2011-2013 expects the general government deficit to decrease to 4.9% of GDP in 2011. For 2012 and 2013, the deficit is targeted at 3.8% and 2.9% of GDP, respectively. This means that the core part of the medium-term fiscal consolidation efforts concentrates on 2011, when measures totalling EUR 1.8 billion, or 2.5% of GDP<sup>4</sup>, are planned to be taken. The measures will affect both budget revenues and expenditures, though a majority of them focuses on expenditures.

<b>Fiscal policy measures in 2011 (ESA95)</b>		
	<b>EUR million</b>	<b>% of GDP</b>
<b>General government revenues</b>	<b>774</b>	<b>1.1</b>
- broadening tax bases for income tax and social contributions	255	0.4
- VAT (raising the basic rate from 19% to 20%)	186	0.3
- excise duties (beer, tobacco, cancellation of exemptions)	135	0.2
- non-tax revenues	199	0.3
<b>General government expenditure</b>	<b>-998</b>	<b>-1.4</b>
- wages in public administration	-154	-0.2
- expenditures on goods and services	-150	-0.2
- current subsidies (Slovak Television, agriculture, housing)	-143	-0.2
- investment subsidies	-76	-0.1
- capital expenditure with low effectiveness	-80	-0.1
- corrections to EU funds	-38	-0.1
- cuts in transfers to local governments	-90	-0.1
- savings in healthcare sector	-85	-0.1
- state funds	-50	-0.1
- other (current expenditures of the Social Insurance Agency, government reserve fund, etc.)	-134	-0.2
<b>Impact on general government balance</b>	<b>1 773</b>	<b>2.5</b>

Source: Ministry of Finance of the Slovak Republic

For the post-2013 period, the Government plans to carry on with its consolidation efforts to gradually decrease the gross general government debt-to-GDP ratio and achieve a balanced budget on the medium-term horizon. The balanced budget is essential to the long-term sustainability of public finances, which represents the key objective under Slovakia's fiscal policy.

### ***Fiscal institutions***

The consolidation of public finances should also be facilitated by improving their transparency. The Slovak Government will therefore primarily focus on drafting a constitutional act on budgetary responsibility to define clear rules of discipline and transparency in public finances. A state budget will contain all necessary information in a comprehensive manner in order for the public to be well informed about the use of public finances. The act will specify in detail which information will always have to be provided to the public in a general government

<sup>4</sup> The need to implement measures accounting for 2.5% of GDP in 2011 has resulted from comparing a scenario without changes in the existing policies, which projects the general government deficit at a level of 7.4% of GDP in 2011, with a target deficit value set at 4.9% of GDP.



budget and a final account of general government. The same will also apply to the reporting on the budgetary performance throughout the year and to publication of macroeconomic and tax projections. At the same time, binding expenditure ceilings will be introduced to force the Government to always decide on the allocation of a pre-defined volume of resources among various priorities. A streamlined independent institution is also planned to be established in order to control the development of public finances and regularly report to the public.

The Government will also improve the quality of existing institutions by enhancing the effective use of programme budgeting at the central government as well as local government levels and complete the building of a public financial reporting and accounting system using applicable international standards. The Government will start in-depth monitoring of net worth of the Slovak Republic, i.e., the difference between the state's total assets and liabilities.

Several years of experience have shown that better regulation is necessary with respect to the possibility of local governments to cumulate debts. More precise rules will be specified for financial management of municipalities, towns and self-governing regions, which have huge financial resources at their disposal following extensive fiscal decentralisation. More stringent constraints will be introduced on increasing local government debts, and rules governing the bankruptcy of irresponsible local governments will be better specified.

### ***Tax policy***

Effective collection of taxes and social contributions reduces distortion in economic decisions, discourages tax avoidance and evasion and reduces compliance costs for individuals and businesses. Also, it ensures adequate public revenues and is able to contribute to increasing the competitive advantage of a small and open economy in international competition. Major problems in the collection of taxes and social contributions in Slovakia mainly stem from different assessment bases for taxes and social contributions, the existence of a number of non-systematic tax allowances, and the lack of effort to fight tax evasion. Changes in the tax system will take aim at increasing its effectiveness and stabilising the share of tax revenues and social contributions in the gross domestic product.

