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BETTER POLICIES FOR BETTER LIVES

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

The economic situation and policies of the Slovak Republic were reviewed by the Committee on 22 October 2012. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 13 November 2012.

The Secretariat's draft report was prepared for the Committee by Caroline Klein under the supervision of Andreas Wörgötter. Statistical assistance was provided by Béatrice Guérard. The Survey also benefitted from consultancy work by Robert Price, Gabriel Machlica, Štefan Kišš, Matej Šiškovič and Jarko Fidrmuc.

The previous Survey *of the Slovak Republic was issued in November 2010.*

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BASIC STATISTICS OF SLOVAK REPUBLIC, 2011

The OECD average is reported in parentheses

LAND, PEOPLE AND ELECTORAL CYCLE

Population (1 000 000):	5.4		Population density per km²	110.2	(34.3)
Under 15 (%)	14.7	(18.4)	Life expectancy (years, 2010):	75.2	(79.7)
Over 65 (%)	13.0	(14.9)	Males	71.6	(76.9)
Foreign-born (%)	n.a.		Females	78.8	(82.5)
Latest 5-year average growth (%)	0.0	(0.5)	Last general election:	March 2012	

ECONOMY

GDP, current prices (billion USD)	96.1		Value added shares (%):		
GDP, current prices (billion, local currency)	69.1		Primary	3.2	
Latest 5-year average real growth (%)	3.7	(0.8)	Industry incl. construction	41.9	
GDP per capita, PPP (thousand USD)	24.2	(35.4)	Services	54.9	

GENERAL GOVERNMENT, 2010

Expenditure (% of GDP)	40.0	(44.9)	Gross financial debt (% of GDP)	47.1	(99.1)
Revenue (% of GDP)	32.4	(36.8)	Net financial debt (% of GDP)	27.0	(60.2)

EXTERNAL ACCOUNTS

Exchange rate (EUR per USD)	0.7		Main exports (% of total merchandise exports):		
PPP exchange rate (USA = 1)	0.5		Machinery and transport equipment	53.2	
Exports of goods and services (% of GDP)	89.1		Manufactured goods	18.6	
Imports of goods and services (% of GDP)	86.5		Miscellaneous manufactured articles	9.8	
Current account balance (% of GDP)	0.1	(-0.6)	Main imports (% of total merchandise imports):		
Net international investment position			Machinery and transport equipment	39.9	
(% of GDP, 2010)	-67.2		Manufactured goods	15.5	
			Mineral fuels, lubricants and related materials	14.7	

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate (%) for 15-64 year olds:	59.5	(64.8)	Unemployment rate (%):	13.5	(7.9)
Males	66.3	(73)	Youth (%)	33.2	(16.2)
Females	52.7	(56.8)	Long-term unemployed (%)	8.6	(2.6)
Average worked hours per year	1 793	(1 776)	Tertiary educational attainment		
Gross domestic expenditure on R&D (% of GDP)	0.5	(2.4)	25-64 year-olds (%, 2010)	17.3	(30.7)

ENVIRONMENT

Total primary energy supply per capita (toe):	3.1	(4.3)	CO_2 emissions from fuel combustion		
Renewables (%)	7.5	(8.2)	Per capita (tonnes, 2009)	6.1	(9.8)
Fine particulate matter concentration			Water abstractions per capita (dam^3, 2009)	0.1	
(urban, PM10, $\mu g/m^3$, 2008)	13.1	(22)	Municipal waste per capita (tonnes, 2010)	0.3	

SOCIETY

Income inequality (Gini coefficient, %)	25.7	(31.4)	Education outcomes (PISA score, 2009)		
Relative poverty rate	11.6	(17.7)	Reading	477	(493)
Public and private spending (% of GDP):			Mathematics	497	(496)
Health care (2009)	9.1		Science	490	(501)
Pensions (2007)	8.4		Share of women in parliament (%, July 2012)	17.3	(24.4)
Education (2008)	2.6	(3.7)	Net official development assistance (% of GNI)	0.1	(0.4)

Better Life Index: www.oecdbetterlifeindex.org

Executive summary

The Slovak economy recovered very strongly after the global financial and economic crisis and will remain among the strongest in the OECD. However, job creation is disappointing, domestic demand remains subdued and the external drivers of growth risk fading away. The fiscal room gained in the run-up to euro accession quickly evaporated during the crisis, and public debt has increased considerably since 2008. The main priorities now are to restore public finances while fostering domestic drivers of growth and ensuring the funding of items to promote growth, such as education and active labour market policies. The government has put together a credible consolidation programme for debt stabilisation, but long-term fiscal sustainability issues remain unresolved. This Economic Survey *makes recommendations on how to improve the fiscal framework, raise labour market performance, and strengthen outcomes of the education system.*

The fiscal framework has a pro-cyclical bias and does not facilitate prioritisation according to the outcomes of the government programmes. The government should introduce spending ceilings as planned and adhere to them. It should strengthen monitoring and evaluation of spending programmes, for which the recently established Fiscal Responsibility Board can play a useful role. The structure of taxation should be made less harmful to growth, notably by raising property and environmental taxes and lowering taxes on low wages. The efficiency of the tax system should also be improved by combating tax evasion further and unifying the tax collection as planned. Finally, monitoring the sustainability and adequacy of old age income replacement is crucial.

Educational outcomes are below the OECD average and the education system should be made more inclusive. Efficiency could be improved by using already available school evaluations to raise the quality of teaching. More resources should also be allocated to teacher remuneration and to support of disadvantaged pupils, in particular for the development of pre-school education and the integration of Roma children in the mainstream education system. Transition from school to work of vocational education graduates is weak. Co-operation with employers needs to be enhanced and the acquisition of professional experience during studies should be fostered by developing work-based vocational training.

The crisis raised unemployment, which has increased by 4 percentage points since 2008. Long-term unemployment and regional disparities are high by international standards. The labour market experience of youth, the low skilled and the Roma population is particularly poor. More emphasis should be placed on activation and other active labour market policies, which are currently insufficiently developed. The public employment service needs to be reformed to better implement activation measures, with more resources allocated to the placement services and to the evaluation of programmes. The registration of social benefit recipients with some ability to work should be made mandatory to encourage job search activities and encourage them to enrol in active labour market measures.

Key policy recommendations

Improving the fiscal framework

- Further strengthen the medium-term spending framework by introducing spending ceilings as planned, and adhere to them.
- Increase the scope for monitoring and evaluation of spending programmes. Widen the use of performance elements in financing, contract renewals and compensation.
- Continue efforts to improve tax collection by implementing the transition towards an integrated tax collection system. Further combat tax evasion by strengthening monitoring activities.
- Reform the structure of taxation to make it less harmful to growth, notably by increasing real estate and environmental taxes and lowering labour taxes paid by employers at lower wage levels to encourage greater labour demand.

Raising educational outcomes in a cost-efficient way

- Remove premiums to eight-year grammar schools as planned and strengthen incentives for the integration of pupils with special needs in the standard system.
- Improve the use of available evaluations to identify dysfunctional schools as well as best practices.
- Increase the wages of teachers together with structural measures increasing the efficiency of the system such as consolidating the network of schools, increasing the classroom size and widening the scope for performance-related pay.
- Raise support to disadvantaged pupils. Further encourage participation of children from low-income families and Roma in pre-primary education and the integration of Roma in mainstream education.
- Foster acquisition of professional experience during studies and work-based vocational education and training by creating a legal framework for a dual apprenticeship system.

Increasing employment through activation and better targeted support

- Encourage job search activities and participation in Active Labour Market Policy (ALMP) by all benefit recipients with some ability to work by making their registration in placement services mandatory. Better target the measures to those who may not gain a lot from taking up a job.
- Increase spending on those ALMP whose effectiveness has been demonstrated. Implement the planned data collection and systematic evaluations. Consider testing new programmes with pilot projects before implementation at the national level.
- Allocate more resources to placement services in Public Employment Service (PES). Reorganise PES by creating one-stop shops. Establish an effective online collection of job offers.

Assessment and recommendations

The economy has been resilient

Slovakia has recovered strongly from a deep recession and at a more rapid pace than most other OECD countries. This performance testifies to the ability of the economy, which is highly dependent on exports, to increase productivity growth and achieve wage moderation, thereby regaining international competitiveness. However, GDP growth has remained significantly lower than in the past and underlying imbalances, such as regional labour market disparities, fiscal gaps, and dependence on foreign investors, have become more visible (Figure 1). As in most OECD countries, the 2008-09 crisis and its aftermath generated significant fiscal consolidation needs and debt has increased sharply. Restoring competitiveness supported vital exports. However, weak domestic demand was a drag on economic activity as labour market remains under stress and significant consolidation measures were implemented.

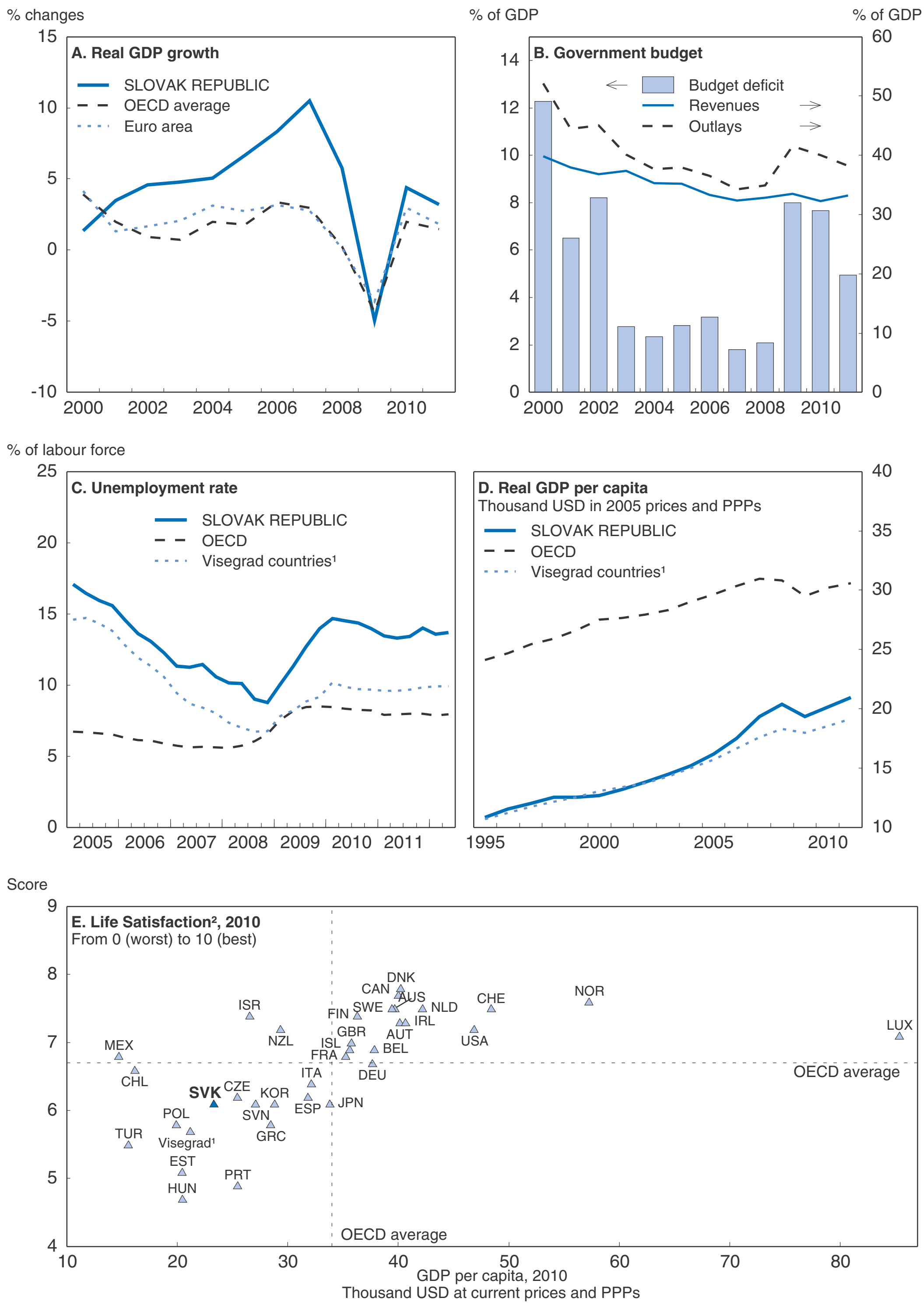
The economy is projected to slow in the wake of the euro crisis and the fiscal consolidation to come. Fewer and smaller new FDI projects are expected while investment in existing foreign-owned companies is likely to be geared towards productivity increases. Weak job creation has reduced the outflow from unemployment, which reached OECD highs and is not set to decline in the absence of policy action, further feeding back into weak domestic demand and job creation.

The convergence in GDP per capita relative to the upper half of OECD countries has resumed, but at a slower pace than in the past, not least due to increased unemployment and inactivity. Although Slovakia scores relatively well on aggregate life satisfaction, it ranks below the OECD average on several measures of well-being (including life expectancy and housing conditions) and economic wealth (Figure 1). The priority for policy makers in the fragile international environment is to ensure fiscal sustainability in a growth friendly way, respecting a number of constraints and tradeoffs.

Improving labour market outcomes are a key to successful fiscal consolidation. Reducing unemployment and turning benefit recipients into active members of the labour force is creating the potential for a multiple dividend increasing potential growth, raising revenues from taxes and social security contributions while relieving the budget from social benefits and reducing income inequalities. Reforms should be broad based and include measures on the supply and demand side, as well as addressing matching efficiency. In particular, endowing job seekers with employable skills will require substantial reforms to the education system as well as in activation policies. It is also important to diversify the sources of growth to stimulate job creation.

Efficiency gains in the public sector will contribute to the fiscal consolidation effort. Multi-year expenditures ceilings combined with outcome-oriented budgeting procedures

Figure 1. **Key macroeconomic indicators**



1. Refers to Czech Republic, Hungary, Poland and Slovak Republic.
2. Life satisfaction is measured by asking people the rate how they value their life in terms of the best possible life (10) through to the worst possible life (0). The score for each country is calculated as the mean value of responses.

Source: OECD *Economic Outlook Database* and OECD (2011), *How's Life? Measuring Well-being*.

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at the central and local level would help to define priorities for public expenditures. Simplifying tax collection and improving the absorption of EU funds would help to both correct fiscal imbalances and spur growth.

Spending cuts and revenue increases will also be required to address fiscal consolidation needs. On the spending side, the room for expenditure cuts is limited and they should continue to be avoided in priority areas such as education and active labour market policy measures which are currently underfinanced. On the revenue side, tax increases should focus on the less distortive taxes, such as property, consumption and environmental taxes. In the longer term, reforms to pension and the healthcare systems are needed to address future increases in spending related to the ageing of the population and cost increasing health care innovations (OECD, 2006; Dormont *et al.*, 2006; Smith *et al.*, 2009).

The in-depth structural chapter on green growth of the *2010 Economic Survey of Slovakia* has documented the progress made and remaining challenges in this area. The Annex A1 on Progress in structural reform confirms the responsiveness of the Slovak government to implement measures facilitating a transition to greener growth. Nevertheless, despite the significant improvements over the past decade energy and greenhouse gas emissions intensities are still quite high by international standards. Further progress will rely on getting incentives right and providing the adequate price signals, encouraging the use of less emission and energy intensive activities.

With respect to more local environmental issues progress is more uneven. Most air quality standards are respected and air pollution has declined overall, although the prevalence of some pollutants has increased (*e.g.* NO_X from road transport), sometimes exceeding values for protection of human health (*e.g.* ground ozone concentration). Waste management is among the worst in the European Union. Waste processing relies heavily on landfills and incentives for recycling are lacking. The costs of cleaning up contaminated sites have been estimated at 1.8% of GDP (OECD, 2011b). Making the transition to greener growth, a more dynamic domestic source of economic activity, employment and wellbeing will require continuing with the implementation of a broad range of measures, including improving the efficiency of existing environmental policies but also promoting entrepreneurship and innovation. In this respect, recommendations detailed in the in-depth chapter on "green growth" in OECD (2010a) are still valid. In particular, more could be done to unleash eco innovation by better integrating the domestic knowledge base with investors.

The short-term outlook has weakened

While remaining one of the strongest in the euro area, the economy has slowed due to both external and internal factors, which reinforce each other. The weakening of the world economy has weighed on Slovakia's main growth drivers. In particular, the euro area debt crisis has reduced demand from its main trading partners and weakened investor confidence. While exports and investment continued to contribute positively to growth, supported by FDI inflows to existing enterprises, their contribution has weakened. Export and investment growth have normalised after one-off increases mainly due to the opening of new production lines in the automotive sector in 2011 and beginning of 2012. Domestic demand has remained weak reflecting the high unemployment rate and significant fiscal consolidation. Firms seem to have adjusted employment and remuneration to remain competitive. As a consequence, the recovery in the labour market has slowed, employment remains below pre-crisis levels, and real wage growth has come to a standstill. Precautionary saving increased on the back of deteriorated consumer confidence. The increase in the VAT rate as well as the wage cuts in the public sector and temporarily higher inflation also contributed to lowering household real disposable income. The brisk turnaround of real appreciation and terms-of-trade gains weighs on domestic demand and reinforces private and public deleveraging needs.

Growth is set to gradually pick-up in the coming years (Table 1). Exports will likely remain the main drivers of growth on the back of stronger world trade, although the outlook for Slovakia's main export markets (especially Germany) is uncertain. Export oriented companies are under pressure to improve competitiveness and invest in order to increase productivity rather than to create new jobs. It is likely that further efforts to restore competitiveness will be necessary. Thus, labour market outcomes are expected to improve only slowly, with the unemployment rate decreasing to 13% by 2014. Given the outlook for high unemployment and low wage increases inflation is set to decline close to 2.5% in 2013 and 2014. The new government is sticking to its plan of reducing the deficit to below 3% of GDP by 2013 and to 2.4% in 2014 from 4.6% in 2012. This will require a significant consolidation effort, which the government intends to achieve mainly by revenue increases, but also by a reduction of the size of the second pension pillar. As a consequence, domestic demand is set to resume only slowly.

Table 1. **Short-term projections**

Percentage changes, volume (2005 prices)

	2010	2011	2012	2013	2014
GDP at market prices	**4.4**	**3.2**	**2.6**	**2.0**	**3.4**
Private consumption	-0.7	-0.5	-0.1	0.8	1.4
Government consumption	1.0	-4.3	-0.6	0.2	0.7
Gross fixed capital formation	6.5	14.2	0.5	0.6	2.5
Final domestic demand	1.0	1.9	0.0	0.6	1.5
Stockbuilding[1]	2.5	-0.7	0.0	-0.1	0.0
Total domestic demand	3.8	1.1	0.0	0.5	1.5
Exports of goods and services	16.0	12.7	8.8	4.7	6.7
Imports of goods and services	14.9	10.1	6.3	3.7	4.9
Net exports[1]	0.7	2.0	2.3	1.0	1.9
Memorandum items					
GDP deflator	0.5	1.6	1.8	1.4	1.6
Harmonised index of consumer prices	0.7	4.1	3.7	2.5	2.4
Private consumption deflator	1.0	3.8	3.6	2.5	2.4
Unemployment rate	14.4	13.5	13.7	13.6	13.0
General government financial balance[2]	-7.7	-4.9	-4.6	-2.9	-2.4
General government gross debt[2]	45.9	48.0	57.0	59.7	60.9
General government debt, (Maastricht)[2]	41.0	43.3	52.2	54.9	56.2
Current account balance[2]	-3.7	-2.1	1.7	1.8	3.1

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. See *OECD Economic Outlook* Sources and Methods (*www.oecd.org/eco/sources-and-methods*.).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

Source: OECD Economic Outlook 92 Database.

These projections, which assume a gradual improvement of the international environment, in particular a smooth resolution of the euro area debt crisis, are surrounded by considerable uncertainty. Trade developments are the main risk for growth, as the Slovak economy relies mainly on external demand. At the same time, a positive current account reduces the dependence on external financial sources. Nevertheless, a repetition of the 2009 collapse of world trade would again have serious consequences for Slovakia, affecting both exports and also FDI inflows. The room for productivity increases and wage moderation to restore competitiveness will be crucial in determining future developments of investment (FDI in particular) and employment, the risk being a relocation of production to cheaper locations. However, a success of recent euro crisis resolution measures could lead to a more rapid recovery of investor sentiment and in this case Slovakia would again benefit as a location for foreign direct investment.

