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**COMMISSION STAFF WORKING PAPER**

**Assessment of the 2011 national reform programme and stability programme for  
SLOVAKIA**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**on the National Reform Programme 2011 of Slovakia and delivering a Council Opinion  
on the updated stability programme of Slovakia, 2011-2014**

{SEC(2011) 815 final}

## **1. INTRODUCTION**

Following the severe slump during the global economic downturn in 2009, real gross domestic product (GDP) strongly rebounded in 2010 while the labour market continued to worsen. In contrast with the favourable outlook for output, employment is expected to remain well below the pre-crisis level in 2011. In response to a significant deterioration of the public finances in 2009-10, the Slovak authorities have adopted an ambitious consolidation package for 2011 and further measures for 2012-13 are also proposed in the Stability Programme (SP) and in the National Reform Programme (NRP), together with economic reforms to support sustainable and inclusive growth. The two documents confirm the commitment of the authorities towards fiscal consolidation and structural reforms. They also reflect the short term commitments that the Slovak government presented on 30 March 2011 under the Euro Plus Pact (EPP).

## **2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK**

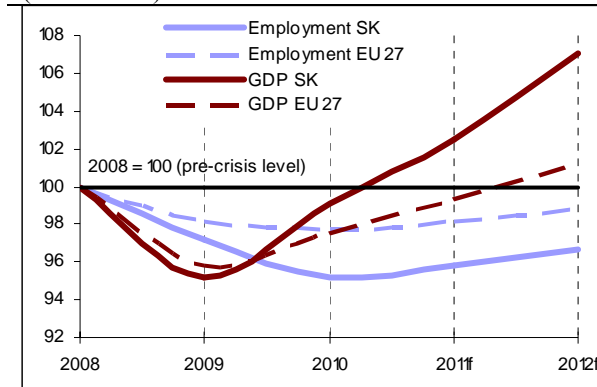
### **2.1. RECENT ECONOMIC DEVELOPMENTS**

With an average real GDP growth of 5.5% in the period 2000-2008, Slovakia was one of the fastest growing economies in the EU during the years that preceded the crisis. At the same time, public and private debt remained relatively low, an initially large current account deficit was significantly reduced, and inflation decelerated in the second half of the decade also in view of a strong nominal exchange rate appreciation. The unemployment rate was halved from 18.8% in 2000 to 9.5% in 2008, but despite significant progress it remained one of the highest in the EU. Sustained economic growth, together with consolidation efforts, supported the correction of fiscal imbalances: the headline deficit decreased from 12% of GDP in 2000 to below 3% of GDP reference value in 2003 and exceeded it only once in the period up to 2008. The ratio of public debt to GDP fell by almost 15 pps. to some 28% of GDP in 2008.

Given its large trade openness and specialisation in durable manufacturing goods, the Slovak economy was strongly hit by the collapse in world trade and aggregate demand which followed the financial crisis. In the presence of spare capacity, unemployment rose to 12% and GDP contracted by 4.8% in 2009. Price growth decelerated to historically low levels, below 1%. House prices – that had more than doubled between 2002 and 2008 (one of the fastest increases in the OECD) – fell by more than 10%. The economic situation significantly improved in 2010 in terms of output growth, but it continued to deteriorate in terms of jobs (Figure 1). Growth rebounded to 4%, mostly on account of the recovery in external demand. Unemployment, however, rose further in 2010 and in just two years went from 9.5% to 14.5% - one the highest levels and largest increases in the EU - reversing part of the significant progress achieved in the pre-crisis years of buoyant growth and economic reforms.

The crisis also induced a significant deterioration of public finances and the headline deficit soared from 2% of GDP in 2008 to some 8% of GDP in 2009-10. While still at a relatively low level, the debt-to-GDP ratio also increased by 15 pps. and reached 41% of GDP in 2010. The largely foreign-owned financial sector remained sound during the crisis and no bank had to be bailed out. The stability of the sector has been supported by a large deposit-to-loan ratio, limited direct exposure to risky securities, and a negligible share of loans in foreign currency.

Figure 1 Real GDP and Employment in Slovakia  
(annual data)



Source: Ameco (National Accounts)

Note: Data for 2011 and 2012 are projections based on the Commission 2011 spring forecast

## 2.2. OUTLOOK

The economic recovery has so far mostly been driven by favourable external demand, which will remain the main driving force also in 2011, when output is expected to expand at a slightly more subdued pace than in 2010. Given the slow recovery in the labour market, the generally low levels of wages (as a share of GDP), the negative impact of consolidation measures on disposable incomes and a spike in inflation, household consumption is expected to provide only a marginal contribution to growth in 2011. Improvements in private sector employment would be partly offset by announced layoffs in state-owned companies and at the central government level. Growth is forecast to accelerate to 4.4% in 2012 on account of sustained external demand, a pick-up in private consumption and under the assumption of a resumption in investment in infrastructure, also financed through EU funds. As for public finances, the deficit is expected to decline substantially in 2011 to slightly above 5% of GDP on the back of consolidation measures estimated at some 2.5% of GDP. In the absence of new policy measures, the deficit would reach some 4.6% in 2012. The debt ratio is forecast to increase further to close to 47% of GDP in 2012.

## 3. MONITORING, PROCEDURAL ISSUES AND GOVERNANCE

The Slovak government submitted the 2011 NRP and the 2011 update of the SP to the European Commission on 2 May and 28 April 2011, respectively. The two documents outline the mid-term fiscal strategy and the key structural reforms on the basis of the Programme priorities of the government. The NRP reflects also the commitments made by Slovakia under the EPP, although there is no specific reference to it in the NRP. While the NRP describes reform measures of the government until 2014 and contains the targets set by the government for Slovakia for 2020, more forward looking elements, including trajectories until 2020 to reach the national targets and indications concerning expected impacts of the measures planned by the government until the end of 2014 are missing. By means of the 2020 targets, the NRP nevertheless establishes a longer-term vision for the necessary modernisation of the Slovak economy, i.e. recognising the importance of education and R&D and the need to increase employment participation rate and strengthen social inclusion. Slovakia has also defined additional quantitative targets in other areas such as business environment or transparency of institutions. To ensure policy co-ordination, the NRP was prepared under the responsibility of the Prime Minister and the Minister of Finance and in consultation of selected ministries. Stakeholders and social partners were consulted. The participation of the regional and local authorities in the process seems to have been ensured mainly at political level. Involvement of civil society is foreseen mainly during implementation.

<b>Europe 2020 targets</b>	<b>Current situation in Slovakia<sup>1</sup></b>	<b>Slovakia's Europe 2020 target in the NRP</b>
R&D investment in % of GDP	0.5%	1%
Employment rate (in %)	65%	72%
Early school leaving (in %)	4.9%	6%
Tertiary education attainment (in %)	17.6%	40%
Reduction of the number of people in or at risk of poverty or exclusion	1.06 million	-170,000
Energy efficiency – reduction of energy consumption in Mtoe <sup>2</sup>		Reduction in energy consumption 1.65 Mtoe
Reduction in greenhouse gas emission reduction (compared to 2005 levels) (non-ETS sectors)	-3% <sup>3</sup>	+13% <sup>4</sup>
Renewable energy (% of total energy use)	8%	14% of energy from renewable sources in gross final consumption of energy

#### **4. POLICY CHALLENGES AND ASSESSMENT OF POLICY AGENDA**

##### **4.1. CHALLENGES**

With the recovery now well under way, Slovakia faces two main post-crisis structural challenges: addressing imbalances in public finances and ensuring full utilisation of the economy's labour potential.

Restoration of sound public finances after the disruption brought by the crisis is a necessary condition to preserve a macroeconomic environment that is conducive to long-term growth. A well-designed fiscal framework could prove instrumental to this end. The challenge will be to ensure that consolidation addresses structural weaknesses and is sustainable in the long-run, while preserving expenditure in growth-enhancing items. The long term sustainability of public finances needs to be addressed through adjustments in the pension system.

In the labour market, persisting levels of unemployment already represented a major bottleneck to growth during the pre-crisis years when total factor productivity growth and return on capital were among the highest in Europe. In the short term, with both growth and unemployment set to remain high and an ambitious consolidation plan under way, reversing the past surge in unemployment before it becomes structural appears to be the most challenging legacy of the crisis for Slovakia.

<sup>1</sup> Eurostat 2009 figures.

<sup>2</sup> As estimated by the Commission. Mtoe = Million tonnes of oil equivalent.

<sup>3</sup> This quantity corresponds to the 2005-2008 evolution of the emissions not covered by the EU Emissions Trading System. As the scope of the Emissions Trading System evolved between 2005 and 2008, these emissions are estimated on the basis of the main relevant UNFCCC source categories (as opposed to the difference between total emissions and EU ETS verified emissions).

<sup>4</sup> The national emissions limitation target defined in Decision 2009/406/EC (or "Effort Sharing Decision") concerns the emissions not covered by the EU Emissions Trading System. It is expressed as the minimum relative decrease (if negative) or the maximum relative increase (if positive) compared to 2005 levels.<sup>5</sup> The programme provides three alternative not-fully-fledged scenarios, which assess specific risks, namely (i) faster recovery of the external economy, (ii) higher oil prices, and (iii) increased interest rates.