The Government will reduce differences in the tax burden on incomes from different sources (legal forms), thus strengthening horizontal equity in taxation. The main objective is to reduce the tax burden on labour, which is considerably higher than that on capital, thus decreasing the effectiveness of the tax and social contribution system. Fiscal neutrality of proposed measures will be ensured by shifting the burden to consumption and capital. This will be accompanied by a further analysis and subsequent cancellation of unreasonable exemptions in the tax and social contribution system with the aim of converging their assessment bases (the income tax base is now still much wider than the assessment base in the case of social contributions). The Government will transfer the obligation to pay social contributions upon employees and a "super-gross" wage will be introduced, with the respective increase in the gross wage. In order to further simplify the tax and social contribution system, the Government will consider the possibility of cancelling compulsory health insurance contributions and making them part of the tax system.

Preventing tax evasion is another priority area. Total revenues from taxes and social contributions have not reflected macroeconomic developments in recent years; it implies that the collection of some taxes and social contributions has become less effective. At the same time, a decline in tax revenues expressed as a share of GDP makes fiscal consolidation more difficult, as it requires that more stringent consolidation measures be adopted on the expenditure side.

Value-added tax deserves particular attention, given the fact that VAT revenues have long not developed in line with the macroeconomic base. A number of measures must be adopted concurrently in order to address this problem, including through improving the effectiveness of control mechanisms, legislative changes, and simplifying and unifying collection of taxes and social contributions, all of which should bring additional resources to the general government budget.



The Government will unify the collection of taxes and customs, and later social contributions, into a single authority, to be set up by restructuring the existing tax offices, and introduce a unified annual settlement of income tax and social contributions. It will simplify tax return forms and reduce the number of various administrative forms and reports. It will consider introducing a register of financial statements so that accounting units would not have to submit financial statements to several state authorities. Creating a tax administration built on electronic communication will reduce the administrative burden on taxpayers and substantially simplify their obligations.



### 3 Environmental sustainability and energy sector

As the global leader in combating climate change, the EU has made ambitious commitments to transform economies to low-carbon ones and reach a global post-Kyoto agreement containing emission obligations also for developing countries. For this purpose, the EU earmarked fast-start funding of EUR 2.4 billion annually for the years 2010 to 2012 for developing countries; Slovakia will contribute EUR 9 million in this period (1 mil + 4 mil + 4 mil). The Slovak Government fully endorses the tasks defined at the European level and has set its own national targets. With the aim of ensuring more effective management in this area, an institutional framework will be developed to address the climate change agenda, including the division of responsibilities. The proposal will also include strengthening analytical capacities of individual ministries as an essential requirement for the preparation of basic analytical papers necessary for decision-making purposes, starting with marginal abatement cost curves (MACC).

#### ***Reducing greenhouse gases emissions***

Slovakia has reduced its total emissions roughly by 34% compared to the 1990 level, which ranks it among the best in Europe. This reduction was largely caused by a natural change in the structure of Slovak economy, as the share of services on GDP increased, while agriculture decreased. Preserving the share of nuclear energy generation and a gradual increase in the use of more environmentally-friendly natural gas instead of the usual fossil fuels also played a role.

Approximately 43% of total emissions are produced by companies under the Emission Trading System (ETS). Due to the market principles governing the trading in emission allowances, further reductions can be expected in these sectors (electricity generation, lime, ceramics, brick, glass, cement industries, steel and iron manufacturing, paper mills, oil refineries). The transport sector represents a major challenge in this respect, as its emissions have increased approximately by 30% compared to the 1990 level. As far as reducing emissions in the agricultural sector is concerned, the Government wants to continue implementing measures under Rural Development Programme Axis 2 *Improving the Environment and the Countryside* (environmentally-friendly agricultural practices). The Government will review subsidies with negative impacts on the environment, especially those in the energy sector (coal mines).