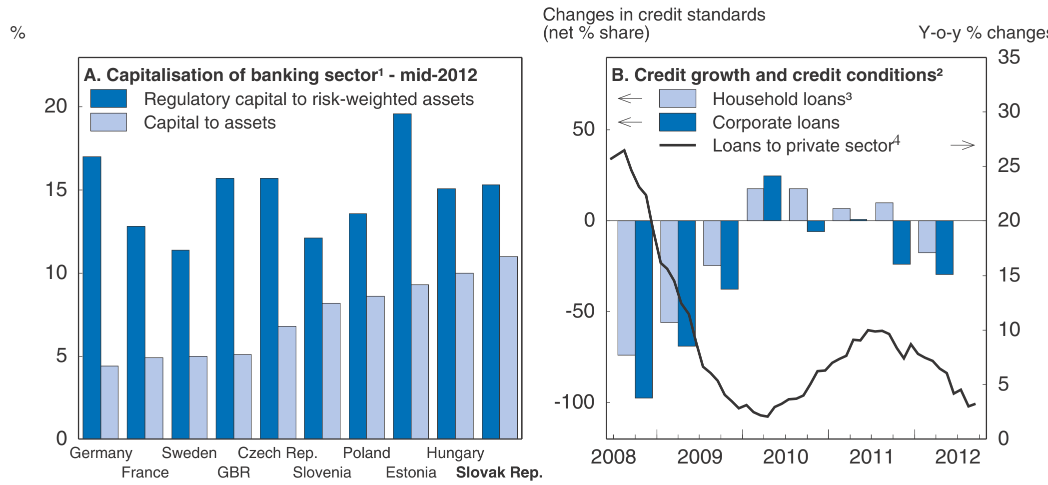
Domestic demand is another risk to the projection. A successful fiscal consolidation would strengthen confidence and thus stimulate domestic demand. The household saving ratio has been increasing to historical highs during the crisis and could be reduced if consumer confidence improves. A credible fiscal consolidation could also lower financing costs and reinsure investors. By contrast, the size of the fiscal multipliers may be higher than projected in particular if the economic environment deteriorates further. Overall, downside risks are predominant.

The euro debt crisis could also weaken the foreign-owned banking sector but the risks remain contained. Ownership is dominated by groups located in euro area countries with long-term strategic interests in the region. A deterioration of the euro area crisis could spillover by increasing spreads on Slovak government bond, which are mainly held by the Slovak banking sector. Also, it could significantly raise the share of non-performing loans and lead to liquidity withdrawal by parent banks (IMF, 2012). At the same time, with a loan to deposit ratio at around 90%, the banking sector does not rely on foreign funding. This should continue as long as the currently low demand for loans prevails. The banking sector appears to be well capitalised with a Tier 1 ratio at 14% in June 2012 (Figure 2). The share of non-performing loans in total loans is relatively low (5.4%) and falling. In addition, the National Bank has enacted regulatory measures on top of what is foreseen under the Basel III framework to enhance banking sector stability. This includes notably restrictions on dividend distribution depending on the level of core Tier 1 ratio to protect the capital buffer from being eroded by dividend payments. Cross border co-operation among supervisors has strengthened and credible medium to long-term business strategies of the respective mother banks make it likely that future capitalisation needs will be met in a way which reduces the risk of a credit crunch. However, as long as the euro crisis is not resolved, contagion risks will impose a premium on access to wholesale financing.

Medium and long-term economic prospects are uncertain

The Slovak Republic's main economic challenges are twofold. In the medium-run it is to maintain the productivity and competitiveness of its economy, particularly in relation to neighbouring economies where labour costs are lower. Before 2009, economic growth was driven by a strong inflow of FDI in export oriented manufacturing, in particular in automotive sectors and consumer electronics (flat screens). Since the crisis, the inflow of large, wage-cost sensitive and job-creating FDI projects has come to a standstill and price competitiveness has deteriorated somewhat (Figure 3, left panel). As a member of the euro area, the country has been fully exposed to the foreign trade shock without the possibility to adjust its nominal exchange rate, whereas neighbouring countries experienced depreciations. Competitiveness is now being sustained through reductions of wage costs (Figure 3, right panel). Weak growth and low wage increases are projected to lead to disinflation and to increase the real interest rate and borrowing costs. This may undermine

Figure 2. **Capitalisation of the banking sector and credit conditions**



1. Capital is balance sheet equity (paid-in capital plus reserves). For France as of mid-2011; for the United Kingdom as of end-2011; for Estonia and Sweden as of first quarter 2012.
2. The Eurosystem has developed a survey of bank lending in the Euro area to enhance the Eurosystem's knowledge of financing conditions. The survey addresses issues such as credit standards for approving loans as well as credit terms and conditions applied to enterprises and households. Data presented here show actual changes in bank credit standard in the given 6 months. They are expressed in net percentage share of banks that eased their credit standards calculated as the difference between the percentage market share of banks, which reported easing of their credit standards, and the percentage market share of banks, which reported tightening of their credit standards.
3. Unweighted average of net percentage shares on household loans for house purchase and household loans for consumer credit.
4. Covering both non-financial corporation loans and loans to household and non-profit institutions, in growth rates.

Source: IMF, *Financial Soundness Indicators Database*; European Central Bank, *Statistical Data Warehouse*; National Bank of Slovakia, "Survey on Supply and Demand on Lending Market".

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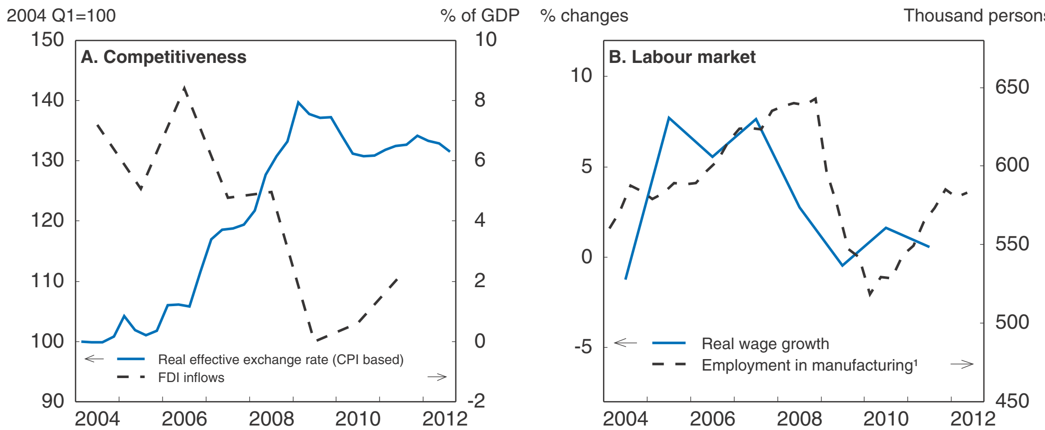
domestic investment and thus the desirable diversification of growth drivers. Slovakia's dependence on assembly (notably of cars and electronics) has advantages, but also poses risks from over specialisation. The challenge is therefore to develop dynamic domestic drivers of growth. This requires improving further business environment notably by removing remaining administrative barriers to entrepreneurship and eliminating corruption as recommended in the previous *Economic Survey* (OECD, 2010a).

In the longer run, population ageing will weigh on growth, increasing the benefits from activating parts of the working age population currently not participating in the labour market and tackling the unsatisfactory transition from school to work. The state of the knowledge economy remains rather backward and not well integrated with the economy, not only compared to the most advanced OECD countries. The levels of innovative firms and scientific publications are relatively low (OECD, 2012c). Improvements in the knowledge economy will be needed to converge towards best performing OECD countries, both in terms of growth and welfare, and to make the transition towards a greener economy. Currently the economy is specialised in energy-intensive production (OECD, 2010a). Adopting green technologies and building capacities for eco-innovation (*i.e.* the implementation of innovative products, processes, marketing methods, organisational structures which lead to environmental improvements) could facilitate the transition, but requires the right incentives and new skills. It could foster the development of new sectors and could create a new comparative advantage for Slovakia as argued in the green growth chapter of the last *Survey* (OECD, 2010a). For instance, innovations aiming at improving energy efficiency would

Figure 3. **Competitiveness and labour market developments**



1. Prior 2008, data were collected according to NACE Rev. 1.1. A correction coefficient is applied to be consistent with current NACE Rev. 2 data in manufacturing.

Source: *OECD Economic Outlook Database* and Statistical Office of the Slovak Republic.

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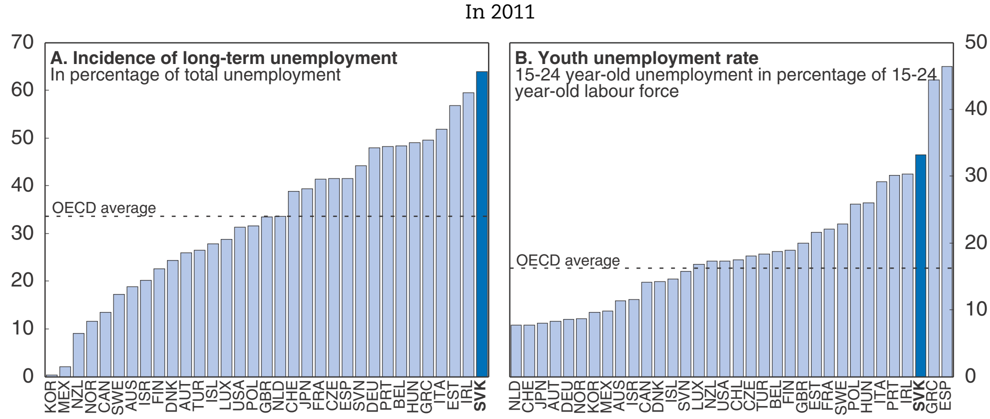
reduce the dependency on imported fossil fuels, the vulnerability of the economy to energy price shocks and the cost of climate change mitigation.

Labour market developments have been unfavourable

Employment has not yet returned to its pre-crisis level as firms attempt to restore competitiveness losses stemming from nominal appreciations before the crisis, as well as depreciations of currencies of neighbouring peers during the crisis. The unemployment rate rose significantly during the crisis and is now the fifth highest among OECD countries at 13.8%. Long-term and youth unemployment rates are particularly high by OECD standards (Figure 4). The incidence of long-term unemployment was twice the OECD average and the youth unemployment rate was the third highest in the OECD in 2011. The share of low educated workers in total unemployment amounts to around 60% and the skills mismatch has been aggravated. The Roma population is *de facto* excluded from the labour market with an unemployment rate above 70% (UNDP, 2012). Labour market

Figure 4. **Labour market outcomes**

In 2011



Source: OECD, *Labour Force Statistics Database.*

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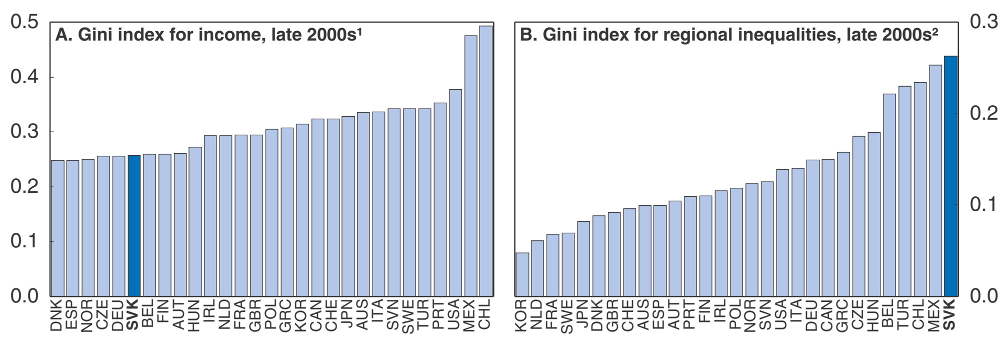
outcomes are set to remain poor, foreshadowing a further rise in structural unemployment, imposing a lower potential output and higher costs of fiscal consolidation.

Beyond the impact of unemployment on growth and wealth, poor labour market performance may also increase inequalities. While inequalities are low in Slovakia compared to the OECD average – the dispersion of wage and household income is among the lowest in the OECD – regional disparities are large because of a concentration of poor households in Eastern regions and high income earners in the Bratislava region (Figure 5). Following the recent increase in long-term unemployment in deprived regions and because of low labour mobility, hysteresis effects may deepen geographical inequalities by excluding a large share of the local population from the labour market. The rate of people at risk of poverty or exclusion – measured by Eurostat as the rate of people at risk of poverty, or severely materially deprived or living in a household with very low work intensity – fell by 11 percentage points from 32% in 2005 to 21% in 2010, because of past falls in unemployment. This trend may reverse with the deterioration of the labour market outcomes if the fading foreign drivers of job creation cannot be replaced and if labour market policies to activate the unemployed are not implemented more forcefully.

Figure 5. **Inequalities**



1. Gini index of inequality of household disposable income, after taxes and transfers. The values of the Gini coefficient range between 0, in the case of "perfect equality" and 1, in the case of "perfect inequality".
2. Gini index of inequality of GDP per capita across TL2 regions. As above, the values of the Gini coefficient range between 0, in the case of "perfect equality" and 1, in the case of "perfect inequality".

Source: *OECD Regional Outlook 2011* and OECD, *Income Distribution and Poverty Database.*

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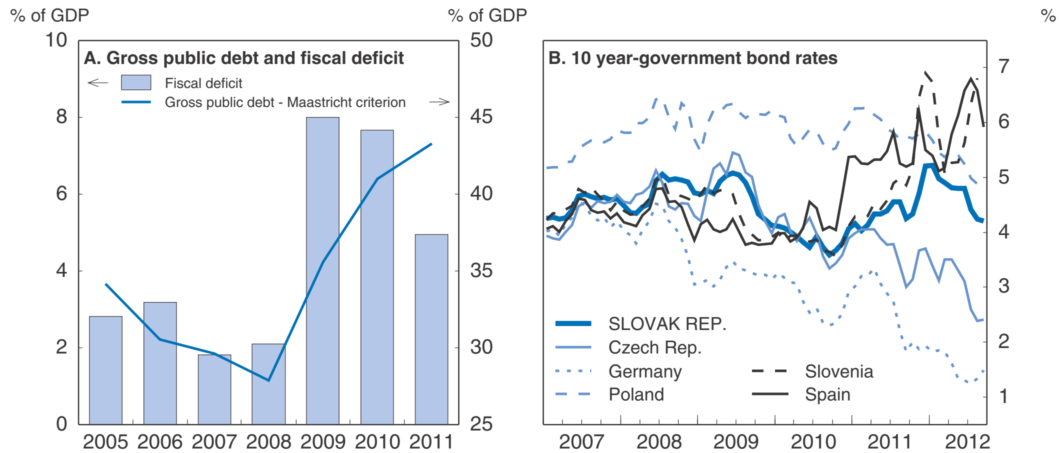
Consolidating public finances in a growth-friendly way

Fiscal consolidation is needed in view of the consequences of high budget deficits for the path of liabilities. The fiscal deficit and debt have increased sharply during the crisis (Figure 6, left panel, Table 2). While the budget balance improved significantly in 2011, in absence of further policy action, general government debt dynamics would continue to increase rapidly. According to recent OECD estimates, stabilising debt at 50% of GDP in 2050 would require improving the underlying primary balance by 3 to 5% of GDP, on top of the current consolidation efforts, from 2012 onwards depending on assumptions on the future increases in pension and healthcare spending. New challenges, such as higher unemployment and population ageing, add to inherited spending pressures, stemming from distorted incentives in favour of cost-increasing health care innovations. There is thus no alternative to continued fiscal consolidation, especially given the risks surrounding public borrowing costs. Moreover, the spread of Slovak government bonds over German reference bonds increased to more than 300 basis points by mid-2012 (from around 100 basis points at the beginning of 2011), the sixth highest absolute rise in the

Figure 6. **Fiscal deficit and 10-year government bond rates**



Source: *OECD Economic Outlook Database.*

StatLink http://dx.doi.org/10.1787/888932748422

Table 2. **Public finances**

		2005	2007	2008	2009	2010	2011
Government deficit	SVK	-2.8	-1.8	-2.1	-8.0	-7.7	-4.9
	OECD	-2.4	-1.3	-3.4	-8.2	-7.7	-6.5
	Euro area 15	-2.6	-0.7	-2.1	-6.3	-6.2	-4.1
Gross public debt	SVK	37.4	33.5	32.2	40.4	45.9	48.0
	OECD	77.9	74.2	80.7	92.2	98.7	102.9
	Euro area 15	78.2	71.9	77.1	87.8	93.1	95.2
Government total receipts	SVK	35.2	32.4	32.8	33.5	32.3	33.2
	OECD	36.9	37.8	37.6	36.4	36.3	36.7
	Euro area 15	44.8	45.3	45.1	44.9	44.8	45.4
Government total disbursements	SVK	38.0	34.2	34.9	41.5	40.0	38.2
	OECD	39.3	39.1	41.0	44.5	44.0	43.2
	Euro area 15	47.4	46.0	47.2	51.3	51.0	49.5
Net government interest payments	SVK	1.1	1.0	0.9	1.1	1.2	1.4
	OECD	1.7	1.6	1.6	1.5	1.6	1.8
	Euro area 15	2.7	2.6	2.6	2.5	2.5	2.6

Source: OECD, *Economic Outlook Database.*

euro area (Figure 6, right panel). In the meantime spreads have fallen again, but remain sensitive to changes in the assessment of the ability to meet fiscal targets.

Delaying consolidation for too long may have adverse effects on growth, in particular because of higher risks premiums (Padoan *et al.*, 2012). Financial markets have become more prone in abrupt changes in confidence. Under current circumstances the uncertainty is so high that a temporary cyclical worsening of fiscal accounts would be interpreted as a structural inability to control public debt. Therefore, fiscal consolidation plans to reach the below 3% of GDP deficit target in 2013 and comply with the EU requirements should be implemented. In addition, fiscal policies should be coupled with structural reforms which increase the growth potential of the economy. Effective prioritisation of government expenditure programmes in this respect will be important.

Improving the fiscal framework

Strengthening the medium-term budgetary framework

To limit the risks of slippage from the long-run adjustment path, the medium-term budgetary framework needs to be strengthened. In the past, structural deficit problems have arisen from a failure to reduce deficits enough during boom years, associated with a tendency to use supplementary budgets to spend short-term revenue windfalls. The government introduced new rules to strengthen fiscal discipline in 2011.

An upper limit of 60% of GDP has been set on general government debt until 2017, with graduated sanctions being phased in when the debt level exceeds 50% of GDP. Starting 2018, the debt bracket will be cut by 1 percentage point annually, until it reaches the final ceiling of 50% of GDP in 2028. In addition, in March 2012 Slovakia was among the 25 EU-signatories to the *Fiscal Compact*, which introduces stricter fiscal surveillance, notably by establishing a balanced structural budget rule that must be transposed into national legislation within one year after the ratification of the treaty. The national fiscal rules would then need to be made consistent with the EU fiscal discipline requirements. These requirements lead to a trend decline of government debt, while the Slovak rule at the moment foresees corrective action only if the debt level exceeds the threshold. In the long run, the structural balance rule will also be more binding than the debt ceiling. A way out could be to introduce spending ceilings consistent with reaching a structural balance in the medium term in national legislation.

A Fiscal Responsibility Board has been set up notably to monitor and evaluate compliance with fiscal rules. In particular, it will assess whether the short- and long-run sustainability criteria are being met and advice on the budget adjustment needed to achieve them if they are not. The creation of an independent body to monitor government policy is an important advance in the pursuit of budget transparency.

Improving budgeting procedures

Reforms of the budgeting procedures can facilitate consolidation and ensure long-term sustainability of public finances. It could help to prioritise public spending more effectively to maximise its growth enhancing potential. Main elements include the following items:

- An increasing focus on multi-year budget planning has been implemented, but targets for the out years have been indicative and subject to *ad hoc* change. More effective budget planning is thus needed to ensure that the consolidation process is successful. Expenditure ceilings should be introduced as planned.
- High-level budgetary allocations are made centrally and reflect political priorities, but budgets need to be implemented flexibly to ensure efficiency and service quality, based on results. More freedom should be given to ministries in using funds, for instance by enhancing some degree of end-of-year flexibility. This managerial flexibility should be conditioned to the further development of monitoring and accountability.
- Appropriate performance and results information should be included in the annual budget documentation. While Slovakia has clearly achieved a higher standard of fiscal reporting and transparency, there is room for further improvement. Slovakia ranks poorly in the "Open Budget Index 2010" regarding the provision of satisfactory information on public finances and stands behind the Czech Republic and Poland (International Budget Partnership, 2010). Also, budget allocation is not linked closely to

programme monitoring and evaluation, and administration capacities are too weak to ensure follow-up assessments. Finally, despite some progress, corruption remains an issue. The public administration needs to make better use of results-oriented budgeting, including improved *ex post* audit processes, enhanced transparency and greater public oversight. The government plans to appoint analysts in each Ministry to assess the efficiency of policies. While this is highly welcome, the use of performance elements in financing, contract renewals and compensation could also be widened.

Ensuring the sustainability of the pension system

With the rapid ageing of the population, reforming the public pension system will be necessary to ensure its long-term sustainability. By 2060, Slovakia will have had the steepest increase in the old-age dependency ratio of all EU member states and will rank second after Poland in its level. Under current policies, pension expenditures are projected to increase by 5.2% of GDP by 2060, compared with an average increase of 1.5% of GDP in the EU27 (European Commission, 2012). Recent reforms to delay retirement age and modify the indexation of pension, in line with recommendations from the last *Survey* (OECD, 2010a), are thus welcome. The retirement age will be gradually increased in line with gains in life expectancy and pension growth will be progressively linked to the inflation rate of a retiree consumption basket. These measures may nevertheless not be sufficient to ensure the sustainability of the first pillar in the face of likely future increases of life expectancy. Consideration should be given to adapting the replacement rate to the financing conditions, for instance by including a sustainability factor into the pension formula to ensure a cut-back of replacement rates as the old-age dependency ratio worsens as in place in several countries like Sweden, Germany or Austria and as recommended in the last *Survey* (OECD, 2010a). In doing so, care needs to be taken to avoid undermining old age poverty alleviation.