### **Box 1: Slovak Action Programme 2011 for the Euro-Plus-Pact (EPP)**

On 30 March 2011 the Slovak Prime Minister, Iveta Radičová, with a letter addressed to the president of the European Council, Herman Van Rompuy expressed the commitments of her government in the context of the Euro Plus Pact (EPP).

In line with the objectives set by the EPP, the letter includes measures to be adopted in the next 12 months to foster:

(i) competitiveness: through lower administrative burden, tackling corruption, increase in transparency of public procurement and the judiciary system, and reform of the tax system

(ii) employment: reform of the labour code

(iii) public-finance sustainability: reform of the pension system and strengthening of the fiscal framework

All the measures proposed are included in the National Reform Programme (NRP) and respond to the objective of the Euro Plus Pact to improve Slovakia's competitiveness and contribute to a higher degree of convergence in the euro area.

In the context of continued catching-up, additional key challenges for growth are fostering a business environment that can sustain improvement in the non-price competitiveness of Slovak businesses, setting up a clearly defined and broadly shared medium term strategy in areas such as transport infrastructure, education and innovation, and significantly improving the growth-prospects of the less developed regions of the country, also in view of tackling high rates of structural unemployment. In the medium-to-long term, establishing the conditions to promote further increases in labour productivity in view of the diminishing scope for both technological absorption and capital inflows remains a key challenge.

## **4.2. ASSESSMENT OF THE POLICY AGENDA**

### **4.2.1 MACROECONOMIC POLICIES**

#### **Public finances**

The reference macroeconomic scenario<sup>5</sup> underpinning the Stability Programme, foresees a deceleration of real GDP growth in 2011 to just below 3.4%, after the strong rebound in 2010, when the economy grew at 4%. While this is in line with the Commission services' spring 2011 forecast, the composition of growth is slightly different. The programme's reference scenario projects a more drastic fall in government and private consumption. The latter would be a result of the consolidation efforts and the sluggish recovery in the labour market. For 2012, the SP projects an acceleration of economic activity, with real GDP growing by 4.8% against 4.4% forecast by the Commission services. The reference scenario expects more robust export growth compared to the Commission forecast, against the backdrop of an assumed stronger foreign demand growth.

The composition of growth in the programme scenario implies a less positive effect on tax revenue in both years than in the forecast of the Commission services, more particularly in 2011. The projected growth rates of close to 5% for the outer years of the programme period are well above the potential output projection of the Ageing Working Group. Inflation is forecast to pick-up from around 1% in 2009-10 to 3.4% in 2011 due to the acceleration in food and energy prices as well as the impact of the VAT rate hike. It is forecast to decrease to 3% in 2012, and pick up again in the following years with accelerating economic activity. The inflation projections are broadly in line with those of the Commission forecast for the years covered therein (2011 and 2012).

Output gaps as recalculated by Commission services based on the information in the SP, following the commonly agreed methodology suggest that the Slovak economy would remain below its potential until 2013, one year longer than assumed by the Commission (Table II in Annex).<sup>6</sup> Overall, the programme scenario is based on broadly plausible macroeconomic assumptions for 2011 and 2012, but somewhat favourable assumptions for the outer years.

In view of the worsening fiscal stance in the first half of 2010, the original target for the budget deficit was revised in September 2010 from 5.5% to 7.8% of GDP. In April 2011, the authorities notified a deficit of 7.9% of GDP for 2010. The large gap compared to the initial target was almost equally due to revenue shortfalls and above-budgeted spending. Export-driven growth did not translate into higher tax revenues. Also as a result of the rapid deterioration of the labour market, personal income tax and social contributions collection together with indirect tax receipts<sup>7</sup> fell short of expectations. Several factors impacted the expenditure side including: (i) clearance of arrears accumulated in railway companies, hospitals and healthcare insurance companies; (ii) a deficit in the local administrations instead of the assumed balance of the sector as a whole; (iii) unexpected expenditure (e.g. compensations for termination of PPP projects and damages from floods). Remission of guarantees-related receivables vis-à-vis non-financial corporations and floods-related spending constituted expenditure-increasing one-offs amounting to 0.3% of GDP.

The general government deficit target for 2011 is 4.9% of GDP, 0.5 pp. higher than in the previous update. The Commission services' forecast for 2011 is a deficit of 5.1% of GDP. The consolidation effort is almost equally driven by expenditure cuts and revenue increases, with a marginally stronger focus on expenditures. The authorities assume a one-off measure amounting to 0.1% of GDP in both 2011 and 2012, which arises from a temporary tax on the transfer and holding of excessive CO<sub>2</sub> emission allowances. Based on Commission services' calculations of the structural balance based on the information in the SP (using commonly agreed methodology), the implied consolidation effort would amount to 2.9 percentage points.

The objective of the budgetary strategy is achieving a close-to-balance budget in the medium term, a somewhat weaker formulation than the envisaged balanced budget target by 2015 set in the previous update. In view of projected headline deficits close to 5% of GDP until 2013 in the absence of further consolidation measures, the main goal in the short term is to reduce the headline deficit below 3% of GDP by 2013, one year later than envisaged in the previous programme, but in line with the Council recommendation under the Excessive Deficit Procedure (EDP). Under current proposals, the adjustment is expenditure-based without a significant use of one-off measures.

The SP targets headline deficits of 3.8% and 2.9% of GDP in 2012 and 2013, respectively, with most of the consolidation effort taking place already in 2011 as explained above. However, given the early stage of the preparation of the budget for 2012, the government has not so far proposed a full and firm set of measures to ensure the announced deficit reduction. Instead, figures of the General Government Budget Framework for 2012-2014<sup>8</sup> are presented, where the government has proposed consolidation measures that would contribute

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<sup>6</sup> A faster closure of the output gap projected in the Commission forecast is due to lower estimates of the potential output based on an assumption of higher NAIRUs.

<sup>7</sup> A part of the shortfall from excise tax collection was due to legislative changes, namely a reduction of the tax rate on diesel fuels.

<sup>8</sup> This is the first document of the budgeting process in which headline deficit targets are presented. These are later worked out in the tri-annual general government budget. It was adopted on 11 May 2011.

substantially to meeting the budgetary objectives. These measures focus on freezing the public wage bill at the level of 2011 (except teachers) and reducing spending on goods and services. According to the SP, implementation of these measures would yield a headline deficit of 4.1% and 3.7% of GDP in 2012 and 2013, respectively.

As the above-mentioned measures are not sufficient to reach the envisaged consolidation path, the SP proposes an array of additional measures to be considered when drawing up the upcoming budget. These are essentially the same set of measures for the whole 2012-14 period, with the strongest impact being in 2012. Some of them lack quantification (e.g. closure of some non-specified budgetary and semi-budgetary organizations). Of these additional measures, only the property tax, corporate income tax amendments, and the adjustment of the pension indexation mechanism would have a significant impact on public finances. Despite being initially proposed as fiscally neutral, the planned reform of payroll taxes to be implemented from 2012 will likely have a negative impact on the government balance. Moreover, an envisaged reduction of employees' social contribution rates in the future would put additional downward pressure on government's revenues.

Assuming that the budget targets as planned by the authorities are met, the government's fiscal effort, as measured by the change in the recalculated structural balance, would amount to 0.7% of GDP in both 2012 and 2013. Together with a significant consolidation effort in 2011, the average annual fiscal effort for the period 2011-13 would stand at around 1.4%, which is above the adjustment required by the Council. The structural balance in 2014 suggests an expansionary fiscal stance. The consolidation measures presented in the SP focus essentially on limiting or further cutting expenditure, which leads to a more than 5 pps. decline in the expenditure/GDP ratio over the period 2011-2014.<sup>9</sup> Hence, when assessed against the projected rate of medium term potential output growth expenditure projections seem to ensure an appropriate adjustment path towards the medium-term objective (MTO).<sup>10</sup>

The main risk to the targets of the proposed consolidation package stems from a potential failure to properly implement the envisaged measures. For example, the planned cuts in the public wage bill in 2010 fell short of the target.<sup>11</sup> With no changes to the decentralized approach of addressing wage policies by the line ministries, the outcome of the wage bill cuts could again fall short of plans. More importantly, the strategy beyond 2011 once again rests largely on across-the-board expenditure cuts without providing further details on how these are to be achieved. At the level of local governments, no steps have been taken so far to limit the expenditure slippages observed in the past. The increases in tax rates are subject to adoption risks, given that the 50% increase in the real estate tax would have to be decided by the local authorities and proposals to raise excise taxes on beer were rejected in the 2011 budget. Also, an agreement has not yet been reached within the governing coalition on this issue. Moreover, proposals for revenue-reducing measures as observed in the past (e.g. the planned payroll taxes reform), could pose a risk to consolidation effort.