#### ***Renewable energy sources (RES)***

The Slovak Republic has committed to increase the share of renewable energy sources (RES) on gross final energy consumption from 6.7% in 2005 to 14% in 2020, and the share of renewable energy used in the transport sector to 10%. The Government has approved a National Action Plan for Renewable Energy for this purpose. The action plan contains measures that are already in place (e.g., compulsory addition of bio-components to fuels, promoting RES use in the business sector and in households, feed-in tariff schemes) and those that are planned (e.g., guaranteed compulsory purchase of biomethane, support of fast-growing forestry species, mandatory use of RES in new and modernised buildings), which will be further elaborated on and submitted to the Government for discussion. Priority will be given to technologies the use of which leads to having energy prices close to market prices, with regard to acceptable end-user energy prices. It is equally necessary to concentrate on developing a smart and fully integrated energy infrastructure to ensure a higher share of renewable energy, as well as steady energy supplies. The renewable energy support scheme should also be reviewed. Under the support scheme, no preference should be given to a particular renewable energy source, and market instruments should be used to the largest possible extent.

#### ***Energy efficiency***

A 20% increase in energy efficiency is also one of the targets set under the Europe 2020 strategy. Individual national targets are unavailable at this moment; they will be discussed as part of the revision of the Directive on end-use energy efficiency and energy services in the course of 2011. Slovakia's current national target in this



area was set by the Slovak Energy Security Strategy of 2008 as saving 11% of final energy consumption by 2020 (compared to the average consumption for the 2001-2005 period). Slovakia is currently the fifth most energy intensive country of the EU. In connection with the aim of reducing energy intensity to the EU level, an Energy Efficiency Action Plan for 2011-2013 will be presented, containing the assessment of measures taken under the Energy Efficiency Action Plan for 2008-2010 and a proposal for further implementation of these measures or adoption of additional measures in the 2011-2013 period. To that end, it is necessary to analyse the effectiveness of the measures already implemented and, based on that analysis, propose additional measures to reduce energy consumption. It is equally important to prepare an in-depth analysis of the potential for further cuts in energy consumption in individual sectors of the national economy.



## 4 Measures proposed within the NRP priority areas

This chapter provides a list of measures which the Government will implement within the individual priority areas. The political will to implement structural reforms is vital to their success. However, high-quality solutions also require the expert capacities behind these reforms. An adequate institutional framework that utilises sufficient expert and analytical capacities is capable of generating high-quality measures. The Government will set up analytical units within the key ministries tasked with analysing the proposed measures and linking them to budget, monitoring and evaluation.

### 4.1 Education, science and innovation

Education, research and development raise labour productivity and are essential to building a knowledge-based society. The benefits of education to the individual and the society come in the form of improved quality of life and health. The main strengths of the Slovak education system include a high proportion of young people with completed secondary education and a rising trend in the number of tertiary level graduates. Major challenges include increasing the funding and improving the quality of education provided. Further important issues include the disparity between the skills acquired in school and actual labour market needs, as well as the absence of lifelong learning. Within the context of improving the system as a whole, measures to reduce information asymmetry deserve special attention. In the field of science and research, it is necessary to focus in particular on the insufficient linkage between business and research, and the poor efficiency of R&D expenditure.

#### *Primary and secondary education*

Making the final year of kindergarten mandatory will improve the preparedness of children for their studies, and will mitigate the disparities among children coming from different environments. This measure will help reduce the elementary school drop-out rate and improve the poor educational results of children coming from a socially disadvantaged environment. The Government will also promote the development of talented youth through support of nationwide knowledge competitions and olympiads.

A simplified structure of the study fields and a greater number of flexible and variable education positions in secondary schools will give graduates an education that better matches the demand in the labour market. When combined with the introduction of mandatory English, the Government will thus help improve the graduates' chances of employment.