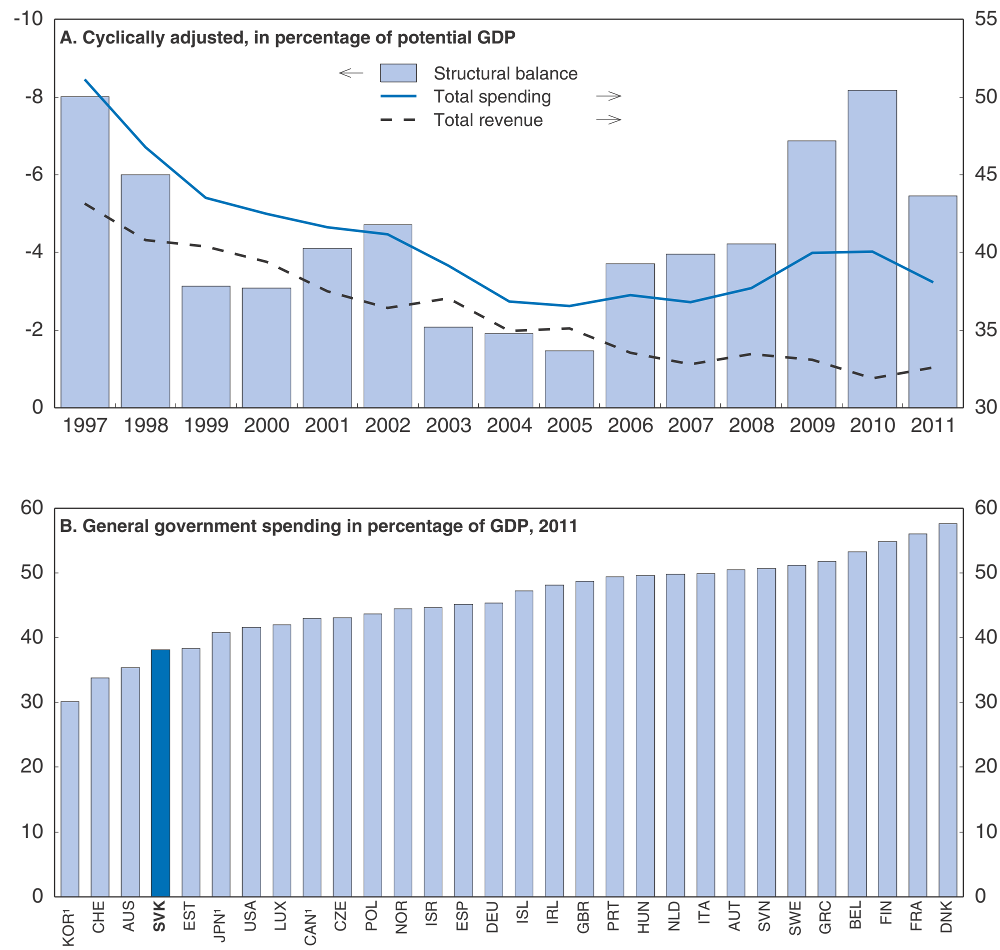
The redistributive effect of the current pension system is weak by OECD standards. Recent reforms make the pension system more progressive. The temporary increase in pensions by a fixed amount is aiming at increasing solidarity for existing pensions. Also, in line with recommendations from previous *Surveys* (OECD, 2009; 2010a), the link between earnings and subsequent pensions will be weakened for new pensioners directly in the pension formula. These reforms are welcome as they reduce the risk of poverty traps for pensioners who do not accumulate entitlements beyond the poverty level. The reforms will have to be accompanied by measures ensuring that it is always more advantageous to work than to stay inactive.

The contribution rate to the second pillar has been reduced from 9 to 4% as part of its consolidation strategy. The contribution rate will start to increase in 2017 by 0.25% each year until it reaches the target level of 6% in 2024. In the currently exceptional situation a temporary reduction of contributions to the second pillar may help to avoid otherwise necessary pro-cyclical fiscal consolidation measures. However, weakening the second pillar may undermine the sustainability of the pension system if it directly or indirectly increases future liabilities of the first pillar. Also, this reform may damage the old age security system in the long run. Second pillar pensions can make old-age income replacement systems more robust, because they widen sources from which incomes will be drawn (OECD, 2010a). This is crucial in Slovakia as the generosity of the fist pillar will be reduced by the reforms required to ensure its long-run sustainability. Evaluating the sustainability of the pension system as a whole, assessing the impact of recent reforms on the old age security system and determining the optimal size of the second pillar is urgently needed. Finally, Slovakia exhibits an extraordinary degree of system changes and reform reversals, inducing potentially large inefficiencies. One of the crucial design features of second pillar systems is the stability of the regulatory framework, without which any investment strategy can become overly short term and may suffer from restrictions on the ability to pursue profitable investment strategies. Frequent design changes in the pension system should be avoided.

Reducing the cost of consolidation

Given consolidation needs, corrections to both revenue and expenditure paths are parts of the consolidation strategy. Total receipts and spending per unit of GDP declined over the past decades, not least due to strong economic growth (Figure 7). Public spending is low by international comparison and the room to further reduce it is tight. Slovakia, as a catching-up economy with a low level of public spending, may need to increase investment in growth-enhancing areas. In addition, past consolidation measures included already significant expenditure cuts (55% of the consolidation effort). Nevertheless, potential efficiency gains in the public sector should be achieved. In this respect, increasing efficiency in the drawing of

Figure 7. **General government spending and revenue**



1. Refers to 2010.
Source: *OECD Economic Outlook 91 Database.*

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EU funds as well as in the healthcare sector would be particularly helpful. By contrast, a further decline in tax revenues is unlikely to be sustainable. Tax increases should focus on taxes which are less damaging for growth and for labour market outcomes in particular such as real estate, environmental or consumption taxes (OECD, 2010e). Tax expenditures should be removed in order to improve resource allocation.

Refining the planned consolidation measures

In 2013, reducing the deficit to below 3% of GDP will require a consolidation effort of around 3% of GDP. The preliminary budget for 2013-15 already included measures amounting to 0.7% GDP (*e.g.* the freeze of public wages and expenditure in goods, services and capital). The government has decided to save additional 3% of GDP: a reserve amounting to 0.7% of GDP will be created to finance a possible shortfall of revenues. In case of sufficient revenues this amount could be used for priority spending. The opportunity cost of these new expenditures may be high, requiring a high rate of return on investment financed by it. Thus, the effectiveness of the additional spending should be carefully assessed before being implemented.

After significant spending cuts in the previous consolidation package, the government's planned consolidation will mainly rely on tax increases (Table 3). The consolidation effort will be sizeable and will weigh on growth, but some refinements of the planned measures would limit potentially adverse effects.

- The contribution rate to the first pillar will be increased from 9 to 14% and the contribution rate to the second pillar reduced from 9 to 4%. This measure is likely to have no impact on domestic demand and will bring in around 1% of GDP for the budget.
- The partial harmonisation of taxation of self-employed and standard labour contracts is highly welcome. Self-employed workers currently benefit from a lower tax wedge, as their tax base for social security contributions is only half of the average monthly taxable income of the previous year. This encourages involuntary self-employment as firms may try to evade social security contributions by substituting regular employees with self-employed (OECD, 2010a).
- The formerly flat income tax will be made progressive. The tax rate will increase from 19% to 25% for a monthly income above EUR 3 311 in 2013. More importantly the maximum assessment base for social security contributions will be increased from one and half, three and four to five times the average wage. These measures will increase redistribution in the tax system from its currently relatively low level (Joumard *et al.*, 2012) and better split the consolidation effort among citizens according to their capacity to pay. However, for specific groups (in particular earning between 4 to 5 times the average wage), these measures will induce a large increase in marginal tax rate. It would be advisable to explore how this increase could be smoothed.
- The tax burden on business will be increased. The corporate income tax will be increased from 19 to 23% (which remains below the tax rate in most OECD countries). At the same time, the tax base of the bank levy introduced in 2012 will be broadened to household deposits and temporary extra taxes will be levied on profits in regulated sectors (energy, telecommunication, insurance, postal services) in 2013.

Alternative tax measures less harmful to growth exist. A new real estate tax based on the market value of property was considered but not included in the 2013 budget proposal. This measure in line with OECD recommendations (OECD, 2010a) should be implemented

Table 3. **Consolidation measures as planned in November 2012**

% of GDP

	2013	2014	2015
Expenditures	**1.2**	**1.4**	**1.9**
Cuts in wage bill and consumption of central government	0.4	0.6	0.7
Revenues	**2.4**	**1.9**	**1.9**
Direct taxes	0.9	1.0	1.0
Pension system (soc. sec. contrib. first pillar)	1.0	0.7	0.7
Bank levy	0.1	0.1	0.0
Levy on regulated sectors	0.1	0.0	0.0
Indirect taxes (tobacco, gambling, vehicles)	0.2	0.2	0.1
Reserves	**-0.7**	**-0.4**	**-0.5**
Total	**3.0**	**3.0**	**3.3**

Source: Ministry of Finance.

swiftly. Slovakia has fairly low tax receipts from property of around 1% of total tax revenues, a quarter of the OECD average (Table 4). Increasing property taxes to the OECD average would raise government revenues by 0.6% of GDP. It would also reduce a tax distortion. The current taxation of real estate is below the level of taxes on investment in financial assets and is not based on market values, thereby distorting the allocation of capital towards owner occupied housing and amplifying the volatility of house prices.

Table 4. **Composition of tax revenues**

% of total tax revenue, 2009

	Slovakia	OECD
Labour taxes	52	52
Personal income tax	8	25
Social security contributions	44	27
Taxes on goods and services	36	33
Corporate income tax	9	8
Taxes on property	1	5
Recurrent taxes on immovable property	1	3

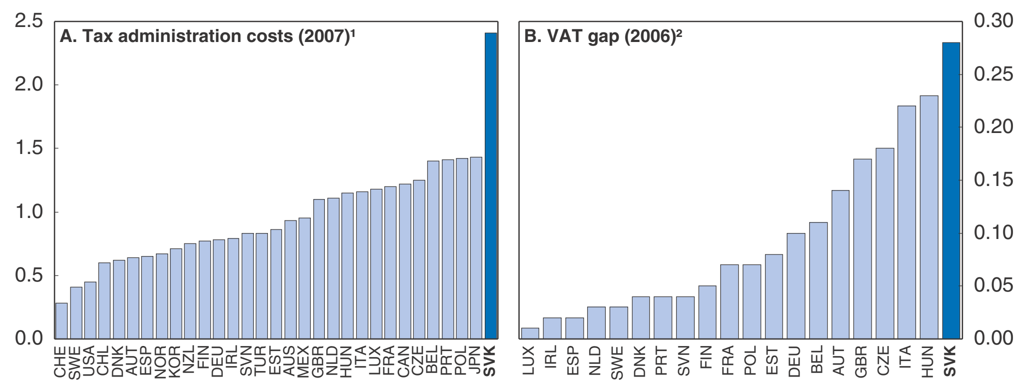
Note: Social security contributions include those paid by the self-employed and benefit recipients.
Source: OECD (2011d), *Revenue Statistics*.

The government should also consider developing the taxation of environmentally harmful activities, which could contribute to fiscal consolidation while supporting green growth. The introduction in 2013 of a car registration fee on personal cars is a step in the right direction. Reducing further exemptions and reduced tax rates on energy consumption would increase tax revenues by 0.1% of GDP, discourage wasteful consumption and encourage the adoption of energy-saving technologies and clean energy sources. The creation of a carbon tax in the sectors not covered by the EU-ETS would improve the pricing of negative externalities generated by CO_2 emissions and reduce the cost of climate change mitigation in Slovakia (OECD, 2010a). However, the redistributive impact of such measures should be carefully assessed and actions should be envisaged to compensate possible negative social effects.

Improving the collection of taxes

Efficiency gains in the tax system would contribute to improving the fiscal situation while stimulating productivity gains both in the public sector and in the private sector. Tax collection is particularly inefficient in Slovakia, suggesting that reforms of tax administration may lead to substantial benefits. The administrative cost of tax collection, which compares annual administration costs with the total revenue collected, is the highest in the OECD (Figure 8). Paying taxes is still more difficult in Slovakia than in most of other OECD countries (World Bank, 2011). The reasons for the poor performance of the tax system seem to lie in both low tax compliance and high collection costs. The planned transition towards an integrated tax collection system (UNITAS I and II projects, unifying the collection of taxes and social security contribution) is welcome as it could generate significant synergies, reducing administrative costs for both taxpayers and the administration and could facilitate the control of undeclared work, tax evasion and fraud through better crosschecking and auditing (Leibfritz, 2011). These reforms should be implemented swiftly and monitored.

Figure 8. **Efficiency of tax collection**



1. Ratio of aggregate tax administration costs per 100 units of net revenue collection.
2. The VAT gap is defined as the difference between the accrued VAT receipts and the theoretical receipts, as a share of the latter.

Source: OECD, *Government at a Glance 2011* and Reckon (2009), *Study to Quantify and Analyse the VAT Gap in the EU25 Member States.*

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While exemptions or reduced VAT rates are not widespread and the standard VAT tax rate is close to the European average, actual VAT revenues fall significantly short of what a standard rate would produce (as measured by the VAT gap, Figure 8). Decreasing the VAT gap to the EU average would raise extra revenues by more than 1% of GDP (OECD, 2010a). Combating tax evasion, which is likely to be an important reason for low VAT revenue collection efficiency, should represent an important part of the effort to make the system more efficient and monitoring activities should be strengthened. However, the scope for increasing VAT collection efficiency may be limited in certain regions because of cross border shopping. The reasons for a striking regional concentration of an excessive VAT gap (also significant in Austria and its neighbours) should be explored and countered with an EU-led cross-border task force.

Raising transparency and efficiency of public procurement

The Slovak Republic spends a larger share of total public spending on procurement than the EU average (29% *vs.* 22% on average in the EU27). Greater transparency in public procurement is important for cost reduction, not least because it would reduce the risk of fraud, corruption and mismanagement of public funds. Progress has been made in this direction. However, Slovakia does not publish the justification for contract awards and does not allow tracking of public procurement spending online. Furthermore, procurement rules tend to hamper contracting authorities from choosing the most economically advantageous tender because they restrict the choice in evaluation criteria and often forbid qualitative criteria on the grounds that they are discriminatory (OPKE, 2011). The Public Procurement Act should be amended to ensure that the tender achieving the best value for money, meaning the optimal combination of quality and cost, is selected.

In some areas current procurement rules are perceived to be too difficult to apply. Administrative barriers cause large time delays and undermine the provision of public services. As a consequence, efficiency gains from outsourcing cannot be reaped, or government services are provided in a less targeted form than necessary. Difficulties of this nature should be analysed and a task force implemented to provide recommendations on making procurement rules easier to apply, but without undermining the objectives of fighting corruption and increasing efficiency.

Increasing absorption of EU funds

Fully exploiting available sources of funding, notably EU funds, could help to cushion the expenditures cuts induced by fiscal consolidation. It is thus unfortunate that Slovakia is among the countries with the lowest rate of absorption of EU funds (KPMG, 2011). For the implementation period 2007-13, the available budget amounts to close to 3% of GDP per year, including co-financing from the state budget (around 10% of the total) but less than 25% of funds has been used by end 2011. One of the main reason behind the low absorption of EU funds is that the selection process of projects is burdensome and not transparent (OECD, 2010a). As a consequence, stakeholders have only limited access to these funding opportunities. A partnership between the European Commission and the Slovak authorities has been established to discuss and monitor the reasons behind the low absorption of EU funds. The system for EU funds' management should be reformed based on this analysis. In particular, the administrative hurdles to the submission of projects should be reduced.

Improving cost-efficiency in the healthcare sector

The healthcare sector is a key area for the fiscal consolidation strategy. Healthcare spending accounted for 16% of public expenditures in 2010 and rapid population ageing will add to spending pressures. Efficiency in the healthcare sector is low by international standards (OECD, 2010a). As a result, the adoption of "best practices" may yield large productivity increases. According to OECD estimates, Slovakia could achieve the same health outcomes with cost savings of around 2% of GDP in 2060 (Joumard *et al.*, 2010).

A number of measures to reduce such costs have been implemented recently, in line with OECD recommendations. Since 2011, the prescription of generics has been made mandatory for certain types of drugs. Health parameters have been introduced in the risk-equalisation formula for insurance companies. The decision to start implementing a system of diagnosis related groups (DRG) to standardise payments for healthcare procedures and reduce hospital costs is welcome. Further reforms should be considered, such as extending mandatory generic prescription.

The government has announced that it does not want to continue with the recommended transformation of hospitals into joint stock companies. It will therefore be important to search for other ways to improve incentives for cost-effective hospital management. Strengthening the capacity of the public administration to monitor, assess and evaluate health care spending programmes and institutions is therefore becoming even more important (see above).

Slovakia is using a multi-company model for health care insurance. The focus of policy in this case should be to increase competition between health-care providers as well as health insurers and also ensure transparency through better public information on costs and quality. In this regard, extending the collection of quality indicators is thus desirable (OECD, 2010a). Consideration is currently being given to merge and nationalise healthcare insurance providers. This option is acceptable *per se* as evidence tends to show that such a model is not sub-optimal compared to a multi-company model (Joumard *et al.*, 2010). However, as for the pension system, frequent changes should be avoided in the healthcare system unless they are supported by cost and benefits analysis.

Box 1. **Key recommendations for fiscal policy**

- Further strengthen the medium term spending framework by introducing spending ceilings as planned, and adhere to them.
- Increase the scope for monitoring and evaluation of spending programmes. Widen the use of performance elements in financing, contract renewals and compensation.
- Continue efforts to improve tax collection by implementing the transition towards an integrated tax collection system. Further combat tax evasion by strengthening monitoring activities.
- Reform the structure of taxation to make it less harmful to growth notably by increasing real estate and environmental taxes and lowering labour taxes paid by employers at lower wage levels to encourage greater labour demand.

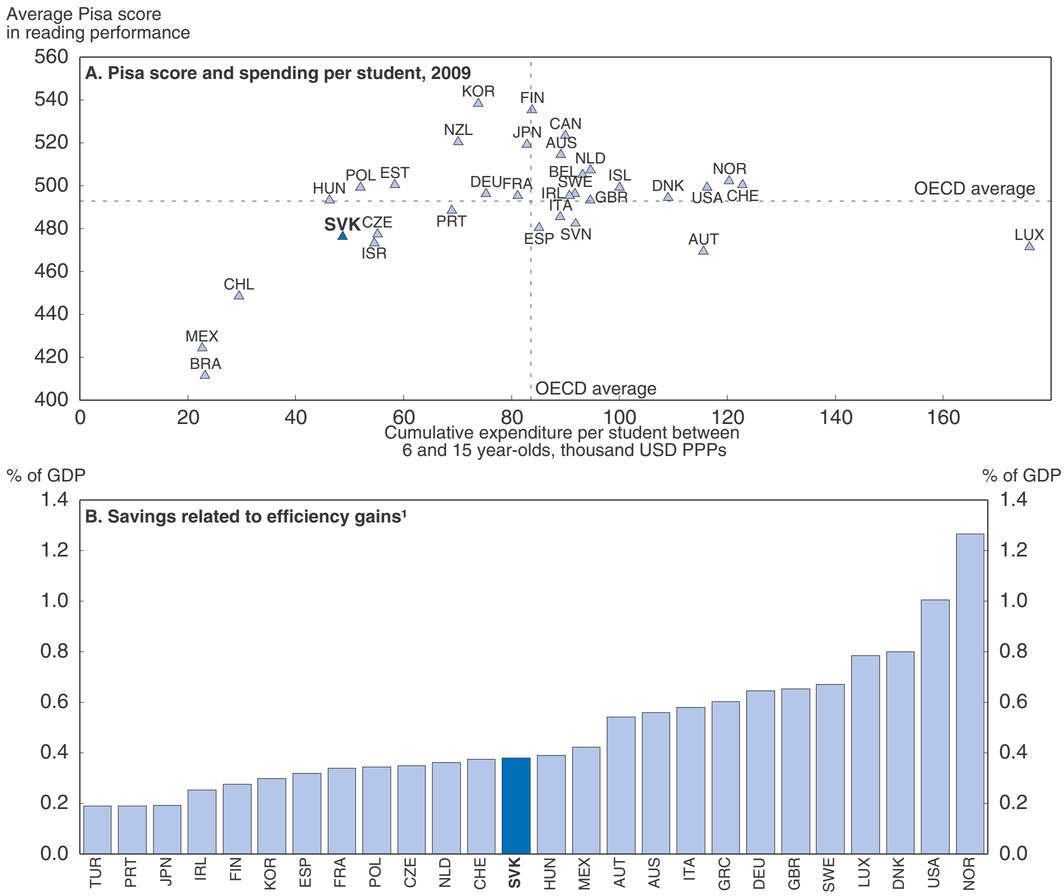
Reforms to underpin longer-term growth

Slovak educational and labour market outcomes are weak by international standards. Improving performance in these two areas is a priority task. Policy measures to create jobs, increase labour supply and improve matching on the labour market would stimulate growth, improve the sustainability of public finances and reduce inequalities. However, not enough resources are allocated to education and labour market policies and there is room for efficiency gains.