There is scope to raise revenues from taxes which are least harmful to growth (e.g. property and environmental taxes) and to improve tax collection, especially in view of a large VAT

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<sup>9</sup> The expenditure/GDP ratio is based on an assumption of implementing three expenditure measures focusing on public wage bill cuts and goods and services savings. Thus the ratio is not based on the official deficit targets.

<sup>10</sup> For a country that has reached its MTO, fiscal policy is considered "prudent" if expenditures in year  $t$  do not grow faster than a reference rate of medium term potential GDP growth, unless the excess of expenditure growth is matched by discretionary revenue measures. Where the country has not yet reached its MTO, expenditure growth should be capped at (approximately) 1 pp. below the reference rate of medium term potential GDP growth, unless the excess of expenditure growth is matched by discretionary revenue measures.

<sup>11</sup> The public wage bill in 2010 exceeded the originally budgeted level by 0.8% of GDP.

gap<sup>12</sup>. Property taxation could yield supplementary revenues by linking the tax base to the actual development of property market prices and/or raising the rates. Transport taxation could be another potential source, in particular by extending the annual circulation tax to private users. These additional resources could be considered also in view of Slovakia's low expenditure on growth-enhancing items. The gross fixed capital formation of the government has declined from levels close to 3% of GDP at the beginning of 2000s to levels around 2% of GDP, just before the crisis falling behind its regional peers. The same is true for expenditure on education, which amounted to 3.5% of GDP in 2008, lagging behind the EU average by over 1.5% pps.

After falling below 30% of GDP in 2008, general government debt increased significantly during the crisis years to 41% of GDP in 2010, driven primarily by high headline deficits. The programme projects a further increase to more than 45% of GDP in 2012, about 2 pps. lower than the Commission services' projection. After stabilising in 2013, the public debt/GDP ratio would improve marginally in 2013 (Table IV in Annex). While the debt ratio would remain at a relatively low level during the programme period compared to the EU average, further developments depend on the success of the planned consolidation.

#### **Box 2. Main measures**

The government's consolidation strategy relies relatively more on the reduction of expenditures, especially after 2012. Expenditure cuts or freezes are broad-based starting with the public wage bill, intermediate consumption (also through improved public procurement) as well capital expenditure. The revenue measures include tax base broadening for both personal and corporate income tax, an increase of the VAT rate, higher excise duties combined with elimination of several exemptions and higher non-tax revenue (e.g. sale of CO<sub>2</sub> allowances).

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<sup>12</sup> The VAT gap is the difference between accrued VAT receipts and the theoretical net VAT liability for the economy as a whole.



### Main budgetary measures (% of GDP)

Revenue	Expenditure
<b>2011</b>	
<ul style="list-style-type: none"> <li>• Broadening of tax base for personal income tax and social contributions (0.3%)</li> <li>• VAT rate increase (0.3%)</li> <li>• Increase in excise duties and elimination of exemptions (0.2%)</li> <li>• Non-tax revenue from sale of CO<sub>2</sub> emission allowances, special levies on electricity production and fuels, etc. (0.3%)</li> </ul>	<ul style="list-style-type: none"> <li>• Public wage bill cuts (-0.2%)</li> <li>• Reduction spending in goods and services (-0.2%)</li> <li>• Cuts in subsidies (-0.3%)</li> <li>• Reduction in capital expenditure (-0.1%)</li> </ul>
<b>2012</b>	
<ul style="list-style-type: none"> <li>• Broadening of corporate income tax base(0.1%)</li> <li>• Increase in the real estate tax (0.2%)</li> <li>• Sale of CO<sub>2</sub> allowances (0.1%)</li> <li>• Higher dividend from state-owned companies (0.1%)</li> </ul>	<ul style="list-style-type: none"> <li>• Public wage bill freeze (-0.2%)</li> <li>• Cuts in goods and services spending (-0.5%)</li> <li>• Reduction in electronic toll payments (-0.1%)</li> </ul>
<b>2013</b>	
<ul style="list-style-type: none"> <li>• n.a.</li> </ul>	<ul style="list-style-type: none"> <li>• Public wage bill freeze (-0.2%)</li> <li>• Cuts in goods and services spending (-0.1%)</li> <li>• Adjustment of pension indexation (-0.1% of GDP)</li> </ul>
<b>2014</b>	
<ul style="list-style-type: none"> <li>• n.a.</li> </ul>	<ul style="list-style-type: none"> <li>• Public wage bill freeze (-0.2%)</li> <li>• Cuts in goods and services spending (-0.2%)</li> <li>• Adjustment of pension indexation (-0.1%)</li> </ul>

In addition, the government plans to carry out a reform of the tax and social contribution systems to increase the efficiency of the system by simplifying it and unifying collection of tax and social security contributions. The authorities also address the issue of inefficiencies of the state-owned companies. The loss-making railway companies are to be restructured and the freight transporter CARGO privatised. The government also decided to partially or fully sell its stake in several companies and opted for a long-term lease for the Bratislava airport.

Slovakia is at high risk with regard to the long-term sustainability of public finances. The long-term cost of ageing is above the EU average. Furthermore, the current budgetary position compounds the cost of ageing: based on the current fiscal position, debt would increase to 79% of GDP by 2020. Even the full implementation of the programme would not be enough to put debt-to-GDP ratio on a downward path by 2020. Ensuring sufficiently high primary surpluses over the medium-term would be needed to improve the sustainability of public finances.

The ageing-related expenditure is projected to increase by 5.5 pps. of GDP between 2010-2060, above the EU average of 4.6 pps. of GDP. Spending on pensions would be the main driver, increasing by more than 50% and putting significant pressure on public finance. This would be the case despite a major pension reform implemented in 2004-06, which did not address systematically the expected future increases in longevity. There are also specific

shortcomings within individual pillars that undermine their viability in the medium to long run. In the case of the pay-as-you-go (PAYG) pillar they include (i) a considerable merit component due to a close link between contributions and individual pension entitlements and (ii) indexation mechanism that assigns equal weights to price and wage increases. The fully-funded pillar is weakened mainly due to changes in 2008-09, including the requirement for the pension funds to cover incurred losses over a 6-month period and the removal of compulsory participation for new labour market entrants. The SP and the NRP envisage several adjustments to address the current shortcomings, which would contribute to delivering adequate pensions without compromising fiscal sustainability.

With the reform of 2005, which introduced multi-annual planning, programme budgeting and several fiscal rules, Slovakia significantly improved its fiscal framework. However, the current set-up has not prevented the government from running deficits even in years of high economic growth. To address the framework's weaknesses, the SP proposes an extensive fiscal governance reform. The envisaged measures would significantly improve fiscal governance. However, the authorities would need to ensure that the envisaged multi-annual expenditure ceilings are well-designed and enforceable and encompass the central government level and the social security system. The envisaged publication of fiscal data would need to be done in a timely manner to support in-year monitoring of fiscal developments and the enforcement of fiscal rules.

#### **4.2.2 LABOUR MARKET POLICIES**

Ensuring full utilisation of the labour potential by simultaneously tackling structural and cyclical rates of unemployment among the highest in Europe is a key challenge (Figure 2-Figure 3). While structural unemployment dates back to the early years of the transition, the recent surge in joblessness is related to the poor performance of the labour market during and after the 2008-09 crisis when part of the progress achieved in the pre-crisis years of buoyant growth and economic reforms was reversed. While both types of unemployment need to be addressed, the required policy responses will have to be different.

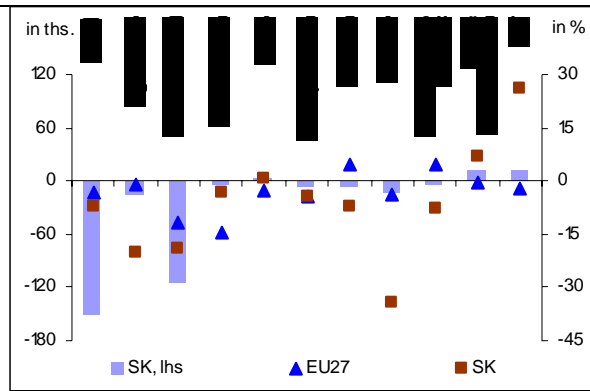
##### **Unemployment and labour market participation**

In the wake of the crisis, unemployment rose especially among workers with low and medium education levels and young people, while long term unemployment has remained the highest in the EU (9.2%). Large changes in the employment and unemployment levels left the participation rate unchanged at around 68%. In absolute terms, job losses in manufacturing represent nearly three quarters of the total losses. Several temporary measures on both the supply and the demand side were already adopted in 2009.<sup>13</sup> Despite an overall sustained policy response and a strong rebound in growth, the labour market continued to deteriorate in 2010, suggesting that underlying problems may have been only temporarily mitigated by the extraordinary pre-crisis growth rates.