Changing a teacher career growth system will incite teachers to invest in their qualifications, improving the overall quality of the pedagogical process. The new system will be free of formalism and will be based on active work with pupils. Real competition in the market for textbooks will also develop, improving both their quality and availability.

In terms of the functioning of the regional education system as a whole, financial sustainability is becoming the key issue. The funding level directly affects the quality of human resources – a vital element in the proper functioning of the entire regional education system. After its six years of operation, the Government will also fine-tune the normative funding system, which has served its purpose of rationalisation, but also resulted in phenomena that impacted adversely on the quality and structure of schools.

#### *Tertiary education*

The Government will promote the development of top-class tertiary schools and teams by announcing an open call for projects aimed at achieving excellence. This call will cover university-wide projects, which will represent the workhorses driving the improvement of tertiary schools, as well as smaller projects focused on attracting internationally renowned scientists and pedagogues to Slovakia.



Public trust in the quality of output of tertiary education will be increased by restricting fraud in obtaining tertiary diplomas.

The Government will also lay the groundwork for improving the quality of tertiary schools by changing the accreditation process and by strengthening the Accreditation Commission. It will reduce the administrative burden associated with the accreditation process and examine the processes employed by tertiary schools to improve the quality and introduce more stringent requirements for part-time studies.

The Government will be promoting the international dimension of Slovak tertiary schools' activities. It will support the engagement of schools in international research projects and networks, as well as the mobility of students, tertiary teachers and researchers. It will define objectives for the language skills of tertiary teachers and administrative staff.

Financial sustainability is also becoming vital in tertiary education. The Government will implement a more accurate measurement of the input/output ratio, review and stabilise the criteria for the allocation of subsidies to tertiary schools, and promote the improvement of the tools of economic performance monitoring in tertiary education.

### ***Lifelong learning and training***

As societal development is becoming more dynamic, lifelong learning – and further training in particular – is gaining in importance. An effective system of further training will give citizens easy access to flexible extension and deepening of their qualifications, which in turn will improve their chances of employment in the labour market, as well as their personal growth and quality of life. The lifelong learning strategy will be reviewed and updated; it will mainly include measures to systemically reduce information asymmetry in the area of further training. Creating freely accessible educational content will raise the level of citizens' key competencies, facilitating their employment in the labour market. Support will be given to further training activities that target personal development and an improved quality of life.

### ***Science, research and development***

A new science funding system will be introduced to improve the efficiency of funds allocation to the best research projects. A transparent system of institutional and grant financing of research will be set up to ensure a level playing field for all research facilities. This will incite more intensive cooperation among individual facilities within tertiary schools and other research institutions. The new system will concentrate funds in demanding projects based on a competitive principle, with mandatory engagement of high-quality foreign evaluators in the decision-making regarding these projects. The Government will also pave the way for increased private funding of science and research.

It plans to improve the effectiveness of EU funds drawing, in particular by reducing the administrative burden placed on school and scientific staff. The process of managing EU funds in the fields of education, research and development, which is overly complicated and bureaucratic and is the cause of poor transparency and purpose of the funds drawn, as well as of very poor drawing, will be simplified and made more efficient. This will limit room for corruption and increase the volume of funds actually flowing into science and education.

### ***Innovation***

The Government will create conditions for the promotion of innovation activities both in the private and public sector. The existing tools to support innovation are lacking; they work with small volumes of funds and their effectiveness and efficiency is questionable. Therefore, it is necessary to introduce a system of modern support tools that will increase innovation activity in the business and academic communities. Tools will be developed to directly support clusters and interlink universities with the business sector. Investment aid granting rules will also change with a view to targeting investments of high technological value of production and investments in applied research.