Raise educational outcomes

The education budget should be sheltered from general budget cuts and to the extent possible, more resources should be devoted to this growth-enhancing area. Improving educational outcomes is a priority to increase productivity, improve the matching on the labour market and reduce inequality. While the education level has been increasing, the level and the quality of education remain below OECD averages (Figure 9). Public and

Figure 9. **Spending, average achievement and saving opportunities in education**



1. Potential savings represent the difference between a no-reform scenario and a scenario where all schools in each country would become on average as efficient as those in the best performing country. Estimates of efficiency are based on DEA analysis at the national level with two outputs (average Programme for International Student Assessment – PISA score and homogeneity of PISA score) and two inputs (teachers per 100 students and socio-economic background of students).

Source: OECD (2012), *Education at a Glance*, Table B1.3b; *PISA 2009 Database* ; Sutherland, D. *et al.* (2007), "Performance Indicators for Public Spending Efficiency in Primary and Secondary eEducation", *Economics Department Working Papers*, No. 546.

StatLink http://dx.doi.org/10.1787/888932748479

private returns to education are relatively high by OECD standards with net internal rates of returns 2 to 22 percentage points above the OECD average (Šiškovič, 2011). Improving education quality would have a significant impact on future economic growth. According to OECD estimates, increasing average PISA scores of all labour force participants to OECD highs would raise GDP growth by 0.9% in Slovakia (OECD, 2010c).

Notwithstanding strong increases over the past decade, Slovakia is among OECD countries which spend least on education per student (Figure 9). Public spending on education accounts for 4% of GDP, one third less than the OECD average. Studies do not find any close relationships between the level of spending and the quality of education. Increasing education spending alone will not be sufficient to improve educational outcomes, especially as educational outcomes are relatively good given the low level of spending (Sutherland *et al.*, 2007).

Improving the allocation of funds and the evaluation of schools

While efficiency in primary and secondary education is relatively high, the allocation of available resources could be improved. Although the funding system is providing room to support poor performers it is encouraging schools to separate out very good as well as poor performers or students with behavioural problems or special needs. Premiums are allocated to eight-year grammar schools (schools for the best pupils, selected at age 10). Also, financial incentives for integrating pupils with special needs in mainstream education are quite low (Friedman and Surdu, 2009). These practices are inefficient as they may have no impact on overall educational outcomes and tend to increase the influence of socio-economic background on learning outcomes (OECD, 2010f). Thus, the planned removal of premiums for eight-year grammar schools by 2013 is highly welcome and existing incentives for integrating pupils with special needs in standards schools or classes should be developed.

The network of primary and secondary schools could also be revised. The average number of pupils per school decreased by around one third since 1990 and the average number of pupils per class is below the OECD average. Consideration should be given to merging schools while taking into account its impact on local development and make sure induced costs do not exceed benefits. Increasing the number of pupils per class should also be envisaged, for instance by modifying the upper limit on size of classes fixed by law. Removing premiums allocated to small schools and replacing them with grants not linked with the size of the school might also encourage economies of scale. Also, the structure of the secondary education network should adapt to the increase in tertiary education attainment. Strengthening the selection of pupils entering grammar schools is currently discussed to avoid a "dumbing down" of general education. While care should be taken to ensure that quality is maintained, the education system should adapt to the rapid development of demand for higher education and provide opportunities for pupils to pursue their studies. The government should ensure vocational schools are adequately preparing pupils to succeed in tertiary education.

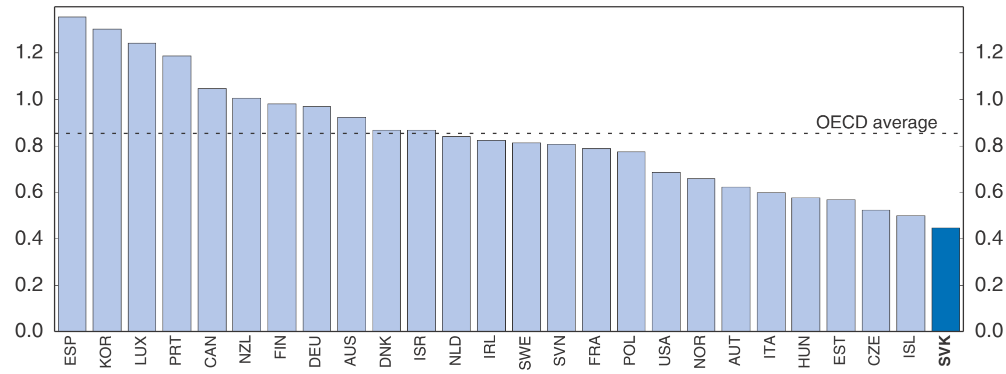
Recent reforms providing more autonomy to schools should improve the efficiency of budget management at the local level. However, additional actions to ensure that the high level of autonomy generates high quality outcomes and to monitor equity across the school system are needed. Available evaluations of schools outcomes which are currently used to assess the level of pupils and the outcomes of schools should be extended to also identify dysfunctions as well as best practices. In particular, individual school evaluations by the Inspectorate can go beyond ensuring compliance with regulations and can play a key role in making use of information in order to improve the quality of teaching and learning. Efforts to introduce value-added measures of school performance would complement evaluations by the Inspectorate because published school average results are not adjusted to take account of the context of each school and as such are open to misinterpretation and "cream skimming". More robust measures would help to target schools with difficulties and facilitate the diffusion of successful teaching methods.

Allocating more resources to teaching activities

The best performers in PISA are countries which invest in teachers (OECD, 2012a). But teachers in Slovakia are among the worst paid in the OECD (Figure 10). On average, a teacher earns less than half the average wage of a tertiary graduate, compared to between 77 and 89% in the average OECD country (OECD, 2011c). Bringing up teacher remuneration to 75% of the average wage of a tertiary graduate would require a pay rise of

Figure 10. **Teachers' remuneration**

2010 or latest available year



Note: Ratio of teachers' salary after 15 years of experience to earnings of full-time, full-year workers aged 25-64 with tertiary education.

Source: OECD (2012), *Education at a Glance*, Table D3.1.

StatLink http://dx.doi.org/10.1787/888932748498

around 50%, costing around 0.5% of GDP. The low attractiveness of the remuneration may partly explain the low quality of teaching, in particular in certain fields which require scarce skills or skills valued by the private sector. For example, in 2010/11, around half of English courses were provided by unqualified teachers (State School Inspection, 2011). The wages of teachers should be increased to improve the attractiveness of the profession while at the same time creating incentives for quality improvements. This should be accompanied by a widening of performance monitoring and pay. The share of best practices should be encouraged by rewarding collaborative practices and outcomes. This could be partly financed by efficiency gains. According to OECD estimates, eliminating inefficiency in primary and secondary schools could save up to 0.4% of GDP (Figure 9).

Raising support to disadvantaged pupils

In Slovakia, the share of pupils with a poor reading proficiency in PISA is significantly higher than the OECD average and the impact of disadvantaged socio-economic background on educational performances is significant. In particular, the Roma student population has very poor educational outcomes, with less than 20% of them reaching an upper secondary education level. According to PISA scores, best performing school systems are those which commit themselves to ensuring that all students succeed (OECD, 2012a), suggesting that more resources should be provided to support disadvantaged pupils. Good-quality early childhood education has a positive impact on future educational outcomes, in particular for children from socio-economically disadvantaged backgrounds (OECD, 2010d). The currently low participation of Roma in pre-primary education should be encouraged by making pre-primary education mandatory or by giving priority access to low income families.

While legislation is in place to avoid discriminatory placement of Roma children in special schools and classes, some evidence tends to show that Roma children are disproportionally placed in special educational programmes providing a low quality of education and *de facto* excluded from higher levels of the education system (Friedman and Surdu, 2009; World Bank, 2012). These practices should be avoided and financial incentives for schools to integrate Roma in standard classes should be strengthened. In the National Roma Integration Strategy, Slovakia defines a broad range of measures that should be quickly implemented and regularly monitored. Current changes in the financing formula that oblige schools to devote a certain share of financial resources to disadvantaged pupils are welcome and measures to provide special assistance to least performing students should be developed further. In particular, the tracking system of children into special schools should be reformed and the number of teaching assistants should be increased as envisaged in the Strategy.

Improving school-to-work transition

With Slovakia having the third highest youth unemployment rate in the OECD in 2011, transition from school to work is an increasing concern. In particular, unemployment is prevalent among graduates from vocational schools, who accounted for 64% of the youth graduates in 2009, 20 percentage points more than the OECD average. In 2010, the unemployment rate of 24-35 olds graduated from a vocational secondary school was four percentage points higher than for graduates from general secondary schools. The reasons behind the low performance of vocational schools are difficult to identify as information on the Slovak vocational education and training (VET) system can be improved further. This could be done through an OECD review of the VET system.

Available indicators suggest that the VET system may not have adapted to the structural changes of the labour market. Improving the matching between employers' requirement and vocational education requires developing mechanisms to regularly identify current and future labour market needs. In this respect, VET councils involving business representatives and aiming at discussing and defining the educational programmes at the regional and sectoral level have been established. Also, the system of competency-based curricula introduced in 2008 and including transferable knowledge should ensure a good balance between developing professional competences that increase the chances for immediate employability and providing transferable knowledge increasing adjustment capabilities during structural shifts in the economy and through the whole lifetime of the worker. More consideration should be given to the development of short (2-3 years), flexible, and more vocationally-oriented tertiary programmes to better adjust to structural changes in labour market requirements. These programmes are under-developed in Slovakia, though they could bring tertiary education closer to the labour market needs and reduce the length of studies, while being more accessible to VET graduates willing to pursue their studies.

Acquisition of professional experience during studies should be fostered. Studies highlight that in-work training improves school-to-work transition for VET graduates (Hoeckel, 2008; OECD, 2010b). However, only 30% of VET pupils participate in some form of workplace training in Slovakia. The apprenticeship system is not attractive to firms, even if some measures have been implemented to simplify the hiring of trainees or have created financial incentives for firms to provide training. One option to foster work-based VET would be to create a legal framework for a dual apprenticeship system (alternation of class and work as in Germany or Austria). Indeed, dual apprenticeship systems deliver outcomes in terms of skill acquisition that appear to better equip workers to take advantage of changes in labour demand (OECD, 2012b). At least, curricula should include more compulsory internships to better prepare graduates to enter the labour market.

Without national standards for assessment of competences, certificates delivered by VET schools provide employers with limited information on the nature and the level of graduates' competences hindering the recruitment of VET graduates, also contributing to reduced regional mobility. A national system of certification of competences acquired in the

VET system could improve labour market matching by reducing asymmetric information between employers and employees (OECD, 2010b). Since 2008, competency-based curricula have been established based on national standards and certificates delivered by VET schools include information on the competences acquired. Providing a consistent method to assess the learning outcomes of vocational programmes would also ensure that all those with the same qualification have the same competences, at a similar level and underpin quality and consistency in the VET system as well as remove barriers for regional mobility.

Developing lifelong learning

Developing lifelong learning is also essential to adapt skills to structural changes in labour market requirements, avoid the erosion of qualifications and provide a second chance to early school leavers. While participation in adult education is relatively high in Slovakia, the number of expected hours in training during a working life is significantly below the OECD average (OECD, 2011c). Slovakia launched the "Lifelong Learning and Lifelong Guidance Strategy" in 2007 but few measures have been implemented since then. A National System of Occupations is being developed, a National System of Qualification is to be established to ease the recognition of competencies acquired through non formal education, and a Further Training Information System is also established to improve access to information on training options. Providing information on the quality and returns of training and ensuring recognition of learning outcomes in the labour market and in the educational system is crucial for the good functioning of the training market. These initiatives should thus be pursued further while ensuring a close co-operation with the abovementioned councils in charge of defining the educational programmes in VET schools to avoid overlaps.

The cost of training and the difficulty of combining training and work are the main hurdles to participation in adult learning in Slovakia (Eurostat, *Adult Education Survey*) and little has been done in these areas. Incentives for firms to provide training are weak and adult learning is mainly funded by the public sector. Participation of low qualified and older workers in adult education is particularly low. Incentives for employers to allocate more resources and time to training should be enhanced, for instance by deducting training costs from the corporate tax base. Public support should be targeted to low qualified and older workers.

Box 2. **Key recommendations for education policy**

- Remove premiums to eight-year grammar schools as planned and strengthen incentives for the integration of pupils with special needs in the standard system.
- Improve the use of available evaluations to identify dysfunctional schools as well as best practices.
- Increase the wages of teachers together with structural measures increasing the efficiency of the system such as consolidating the network of schools, increasing the classroom size and widening the scope for performance-related pay.
- Raise support to disadvantaged pupils. Further encourage participation of children from low-income families and Roma in pre-primary education and the integration of Roma in mainstream education.
- Foster acquisition of professional experience during studies and work-based vocational education and training by creating a legal framework for a dual apprenticeship system.

Improve labour market performance

Removing barriers to wage flexibility and labour mobility

Being a member of a monetary union requires having a flexible labour market to adjust to shocks. Wage flexibility and geographical mobility are keys in this respect. Recent reforms of the legal extension are going in the right direction. However, remaining labour market rigidities should be removed, in particular the regulation stipulating that employees not covered by collective wage agreements are subject to a minimum wage that differs by the type of work. These wage floors may be a hindrance to local wage adjustment and should therefore be phased out (OECD, 2010a). Also, the labour code has been reformed twice since 2011 (Box 3). The induced instability in the labour legislation may weaken business confidence and generate adaptation costs for employers. Also the impact of the recent measures has not been adequately analysed and some changes may have a negative impact on employment. In addition, more should be done to foster geographical mobility, addressing the unusually large regional differences. Among contributing factors is the absence of an adequate rental housing market. The housing sector should be reformed as recommended in the *2009 Economic Survey* (OECD, 2009).

Box 3. **Recent and future changes in the labour code**

The labour code was amended on 1 September 2011, easing employment protection legislation (EPL) for both permanent and fixed-term contracts. After this reform, EPL strictness has been among the lowest in the OECD and the differences between protection of permanent and temporary contracts have been significantly reduced (Harvan and Machlica, 2011). The labour code was reformed again in October 2012 with measures partly undoing some of the 2011 changes. While not strongly undermining employment, these reforms – effective on 1 January 2013 – might have some negative effects on job creation. Some measures are quite positive though, as they increase the flexibility in working hours.

- Protection of permanent contracts will be tightened closer to 2010 levels. The simultaneity of redundancy payment will be re-introduced and the possibility to reduce the notice period by collective agreement removed. While employment protection of regular contracts will not become excessively tight, these measures will tend to reduce job turnover and may undermine productivity growth. By increasing firing costs and thus the risk of higher costs in the event of dismissal, this type of regulation may depress hiring.
- The 2011 changes in the regulation of fixed-term contracts will be repealed. The maximum cumulated duration of temporary contracts will be reduced from three to two years and the maximum number of renewals from three to two within two years. Reducing differences between permanent and fixed-term contracts is welcome as it limits the risk of labour market duality.*
- The impact of the envisaged amendments of the labour code on the flexibility of working hours is mixed. The legislation includes the obligation for firms to find an agreement on flexible working hours with employee representatives. At the same time, employers will be allowed to balance the working time accounts in 30 months (instead of 12 months previously). This measure is welcome as the flexibility in working hours allows firms to adjust to the business cycle and reduces volatility on the labour market, as demonstrated by the German example (Hüfner and Klein, 2012).

* Differences in protection of permanent and temporary contracts may lead to labour market duality inducing lower human capital accumulation and higher income inequality but would not reduce unemployment (de Serres *et al.*, 2012; Koske *et al.*, 2012).

While the tax and social security burden on labour has declined significantly since 2004, it remains particularly large for low income earners, with a tax wedge for a single person earning 67% of the average wage which is some 4 percentage points higher than the OECD average (Table 5). This hampers labour demand for low wage earners, who make up the largest share in the unemployment pool. Consideration should be given to reducing social security contributions paid by employers for low-income workers to boost labour demand.

Table 5. **Tax wedges**

Per cent (2011)

	Slovakia	OECD
Single, 67% of average wage	36	32
Single, average wage	39	35
Single, 167% of average wage	41	40
Single parent, 2 children, 67% of average wage	24	16
One-earner couple, 2 children, average wage	25	25
Two-earner couple, 2 children, 100% + 67% of average wage	33	30

Source: OECD (2011), *Taxing Wages*.

Strengthening work incentives

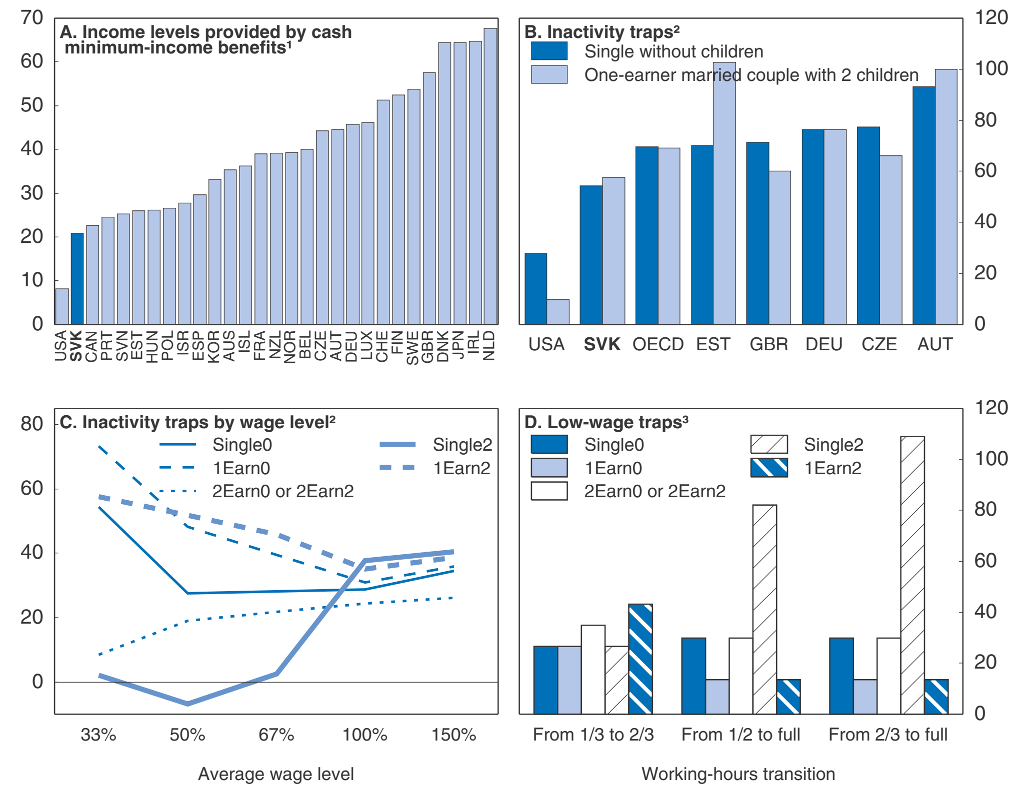
Notwithstanding the relatively high tax wedge on low-income workers, overall, the tax and benefit system generates fewer disincentives to work, even for a low wage, than on average in the OECD. The level of social assistance benefits is very low, with minimum income benefits amounting to only 20% of the median income, well below the poverty threshold. Also, the inactivity traps are lower in Slovakia than in most other OECD countries (Figure 11).

There is room to improve work incentives further, however, while continuing to protect the most vulnerable. Contrary to most other OECD countries, Slovakia does not encourage job search activities for social benefit recipients. Registration of social benefit recipients with ability to work in placement services should be made mandatory. Also, the social assistance system is quite complex and benefit recipients may not be aware of available financial and material support.

Furthermore, the net economic gains associated with low paid jobs are not significant in a number of cases. The average and marginal effective tax rates of labour revenues varies widely depending on household composition and on the wage level, for instance exceeding 80% for one earner couples receiving the activation allowance (Figure 11). The in-work tax credit (employee bonuses) introduced in 2009 is quite low and not well targeted: some low-income workers (those earning less than 6 times the monthly minimum wage per year or working less than six months during a year) are not eligible. An activation allowance is allocated to long-term unemployed taking up a full time job or to all benefit recipients with material need and with the ability to work participating in activation activities, such as training or small community work. The allowance is too low to compensate the losses of benefit received to cover basic material needs for those taking formal jobs and is not paid to those working part time. It reduces work incentives for those participating in activation activities. The social assistance system should be reformed to get the balance right between poverty alleviation and activation for both improving income adequacy and reducing benefit dependency. In-work benefits should be merged to simplify the system and to better target to those who may not gain a lot from taking up a job, such as part-time workers.

Figure 11. **Work incentives**

2010



Note: Type of family: Single0 = Single person, no children; 1Earn0 = One-earner married couple, no children; 2Earn0 = Two-earner married couple, no children; Single2 = Lone parent with 2 children; 1Earn2 = One-earner married couple with 2 children; 2Earn2 = Two-earner married couple with 2 children.

1. Net income value including cash housing assistance in % of median household incomes, 2010.
2. Average effective tax rates for a transition into full-time work for persons without entitlement to unemployment insurance but entitled to social assistance. Panel B refers to inactivity traps at 33% of the average wage.
3. Marginal effective tax rates for part-time employees in 2010 for different working-hours transition (in %).

Source: OECD, *Benefits and Wages: Statistics*.