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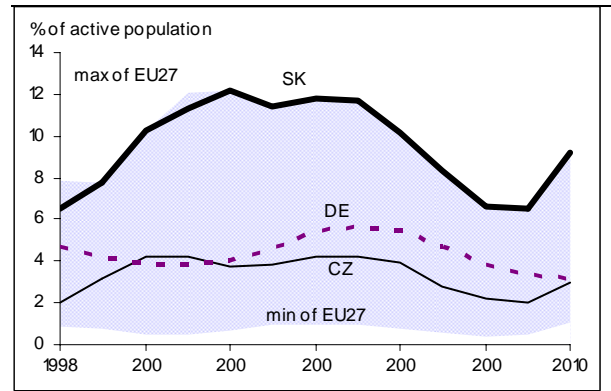
<sup>13</sup> These included a short-time working scheme running until the end of 2011, temporary reduction of social contributions for self-employed, and subsidies for companies hiring unemployed persons for more than 12 months.

Figure 2 - Change in the number of employees during 2008Q3-2010Q3 in Slovakia by occupation



Source: Slovak statistical office

Figure 3 - Long-term unemployment in Slovakia (annual average)



Source: Eurostat

As outlined in the NRP and in the EPP, Slovakia is addressing the post-crisis challenges in the labour market chiefly by reforming the Labour Code. The proposed reform aims primarily at increasing flexibility in the labour market.<sup>14</sup> Further flexibility can support the creation of new jobs through a reduction in the overall cost of hiring and firing. While rigidity in terms of notice periods for permanent employees (particularly for collective dismissals) was slightly above the OECD average in 2008, the overall employment protection legislation (EPL) index stood slightly below the OECD average. Looking at the recent labour market performance, the acute increase in unemployment experienced in 2009-10 does not point to excessive rigidity in the labour market during the crisis either. Given the existing structural weaknesses in the labour market, further and more effective support to address unemployment created during cyclical spikes would improve its resilience.

Labour market services and active labour market policies (ALMPs)<sup>15</sup> have not proved sufficiently effective so far, as also suggested by one of the highest pass-through rate to long-term unemployment in the EU (60%). Slovakia was also invited on several occasions to redesign and refocus the system as a whole. As details on the reform of labour market services and ALMPs are not known at this stage, the assessment is limited. In general, well designed, targeted and effectively implemented labour market services and ALMPs can play a major role in favouring a more rapid re-absorption into the labour market of those who have lost their jobs in 2009-10, as well as other long term unemployed. Despite high unemployment, expenditure and participation in labour market services and ALMPs are among the lowest in the EU and a monitoring and an evaluation system for assessing the efficiency of individual policies is still missing.

The proposed tax and social contribution reform simplifies the tax code and reduces the administrative burden for employers. The reform does not envisage a reduction in social security contributions for employees and the effect on the tax wedge is therefore expected to be limited. Depending on future developments in public finances, the declared objective of the reform is to gradually reduce social security contributions. As the employment rate for low-skilled workers is the lowest in the EU (14.3% in 2009 compared to the EU average of

<sup>14</sup> Around 140 changes to the existing labour code have been proposed, including: abolition of the concurrence of a notice period and severance pay; extension of the maximum length of fixed-term contracts; partial relaxation of collective dismissals and broadening the scope of issues that can be collectively negotiated at the company level.

<sup>15</sup> Labour market services refer to labour market interventions where the main activity of participants is job-search related. ALMPs refer to labour market interventions where the main activity of participants is not job-search related (e.g. training, supported employment, employment and start-up incentives, etc...)

46.2%), and the tax wedge for the low-paid (earning 67% of the average wage) was around 34.5% in 2010 (slightly above the OECD average of 31.3%), redesigning the tax wedge at the bottom of the wage distribution curve first may help support labour demand for the currently unemployed and provide an incentive to reduce the level of 'false' self-employment and unregistered work.

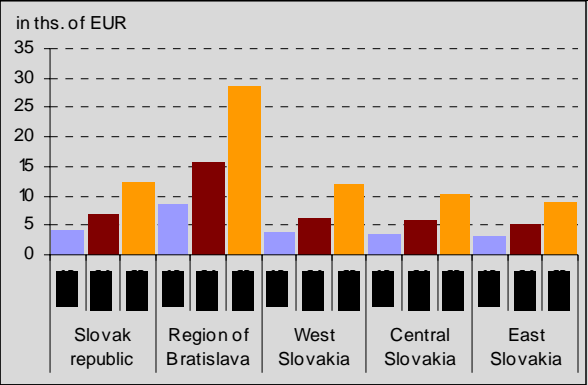
**Structural unemployment, skill mismatches and social inclusion**

Gradually and progressively tackling the determinants of high levels of structural unemployment remains a challenge for Slovakia. The Slovak labour market is characterised by a relatively high degree of jobs mismatches that varies considerably across regions. On the demand side, the job vacancy rate in 2008 was only 1.3%, considerably lower than the EU average (2%). At the same time, regional differentiation in the job vacancy rates and unemployment rates were extremely large, reflecting underlying and equally large economic differentials.

**Box 3: Structural unemployment in Slovakia**

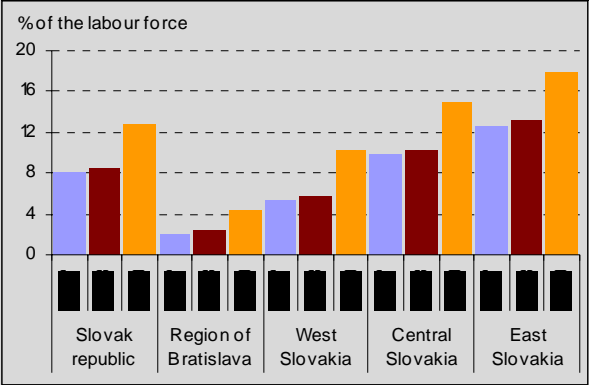
Despite significant progress achieved in the pre-crisis years of buoyant growth and economic reforms, long-term unemployment remains the highest in the EU and a distinctive feature of the Slovak labour market. This aspect partly dates back to the early years of the transition, when the major structural shift that took place in the economy left nearly a quarter of the labour force unemployed. Hysteresis effects, human capital depreciation, and the presence of marginalised Roma communities help to explain how a large part of the labour supply remained unemployed for lengthy time-spans. Furthermore, the labour market varies extensively across regions and unemployment is highly correlated to persistent and widening regional disparities in the levels of economic activity. Still today, GDP per capita in the Bratislava region is twice as high as in the country as a whole and four times higher than in the East. Together with low labour mobility within the country, this explains why in 2009, after a severe recession, the rate of registered unemployment was bordering 20% in the East and was as low as 4% in the Bratislava region. Finally, the figures on unemployment partly underestimate the important presence of the marginalised Roma community in the Slovak territory – estimated to be between 2% and 8% of the population – as it is unlikely to be fully captured by official statistics.

GDP per capita in the Slovak regions



Source: Slovak statistical office

Registered unemployment in the Slovak regions



Source: Slovak statistical office

The important presence of skill mismatches is also a distinctive feature of the Slovak labour market. Firms occasionally signalled shortages of labour in the booming pre-crisis period and some vacancies remained unfilled for both skilled and unskilled workers despite the relatively large incidence of long-term unemployment. Labour shortages (as measured by the job

vacancy rate) were reported in particular in manufacturing, public administration and defence, utilities and construction.

With a view to improving the relevance of school education and vocational education and training to the labour market needs, a number of measures are planned. The government has also set a target related to the basic competences assessed by the Programme for International Student Assessment (PISA) and plans to increase investment in schools' infrastructure, particularly in the field of Information and Communication Technology (ICT). Other plans aim to reduce the administrative burden within school administrations, to introduce school quality assessment systems and work-based learning schemes in vocational education and training (VET). Overall, a comprehensive package of reforms to tackle the challenge of skills mismatches in the labour market through better education and training has been launched. Plans to review the adult learning and continuing VET system are also positive as a recent law in this area does not adequately respond to the challenges. While presenting positive aspects, the new plans do not appear to put forward any incentives to boost adult participation in lifelong learning, which remains one of the lowest in the EU (2.8% compared to the EU average of 9.3% in 2009).

The authorities also propose the introduction of an 'intermediate labour market', where a 'scaled compensation' will be provided to cover for the employer's payroll contribution costs when hiring a long-term unemployed person. While additional information to that provided in the NRP is necessary to assess the scheme, its introduction, in principle, can tap into existing shortcomings in social assistance. Although social assistance is low, unconditional support and the lack of participation in effective ALMPs negatively impact on the motivation and employability of the long-term unemployed. Depending on the overall final set-up, risks of misuse of the scheme (e.g. inefficient subsidising of employers) could also emerge and its effectiveness will need to be closely monitored and evaluated from the first introductory phases.

Although the number of people at risk-of-poverty or social exclusion as measured by the agreed Europe 2020 indicator has significantly improved in the second half of the past decade<sup>16</sup>, the unemployment rate among those with lower secondary education or less remained at 47%, four times the average and the highest in the EU. The relatively low level of at risk of poverty can be partly explained by the high growth rates during the 2000s and a relatively low 'risk-of-poverty threshold' – which is set at 60% of the median disposable income (after social transfers) – also reflecting the generally low level of wages. Furthermore, excluded Roma communities living in segregated rural areas are not necessarily fully captured in official statistics on poverty in Slovakia. The envisaged Act on Socially Excluded Communities deals with on-site social work in Roma settlements, pre-primary education and social housing.