## 4.2 Employment and social inclusion

Slovakia belongs to countries with a relatively high unemployment rate. Its reduction and increasing employment, apart from the social dimension, also has an important impact on performance of the economy through increased workforce participation and productivity. A particular challenge is to improve the situation on the periphery of the labour market bordering on inactivity. For a number of years, Slovakia has had the highest unemployment rate in the EU and a relatively low employment rate of elderly. Further persistent challenges include interconnecting the education system with the labour market and regional disparities.

### **Employment**

Factors that should significantly contribute to increasing employment include, in particular, a reduced payroll tax and insurance contribution burden, more flexibility in employment relationships, and reduced employer costs and administrative burdens. An amendment of the Labour Code and other employment regulations will simplify the creation, alteration and termination of an employment contract, thus supporting employer ability to flexibly respond to changing labour market needs and create jobs. The minimum requirements on working time management will be updated. A review of the degree of participation of employee representatives will reduce the restrictions that bind employers in deciding upon working conditions.

The effectiveness and efficiency of the individual tools to tackle unemployment will be improved by a comprehensive review of active labour market policies. This concerns, in particular, that there are used for the purpose intended, prevention of their misuse, and a reduced administrative burden associated with their implementation. Permitting competition for public employment services will allow non-public employment services to take part to a greater extent in supporting and assisting labour market participants, especially in terms of integrating the long-term unemployed and other designated groups of disadvantaged jobseekers in the labour market. The Government will thus follow up on the recent changes in active policies.

The high rate of long-term unemployment will also be addressed by increasing the motivation of the long-term unemployed to seek and accept jobs through the introduction of an intermediate labour market. The long-term unemployed are often only capable of finding work at the minimum wage or a very low wage, which differs little from the unemployment benefit. Therefore, in addition to the low interest of employers in this group, their chances of finding employment are also reduced by the low financial attractiveness of the jobs available. The introduction of an intermediate labour market will provide a stage in between long-term unemployment and employment, allowing the long-term unemployed to receive part of the subsistence benefit and the associated bonuses along with their pay. This will increase their motivation to also work for a lower wage, helping them to develop working habits and gain skills. If they lose their job, they will thus have sufficient working skills to prevent them from relapsing into the group of the long-term unemployed.

Employment support will also be directed at parents, especially during the stage of raising minors, when their income declines. At present, it is not possible to receive a parental allowance while being employed. For parents, it frequently does not even pay off to work unless their pay significantly exceeds the allowance they thus have to sacrifice. In order to rectify the existing situation, legislative barriers preventing parents from working while receiving the family allowance will be eliminated.

### **Social inclusion**

The Government will promote social inclusion and employment by making the existing tools of assistance in material need more effective, and by creating new ones. The present system of assistance in material need is complicated and does little to activate the recipient. More stringent and specifically targeted conditions of assistance in material need, along with the introduction of activation elements, will help motivate the recipients to look for employment. The Government will also define priorities and take measures to address the issues of socially excluded communities, with a view to encourage their members to work, raise and educate children, and to care for dignified housing.



The Government will improve the integration and social inclusion of persons with disabilities and ensure the provision of accessible, sustainable and high-quality social services. In view of the demographic development linked with an ageing population and the increasing numbers of persons dependent on the help of others, it is becoming increasingly important and necessary to ensure long-term, accessible and sustainable social care and health care. In this context, social services are indisputably gaining in importance as a source of jobs on the one hand, and as a means of aligning work and family life on the other – namely in connection with the presence of a family member dependent on the help of another person.

### **4.3 Business environment**

The most significant drawbacks of the Slovak business environment include poor enforceability of rights, non-transparent public procurement (disrespect for public procurement rules and procedures), and the provision of subsidies (including structural funds). There is excessive bureaucracy, i.e., an undue administrative burden placed on entrepreneurs and businesses, especially when paying taxes and contributions. There is no comprehensive system to facilitate the establishment and winding up of innovative companies (including access to venture capital). A stable and predictable business environment also inevitably requires a responsible fiscal policy. Therefore, the Government's aim in the business environment sphere is to simplify the existing legislation, to relax the conditions for starting up a business, and to promote stronger competition and innovative enterprises. A reduced payroll tax and insurance contribution burden implies lower labour costs for employers. The Government will also make bankruptcy legislation more effective, including the reinstatement of bankruptcy proceedings initiated by creditors.