StatLink http://dx.doi.org/10.1787/888932748517

Female labour participation is relatively low in Slovakia, in particular for mothers with dependent children (59% *vs.* 66% on average in the OECD and more than 85% in some countries). The length of the maternity leave and of the parental leave is high by international standards. Combined with a lack of affordable childcare options, this may be associated with career interruptions and thus a low female participation. A six-month maternity leave is considered as providing a good balance between child well-being and mother's employment opportunities (OECD, 2011a). In 2011, the length of maternity leave was increased to 34 weeks in Slovakia (*vs.* 19 weeks on average in the OECD) and the replacement rate rose from 60 to 65%. The mother can decide to finish the maternity leave or transfer her claim on maternity benefit to the father of the child. Parental leave is paid for 136 weeks, two times the OECD average. Countries with shorter periods of leave have higher employment rates among mothers with young children than countries with prolonged periods of paid leave. Long interruptions of work complicate career aspirations, reduce the return on education and the incentives of employers to invest in on-the job training. Too long parental leave may also deteriorate skills and make the return to work difficult (OECD, 2011a). The recent measures on maternity leave should be reconsidered. The length of parental leave should be reduced or at least the parental allowance should be increased for parents choosing to reduce the length of their parental leaves, as done in Austria.

Reforms to maternity leave should be combined with an expansion of childcare facilities which are insufficiently developed. The childcare enrolment rate is the lowest in the OECD (below 40% *vs.* 58% on average in the OECD) and is more than three times higher for high income households than for low income households, one of the worst ratios among OECD countries. Childcare places should be increased and priority given to low income families or at least childcare fees should be means-tested. Beyond their positive impact on female labour market participation, these measures may also contribute to reducing the gender wage gap, which is more pronounced in Slovakia than in the EU27 average (Kusa and Gerbery, 2010).

Reforms to maternity leave and childcare may not reduce fertility. The effect of policies on the fertility rate is found to be small, the duration of the maternity leave in particular (Sleebos, 2003). Also, countries with the highest female employment rates are also among the countries with high fertility rates. Available evidence suggests that policies which help women reconcile work and family, such as the availability of childcare services, may stimulate both labour market participation and fertility (OECD, 2011a).

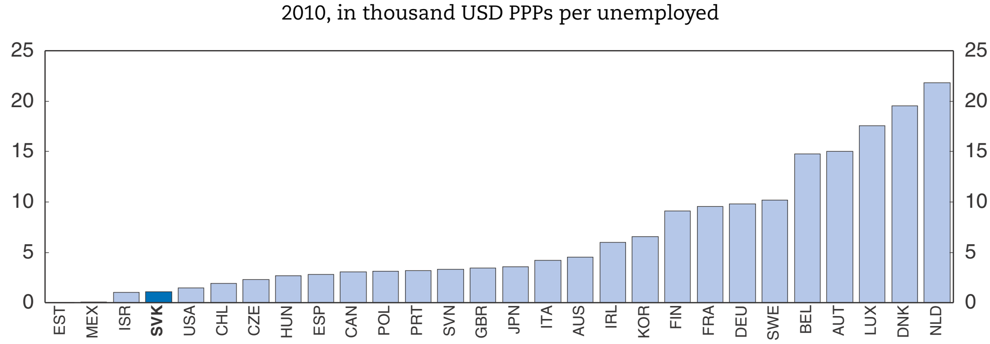
Raising spending on and efficiency of active labour market policies

The high incidence of youth, low qualified and long-term unemployment, as well as regional unemployment differences, suggest deep needs for more comprehensive activation policies. Efficient active labour market policies (ALMP) can contribute to reducing unemployment and ensure a better use of the labour force through better matching and improved mobility.

However, spending on ALMP is among the lowest in the OECD, amounting to 0.3% of GDP compared to an OECD average of 0.7% in 2010. Spending per unemployed is more than ten times below the OECD highs (Figure 12) and has been quite volatile over the past few years. ALMP are mainly financed trough EU funds, which require burdensome administrative procedures, and thus lack flexibility to adapt to labour market needs. Programmes are not targeted towards the most vulnerable groups, which are underrepresented among ALMP participants. Low qualified unemployed account for 40% of participants and 60% of total

Figure 12. **Spending on active labour market policies**

2010, in thousand USD PPPs per unemployed



Note: Active labour market policies cover programmes dealing with PES and administration, training, job rotation and job sharing, employment incentives, supported employment and rehabilitation, direct job creation and start-up incentives. Data refers to 2009 for United Kingdom. Data for other OECD countries often include training allowances, wages or other forms of income support paid to programme participants: Slovak data include some types of income support payment but not the "activation allowance" or regular social benefits that are paid to ALMP participants in some cases.

Source: OECD, *Labour Market Programmes* and *OECD Economic Outlook Databases*.

StatLink http://dx.doi.org/10.1787/888932748536

unemployed. Participation to ALMPs is lower in regions with a high share of long-term unemployed. Also, a large number of available programmes are not used.

Analysing local labour market outcomes, identifying the pockets of underperformance, and setting objectives could help to better define local needs for ALMPs. Also, participation in programmes should be targeted towards those who are more in need and made universally available for the most vulnerable groups. Better targeting would limit potential deadweight losses and create some financial room to develop more intensive ALMPs for in-need groups.

As data on programmes outcomes and evaluations of ALMPs are lacking, their efficiency cannot be fully assessed. However, available evidence points to low effectiveness (*e.g.* Harvan, 2010, on two particular programmes). Thus, while the low level of spending on ALMPs suggests more resources should be allocated in this area, spending on these programmes should only be increased after a proper evaluation of their impact has been made available. The planned data collection and systematic evaluation of the ALMP should be implemented by using international benchmarking. New programmes could be tested with pilot projects before being implemented at the national level.

A relatively high share of ALMP resources goes to start-up incentives (subsidies for unemployed starting a business). While evidence on the effectiveness of these programmes is rather mixed (Dar *et al.*, 1999), spending on these measures is three times higher than the OECD average (0.08% *vs.* 0.02% of GDP) and continues to increase. According to available evidence, net positive effects of start-up incentives on employment are quite low due to significant deadweight and displacement effects. In Slovakia, start-up incentives are generous, not targeted and not carefully monitored. Eligibility criteria should be made stricter and the monitoring of the measures strengthened.

Empirical evidence tends to show that, together with employment incentives, public employment services have the largest positive impact on labour market outcomes (OECD, 2005). In Slovakia, PES services are understaffed and underfinanced. The number of unemployed per PES employee was among the highest in the OECD in 2006 and rose significantly in the aftermath of the crisis. Also, only a small share of resources is allocated to placement services (compared to social services) and the two services are not co-operating. In addition, on top of the job assistance services, PES employees are responsible for registering vacancies and collecting information on the labour market developments. As a result, PES cannot deliver client-oriented individualised services, and positive initiatives, such as the introduction of Individual Action Plans provided to vulnerable jobseekers, are not bearing fruit. PES services should be reorganised by creating one-stop shops for jobseekers. More resources should be allocated to placement services. Effective online collection of job offers should be established to lighten workload of PES employees.

Employment incentives should also be developed because such programmes – wage subsidies in particular – are found to be effective in fostering employment (Kluve, 2010) and would reduce the tax wedge from its currently high level. Incentives should be tightly targeted on long-term jobseekers with low productivity to limit crowding out effects. Placement of long-term unemployed into firms could also be directly promoted, for instance by reducing hiring costs, as such initiatives proved to be effective in the past (*e.g.* in US Steel in Kosice). These policies would be more effective than public works measures, which are currently the main policy targeted towards long-term unemployed. Such measures provide additional revenues to the unemployed and a work routine but do not increase the employability of participants. They can even lock in participants in unemployment as they divert them from looking for a job (Card *et al.*, 2009 and Harvan, 2010). The length and the number of participation in these programmes were reduced in 2008, but job creation programmes still account for a large share of ALMP participants. Job creation programmes should be proposed only when no other options are available and should be complemented by other activation measures, improving the employability of the participant. In particular, these programmes should not be allocated to early school leavers or young unemployed.

In 2009, the share of training in the total ALMPs spending was very low, accounting for only 2% of total spending, six times less than in the average OECD country (27% of spending). Well designed training programmes, in particular those which are job-related and defined in collaboration with local firms improve the employability of job seekers and contribute to addressing labour shortages and skills mismatch. However, public procurement rules for training services induce high administrative barriers and are not used by local labour offices. Training should be supported by simplifying the public procurement procedures and by training PES staff in procurement law. Strong incentives for training providers to offer high quality and job-oriented training should be introduced, for instance by establishing outcome-oriented funding and requiring the certification of acquired competences.

Box 4. **Key recommendations for improving labour market performance**

- Encourage job search activities and participation in Active Labour Market Policy (ALMP) by all benefit recipients with some ability to work by making their registration in placement services mandatory. Better target the measures to those who may not gain a lot from taking up a job.
- Increase spending on those ALMP whose effectiveness has been demonstrated. Implement the planned data collection and systematic evaluations of ALMP. Consider testing new programmes with pilot projects before implementation at the national level.
- Allocate more resources to placement services in PES. Reorganise PES by creating one-stop shops. Establish an effective online collection of job offers.

Other recommendations

- Develop employment incentives targeted towards long-term jobseekers with low productivity. Foster the placement of long-term unemployed into firms for instance by reducing firms hiring costs. Propose job creation programmes when no other options are available, exclude early school leavers from these programmes and complement them with other activation measures improving employability.

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ANNEX A1

Progress in structural reform

This Annex reviews action taken on recommendations from previous *Surveys*. Recommendations that are new in this *Survey* are listed in the relevant chapter.

Recommendations from previous *Surveys*	Action taken since the November 2010 *Survey*
LABOUR MARKET	
Ensure wages adjust to disequilibria in the labour market: consider abolishing the legal extension of collective wage settlements.	Since 2010, the legal extension of collective wage agreements is conditioned to the consent of the employer.
Ensure that further increases in the minimum wage do not have negative impacts on employment opportunities. Take into account advice from an independent expert commission when making decisions about the minimum wage level. Phase out the differentiation of minimum wages by degree of work difficulty and consider minimum wage differentiation at the regional level.	No action taken.
Remove barriers to higher female labour participation: reduce the tax wedge on second earners in two-earner households by lowering the marital income allowance. Consider introducing a surcharge on health insurance for non-working spouses.	Since 2011, working parents are eligible for childcare subsidies.
Ensure adequate public employment service capacities: implement cost-efficiency analysis of existing programmes and reduce their number if necessary. Increase spending on training measures and monitor the effectiveness of start-up incentives. Tighten requirements for such incentives in case they are found to be less effective.	A methodology for assessing the efficiency of active labour market measures has been developed and approved by the Ministry of Labour beginning of 2012. Data needed for the evaluation should be available by end of 2012. Some ineffective measures have been removed.
Remove barriers to labour flows at the national (*e.g.* between the academic and the business spheres) and international level. Facilitate high skilled migration.	The EU Directive introducing EU work and residence permits (Blue cards) for high skilled third country nationals has been transposed into national legislation in October 2011.
EDUCATION	
Make tertiary education more attractive to technical secondary school graduates: develop short (2-3 years) occupationally oriented programmes. Introduce tuition fees for full-time students at state universities coupled with income contingent repayments, facilitate entry of new institutions, replace budgetary allocations to universities with competitive research grants or at least make them rely more on outcomes.	Since 2010, the funding rules for universities are reformed and are increasingly based on outcomes (publication, grant-gaining).
Improve skilled labour force availability by developing lifelong learning, by ensuring the good functioning of the training market and by including training in "green skills" (*i.e.,* ability to use green technologies and techniques) in the educational programmes.	Since 2009 (law on lifelong learning), the tools for the accreditation of educational programmes based on qualification standards and for recognition of qualification acquired in further education are developed. Analysis and integration of "green skills" in relevant educational programs are currently undergone.

Recommendations from previous *Surveys*	Action taken since the November 2010 *Survey*
HOUSING MARKET	
Make housing supply more responsive to demand. Investigate constraints on competition and possible infringements of law in the construction sector to guard against anti-competitive behaviour. Swiftly implement the planned new Building Act in order to simplify and speed up the land planning process.	No action taken.
Remove obstacles to the expansion of a private rental market: End the right-to-buy policy or make it less attractive by adjusting conditions closer to market prices. Increase the taxation of real estate by basing it on actual property prices and by raising the tax rate to neutral levels. Further reduce the subsidisation of owner-occupied housing.	No action taken.
Consider phasing out the tenant protection for indefinite rental contracts.	No action taken.
Consider bringing the rent level in public housing apartments closer to market levels or at the very least for the tenants who no longer fulfil the eligibility criteria. Consider raising housing allowances, make them more widely available and take into account regional differences in housing costs when setting the amounts.	No action taken.
PRODUCT MARKETS	
Resume the privatisation process. Privatise the remaining government shares in the telecommunications incumbent. Pursue further entry of private capital in companies active in electricity generation and trade as well as in gas trade.	No action taken.
Make the disbursement of subsidies to the railways industry more conducive to competition. Avoid discretion in the allocation of subsidies to the railways industry. Instead of disbursing subsides to the incumbent railway transport service operator, they should be used to lower network access prices or be made contestable through the public tendering of public service obligations.	Public tendering in public transport will be introduced gradually in line with the EU regulation on public passenger transport services by rail and by road.
Foster the spread of e-business and e-commerce: Establish centres that provide comprehensive information on the benefits of e-business and e-commerce, disseminate best practices, offer training courses and workshops as well as support services for the establishment of e-business and e-commerce activities. Consider the involvement of business and industry associations in order to gain economies of scale and to better tailor the services to the needs of specific industries.	No action taken.
Reassess the current regulatory framework on consumer protection, privacy and security to increase transparency and to ensure that consumers participating in e-commerce activities are sufficiently protected from any misuse. Introduce efficient and fair out-of-court dispute settlement mechanisms to build consumer confidence in electronic commerce.	No action taken.
Strengthen competition in network industries, Ensure that the price regulation does not deter the entry of new competitors in the energy market, notably by improving the stability and the transparency of the price setting framework and reduce non-price discrimination. Reduce delays in the introduction of remedies to foster competition in fixed line telecommunications services. Strengthen the independence of the telecommunications regulator.	Competition in network industries will be strengthened by implementing the third EU Energy package (unbundling of production and distribution of electricity and gas, strengthening the rights of consumers to switch suppliers).
Quickly proceed with the privatisation of Slovenska Posta. Abolish the 2008 amendment of the Postal Act that grants Slovenska Posta the exclusive right to deliver hybrid mail.	No action taken.
Identify administrative burdens and establish a timetable for measures aimed at tackling the identified business barriers. Develop further the establishment of single contact points for firms and unifying procedures for the collection of social security contributions.	Points of single contact are fully operational since 2012 (electronic version). Some barriers in the area of trade licenses have been removed and further reduction in administrative costs is planned.

Recommendations from previous *Surveys*	Action taken since the November 2010 *Survey*
Make sure that e-government is implemented by the target date of 2013: Ensure that the training of employees in computer and Internet skills as well as the adoption of the legal framework to e-government services takes place at an early stage of the implementation phase. Assign a high-level representative in each ministry responsible for the implementation of the action plan.	No action taken.
PUBLIC SECTOR EFFICIENCY	
Encourage greater use of results and performance information in the budget process in all government departments.	No action taken.
Fully enforce the provisions of the laws fighting corruption. Build public support for the adoption of the new draft Law on the Forfeiture of Illegally Acquired Assets.	The Law on the Forfeiture of Illegally Acquired Assets has been adopted in 2010 and entered into force in 2011.
Introduce market mechanisms in the provision of public services.	Market mechanisms in the provision of public services have been introduced (electronic auction).
Provide public policies in support of the Roma minority with a reliable information base. Facilitate the voluntary provision of information by reducing the stigma associated with being Roma.	A new strategy for the integration of the Roma community was adopted in 2011. The project "Statistical Monitoring of Living Conditions of Selected Target Groups" will provide data by 2015.
Restrain government consumption. Consider reducing the number of public employees and freezing wages in nominal terms. Identify cost savings in government procurement.	Wage bill and operational cost were significantly cut in the public sector in 2011 and wages are frozen in 2012. Government budget proposal for 2013-15 includes 5% cut of wage bill of state and public service and 10% cut on goods and services.
Investigate the underlying reasons for the low absorption of EU funds. Consider accelerating projects to get the maximum impact during the time of fiscal consolidation. Improve transparency and simplify the submission requirements for projects and foster co operation between ministries in the certification process.	A close partnership between the European Commission and the Slovak authorities has been established to discuss and monitor the key issues behind the low absorption of EU funds. Measures to simplify procedures and better control the selection of projects have been implemented. The absorption of EU funds accelerated significantly in 2011.
Raising the efficiency of tax administration: improve the performance of VAT collection. Expand the number of verification activities and better enforce the collection of unpaid tax arrears. Implement the plans for a unified collection scheme and proceed quickly with approving the second stage of the reform (UNITAS II).	Strategies to fight tax frauds have been approved by Slovak government in 2011 and are currently implemented. At the same time, the implementation of the second phase of the programme UNITAS has been interrupted.
FISCAL POLICY	
Consider incorporating a deficit rule into the constitution. Consider a strong reporting system and ex post assessments of the government's performance *vis-à-vis* the rules. Introduce an independent fiscal council and multi-year expenditure ceilings, excluding cyclical expenditure items, such as unemployment benefits. Consider introducing an adjustment mechanism to claw back accumulated deviations from the fiscal rule in case of projection errors.	A debt ceiling has been incorporated into the constitution; the constitutional act paves the way for multi-year expenditure ceilings (excluding cyclical expenditure items) and established an independent fiscal council.
Stabilise the functioning of the pension system: Refrain from any opening-up of the two pension pillars. Consider making participation in the DC pension pillar mandatory for all persons joining the labour market for the first time or at the very least, make participation in the DC pillar the default option. Do not change the split between the DB and DC schemes on an ad hoc basis due to short-term budget considerations.	The contribution rate to the second pillar has been reduced from 9 to 4% as part of the government consolidation strategy in August 2012. The contribution rate will start to increase in 2017 by 0.25% each year until it reaches target level of 6% in 2024.
Ensure the long-term sustainability of the DB pillar: Increase the statutory retirement age in line with gains in life expectancy and index pensions on inflation only. Alternatively, consider modifying the existing pension formula to ensure an automatic cut-back of replacement rates as the old-age dependency ratio worsens.	The public pension system was reformed in August 2012. The statutory retirement age is set to increase in line with gains in life expectancy and pensions will progressively indexed on retiree inflation only.
Strengthen the solidarity of the pension system. Consider phasing out the annual Christmas allowance that is paid to some pensioner groups, coupled with a reform to introduce more redistribution into the pension system.	The reform measures passed in August 2012 including changes in the pension formula through adjustment of coefficients for reduction and increasing average pension point. This will result in gradually increasing of the solidarity element in the PAYG pillar.
Shift the responsibility for setting the benchmark to the pension fund level, combined with the requirement to regularly publish information about their performance against an absolute benchmark.	Since January 2013, there is no requirement for setting the benchmark for the pension fund, nor requirement to regularly publish information about performance against benchmark.

Recommendations from previous *Surveys*	Action taken since the November 2010 *Survey*
Increase the taxation of real estate by raising the land tax rate, setting a percentage tax rate for the building and apartment tax and in both cases taking the market value of the property into account when setting the tax base.	The government is planning to expand real estate taxation, with a tax partly based on the market value.
HEALTHCARE EFFICIENCY	
Consider introducing an upper limit for out-of-pocket payments in terms of annual household income.	Since April 2011, the out-of-pocket payments for drugs are capped for low income individuals (*e.g.* pensioners, disabled).
Increase co-ordination in primary care by introducing clinical guidelines promoting disease management. Review the way doctors are compensated, possibly introducing a hybrid system of capitation and fee-for-service.	No action taken.
Further explore the benefits and risks of restructuring the hospital sector through a transformation of state-owned institutions into joint stock companies. Implement a system of disease-related groups.	A roadmap for introducing a system of payment based on diagnostic-related groups (DRG) has been approved.
Encourage physicians to prescribe the substance of a drug, thereby stimulating consumption of generics, as planned. Consider obliging pharmacists to always supply the cheapest generic drug. Consider raising the level of co-payments for partially-reimbursed pharmaceutical products.	Since end 2011, generic prescription (prescription of substance) has been made mandatory for certain products.
Increase competition among insurance funds by allowing the distribution of profits, lifting the strict upper level on administrative costs, and allowing contributions to vary. Consider splitting up or partially privatise the dominant public insurance fund. Improve the risk-equalisation formula by including health parameters.	Regulation on the distribution of profit of insurance companies was revoked. The setting of the upper limit for administrative costs is more flexible and now takes into account the number of insured persons. The redistribution of funds across the insurance companies is currently under revision.
Further improve the list of quality indicators for healthcare providers and consider using the list to define the minimum network of providers with which insurers have to contract.	No action taken.
FACILITATE THE TRANSITION TO GREENER GROWTH	
Phase out the tax exemptions on energy, establish a clear, predictable and credible carbon tax in the sectors not covered by the EU-ETS and reform taxation of motor vehicles by setting rates depending on emissions and energy consumption.	In 2011, several exemptions and reduced tax rates on excise duties were abolished.
Strengthen co-ordination among administrative bodies in charge of environmental and energy policies. Centralise the determination, the implementation and the monitoring of these policies, while merging instruments and funds addressing the same issue.	The Committee for Climate Change Policy Co-ordination established in December 2011 ensures the co-ordination among the different Ministries involved in the climate change mitigation issues.
Better target the support to environmental-friendly activities by defining measurable targets and systematically carrying out evaluations. Monitor the cost effectiveness of support for renewable energy sources (RES).	The support system for renewable energy sources has been assessed in June 2011 and some measures to improve the efficiency of this support have been implemented (reverse auctions for wind and solar energy).
Review regulatory barriers in the solar and wind energy sector by using international benchmarking. Clarify the rules behind the allocation of certificates for solar plants.	Some legislative changes regarding the certification for solar power have been made.
Phase out subsidies which can be replaced by other market-based instruments. Remove tax exemptions on electricity produced from RES. Replace subsidies for RES equipments by soft loans and complement them with an information campaign or at least better target subsidies on credit-constrained households.	The transition from the direct subsidies for households to the system of support lending is currently evaluated.
Ensure a long term support to innovation and R&D by effectively increasing the weight of R&D in public expenditures, by better co-ordinating innovation policy across government bodies and by evaluating innovation policy regularly.	Co-ordination of innovation policy is ensured by the Cabinet Council for Innovation chaired by the Minister of Finance established in 2011.
Consider complementing the R&D financial support with extended tax credits and limit direct public subsidies to basic research or research far from commercial viability. Simplify application procedures for public funding. Ensure access to capital by pursuing initiatives to develop a venture capital market.	In co-operation with the European Investment Fund, the government launched in 2011 the JEREMIE initiative, an EU programme providing funding to innovative SMEs.