On a general note, problems with the effective and efficient absorption of funding under the current EU Structural Funds programming period for marginalised Roma communities remain to be addressed as a matter of policy priority. An Action Plan to speed up the implementation of local strategies in favour of marginalised Roma communities under the "comprehensive approach" was announced in 2011. Its implementation, however, has proven to be particularly slow, hampered by weak administrative capacity and an unclear division of responsibilities.

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<sup>16</sup> The number of people at risk of poverty or social exclusion went from 32% in 2005 to 19.6% in 2009, against 23.1% in EU. Expenditure on social protection benefits is also among the lowest in the EU.

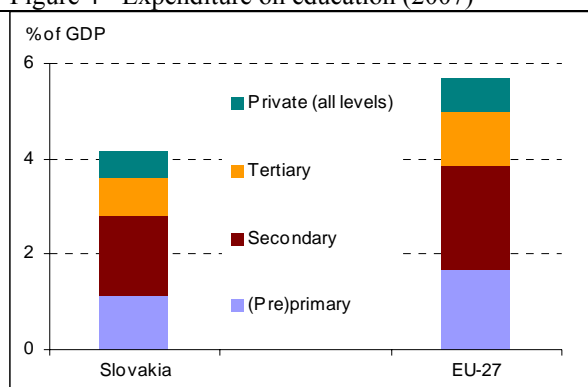
### 4.2.3 GROWTH ENHANCING STRUCTURAL MEASURES

#### Competitiveness, higher education, research and innovation capacity

Despite notable improvements in non-price competitiveness, further progress is key to a sustainable long-term growth. The share of high-tech exports in total exports in Slovakia, for instance, was 4.8% in 2008, while it amounted to 14.1% in the Czech Republic, 22% in Hungary and 12% for the EU. The trade balance remains negative and high-tech exports have a large content of high-tech imports, suggesting that there remains considerable scope for expansion of the higher value-added sectors. A basic prerequisite, however, is the supply of an adequately skilled workforce that could be employed in those sectors. Against this background, most indicators on the degree of innovation capacity for the Slovak economy are weak or very weak (e.g. R&D spending, spending and quality of tertiary education, number of patents), and in several cases even deteriorated during the last decade. Tertiary education attainment remains low (17.6%), well below the EU-average (32.3%). Quality of tertiary education in particular, remains an issue as suggested by a variety of existing indicators (university rankings, number of international publications, low attraction of students from abroad) and the relatively high share of students studying abroad despite free tertiary education being provided at home.

Reforms proposed in the higher education field tackle many of the current problems; however, much will depend on implementation. Slovakia has set an ambitious target of 40% tertiary education attainment which is in line with the Europe 2020 headline target. The NRP, however, does not provide information on how it will be achieved. Given the current figures, this will require a considerable effort to ensure a high completion rate of current students and to attract people already on the labour market into higher education. Furthermore, higher investment in higher education and closer cooperation with businesses (including design of curricula) to increase its relevance to the labour market are also instrumental to the development of a well-functioning knowledge triangle (education, research, innovation), to improve the effectiveness and attractiveness of private and public investment in R&D, and to progressively build the innovation capacity of the Slovak economy. Against this background, higher education institutions that focus not only on supporting outgoing but also incoming students and researchers would promote mobility conducive to quality education and research.

Figure 4 - Expenditure on education (2007)



Source: Eurostat

Given current and past trends, the target for R&D spending – while low in EU comparison – appears ambitious<sup>17</sup>. In particular, private R&D counts for only one-third of the total

<sup>17</sup> Slovakia's R&D expenditure as a share of GDP has been among the lowest in the EU during the past decade and it decreased from 0.65% of GDP in 2000 to 0.47% of GDP in 2008. Against this background, the

expenditure in R&D (EU average is 55%) and it has halved over the past decade. At the same time, the gap with the EU as regards share of employees in knowledge-intensive sectors ) has been widening during the past decade. This is in part related to the structure of innovation expenditure in Slovakia which is heavily biased towards machinery and equipment, suggesting that Slovak firms are technology adopters and efficiency-driven, therefore actively involved in the 'diffusion' of innovation, rather than the 'creation' of innovation. Besides, the scarce public resources currently channelled towards R&D remain fragmented over too many priorities and suffer a lack of coordination between responsible public authorities. The system is also characterised by insufficient links between business and the research base and with international partners, which may pose a drag on the absorption capacity of €1.2 billion of EU funds available for RTD in the current Structural Fund programming period. Aside from higher human capital formation - a key driver of long-term growth - the efficiency of the national innovation system would gain from simplification and greater transparency of the procedures used to allocate funds, including those supporting regional innovation.

### **Business environment, public administration and institutional capacity**

With respect to the business environment, recent international surveys of businesses and entrepreneurs show that low enforceability of law and low transparency are considered as major barriers for doing business in Slovakia. The NRP analyses many of the weaknesses related to transparency of institutions and quality of the business environment and often puts forward ambitious and positive reforms.<sup>18</sup> At the same time, a cross-cutting structural analysis on the efficiency and effectiveness of public administration does not seem to be fully developed, despite its importance for the business environment, public policy in general and a more effective absorption of EU funds. Public administration seems to suffer from lack of technical expertise, heterogenic recruitment practices and high turnover of staff.

Excessively complex and burdensome legislation also pose a drag on local enterprises. The Slovak authorities approved in 2007 an action plan for the reduction of the administrative burden by 25% by the end of 2012. While relevant laws have been identified over the last two years, specific legislative revisions are still pending, and the target is unlikely to be met. A more comprehensive 'better regulation' strategy including enhanced consultation procedures with stakeholders (including enforcers of regulations) is not envisaged in the NRP. Similarly, a 'Unified Methodology' to assess selected effects of new legislative proposals was introduced in 2010. However, there are delays in the actual application of the envisaged methodological framework

Slovakia has completed the adoption of the EU Service Directive, but it has accumulated significant delays in setting up the electronic "point of single contact". In the NRP, the Slovak government expressed its commitment to make the system operational within one year.

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Government has put in place measures to stimulate private sector research dynamics and the demand for innovation in the "New Act on Stimuli for R&D" and the "New Model for Financing S&T" (2009-2010). The planned creation of the Regional Innovation Centres (RICs) is also expected to support innovation infrastructure. The NRP also recognises – as means to support innovation - the need to combat counterfeiting and piracy and thus better protect intellectual property rights, which is an area where Slovakia lags behind.

<sup>18</sup> Those include the adoption of an action plan for the reduction of administrative burden, the introduction of new electronic services, simplification of procedures to create or wind down an enterprise and measures addressing the enforcement of rights and the lack of transparency in public procurement and in the judiciary system. Streamlining civil court procedures; setting deadlines for action by courts on selected matters; promoting the use of alternative and extra-judicial dispute settlement methods and the use of ICT solutions; publication of judicial decisions on internet all represent important areas for action.

As regards access to credit for small and medium enterprises (SMEs), lending and guarantee conditions have significantly tightened in the wake of the financial crisis. Even if a pilot project the JEREMIE initiative was launched in 2010 after several delays<sup>19</sup>, other publicly funded financing schemes for SMEs have been recently suspended due to a protracted restructuring process in the agency managing the schemes, also pointing to institutional weaknesses spilling-over to the business environment and SMEs in particular.

### **Network industries, climate change and energy**

Network industries and market services in Slovakia are in some cases characterized by significantly higher prices than in the rest of the EU, suggesting the presence of market inefficiencies. Energy prices, in particular, have played an important role in driving inflation in Slovakia during the last decade.<sup>20</sup> In line with EU regulations, the Slovak energy market has been progressively liberalised during the past decade. Nonetheless, competition does not appear to have developed strongly and in 2010 electricity prices were still among the highest in the region for households and firms. As incumbent companies are still dominant and consumer switching rates are low there is a risk that higher prices might be due to regulatory barriers or low levels of competition. The negative impact of higher prices on productivity is exacerbated by the high energy intensity of the economy which – despite significant improvement – remains twice as high as that of the EU.<sup>21</sup>

In the field of energy, the NRP envisages several measures to implement the already adopted Energy and Climate package and the Third Liberalisation package of the EU. Furthermore, the authorities aim to prepare a proposal for improving the regulatory framework for network industries by the end of 2011. Efforts in this direction are welcome as higher levels of transparency in the price setting mechanism and the overall regulatory framework would reduce entry barriers in network industries and may hence prove beneficial in lowering prices. In terms of energy efficiency, notable improvements have been achieved in the past years. Yet energy intensity remains among the highest in the EU, almost twice the EU average, clearly suggesting that further progress is warranted. As major legislation in this area has been already transposed, the focus should now be on its implementation. With important energy savings in the existing building stock, additional incentives to improve energy performance of public and private buildings could be considered as well as investments in waste heat recovery from industry, district heating networks and thermal power production.