#### ***Administrative burden and regulation***

Reducing the administrative burden in the business sector will eliminate unnecessary costs and support economic activity and employment growth. The Government will draw up specific proposals of administrative burden reduction in order for Slovakia to meet the target of reducing administrative costs arising from national legislation by 25% by 2012.

Another important element of better regulation is to simplify and accelerate the starting up of business by completing the single business contact points (one-stop shops), which are already in operation. The Government will make it possible for both natural and legal person to communicate with the single contact points in electronic form. It will also facilitate electronic payment of the administration and court fees associated with the issuance of a business license and with the registration of a company in the commercial register maintained by the relevant court. Based on an audit of the permits and licenses issued by the state, it is advisable to consider changing certain registration and permit obligations to the form of simple notification and abolishing those that are unsubstantiated.

#### ***Small and medium-sized enterprises***

The Government will set up a sustainable project aimed at improving the access of smaller innovative companies to funding. In cooperation with the European Investment Fund, the Slovak Government will launch the JEREMIE initiative to support small and medium-sized enterprises; this will provide for the funding of guarantee and loan funds, as well as venture capital funds.

#### ***Transport infrastructure***

The Government will ensure better accessibility of regions by accelerating the construction of the primary road network, i.e., motorways and expressways. It will draw up a motorway and expressway construction programme for 2011 through 2014, and will reallocate resources from EU funds so that they can be used more intensively in the construction of motorways. It will also focus on improving the parameters of 1<sup>st</sup> class roads, addressing problematic sections with a view to improving their capacity and safety parameters.



In order to improve railway infrastructure quality, the modernisation of railways and the building of intermodal terminals will continue with the goal of maintaining the railway's share in the transport market. The Government will also adopt measures to use the railway infrastructure more efficiently, so as to raise its competitiveness. With the aim of improving the quality of services, the Government will adopt measures to revitalise and boost the economic efficiency of railway companies. It will draw up a schedule for the entry of a strategic investor into ZSSK Cargo, and for the renewal of the passenger rail transport fleet.

In the field of aviation, the Government will set the stage for improving the efficiency and for further developing the Bratislava airport and other regional airports. In maritime transport, it will continue to support the development of a high-quality continuous Danube waterway. The objective here is to guarantee the navigability of the Danube waterway in its original basin and to expand the offer of river information services as a prerequisite of competitive inland waterway transport.

### ***E-Government***

E-Government gives citizens and businesses access to the information and services of public administration. Its benefits include improved efficiency of public administration, reduced administrative burden placed on individuals and businesses when communicating with public administration authorities, indirect support of information society and the ICT industry, and less room for corruption and improved transparency in public administration.

The Government will significantly promote the development of E-Government; public services will be accessible through multiple electronic channels, with due regard for warranting information security. Key projects will include those dealing with the development of infrastructure and the fundamental architectural components of an integrated information system operated by the public administration, pursuant to the National Concept for Informatisation of Public Administration. Using ICT in the so-called e-Democracy services will strengthen the active engagement of citizens in the public administration's decision-making processes. The implementation of the above projects, combined with the use of uniform standards in e-Government information systems and adherence to the principles of information system interoperability, will provide the cornerstone for public administration and a technological communication infrastructure that will ensure an effective and simple linkage among the individual sectors of general and local public administration. In terms of mutual cooperation among information systems and e-Government services, it is necessary to address the internal (and subsequently also international) interoperability of information systems of public administration as a whole. Via its ministries, the Slovak government will cooperate in cross-border initiatives and participate in significant pan-European projects with a view to ensuring the best possible interoperability and compatibility of electronic processes as required by the Single European Market.