Recommendations from previous *Surveys*	Action taken since the November 2010 *Survey*
Intensify support for international co-operation, participation in cross-border programs, and cross-funding of projects, develop knowledge networks and encourage collaboration between universities, research institutes and enterprises.	No action taken.
Pursue public investment in ICT infrastructures without pre-empting private initiatives and regularly reassess the efficiency and the necessity of these interventions.	Public investment in ICT infrastructure mainly financed through EU funds is under preparation (building of regional optical networks in isolated areas).

Chapter 1

Improving the fiscal framework to enhance growth in an era of fiscal consolidation

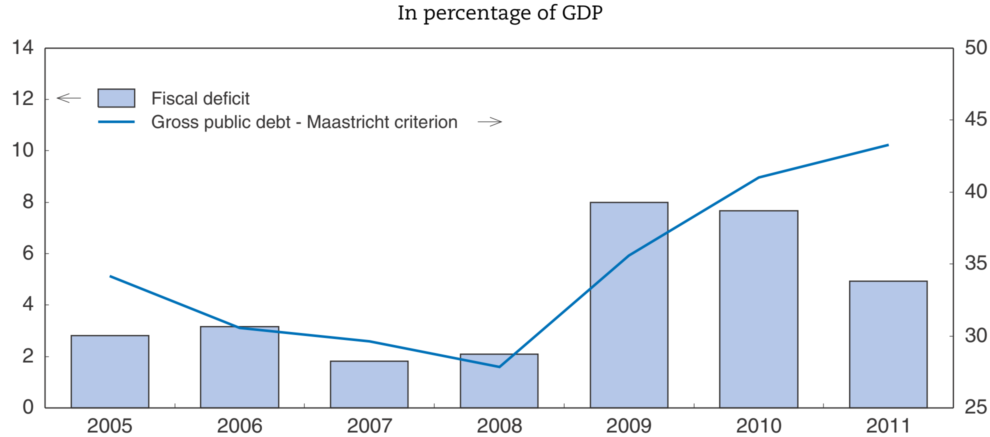
The challenge for fiscal policy is to achieve fiscal consolidation in a way which supports the fragile recovery and protects spending on areas which are important for re-embarking on a trajectory of high trend growth and underpinning a catch-up in living standards. While the recently established fiscal rules have significantly improved the fiscal framework, a further strengthening in medium-term fiscal discipline will be necessary to avoid pro-cyclical fiscal policy. Raising the effectiveness of tax collection, reforming the tax structure towards less distortive taxes and making more out of available EU funds would also play a helpful role in a growth-friendly fiscal consolidation. Finally, more needs to be done to ensure an adequate prioritisation of spending and an efficient use of public revenues. In particular, stepping up the analytical monitoring, evaluation and assessment capacity in spending ministries should help to rein in wasteful spending.

Returning public finances to a sustainable path

At 43% of GDP in 2011, Slovakia's public debt was still significantly lower than the OECD average. However, it has been on a steep upward trajectory since 2008, increasing by 15 percentage points in four years as a result of deficits which at their peak in 2009 reached 8% of GDP (Figure 1.1). Slovakia has been subject to the excessive deficit procedure since 2009, under which it has agreed to reduce the deficit to 2.9% by 2013. While 2011 saw significant progress towards this objective, meeting the budget target for 2013 in a way which permanently reduces the budget deficit to a sustainable level will require significant additional consolidation measures.

Figure 1.1. **General government gross debt and deficit**

In percentage of GDP



Source: *OECD Economic Outlook Database.*

StatLink http://dx.doi.org/10.1787/888932748555

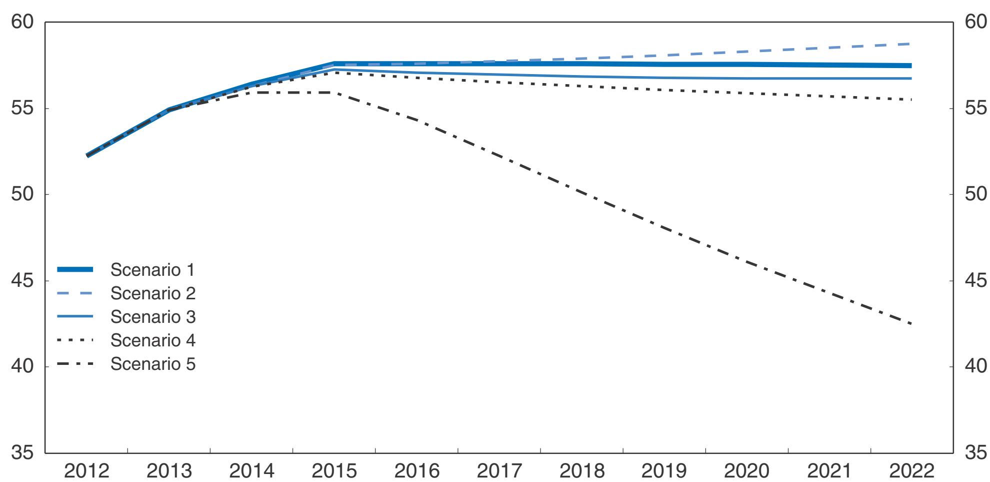
This chapter begins with an assessment of the sustainability objectives and the reforms to rules and institutions needed to restore the credibility of public finances. It then discusses consolidation strategies based on the prioritisation of public spending to foster longer-run growth-enhancing policies. While fiscal consolidation has negative effects on economic growth in the short term, "smart" consolidation can turn a constraint into an opportunity, by reorienting spending towards areas that are growth enhancing, which in Slovakia's case would seem to imply a redirection in favour of spending on education, labour market or infrastructure programmes (see Chapter 2). The final section looks at the institutional reforms needed to lock in consolidation gains and ensure public spending stays on a sustainable path, in light of the fact that part of the present sustainability problem can be traced back to defects of budgetary control. These factors include expenditure rules, budget management and control processes.

Restoring public finances will require a long-term effort

The consolidation process so far has made considerable progress. The deficit fell by more than 3% of GDP between 2009 and 2011, not least due to ambitious consolidation measures. The next consolidation objective, under the excessive deficit procedure, is to reduce the headline deficit to 2.9% of GDP in 2013, which will require further consolidation measures of around 3% of GDP compared to an unchanged policy scenario. Slovak fiscal policy will have taken a fundamental step towards restoring public finances to a sustainable path in the limited sense that the debt/GDP ratio will tend to stabilise at around 55% (Figure 1.2, scenario 1). However, keeping the headline deficit below 3% will require a further gradual decline in the primary deficit to offset rising interest payments on debt; maintaining it at its 2013 level of around 1% would push the debt ratio up to under 60% by the end of the decade (Figure 1.2, scenario 2).

Figure 1.2. **Medium-term debt profiles and sensitivity to bond yields and potential growth**

In percentage of GDP



Note: The simulations are calibrated on the short-term projections published in *OECD Economic Outlook 92*. Thereafter, the output gap is assumed to be eliminated by 2015, after which the economy is assumed to grow at its potential rate. The effective interest rate is driven by the 10-year bond yield, assuming an average public debt maturity of 6¼ years and an overall refinancing rate of 15% a year. Scenario 1: 2.9% deficit maintained after 2013; Scenario 2: 1% primary deficit maintained after 2013; Scenario 3: primary deficit maintained after 2013, 0.5 pp higher potential growth; Scenario 4: primary deficit maintained after 2013, 0.5 pp higher potential growth and 0.5 pp lower bond yield; Scenario 5: 0.5% structural balance achieved by 2018 and then maintained.
Source: OECD calculations based on *OECD Economic Outlook 92 Database*.

StatLink http://dx.doi.org/10.1787/888932748574

Returning to higher potential growth and lower interest rates is key to the consolidation process. Until 2008, debt dynamics were very favourable in that the effective rate of interest on government debt was significantly below the underlying GDP growth rate, helping to reduce the debt ratio for most of the period from the mid-1990s to 2007. Subsequent to the financial crisis, this aid to consolidation has virtually disappeared. Real potential growth was revised down during the crisis and has only partially recovered since then. Slovak bond yields, which had been on a declining trend up to 2010 rose to around 5 per cent at the end of 2011. They have fallen to around 4 per cent since then. Combined with nominal potential growth of 5¼ per cent (3¼ per cent real plus 2% inflation), long-term interest rates maintained at 4% would require an underlying primary deficit (*i.e.* the cyclically adjusted balance net of one-off and temporary measures excluding interest payments on consolidated government liabilities) no higher than around 0.7 per cent of GDP to stabilise the debt ratio; keeping it unchanged of 1 per cent would thus not be sufficient to stop the debt ratio from rising (as noted in Figure 1.2, scenario 2).

However, other, more favourable scenarios are possible. As an illustration, assuming 0.5% lower interest rates and 0.5% higher growth, the debt ratio would slightly decrease even without further reductions in the primary deficit after 2013 (Figure 1.2, scenario 4). The risk premium on Slovak debt could well fall if the credibility of the future Slovak consolidation path were to be established and/or the euro area crisis resolved satisfactorily. Debt risk indicators are relatively favourable: the share of externally held debt is relatively low, foreign currency debt is negligible, the maturity structure is well balanced and contingent liabilities from the banking sector are well contained. Nevertheless, the opposite risk may also materialise. It mainly relates to contagion of the euro debt crisis to the foreign-owned banking sector. As long as the euro crisis is not resolved, contagion risks will impose a premium on access to financing. If the growth rate were to be weaker and interest rates higher, the debt ratio would accelerate. The margins involved between a successful consolidation and one with an unsustainable debt path are quite small.

In March 2012, Slovakia was among the 25 EU-signatories to the Treaty on stability co-ordination and governance in the EMU, which introduces stricter fiscal surveillance, notably by establishing a balanced structural budget rule that must be transposed into national legislation within one year of the ratification of the treaty. For Slovakia, the treaty will require the Medium-term Objective (MTO) to be set at a maximum structural deficit, excluding one-offs, of 0.5% of GDP. Once outside the excessive deficit procedure, the reduction of structural deficits by at least 0.5 percentage points of GDP annually will serve as a benchmark for assessing the adjustment path towards the MTO. An MTO of 0.5% of GDP was incorporated into the Slovak *Stability Programme for 2012 to 2015* and the target deficits were respectively 2.3% and 1.7% of GDP for 2014 and 2015. The government adopted a budget with slightly revised targets for 2014 and 2015 (2.4% and 1.9% of GDP respectively) reflecting lower expectations for future macroeconomic developments. On the basis that the output gap is eliminated by 2015, the MTO should be met in 2018 according to OECD calculations. With a nominal potential growth at 5¼ per cent, long-term interest rates at 4 per cent, and the structural deficit maintained at 0.5% of GDP after 2018, the debt ratio would reach 40% of GDP by the next decade (Figure 1.2, scenario 5).

The MTO implies that the sustainable debt ratio is quite low: the implied "steady state" debt ratio for an economy growing at a trend rate of 5¼ per cent stands at below 10%. An argument could be made for Slovakia's sustainable debt ratio to be higher, depending on the degree to which public borrowing is used to finance investment (Box 1.1). To the extent that growth opportunities are available from public investment, the close-to-structural balance concept should not be an overriding constraint. However, the need of borrowing capacities for temporary spending and the contingent liabilities related to demographics have to be taken into account and argue for a cautious approach. In any case, with a balanced structural budget, progress towards a low debt ratio will be gradual. The debt ratio would remain above the 30% level reached in the pre-crisis years at least until 2030.

Population ageing increases contingent liabilities

Allowing for the implicit liabilities built into the present pension and health systems would entail filling in a larger fiscal gap. By 2050, Slovakia will have the steepest increase

Box 1.1. **Is a near-to-structural balance rule optimal for Slovakia?**

Government investment does not need to be tax-financed. Intergenerational equity suggests that a permanent increase in government spending should always be financed by taxes, implying a long-run balanced budget and a debt ratio of zero. However, it may be argued that public investment should be financed by borrowing, since government debt may be self-financing depending on the rate of return on public investment (implying that no surpluses beside those generated by investment returns are necessary to ensure sustainability).

Public investment is nevertheless difficult to define or measure and attempts to apply a "golden rule" – that government investment can be financed by borrowing – have been unsuccessful and subject to abuse. However, to the extent that it is possible to measure government net worth (*i.e.* taking into account changes in the asset side of its balance sheet) government borrowing can be justified from an inter-generational viewpoint. The intention to calculate and monitor government net worth should give important insights into this aspect of sustainability in Slovakia.

Borrowing capacity is an important factor. While Slovak debt characteristics (maturity, external dependence, etc.) are not out of line with OECD norms, its smaller and less liquid bond market increases its vulnerability to credit market pressures. Research shows that financial markets react in a discrete and abrupt way to debt build-ups and that there are threshold effects. This threshold is likely to be lower for Slovakia than the OECD average.

Tax smoothing requires borrowing capacities for temporary spending. Under the assumption that tax rates should be smooth, debt should be used to finance temporary spending, such as cyclical or unusual investment spending. This requires that governments maintain a capacity to borrow for counter-cyclical purposes. To the extent that the Slovak economy is more vulnerable to cyclical shocks, debt should be lower, but allowing higher fluctuations.

Contingent liabilities need to be taken into account. A more comprehensive and ambitious approach to debt sustainability is to set an objective for government debt which also takes into account the requirement to fund future contingent liabilities. While this may entail a degree of pre-funding, where governments are able to borrow at advantageous rates to fund a build-up in government assets, for a small economy like Slovakia a preferred option would be to aim for a lower level of gross debt.

in the old-age dependency ratio of all EU member states and will rank second, after Poland in level. Ageing of the population is thus a potential source of future tax pressure if debt trends are to be kept on track. Until 2060, the share of ageing-related spending is estimated to increase by 7.5 percentage points of GDP if current levels of pension generosity and health provision are maintained (European Commission, 2012). According to recent OECD estimates, stabilising debt at 50% of GDP in 2050 would require improving the underlying primary balance by 3 to 5% of GDP, on top of the current consolidation efforts, from 2012 onwards depending on assumptions on the future increases in pension and healthcare spending (Sutherland *et al.,* 2012). While future ageing liabilities can be seen as a budgetary imbalance, it can also be viewed as a measure of reform needed to reduce the growth of ageing related spending.

Strengthening the medium-term budgetary framework

To limit the risks of slippage from the long-run adjustment path as has happened in the past, the medium-term budgetary framework needs to be strengthened. Structural deficit problems are partly due to a failure to run an adequate surplus during high growth years (Horvath and Odor, 2009). For instance, between 2004 and 2008, underlying structural primary balances stagnated or even deteriorated while the economy was expanding rapidly (Toth and Bugyi, 2012). Government consumption growth was positively correlated with real GDP growth, at a lower level than in most other Central and Eastern European countries though (Darvas, 2010). There have also been significant upward revisions to the deficit because of "off-budget' financial transactions being reclassified as capital transfers (Odor, 2011).

A debt rule is a useful reinforcement of budget discipline

To shore up the credibility of budget goals, the *National Reform Programme* proposed a reform of fiscal rules and institutions, adopted in the *Fiscal Responsibility Act* (FRA) in December 2011. The focus of the FRA has been placed on debt containment, with supporting rules for government spending, local government borrowing and data disclosure (Box 1.2). An upper limit of 60% of GDP has been set on general government debt until 2017, with graduated sanctions being phased in when the debt level exceeds 50% of GDP. The debt limit is to be reduced by 1% of GDP per annum after 2017, falling to 50% of GDP by 2028, with the threshold for sanctions becoming 40%. Sanctions starting from 55% of GDP would not be applied for the period of 24 months after a new government comes into office or in case of severe recessions, financial crises, natural catastrophes or war.

Box 1.2. **Procedures for containing government debt**

The *Fiscal Responsibility Act* establishes procedures for the introduction of escalating measures to justify or correct debt accumulation as debt approaches or exceeds specified limits. Potential sanctions are graduated depending on the proximity to the debt ceiling (60% until 2017 and 50% from 2028 onwards):

- From 50% of GDP up to 53% of GDP (40% and 43% from 2028 onwards) the Ministry of Finance addresses a letter to the parliament explaining the reasons for high debt including measures for its reduction.
- From 53% of GDP up to 55% of GDP (43% and 45% from 2028 onwards) the government submits to the parliament a proposal of measures for debt reduction and the wages of government members are reduced to the level applicable in the previous fiscal year.
- From 55% of GDP up to 57% of GDP (45% and 47% from 2028 onwards) the Ministry of Finance freezes 3% of state budget expenditures (with pre-defined exemptions such as interest payments, EU funds and co-financing), while reserves of the government and the Prime Minister are frozen as well; the government should submit to the parliament a general government budget proposal which maintains or reduces the consolidated general government expenditure (with pre-defined exemptions such as interest payments, EU funds and co-financing) compared to the previous year. It applies also to local governments.
- From 57% of GDP up to 60% of GDP (47% and 50% from 2028 onwards) the government should submit to the parliament a balanced (or in surplus) general government budget – it applies also for local governments.

Box 1.2. **Procedures for containing government debt** *(cont.)*

- From 60% of GDP (50% from 2028 onwards) the government asks the parliament for a vote of confidence.

The sanctions applying from the 55% threshold are not enforceable for a period of 36 months after the occurrence of an economic downturn – defined as a difference of at least 12 percentage points between the final annual GDP growth rate in the previous year and the final annual GDP growth rate in the year preceding the previous year – or if general government expenditures on banking system bailouts, natural disasters and international treaties together exceed 3% of GDP.

A debt ceiling can be an effective way of ensuring stock-flow consistency and can be an important back-up to a structural balance rule, not least by making an important contribution to budget transparency. It is less subject to the accounting gimmickry that can plague the pursuit of deficit targets (such as off-budget spending). It is also less subject to measurement error than a structural deficit rule, which can be misleading if output gap and potential growth estimates are set too optimistically, a vulnerability which may be accentuated in a small, open and catching up economy like Slovakia. For instance, a mechanical projection of the structural deficit in 2010 using pre-crisis estimates of potential growth would have been nearer to 4% than 8% of GDP. However, a debt rule cannot substitute for a deficit rule and can, in certain circumstances conflict with it. For example, while there is an exemption for severe recessions, if the ceiling is to be a constraint on fiscal policy, a debt rule calls for possible pro-cyclical fiscal action, when debt is near the ceiling. As designed, the system is intended to enforce continued consolidation during cyclical downturns. This feature is in contradiction to a structural balance rule, which explicitly avoids pro-cyclicality. This may increase the difficulties both of implementing the debt cap and of establishing its credibility, as for instance is the case in Poland (OECD, 2012b).

At this stage, the debt rule may not coincide with the structural budget objective. The debt rule is likely to come into play from 2014. Thereafter it might be a weaker budget constraint than the pursuit of structural budget balance which, as described above, will put government debt on a trajectory towards a 40% ratio long before 2028 (Figure 1.2). The national fiscal rules would thus need to be made consistent with Slovakia's new EU fiscal discipline requirements, complementing and reinforcing a cyclically adjusted deficit target. Not to do so would be to risk debt ceilings becoming targets which do not provide sufficient incentive to maintain a structural budget balance. One way of forestalling such a possibility would be to introduce into national legislation spending ceilings consistent with reaching a structural balance in the medium term.

The new Fiscal Responsibility Board will help monitor fiscal sustainability

A *Fiscal Responsibility Board* (FRB) has been set up notably to monitor and evaluate compliance with fiscal responsibility rules (Box 1.3). In particular, during the budget preparation, it will determine whether the short- and long-run sustainability criteria are being met and the budget adjustment needed to achieve them if they are not. In that context, one of its most important roles will be to construct and compute an indicator of long-term sustainability which will reflect implicit and contingent liabilities, especially

Box 1.3. **Nature and role of the *Fiscal Responsibility Board***

Independence of the FRB

The Fiscal Responsibility Board (FRB) is an independent body and comprises 3 members elected by the parliament (for the first time, a 3/5 majority is required for each member, afterwards only the vote on the head of the FRB will require such majority) and a secretariat. Members have a 7-year mandate (which cannot be repeated). The National Bank of Slovakia (NBS) Governor proposes a candidate for one of the three members. Membership of the FRB is incompatible with membership of NBS' Board. The FRB is financed by the NBS.