Finally, The NRP also presents new commitments to greenhouse gas reduction and the use of renewable energy. The recent trend in greenhouse gas emissions appears to be broadly in line with the 2020 targets, but it also reflects the effects of the economic downturn which tends to reduce emissions. With the recovery well under way and given the weight of the road transportation sector in the national emissions, focused efforts in this area would prove particularly effective in further reducing emissions. While reinforcements of the electricity infrastructure may be needed to ensure that 14% of energy in gross final consumption of energy comes from renewable sources, additional measures in support of a greener growth

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<sup>19</sup> The JEREMIE initiative (Joint European Resources for Micro to Medium Enterprises) offers EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds to finance SMEs by means of equity, loans or guarantees.

<sup>20</sup> Energy price increases were mostly due to lack of diversification of natural gas imports, only pro forma competition on the electricity market and high production costs of electricity from domestic coal and renewable energy.

<sup>21</sup> High consumer prices, however, are also a feature of other network-based service providers such as telecommunications. The latest available data for 2008 show that in Slovakia the cost of local and long-distance calls per minute are among the highest in the EU and there is also a high concentration in the market for mobile telecommunications. At the same time, the broadband internet penetration rate is low pointing to insufficient investment by the main service providers.



may bring several other benefits in terms of energy efficiency and reduction of atmospheric pollution.

## **5. SUMMARY**

The government adopted an ambitious consolidation package for 2011 and plans further austerity measures in the following years to reach a headline deficit of 2.9% of GDP in 2013, the deadline year under the Excessive Deficit Procedure (EDP). This commitment is spelled out in the SP. While the macroeconomic scenario backing the budgetary targets appears to be plausible for 2011-12, growth rates may be on the high side for the outer years of the programme. The consolidation effort for 2011 places somewhat more emphasis on the expenditure side (e.g. savings on current and capital spending) and is complemented by revenue measures (e.g. VAT hike). Beyond 2011, the authorities have proposed a freeze in the wage bill and further reductions in expenditure for goods and services as well as an array of possible additional measures, which may be sufficient to meet the government's budgetary targets, but are subject to adoption risks. Overall, the consolidation strategy does not sufficiently safeguard expenditure in growth-enhancing items, including transport infrastructure and education. The proposed reform of the fiscal framework could considerably improve the current set-up and reinforce the planned consolidation efforts of the government. Finally, stabilisation of the pension system through its adjustments described in the programme appears to be an adequate response to the long-term challenges of public finances.

The NRP outlines a range of measures to foster growth and jobs. Although the level of ambition varies, overall policies are put forward in many areas that are crucial for future growth and jobs, including education, the business environment, and the quality and transparency of institutions. For other areas such as energy efficiency and innovation, measures seem to be less ambitious or less underpinned by credible trajectories. Many of the labour market policies proposed in the NRP represent positive developments. However, it does not develop in detail on effective labour market services and active labour market policies, targeted reductions of the tax wedge and increased relevance of the education and training system to the labour market needs. With productivity and prices approaching the EU levels, current steps to improve the quality of education and higher education may not sufficiently address the need to enhance competitiveness and the innovation capacity of the economy, also in view of diminishing scope for further technological absorption and capital inflows. The issue of the capacity of public administration and its impact in the actual implementation of policies, regulatory frameworks and public procurement does not appear to be adequately developed despite the key role that this will play in implementing many of the reforms proposed and in ensuring their success.

STATISTICAL ANNEX

Table I. Macro economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012
<b>Core indicators</b>							
GDP growth rate	4.3	3.9	7.9	-4.8	4.0	3.5	4.4
Output gap <sup>1</sup>	-0.3	-2.6	3.3	-2.1	-1.6	-1.2	0.2
HICP (annual % change)	7.2	7.8	3.2	0.9	0.7	3.6	2.9
Domestic demand (annual % change) <sup>2</sup>	6.2	3.7	6.8	-7.3	2.4	1.5	3.6
Unemployment rate (% of labour force) <sup>3</sup>	13.1	18.5	12.6	12.0	14.4	14.0	13.3
Gross fixed capital formation (% of GDP)	31.1	26.1	26.0	20.6	20.3	20.7	21.3
Gross national saving (% of GDP)	24.8	21.1	20.7	16.4	20.2	20.8	21.4
<b>General Government (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>-6.5</b>	<b>-6.4</b>	<b>-2.5</b>	<b>-8.0</b>	<b>-7.9</b>	<b>-5.1</b>	<b>-4.6</b>
<b>Gross debt</b>	<b>33.8</b>	<b>45.3</b>	<b>30.5</b>	<b>35.4</b>	<b>41.0</b>	<b>44.8</b>	<b>46.8</b>
<b>Net financial assets</b>	<b>12.7</b>	<b>-6.9</b>	<b>-6.9</b>	<b>-17.2</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	42.6	37.5	33.5	33.6	33.1	33.6	32.9
Total expenditure	49.0	43.9	36.0	41.5	41.0	38.8	37.4
<i>of which: Interest</i>	2.6	3.3	1.5	1.4	1.3	1.6	1.7
<b>Corporations (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>-4.2</b>	<b>0.4</b>	<b>-3.2</b>	<b>4.9</b>	<b>5.7</b>	<b>3.6</b>	<b>3.8</b>
<b>Net financial assets; non-financial corporations</b>	<b>-57.9</b>	<b>-51.5</b>	<b>-55.0</b>	<b>-45.4</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>-10.9</b>	<b>-10.4</b>	<b>-1.5</b>	<b>7.7</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	22.5	18.3	20.4	11.8	14.9	16.3	17.0
Gross operating surplus	25.9	24.9	27.4	24.1	26.8	26.2	27.1
<b>Households and NPISH (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>4.5</b>	<b>-0.6</b>	<b>-1.4</b>	<b>0.7</b>	<b>2.1</b>	<b>1.5</b>	<b>1.3</b>
<b>Net financial assets</b>	<b>49.4</b>	<b>38.8</b>	<b>17.5</b>	<b>12.2</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	32.6	31.4	31.0	32.2	31.6	31.4	31.1
Net property income	5.3	3.3	1.2	1.5	1.2	1.4	1.6
Current transfers received	16.9	16.9	16.0	18.6	18.5	18.3	18.1
Gross saving	7.4	5.2	4.0	5.4	6.2	5.5	5.2
<b>Rest of the world (% of GDP)</b>							
<b>Net lending (+) or net borrowing (-)</b>	<b>-6.2</b>	<b>-6.5</b>	<b>-7.0</b>	<b>-2.4</b>	<b>-0.6</b>	<b>-0.7</b>	<b>-0.2</b>
<b>Net financial assets</b>	<b>6.7</b>	<b>30.1</b>	<b>45.9</b>	<b>42.7</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-6.7	-4.5	-3.0	-0.4	-1.0	-0.5	0.1
Net primary income from the rest of the world	0.2	-2.0	-2.9	-1.6	-1.2	-1.4	-1.6
Net capital transactions	-0.3	-0.5	0.4	0.8	2.3	2.1	2.3
Tradable sector	54.9	52.6	52.7	49.1	49.2	n.a	n.a
Non tradable sector	34.9	37.2	37.3	41.9	42.2	n.a	n.a
<i>of which: Building and construction sector</i>	5.9	5.9	7.3	8.6	8.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	94.0	105.1	136.6	167.7	160.3	160.2	160.5
Terms of trade goods and services (index, 2000=100)	99.0	98.9	96.2	93.3	91.5	90.0	89.8
Market performance of exports (index, 2000=100)	96.8	108.4	130.9	132.5	138.3	140.7	142.5
<b>Notes:</b>							
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2000 market prices.							
<sup>2</sup> The indicator on domestic demand includes stocks.							
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.							
<b>Source :</b>							
<i>Commission services' spring 2011 forecast</i>							

**Table II. Macro economic scenario for the budgetary projections**

	2010		2011		2012		2013	2014
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	4.0	4.0	3.5	3.4	4.4	4.8	4.8	4.8
Private consumption (% change)	-0.3	-0.3	1.3	0.1	3.6	3.5	4.0	4.1
Gross fixed capital formation (% change)	3.6	3.6	4.5	4.8	6.5	5.9	3.4	4.7
Exports of goods and services (% change)	16.4	16.4	8.5	8.1	8.2	10.0	10.7	10.9
Imports of goods and services (% change)	14.9	14.9	5.9	5.7	7.3	9.0	9.5	10.7
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	0.6	0.7	1.3	0.1	3.6	3.1	2.7	3.5
- Change in inventories	1.8	1.9	0.2	0.6	0.0	0.2	0.0	0.0
- Net exports	1.0	2.1	2.0	2.5	0.8	1.8	2.2	1.4
Output gap <sup>1</sup>	-1.6	-1.9	-1.2	-2.2	0.2	-1.1	0.0	1.2
Employment (% change)	-1.4	-1.4	0.6	0.3	0.9	0.9	1.2	1.2
Unemployment rate (%)	14.4	14.4	14.0	13.9	13.3	13.3	12.5	11.8
Labour productivity (% change)	5.5	5.4	2.9	3.1	3.5	3.9	3.5	3.6
HICP inflation (%)	0.7	0.7	3.6	3.4	2.9	3.0	3.6	3.7
GDP deflator (% change)	0.5	0.5	1.6	2.8	2.4	2.4	2.8	2.9
Comp. of employees (per head, % change)	2.7	2.6	3.9	3.7	5.1	5.8	6.0	6.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-0.6	-2.1	-0.7	-0.7	-0.2	-0.1	0.9	1.1
<p><u>Note:</u>  <sup>1</sup>In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.</p> <p><u>Source :</u>  <i>Commission services' spring 2011 forecasts (COM); Stability programme (SP).</i></p>								