## **4.4 Transparent conditions and enforceability of rights**

A transparent environment free of corruption promotes efficiency and economic growth and contributes to equal opportunities in the economy, ultimately improving social welfare. In order to combat corruption effectively, it is necessary to increase transparency and restrict room for unfair practices in any handling of state property, in public institutions and local government bodies, and in public procurement. The prevailing mistrust of public institutions, courts and judges stems from the poor enforceability of rights, as well as the situation concerning corruption and cronyism in Slovakia.

### ***Corruption and cronyism***

One of the first steps in combating corruption and cronyism will be the mandatory publication of contracts involving public finance. The effect of contracts will be conditioned by their publication on the Internet. Public procurement contracts concluded by the individual ministries and their subordinate institutions in the past will additionally be published.



### ***Public procurement and the effective distribution of public funds***

Effective public spending is best warranted by the transparent application of electronic public procurement and the use of e-auctions by all of the ministries, as well as state-owned enterprises. Transparency can also be improved through the modernisation and expansion of services provided under the Journal of Public Procurement, including, e.g., the publishing of calls for tenders, the results of commission evaluations along with the justification for the exclusion of a tender by the tender evaluation commission, as well as draft criteria for tender evaluation.

The public will also have the possibility to point out specific cases of wasteful spending. The Ministry of Finance will take these notifications into account as well as in the course of budget preparation and drawing. With the aim of further improving the effectiveness of public funds allocation, the Government will introduce transparent rules and a level playing field in the distribution of subsidies within all ministries. This also relates to regular publication of up-to-date implementation overviews (e.g., the progress achieved in contracting, drawing, frequently asked questions and other aids for applicants, examples of projects implemented), as well as the evaluation of cost-effectiveness and efficiency.

### ***Courts and the Judiciary Council***

Increased transparency and prevention of unlawful interference will be ensured through obligatory publication of judicial decisions, including reasoning, and meetings of the Judiciary Council on a central website. All hearings will be recorded and the possibility to keep track of the progress in proceedings will be available.

Judicial proceedings will be speed up and the effectiveness in the work of courts enhanced by means of simplified procedural practices, deadlines for decision-making on selected matters, a new delivery system of judicial documents, and a fully ICT-based judiciary system. In order to avoid any unlawful interference in the case of the replacement of a legal judge, strict rules will be introduced on the preparation of work schedules for judges and stringent conditions for the replacement of a judge.

## **4.5 Health**

Despite a steep increase in healthcare expenditure over the past few years, Slovakia still lags considerably in performance behind EU Member States. Healthcare expenditure in Slovakia grew significantly faster than in countries with similar GDP per capita and the EC expects the growth rate to be one of the highest in the EU by 2060<sup>5</sup>. Nonetheless, the increase in life expectancy was lower than the EU average. Key challenges include increasing efficiency of health expenditures and the availability and quality of healthcare for all groups of the population.

### ***Availability of healthcare and information***

The Government will increase the availability of healthcare by adjusting the minimum network of healthcare providers and the rules for waiting lists. The minimum network of healthcare providers will be adjusted irrespective of their legal form and founder, and the minimum healthcare availability standards will be set for all types of providers. The availability of individual health services will be improved by establishing explicit and transparent rules for waiting lists, coupled with an effective enforcement of the maximum wait time.

By making available the quality ratings of healthcare providers which may be compared with each other, patients will be able to make a more informed choice of their health insurer and health care provider. The rankings of

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<sup>5</sup> OECD (2010) OECD Economic Surveys: Slovak Republic 2010, Paris, OECD Publishing.



healthcare provider based on a unified methodology will be mandatorily published by health insurers on their websites. Patients will participate in the evaluation of healthcare providers.

### ***Pharmaceuticals policy***

The pharmaceuticals policy reform will improve the affordability of drugs and the efficiency of related expenditures. In the area of pharmaceuticals categorisation, the Government will focus on improving the transparency and predictability of pharmaceuticals policy processes and on curbing corruption. Restricting the placement of relatively ineffective or cost-ineffective drugs on the market will be achieved by strengthening the role of the pharmaco-economic assessment of a drug upon its inclusion in the list of drugs covered by the basic insurance package and in setting the level of copayments for drugs.