Role of the FRB

As defined in the constitutional *Fiscal Responsibility Act* the FRB's role is to draw up and publish annual reports on the long-term sustainability of public finances and the compliance with the fiscal responsibility rules and the fiscal transparency. In particular, the FRB will define a long-term sustainability indicator (measured as the difference between the current value and the sustainable value of the structural primary balance in percentage of GDP). On the basis of this indicator, the government will determine the pace at which it intends to improve the sustainability of the public finances (reduce the indicator) for the whole period of its office. The FRB will assess compliance of the government with its plans, by taking into account the impact of factors behind the control of the government on the long-term sustainability indicator. The FRB will also regularly prepare state balance and net worth calculations.

those related to ageing. The FRB will also evaluate the effects of structural reforms (such as parametric changes to pension systems) on budget sustainability. Its remit will also include the calculation of government net worth, which is a potentially important means of evaluating the uses to which public debt are being put, as regards public capital accumulation or consumption.

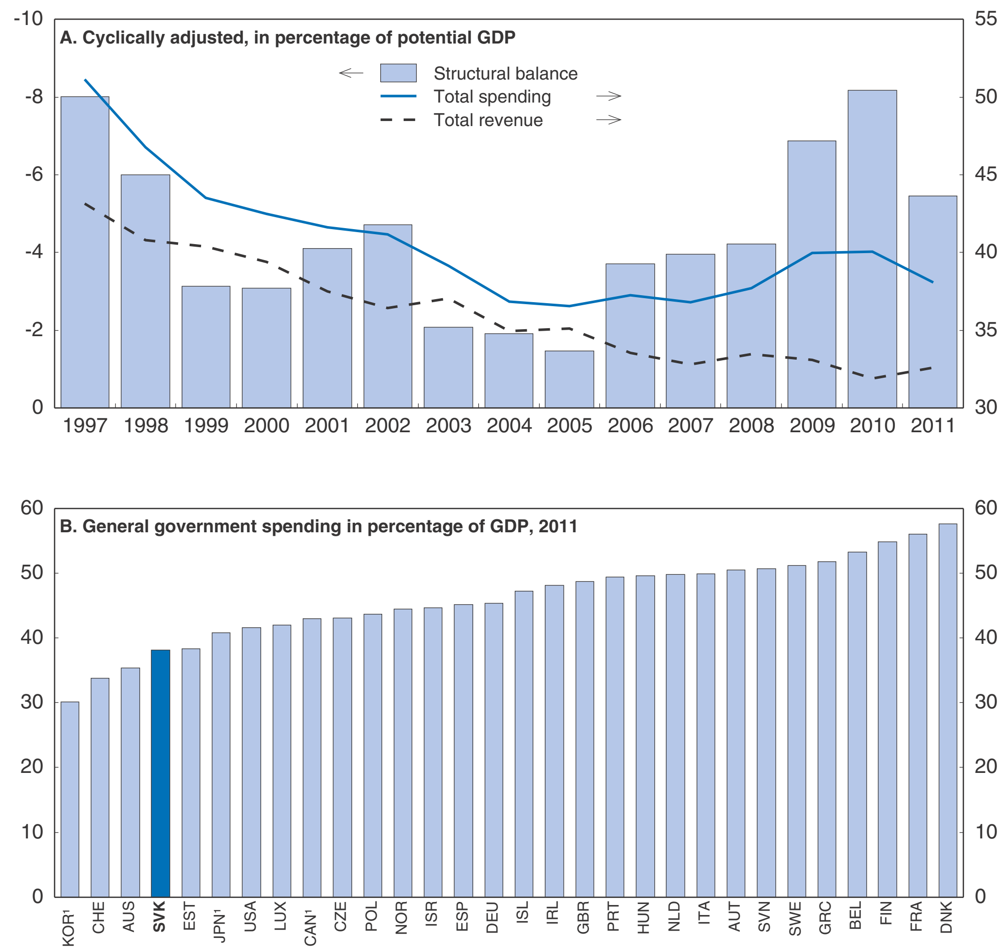
The creation of an independent fiscal council responsible for monitoring government compliance is a potentially important advance in the pursuit of budget transparency. The FRB's mandate and make-up follow OECD best practice, to the extent that best practice can be deduced from the limited history of such institutions (Kopits, 2011). The institution will be independent, reinforced by its being financed by the central bank, and it will have no normative role in policy-making. Its success will depend on its technical competence, which will be severely tested, since its remit is ambitious and moves into uncharted territory. In particular, the sustainability concepts are subject to severe valuation and estimation difficulties, with the long-run sustainability index and the impact of reforms on it being dependent upon important elements of judgement, not least with respect to the discount factors and functional parameters on which they are based. Like all such institutions, to be effective the FRB will need to build up its reputation and credibility, with the continued backing from the government and opposition, based on complete access to government information.

Attaining a sustainable and growth-friendly spending path

Strengthening the medium-term expenditure planning processes

A sharp increase in public expenditure as a ratio of GDP has been the proximate cause of the structural budget deficit that has emerged with the crisis, though the structural deterioration between 2004 and 2008 corresponds to the possibly excessive tax cuts between 2003 and 2006 (Figure 1.3). Corrections to both revenue and expenditure paths have thus needed to be part of the consolidation process so far. Both tax increases and expenditure cuts may damage growth. Reducing public spending further from its currently low level poses two principal challenges. The first is to improve the budget planning framework so as to ensure a chosen medium-term path can be maintained; the second is to prevent expenditure ceilings from becoming distorting, by more effectively prioritising public spending, particularly to maximise its growth enhancing potential.

Figure 1.3. **General government spending and revenue**



1. Refers to 2010.

Source: OECD Economic Outlook 91 Database.

StatLink http://dx.doi.org/10.1787/888932748593

From the middle of the last decade, the focus of budgeting has moved towards multi-year budget planning, but targets for the out years have been indicative and subject to *ad hoc* change. More effective budget planning is thus needed to ensure that the consolidation process is successful. To that end, the *Fiscal Responsibility Act* lays the foundation for new medium-term control mechanisms for the management of public finances, by paving the way for the introduction of expenditure ceilings. These will be specified in detail in an amendment to the General Government Budgetary Rules Act currently under preparation. Unlike the debt rule, the expenditure ceilings are operational instruments and are directly linked to government plans to reduce the gap between the current and the sustainable structural budget deficit (Box 1.3).

The public expenditure ceilings as envisaged by the initial draft of the concerned legislation are defined as the maximum amount of total accrued general government expenditures – including tax expenditures – that could be spent without exceeding the government target of structural deficit. They exclude the expenditures of local governments, EU joint programme funds and debt service. The framework is designed to allow the operation of automatic stabilisers: the ceilings do not include unemployment related expenditures and the tax revenues and expenditures used to calculate the ceilings are cyclically adjusted. The ceilings are set for a period of four fiscal years and expressed in euros.

The spending ceilings will have to be in line with the new EU fiscal discipline requirements. Once outside the excessive deficit procedure and until the MTO are achieved, Slovakia will be required to ensure that expenditure growth is below a specified benchmark in accordance with the EU legislation. This new framework will ensure that adjusted primary general government expenditures, net of discretionary revenue measures, grow in real terms at a slower pace than the reference rate of potential growth of the economy, to an extent that ensures that the underlying cyclically adjusted general government balance declines by 0.5% of GDP year-on-year. Taking account of revenue-side discretionary measures, the Stability programme aim is to contain adjusted real expenditures to a growth rate of less than 1% per annum.

Reprioritising government spending to enhance growth and efficiency

While consolidation usually has negative short-term effects on measured output growth, it can be used as an opportunity to enhance underlying growth. There are several mechanisms. *First*, certain components of public spending, such as education, support for innovation, or infrastructure spending make a direct contribution to growth. *Second*, reducing the distortions due to tax expenditures or subsidies may improve incentives and resource allocation, leading, for example, to higher labour force participation or private capital formation. *Third*, reducing the input costs of public service provision while maintaining outputs would lead to productivity improvements that not only increase welfare directly, but may also improve competitiveness in the private sector. No direct international yardstick exists for reprioritising spending in this fashion. However, in Slovakia's case a number of areas can be identified where resources can be saved or redirected (Table 1.1).

Increasing spending efficiency

Revisiting government wages

Reducing government sector wages towards private sector levels offers possibilities for consolidation. Government/private sector wage relativities increased significantly in Slovakia from the early 2000s. Reversing this change would reduce public spending by around 0.8% of GDP (Table 1.1). Past and future consolidation packages have included restrictions on public wages. The consolidation measures in 2011 include a 10% cut of the central government wage bill. Government entities were able to choose whether to comply with the requirement to cut spending by laying off staff or by cutting the flexible component of their salaries. Around 4 500 public employees were laid off and the average

Table 1.1. **Growth-friendly consolidation strategies**

Instrument	Action	Consolidation objective/mechanism	Potential consolidation contribution	
			OECD average	Slovakia
			Per cent of GDP	
1. Reduce resource costs and increase efficiency				
Reduce government wage bill	Return to government/private sector wage ratio in the early 2000s	Cost savings	0.5	0.8
Increase efficiency in:				
Health care	Improve to efficiency frontier estimates	Reduce costs to fund future expenditure growth	1.9	2.7
Primary and secondary education			0.5	0.4
2. Increase tax efficiency and reduce tax distortions and subsidies				
Improve VAT collection	Raise collection efficiency to OECD average (unweighted)	Increase taxable capacity, shift tax away from labour and enhance economic growth	0.8	0.6
Reduce subsidies	Reduce to OECD average (unweighted) as a share of GDP		0.3	0.2
Increase taxes on residential property	Impose taxes at the unweighted OECD average rate		0.4	0.6
Increase environmental taxes	Emission trading system with full permit auctioning	Increased revenues with enhanced sustainability	2.0	1.8
3. Reform entitlement programmes				
Adjust social transfers to OECD average	Reduce to OECD average (unweighted) as a per cent of GDP		0.8	(=)
Reform pension liabilities	Elimination of tax breaks for retirement	Long-run sustainabiltiy	0.6	0.2
	Enhance second (fully funded) pillar			(-/+)
	Change pension parameters in all three pillars			(++)
4. Increase growth-enhancing spending				
Increase infrastructure spending	Make better use of EU funds	Higher long-term growth potential		(-/+)
	Better management of PPPs and cost-benefit analysis			(-/+)
Increase education spending	Raise volume of funds per student	Higher growth through human capital improvement		(-/+)
	Raise quality of tertiary education system	Higher growth through innovation and "knowledge economy"		(-/+)
Better target labour market spending	Raise capacity and efficiency in PES	Higher labour resource utilisation		(-/+)

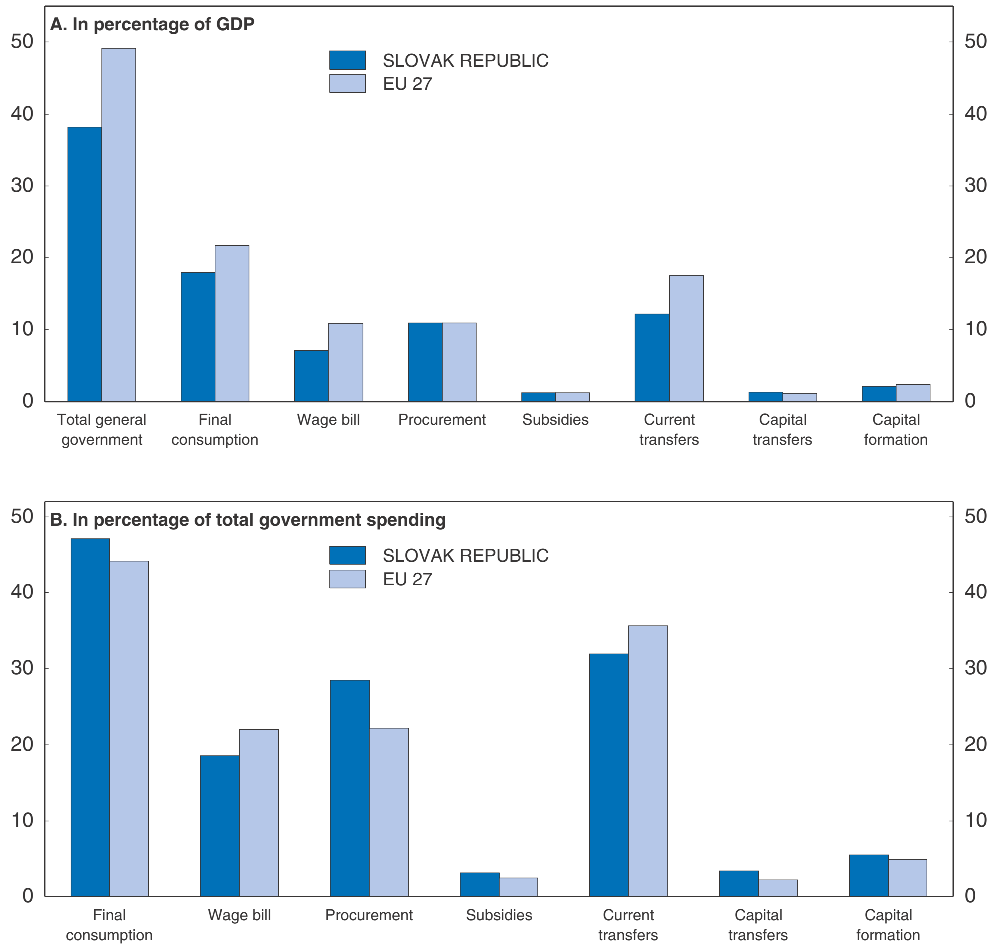
Notes: (n.a.) not available; (=) no effect; (-/+) negative short-term effect, positive long term effect; (++) positive effect.
The elimination of tax breaks for retirement is based on data for 2007 from OECD (2011*b*), *Pensions at a Glance, 2011*.
Health care efficiency estimates are from Joumard *et al.* (2010).
Education efficiency estimates are based on Sutherland *et al.* (2007).
Source: Hagemann (2012) and OECD calculations.

wage cost per employee was reduced by 1.2% in 2011. The payroll expenditures of the 2012 state budget have been frozen at the 2011 level, while for the other general government entities, wages are expected to grow below the projected wage growth in the private sector (MFSR, 2012).

However, the potential for overall wage cost saving is probably significantly lower than 0.8% of GDP. By EU standards, the government wage bill is relatively small as a proportion of GDP and total government spending (Figure 1.4). The ratio of the government wage bill to the share of public employment in the total labour force in Slovakia is similar to the OECD average suggesting Slovak government wage rates are not out of line with international experience (Table 1.2). In any case, the issue of wages needs to be broached on a sector by sector (as well as regional) basis, taking into account the need for quality improvements and

Figure 1.4. **General government expenditure by economic category**

In 2011



Source: Eurostat.

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Table 1.2. **General government labour costs**

General government wage bill		General government employment		Index of cost/productivity	
% of GDP, 2009		% of labour force, 2008		Ratio of government wage bill to employment share	
Slovakia	OECD	Slovakia	OECD	Slovakia	OECD
7.9	11.1	10.7	15	0.74	0.74

Note: The OECD average is excluding Iceland and Turkey due to missing data.
Source: OECD, *Government at a Glance*.

competition for labour with the private sector. In some sectors, government services may be "underpriced" relative to the rest of the economy.[1] For example, public sector wage adjustment may demand an element of catching up in health care and in education (OECD, 2010a). It is welcome that the wages of teachers have been exempted from the freeze and that wages of medical staff (doctors and nurses) were significantly increased in 2012 (+23%). More needs to be done for teachers. Teacher quality has a major impact on student achievement and making teaching financially more attractive is a mean of recruiting more able graduates. Despite some increases, teachers' salaries are considerably low by international comparison and should be raised. This measure should be accompanied by structural reforms to improve the quality of teaching (see Chapter 2).

Ensuring transparency in public procurement

Achieving greater transparency in public procurement is also important for cost reduction, especially given that the Slovak Republic spends around 11% of GDP on procurement, a larger share of total public spending compared to the EU average (Figure 1.4). Providing an adequate degree of transparency throughout the entire public procurement cycle is critical to minimise the risk of fraud, corruption and mismanagement of public funds in order to ensure fairness and equitable treatment of potential suppliers. Progress has been made in this direction. Like the majority of OECD countries, the Slovak Republic publishes most public procurement information on its central procurement website. Since the second half of 2010, the government has operated a mandatory electronic central registry of contracts for the whole public administration. Additionally, contracting entity websites may disclose procurement plans, selection and evaluation criteria, and the name and amount of contract awards to a selected supplier. Some of this information, such as selection and evaluation criteria and contract award, is also published in the official journals. The single-entry procurement website is one of the few in the OECD that allows users to track the outcomes of contracts, an important functionality for making the public procurement transactions more transparent. Finally, like most OECD countries, the Slovak Republic has policies in place to promote the use of digital signatures and electronic filing in the public sector. It also administers public-private partnerships for e-government projects which can help increase innovation in public administrations through greater knowledge transfers and exchange of best practices between the public and private sectors.

However, public procurement still lacks some important elements of transparency. Slovakia does not publish justifications for awarding a contract (which only 40% of OECD member countries do) and does not allow tracking of public procurement spending online (which a third of member countries do). Contrary to most OECD countries with a single-entry procurement website, it does not allow businesses to perform tender searches. Furthermore, procurement rules tend to hamper contracting authorities to choose the most economically advantageous tender as they restrict the choice in evaluation criteria and strike down qualitative criteria as discriminatory (OPKE, 2011). As a result, state institutions are encouraged to make decisions only on the basis of the price offer without taking into account the negative effect on the procurement quality. The Public Procurement Act should be amended to ensure that procurement decisions are also based on quality and that the tender achieving the best value for money, meaning the optimal combination of quality and cost, is selected. Also, procurement authorities should make sure that the Competitive Dialogue procedure, a more flexible procedure defined by the EU Commission and consisting in a pre-selection of candidates followed by a dialogue with bidders with the aim of developing suitable solutions to meet procurement requirements – could be used for complex projects.

In some areas current procurement rules are also perceived to be too difficult to apply. Administrative barriers cause large time delays and undermine the provision of public services. Efficiency gains from outsourcing cannot be reaped, or government services are provided in a less targeted form than necessary. For instance, complicated administrative procedures are one of the main hurdles to the procurement of training programmes by the local labour offices (see Chapter 2). Difficulties of this nature should be systematically recorded. A task force should be implemented to provide recommendations on making procurement rules easier to apply but without undermining their original intentions of fighting corruption and increasing efficiency. The potential savings from greater competition and efficiency in supply are difficult to gauge, but a 10% saving in procurement costs would amount to a little over 1% of GDP.

Improving public service efficiency

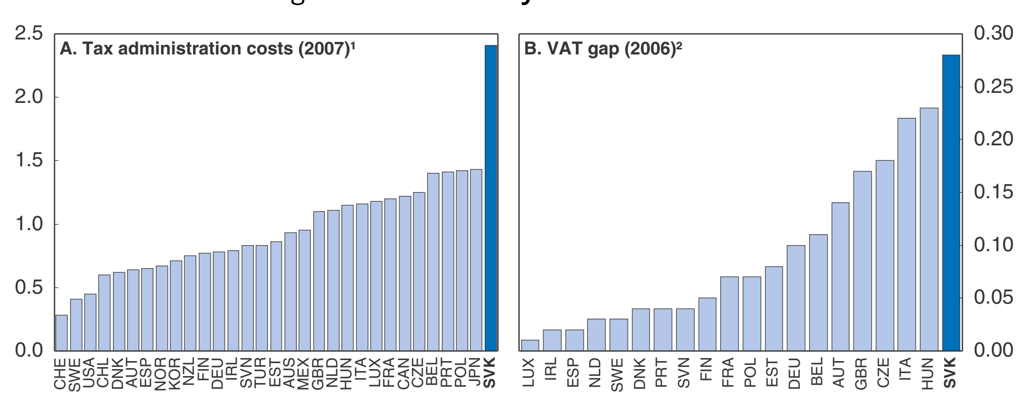
In some areas, greater output efficiency offers opportunities for resource savings. For instance, adopting best practices in health care might yield productivity increases of as much as 2¾ per cent of GDP (Table 1.1). However, achieving efficiency gains is difficult as it often requires determined managerial action and political will and may involve firing the old and hiring new skills. The adoption of best practices also takes time and efficiency gains materialise with some delays.

Efficiency savings in other sectors are probably smaller and international benchmarks are difficult to define. For instance, potential gains in the education sector are limited, Slovakia achieving slightly below-average outcomes in the primary and secondary sectors from significantly below-average spending (Sutherland *et al.*, 2007). Some measures could contribute to enhancing educational outcomes without increasing spending on education, but the improvement would be weak (see Chapter 2).