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2010	2011		2012		2013	2014	Change: 2010-2014
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b> <sup>4</sup>	<b>33.1</b>	<b>33.6</b>	<b>32.9</b>	<b>32.9</b>	<b>31.5</b>	<b>31.0</b>	<b>30.3</b>	<b>-2.8</b>
<i>of which:</i>								
- Taxes on production and imports	10.1	11.0	10.7	10.9	10.0	9.8	9.6	-0.5
- Current taxes on income, wealth, etc.	5.4	5.5	5.8	5.4	6.2	6.2	6.2	0.8
- Social contributions	12.5	12.7	11.9	12.6	11.7	11.6	11.4	-1.1
- Other (residual)	5.0	4.5	4.5	4.1	3.6	3.4	3.0	-2.0
<b>Expenditure</b> <sup>4</sup>	<b>41.0</b>	<b>38.8</b>	<b>37.9</b>	<b>37.4</b>	<b>35.6</b>	<b>34.7</b>	<b>33.3</b>	<b>-7.7</b>
<i>of which:</i>								
- Primary expenditure	39.7	37.2	36.1	35.8	33.8	32.5	31.1	-8.6
<i>of which:</i>								
Compensation of employees	7.9	7.1	6.6	6.8	6.4	6.3	6.1	-1.8
Intermediate consumption	5.0	4.5	4.3	4.4	4.2	4.0	3.9	-1.1
Social payments	19.0	18.6	18.1	18.2	17.6	17.0	16.3	-2.7
Subsidies	1.4	1.0	1.0	0.9	1.0	1.0	0.9	-0.4
Gross fixed capital formation	2.6	1.8	1.8	1.6	1.4	1.3	1.3	-1.3
Other (residual)	3.9	4.2	4.2	3.9	3.2	2.9	2.6	-1.3
- Interest expenditure	1.3	1.6	1.8	1.7	1.8	2.2	2.2	0.9
<b>General government balance (GGB)</b>	<b>-7.9</b>	<b>-5.1</b>	<b>-4.9</b>	<b>-4.6</b>	<b>-3.8</b>	<b>-2.9</b>	<b>-2.8</b>	<b>5.1</b>
<b>Primary balance</b>	<b>-6.6</b>	<b>-3.6</b>	<b>-3.1</b>	<b>-2.9</b>	<b>-2.0</b>	<b>-0.7</b>	<b>-0.6</b>	<b>6.0</b>
One-off and other temporary measures	-0.2	0.1	0.1	0.1	0.2	0.1	0.0	0.2
<b>GGB excl. one-offs</b>	<b>-7.7</b>	<b>-5.2</b>	<b>-5.0</b>	<b>-4.7</b>	<b>-4.0</b>	<b>-3.0</b>	<b>-2.8</b>	<b>4.9</b>
Output gap <sup>2</sup>	-1.6	-1.2	-2.2	0.2	-1.1	0.0	1.2	2.7
Cyclically-adjusted balance <sup>2</sup>	-7.4	-4.8	-4.3	-4.6	-3.5	-2.9	-3.1	4.3
<b>Structural balance</b> <sup>3</sup>	<b>-7.3</b>	<b>-4.8</b>	<b>-4.4</b>	<b>-4.8</b>	<b>-3.6</b>	<b>-3.0</b>	<b>-3.1</b>	<b>4.1</b>
<i>Change in structural balance</i>		2.4	2.9	0.1	0.7	0.7	-0.2	
Structural primary balance <sup>3</sup>	-5.9	-3.3	-2.6	-3.1	-1.8	-0.8	-0.9	5.0
<i>Change in structural primary balance</i>		2.7	3.3	0.2	0.8	1.0	-0.2	
<b>Notes:</b>								
<sup>1</sup> On a no-policy-change basis.								
<sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
<sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
<sup>4</sup> Revenue and expenditure figures are based on a scenario from the General Government Budget Framework for 2012-2014, which assumes three expenditure-reducing measures (i.e. a freeze of the public wage bill and two measures focused on goods and services savings) for 2012-14. These measures, however, do not ensure achievement of the general government balance targets.								
<b>Source :</b>								
<i>Stability programme (SP); Commission services' spring 2011 forecasts (COM); Commission services' calculations</i>								

**Table IV. Debt dynamics**

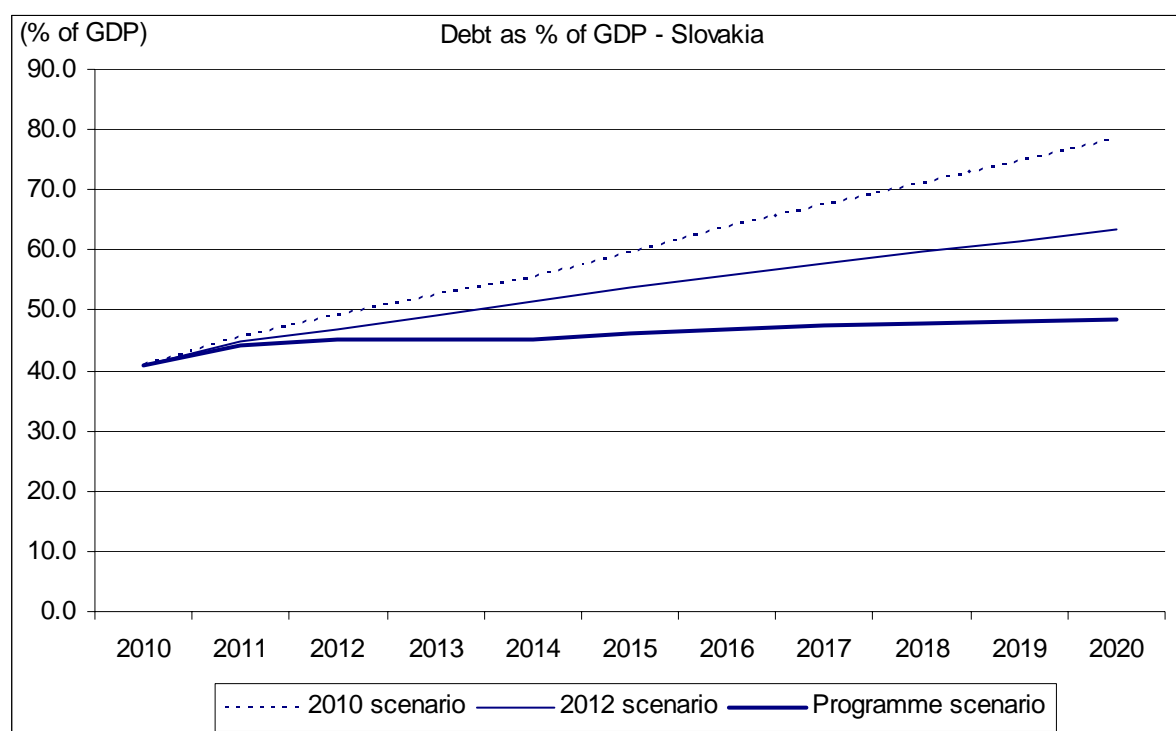
(% of GDP)	average 2005-09	2010	2011		2012		2013	2014
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>31.5</b>	<b>41.0</b>	<b>44.8</b>	<b>44.1</b>	<b>46.8</b>	<b>45.3</b>	<b>45.3</b>	<b>45.2</b>
Change in the ratio	-1.2	5.5	3.9	3.2	2.0	1.1	0.0	0.0
<i>Contributions<sup>2</sup> :</i>								
<b>1. Primary balance</b>	<b>2.1</b>	<b>6.6</b>	<b>3.6</b>	<b>3.1</b>	<b>2.9</b>	<b>2.0</b>	<b>0.7</b>	<b>0.6</b>
<b>2. “Snow-ball” effect</b>	<b>-0.7</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.6</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-1.0</b>
<i>Of which:</i>								
Interest expenditure	1.4	1.3	1.6	1.8	1.7	1.8	2.2	2.2
Growth effect	-1.6	-1.4	-1.4	-1.3	-1.9	-2.0	-2.0	-2.0
Inflation effect	-0.5	-0.2	-0.6	-1.1	-1.0	-1.0	-1.2	-1.2
<b>3. Stock-flow adjustment</b>	<b>-2.6</b>	<b>-0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.5</b>
<i>Of which:</i>								
Cash/accruals diff.	-0.3	-0.3		0.1		0.1	-0.2	0.0
Acc. financial assets	-2.0	-0.6		0.6		0.2	0.6	0.5
<i>Privatisation</i>	-0.4	0.0						
Val. effect & residual	-0.4	0.0		0.0		0.0	0.0	0.0
<p><u>Notes:</u></p> <p><sup>1</sup>End of period.</p> <p><sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other</p> <p><u>Source :</u></p> <p><i>Stability programme (SP); Commission services’ spring 2011 forecasts (COM); Commission services’ calculations</i></p>								