The effectiveness of expenditures on pharmaceuticals will also be improved by introducing a drug prescription based on its active substance – the so-called generic prescription, and by the use of therapeutically equivalent drugs sold at a lower price and with a lower copayment. This will prevent questionable marketing practices in the medicines supply chain. Likewise, the introduction of a degressive margin applied on drugs supplied to hospitals as well as more relaxed rules for the sale of drugs over the Internet and the sale of over-the-counter drugs in other (registered) stores will contribute to a more effective use of public funds.

The Government will promote affordability of drugs for socially vulnerable groups by introducing ceilings for their total drug costs. Patients with a disability, and pensioners, will pay a maximum of 30 euro or, respectively, 45 euro, in copayments for drugs per quarter, and any additional payments will be refunded by their health insurer.

### ***Providers and health insurance market***

Increased efficiency of healthcare expenditures will be considerably strengthened by changes in the regulation of the health insurance market and the healthcare provider market. The Government will impose an obligation to publish on the Internet all contracts between health insurers and healthcare providers. The transformation of state-run hospitals into stock companies, and allowing the same for non-profit organisations, will facilitate better management of hospitals. This will improve the supervision over the effective use of funds and exert pressure on preventing operational losses observed in the past. At the same time, it will strengthen the accountability for the management of hospitals and create more space for the inflow of private capital.

The effectiveness of healthcare expenditures will also be increased by introducing a payment system based on diagnosis-related groups (DRG). For every hospital hospitalisation, the DRG system will assign a previously set specific volume of funds based on the diagnosis, procedures, age, gender, presence of other diseases or complications, and other measurable criteria. Each hospital will thus receive the same amount of money for an identical standardized procedure with the same diagnosis from an insurance company.

The Government will improve the health insurance market by reducing the space for health insurance companies to choose low-cost and high income groups. The risk adjustment system will be supplemented with diagnostic information obtained on the basis of the so-called pharmacy-based cost groups (PCG). A mechanism for the solidarity-based sharing of a portion of catastrophic costs of the insured will be established.

**ANNEX 1 – Europe 2020 targets**

	<b>Proposed national target</b>	<b>EU target</b>
<b>Employment</b> (as a percentage of 20-64 year-olds to be employed)	71 - 73%	75%
<b>R&amp;D expenditure</b> (as a percentage of GDP)	0.9 – 1.1% GDP	3.0% GDP
<b>Education</b>  <b>Early school leavers</b> (as a percentage of 18-24 year-olds)  <b>Tertiary education</b> (as a percentage of 30-34 year-olds)	  6%  30%	  10%  40%
<b>Poverty and exclusion</b> (combination of the risk of poverty; material deprivation and jobless households)	At least 170,000 fewer people in or at risk of poverty and social exclusion.	At least 20 million fewer people in the EU in or at risk of poverty and social exclusion.
<b>Climate change and energy</b>  <b>Total greenhouse gas emissions</b>  <b>Renewable energy sources</b>  <b>Energy efficiency</b>	 Reduce the growth of greenhouse gas emissions outside the ETS sector so as not to exceed the 2005 level by more than 13%.  Increasing the share of renewables in gross final energy consumption to 14%.  Raising energy efficiency by saving 11% of final energy consumption when compared with the average consumption of 2001 – 2005.	 In 2020, reducing greenhouse gas emissions by 20% compared to 1990 levels. <sup>6</sup>  Increasing the share of renewables in gross final energy consumption to 20%.  Raising energy efficiency by saving 20% of primary energy consumption compared to the base scenario of the PRIMES model.

<sup>6</sup> The EU is committed to taking a decision to move to a 30% reduction as its conditional offer, provided that a global and comprehensive agreement is reached for the period beyond 2012.