**Table V. Long-term sustainability indicators**

Slovakia	Baseline scenario (2010)			Programme scenario		
	S1	S2		S1	S2	
Value	9.0	10.4		4.1	5.6	
<i>of which:</i>						
Initial budgetary position (IBP)	6.8	6.9		2.0	2.1	
Debt requirement in 2060 (DR)	-0.1	-		-0.2	-	
Long-term change in the primary balance (LTC)	2.3	3.5		2.3	3.5	
	2010	2015	2020	2010	2015	2020
Debt as % of GDP	41.0	59.6	78.5	41.0	46.2	48.5

*Note:* The 'baseline' scenario (2010) depicts the sustainability gap under the assumption that the 2010 budgetary position remains unchanged over the medium-term (until the end of the period covered by the programme). The 'programme' scenario depicts the sustainability gap under the assumption that the budgetary plans of the programme are fully implemented.

**Figure. Medium-term debt projection**



**Table VI. Financial sector indicators**

	2006	2007	2008	2009	2010
Total assets of the banking sector (% of GDP)	109.8	98.5	93.7	88.7	87.2
Share of assets of the five largest banks (% of total assets)	66.9	68.2	71.6	72.1	...
Foreign ownership of banking system (% of total assets)	78.3	83.1	92.8	96.1	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	3.2	2.5	2.5	5.3	5.8
- capital adequacy ratio (%) <sup>2)</sup>	13.0	12.8	11.1	12.6	12.7
- profitability - return on equity (%) <sup>3)</sup>	16.6	16.6	16.3	7.6	11.9
Private credit growth (annual % change)	...	22.5	23.0	6.2	2.1
Residential property prices (y-o-y % change)	16.8	23.9	22.1	-11.1	-3.9
Exposure to countries receiving/repaying official financial assistance (% of GDP) <sup>4)</sup>	...	...	...	...	...
Private debt (% of GDP)	47.8	47.7	47.2	48.7	48.9
Gross external debt (% of GDP)					
- Public	13.1	11.7	11.9	12.0	14.8
- Private	29.2	25.9	27.7	26.4	27.4
Long term interest rates spread versus Bund (basis points)*	64.9	27.4	73.9	148.3	112.8
Credit default swap spreads for sovereign securities (5-year)*	...	...	145.5	106.9	77.8

Notes:

<sup>1)</sup> Break in series in 2006.

<sup>2)</sup> The capital adequacy ratio is defined as total capital divided by risk weighted assets.

<sup>3)</sup> Net income to equity ratio. Excludes foreign branches.

<sup>4)</sup> Covered countries are IE, EL, PT, RO, LV and HU.

\* Measured in basis points.

**Source :**

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission services (long-term interest rates), World Bank (gross external debt), Eurostat (residential property prices) and ECB (all other indicators).

**Table VII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Employment rate (% of population aged 20 - 64)	64.5	66.0	67.2	68.8	66.4	64.6
Employment growth (% change from previous year)	1.6	2.1	2.1	2.9	-2.5	-1.4
Employment rate of women (% of female population aged 20 - 64)	56.7	57.5	58.7	60.3	58.2	57.4
Employment rate of men (% of male population aged 20 - 64)	72.5	74.6	76.0	77.4	74.6	71.9
Employment rate of older workers (% of population aged 55 - 64)	30.3	33.1	35.6	39.2	39.5	40.5
Part-time employment (% of total employment)	2.5	2.8	2.6	2.7	3.6	3.9
Fixed term employment (% of employees with a fixed term contract)	5.0	5.1	5.1	4.7	4.4	5.8
Unemployment rate <sup>1</sup> (% of labour force)	16.3	13.4	11.1	9.5	12.0	14.4
Long-term unemployment <sup>2</sup> (% of labour force)	11.7	10.2	8.3	6.6	6.5	9.2
Youth unemployment rate (% of youth labour force aged 15-24)	30.1	26.6	20.3	19.0	27.3	33.6
Youth NEET <sup>3</sup> rate (% of population aged 15-24)	15.8	14.4	12.5	11.1	12.5	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	6.3	6.6	6.5	6.0	4.9	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	14.3	14.4	14.8	15.8	17.6	:
Labour productivity per person employed (annual % change)	5.0	6.3	8.3	2.8	-2.3	5.5
Hours worked per person employed (annual % change)	1.8	-0.7	2.0	-0.9	-4.2	3.2
Labour productivity per hour worked (annual % change; constant prices)	3.1	7.1	6.1	3.7	1.9	2.2
Compensation per employee (annual % change; constant prices)	6.8	4.8	7.2	3.9	6.3	2.2
Nominal unit labour cost growth (annual % change)	4.2	1.5	0.2	4.0	7.5	-2.7
Real unit labour cost growth (annual % change)	1.8	-1.4	-0.9	1.1	8.8	-3.1

Notes:

<sup>1</sup> According to ILO definition, age group 15-74)

<sup>2</sup> Share of persons in the labour force who have been unemployed for at least 12 months.

<sup>3</sup> NEET are persons that are neither in employment nor in any education or training.

Sources:

Commission services (EU Labour Force Survey and European National Accounts)

**Table VII. Labour market and social indicators –continued**

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Sickness/Health care	4.98	4.76	4.75	4.74	5.05
Invalidity	1.31	1.31	1.34	1.31	1.40
Old age and survivors	7.02	7.09	6.91	6.75	6.59
Family/Children	1.73	1.67	1.65	1.55	1.47
Unemployment	1.03	0.55	0.53	0.56	0.62
Housing and Social exclusion n.e.c.	0.54	0.52	0.56	0.50	0.37
<b>Total</b>	<b>16.6</b>	<b>15.9</b>	<b>15.7</b>	<b>15.4</b>	<b>15.5</b>
of which: Means tested benefits	0.84	0.87	0.98	0.91	0.72
<b>Social inclusion indicators</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Risk-of-poverty or exclusion <sup>1</sup> (% of total population)	32.0	26.7	21.3	20.6	19.6
Risk-of-poverty or exclusion of children (% of people aged 0-17)	35.0	30.4	25.8	24.3	23.7
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	29.0	25.6	22.0	21.9	19.7
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	13.3	11.6	10.5	10.9	11.0
Value of relative poverty threshold (single HH per year) - in PPS	2388	2772	3360	4056	4716
Severe Material Deprivation <sup>3</sup> (% of total population)	22.1	18.2	13.7	11.8	11.1
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59 not student)	6.6	6.2	6.4	5.2	5.6
In-work at-risk-of poverty rate (% of persons employed)	9.0	6.3	4.9	5.8	5.2
<b>Notes:</b>					
<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).					
<sup>2</sup> At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.					
<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone					
<sup>4</sup> People living in households with very low work intensity: Share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.					
<b>Sources:</b>					
For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.					



**Table VIII. Product market performance and policy indicators**

<b>Performance indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	4.0	7.9	8.4	3.5	-2.1	5.9
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	12.8	14.5	14.5	5.6	-12.9	6.3
Labour productivity <sup>1</sup> in electricity, gas, water (annual growth in %)	4.7	44.5	-12.3	-2.7	-1.0	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	-0.2	14.4	6.6	10.6	-9.5	2.0
Patent intensity in manufacturing <sup>2</sup> (patents of the EPO divided by gross value added of the sector)	0.5	0.5	0.2	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2001-2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Enforcing contracts <sup>3</sup> (days)	n.a.	565	565	565	565	565
Time to start a business <sup>3</sup> (days)	n.a.	25	25	16	16	16
R&D expenditure (% of GDP)	0.6	0.5	0.5	0.5	0.5	n.a.
Tertiary educational attainment (% of 30-34 years old population)	12.0	14.4	14.8	15.8	17.6	n.a.
Total public expenditure on education (% of GDP)	4.1	3.8	3.6	3.6	n.a.	n.a.
	<b>2003</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	1.8	n.a.	n.a.	1.6	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	1.5	n.a.	n.a.	0.8	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>6</sup> (Index; 0=not regulated; 6=most regulated)	2.8	2.3	2.2	2.0*	n.a.	n.a.
<b>Notes:</b>						
<sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
<sup>2</sup> Patent data refer to applications designated to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
<sup>3</sup> The methodologies, including the assumptions, of this indicator is presented in detail at the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a> .						
<sup>4</sup> The methodologies of the Product market regulation indicators are presented in detail at the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html</a> . The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.						
<sup>6</sup> Aggregate ETCR.						
*figure for 2007.						
<b>Source :</b>						
Commission services, World Bank Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						