Improving the collection of taxes

Indicators suggest that tax collection is not cost-efficient. The "cost of collection ratio", which compares annual administration costs with the total revenue collected, is the highest in the OECD (Figure 1.5, left panel). The structure of the revenue authorities is being simplified with the multiple local and branch offices of the Tax Directorate being replaced by new regional tax offices. This should lead to greater administrative harmony and efficiency. A merger of the tax and customs administrations into one institution is also planned and should also help to improve the tax collection ratio. Finally, the transition

Figure 1.5. **Efficiency of tax collection**



1. Ratio of aggregate tax administration costs per 100 units of net revenue collection.
2. The VAT gap is defined as the difference between the accrued VAT receipts and the theoretical receipts, as a share of the latter.

Source: OECD, *Government at a Glance 2011;* and Reckon (2009), *Study to Quantify and Analyse the VAT Gap in the EU25 Member States.*

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towards an integrated tax collection system (UNITAS I and II projects, unifying the collection of taxes and social security contribution) could reduce administrative costs for both taxpayers and the administration and facilitate the control of under-declared work, tax evasion and fraud through better crosschecking and auditing (Leibfritz, 2011).

Value added tax (VAT) revenues fall significantly short of what a standard rate would produce (Figure 1.5, right panel). The reduced VAT rates are contributing only slightly to the high VAT gap. By contrast, low tax compliance is likely to be one of the main reasons for low VAT revenue collection efficiency (OECD, 2010a). Bringing the efficiency of VAT revenue collection up to the OECD average would raise extra revenues equivalent to 0.6% of GDP (Table 1.1). Thus, combating tax evasion should represent an important part of the effort to make the system more efficient and monitoring activities should be strengthened.

Reducing tax expenditures to remove distortions

Tax allowances and exemptions can distort incentives, inhibit growth (particularly via the labour and capital markets) and cause resources to be allocated sub-optimally. Removing tax breaks can be seen as both a potential source of budgetary revenues and as a driver of economic growth. Since many of these tax breaks offer an indirect way of meeting spending objectives without necessitating direct budgetary provision, they should probably be treated on a par with government spending *per se*, and this is, in fact, the case with respect to setting expenditure ceilings.

There are three areas where action on tax expenditures may assist growth while taking pressure of other items of expenditure: removing the preferential treatment given to property, phasing out tax advantages for self-employed and reducing exemptions and reduced tax rates on environmental externalities.

- Slovakia has relatively low receipts from recurrent real estate taxation and increasing these to the OECD average would remove a distortion and raise government revenues by 0.6% of GDP (Table 1.1). The current taxation of real estate is lower than that on investment in financial assets and is not based on market value, thereby distorting the allocation of capital towards owner-occupied housing and amplifying the volatility of house prices (OECD, 2010a). An increase in real estate taxes that takes the market value of the property into account was rightly considered by the government but ultimately not included in the 2013 budget proposal. This measure should be implemented, as quickly as possible. At the same time, a balance should be found to avoid unwanted revenue volatility and possible negative social effects.
- Self-employed workers benefit from a lower tax wedge than standard workers. Before September 2012, their minimum tax base for social security contributions was less than half of the average monthly taxable income of the previous year. Also, social security contributions were not levied on the income earned on some types of sub-contracted work ("work agreement"). This encouraged involuntary self-employment as firms may try to evade social security contributions by substituting self-employed for regular employees (OECD, 2010a). The partial harmonisation of the taxation of self-employed and standard labour contracts implemented mid-2012 is thus highly welcome and the opportunity for further harmonisation should be explored. The government should ensure that the recent reforms remove incentives to involuntary self employment.
- Removing non-neutralities with respect to energy taxation would contribute to reaching consolidation objectives, to improving allocative efficiency and to greening growth. Tax

exemptions on energy are estimated to amount to around 0.1% of GDP. Such exemptions encourage wasteful consumption, provide incentives to develop or maintain energy-consuming technologies and impede investment in clean energy sources. They also increase the cost of climate change mitigation in Slovakia and thus should be phased out (OECD, 2010a).

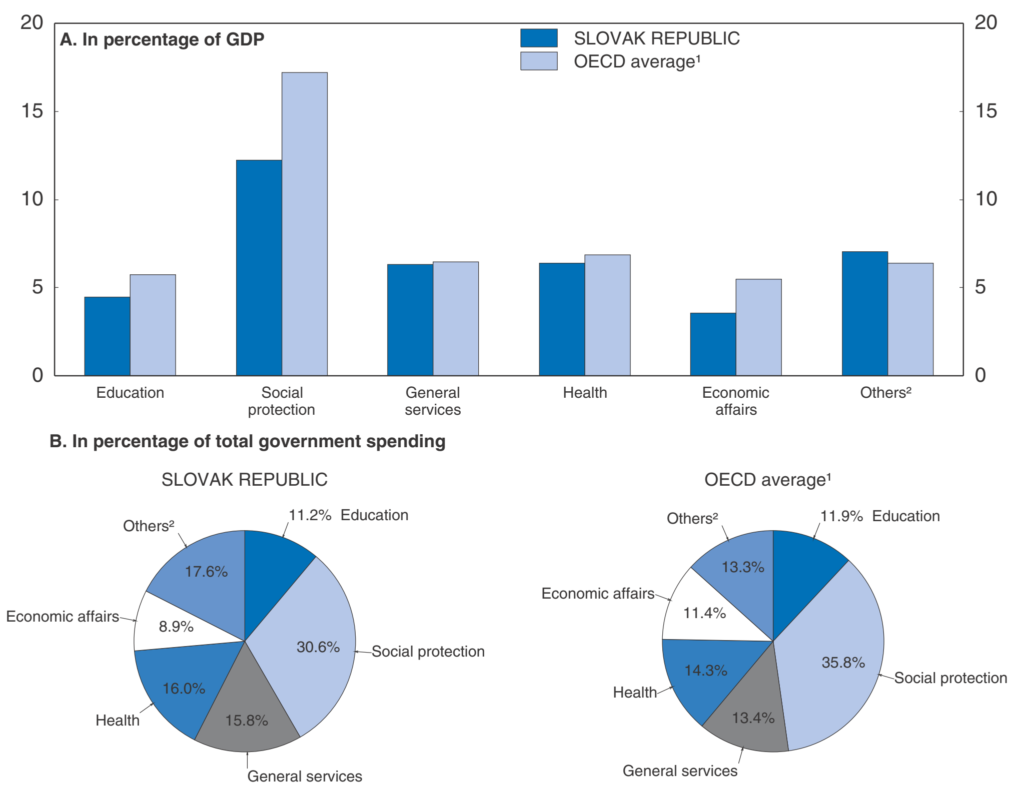
Reforming entitlement programmes selectively

Social spending is relatively low and well targeted

For a large number of OECD economies, reforms to transfer programmes would offer the opportunity for consolidation gains and reductions in disincentives to work, without necessarily affecting the aim of greater distributional equality. Reductions in inequality (as measured by the difference transfers make to the Gini coefficient) are not systematically linked with the ratio of transfer programme spending to GDP, and Slovakia with a relatively low ratio, achieves as much in terms of inequality reduction as countries spending far more (Figure 6 and Figure 7). The fact that social transfers are smaller but more effective than the average reduces pressure for their expansion, but also reduces the potential role they need to play in a growth-friendly consolidation. For instance, disability and family benefits can cause labour

Figure 1.6. **General government expenditure by function (COFOG)**

In 2010



1. Arithmetic average over OECD countries except Australia, Canada, Chile, Mexico, New Zealand and Switzerland; and except the United States for environment protection category.
2. Others include defence, public order and safety, environment protection, housing and community amenities, and recreation, culture and religion.

Source: OECD, *Annual National Accounts Database*.

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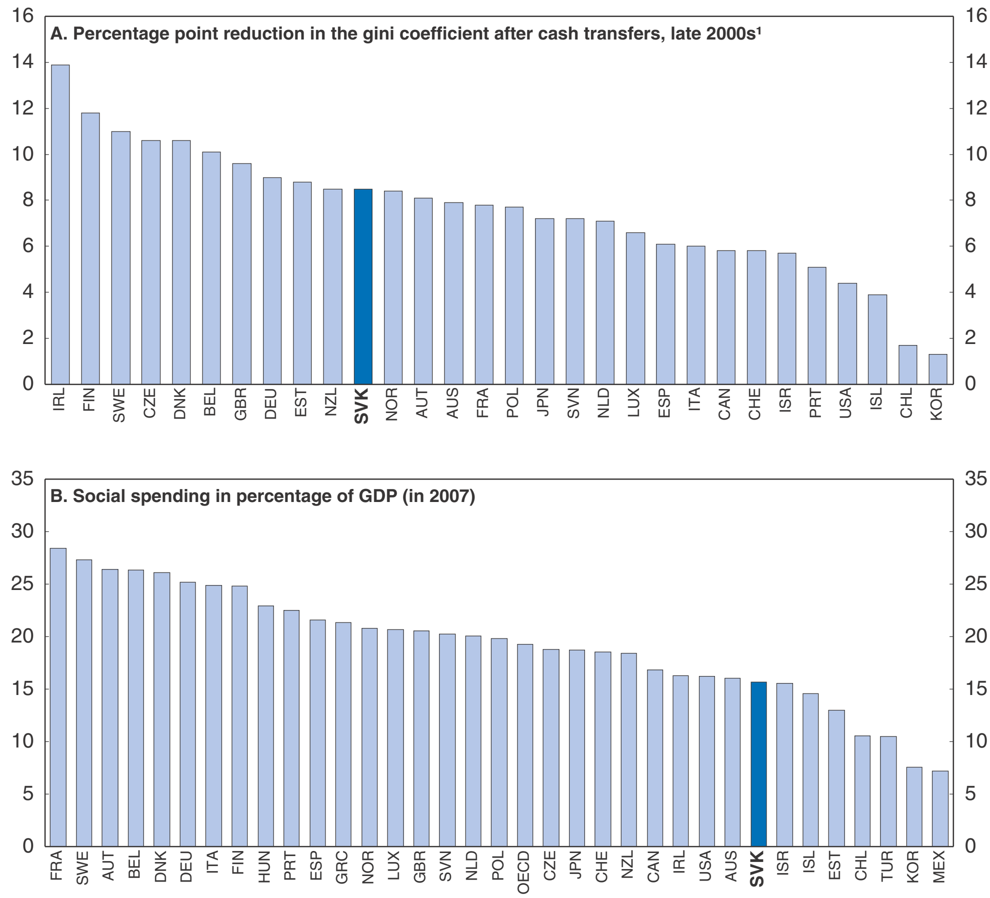
Figure 1.7. **Income inequality and social spending**



1. Income inequality is measured by the Gini coefficient. The Earned Income Tax Credit enters cash transfers. In-kind transfers are not included.

Source: Joumard, Pisu and Bloch (2012), "Less Income Inequality and More Growth: Are They Compatible? Part 3. Income Redistribution via Taxes and Transfers across OECD Countries", *OECD Economics Department Working Paper*, No. 926; OECD, *Social Expenditure (SOCX) and Income Distribution and Poverty Databases*.

StatLink http://dx.doi.org/10.1787/888932748669

market distortions when poorly targeted and are important consolidation instruments in many OECD economies, though less in Slovakia because of their relative low level (Table 1.1).

Public pension system reforms are welcome as a first step

The public pension system, however, is an essential focus for consolidation, the importance of which should be emphasised by the new long-run sustainability indicator introduced by the *Fiscal Responsibility Act*. As noted above, demographics change will significantly raise ageing costs. Reforms delaying retirement and increasing labour force participation are required to ensure the long-term sustainability of the first pension pillar. In a no-change scenario, the public pension system will accumulate debt of over 200% of GDP by 2100 (OECD, 2010a). In August 2012, it was decided that the retirement age will be increased in line with gains in life expectancy and the pension's indexation system revised. These reforms, which are in line with OECD recommendations, are highly welcome. However, they may not be sufficient to ensure the sustainability of the public pension system as they would only halve the future increase in the accumulated debt in the first pillar (OECD, 2010a). One option to ensure the sustainability of the first pillar would be to adapt the pension replacement rate to financing conditions, for instance by including a sustainability factor into the pension formula (OECD, 2010a). In case this measure should unduly increase the risk of old age poverty, a more rapid increase in the retirement age should be considered. By contrast, raising the contribution rate may not be an option given the already relatively high tax wedge.

Raising growth-contributing spending

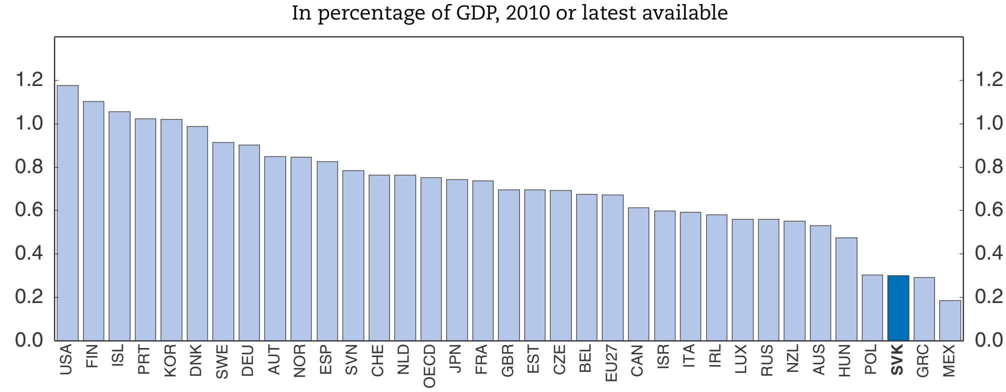
Increasing spending on education and R&D

Slovakia's educational outcomes are below the OECD average. Public spending on education ranks among the lowest in the OECD, at around 4.5% of GDP in 2010, around two percentage points below the OECD average (Figure 1.6). OECD research suggests that reforms which simultaneously increase the average number of years of schooling and raise the quality of educational achievement could raise GDP per capita significantly in the longer term (Gonand *et al.*, 2007). Exploiting foregone human capital opportunities is thus a priority and will require investing more in the education system. However, allocating more resources in this area will not be sufficient to improve performance and structural reforms of the education system are required (see Chapter 2).

As for education, public investment in research and development is low by OECD standards (Figure 1.8). The state of the knowledge economy remains rather backward, not only compared to the most advanced OECD countries (OPKE, 2011). Slovakia is the only Visegrad member with not a single university in any of the leading world university rankings and has the lowest share of innovative firms in the economy. In the ranking of top cited scientific articles it lags behind the Visegrad countries, but also behind countries less economically advanced such as Brazil, Turkey or Mexico. Even though a number of strategic documents refer to the knowledge economy, high level political co-ordination and implementation support has been absent (OECD, 2010a). Three commissions for the knowledge society have been successively established since 2006, following the election cycle and with a limited impact on policy action. The policy implications are complex, but evidently the research and development sector demands greater public resources rather than restrictions due to the consolidation process.

Figure 1.8. **Government budget appropriations or outlays for R&D**

In percentage of GDP, 2010 or latest available



Note: For Israel, defence is excluded. In the United States, general support for universities is the responsibility of state governments; therefore general university funds (GUF) is not included in total Government budget appropriations or outlays for R&D.

Source: OECD *Science, Technology and Industry Scoreboard 2011.*

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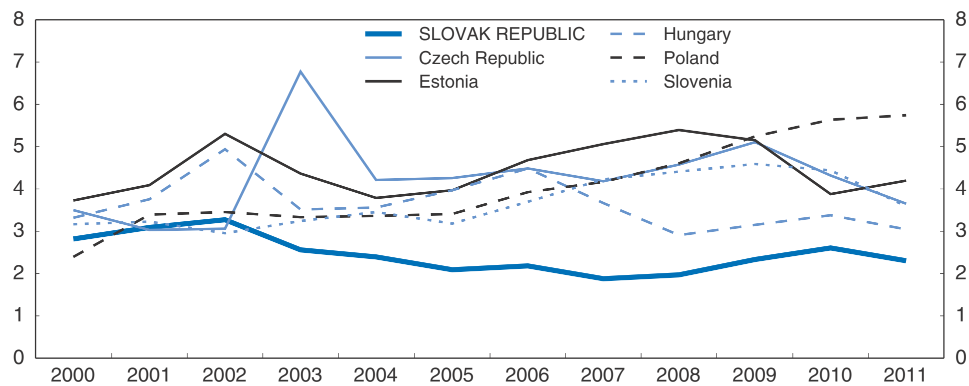
Infrastructure spending to support growth

Public investment has been declining over the past few years to relatively low levels compared to other catching-up economies (Figure 1.9). The role of public investment in future consolidation should be to return to normality, underpinning growth. The optimal government capital stock is impossible to define, but OECD study points to a positive impact of public infrastructure on growth, particularly when the capital stock is relatively low (Egert *et al.*, 2009). However, it also shows that the returns on investment are not uniform, either over sectors or time, with investment in telecommunications and electricity having a stronger impact than road or rail infrastructure. According to OECD estimates, investment in the electricity and telecommunications sectors in Slovakia was still below the threshold beyond which such investment has the highest impact on GDP in the early 2000's (Sutherland *et al.*, 2009). These findings suggest that developing infrastructure could be highly beneficial to growth but also point to the need to establish an effective framework for assessing and selecting infrastructure projects, using tools such as cost-benefit analysis.

Figure 1.9. **Public investment**

In percentage of GDP



Note: General government gross fixed capital formation value in percentage of GDP.
Source: *OECD Economic Outlook Database.*

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One instrument which has been widely adopted to increase efficiency and reduce the budgetary burden is the private financing of infrastructure projects via public-private partnerships (PPPs, Araujo and Sutherland, 2010). However, PPPs may also be used to bypass fiscal rules and may create large contingent liabilities. In addition, there have been problems in designing contractual relationships that allow efficient risk sharing between the public and private sector. In Slovakia two out of three PPP highway projects have been cancelled in 2010 as the authorities estimated that the contracting procedures were not transparent, the assessment of financial risks was inadequate and that financing these projects with EU funds and public funds would be less costly than using PPPs. To avoid abuses, the budgetary treatment of PPP could be changed, so that the general government balance reflects construction costs rather than debt servicing during the lifetime of the project. Also, the funding of infrastructure through PPP will need to be carefully designed to minimise taxpayer exposure to contingent future costs. Following the OECD recommendations for the public governance of PPPs would help Slovakia to get the most from this financing option (Box 1.4). In particular, improving transparency and efficiency of public procurement as mentioned above would be essential.

Box 1.4. Principles for the public governance of public private partnerships

Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities

- Ensure public awareness of the relative costs, benefits and risks of public-private partnerships in comparison with conventional procurement, ensuring a coherent and informed approach to PPP in the public sector and an active consultation and engagement with stakeholders, defining outputs in the PPP contract and monitoring service quality involving end-users.
- Maintain key institutional roles and responsibilities. This requires that procuring authorities, Public-Private Partnerships Units, the Central Budget Authority, the Supreme Audit Institution and sector regulators are entrusted with clear mandates (procurement process, audits, rule monitoring and enforcement) and sufficient resources to ensure a prudent procurement process and clear lines of accountability.
- Ensure that all significant regulation affecting the operation of public-private partnerships is clear, transparent and enforced. Red tape should be minimised and new and existing regulations should be carefully evaluated.

Ground the selection of public-private partnerships in value for money

- Prioritise all investment projects at senior political level. The decision to invest should be based on a whole of government perspective and be separate from how to procure and finance the project.
- Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test which should enable the government to decide on whether it is prudent to investigate a public-private partnerships option further.
- Transfer the risks to those that manage them best. Risk should be defined, identified and measured and carried by the party for whom it costs the least to prevent the risk from realising or for whom realised risk costs the least.
- Prepare the procuring authorities for the operational phase of the public-private partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the public-private partnerships, as the actors on the public side are liable to change.
- Maintain value for money when renegotiating. Only if conditions change due to discretionary public policy actions should the government consider compensating the private sector. Any re-negotiation should be made transparent and subject to the ordinary procedures of public-private partnership approval.
- Government should ensure there is sufficient competition in the market by a competitive tender process and by possibly structuring the public-private partnerships programme so that there is an ongoing functional market. Where market operators are few, governments should ensure a level playing field in the tendering process so that non-incumbent operators can enter the market.

Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process

- In line with the government's fiscal policy, the Central Budget Authority should ensure that the project is affordable and the overall investment envelope is sustainable.

Box 1.4. **Principles for the public governance of public private partnerships** *(cont.)*

- The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of public-private partnerships covers the whole public sector.
- Government should guard against waste and corruption by ensuring the integrity of the procurement process. The necessary procurement skills and powers should be made available to the relevant authorities.

Source: OECD (2012a), *Council Recommendation on Principles for Public Governance of Public-Private Partnerships*, 4 May 2012 – C(2012)86.

Making better use of structural funds

During the period between 2007 and 2013, Slovakia had the opportunity to obtain about EUR 13.4 billion from the EU structural funds (around 3% of GDP per year), including around EUR 6 billion dedicated to education, research and development and transport.[2] As of end-2011, the rate at which those funds are used remained below 25%.

- One of the main reasons for the low absorption is an extremely burdensome national system of EU structural funds administration. Instead of using available mechanisms to simplify grant-giving processes, a number of complicated rules and requirements are imposed by domestic legislation (OPKE, 2011). As a result, both project implementers and the administrating agencies are overburdened by administrative activities.
- There is some evidence that the quality and the transparency of the selection process of certain projects have been low. As a consequence, while being contracted, the projects did not pass the control mechanisms at the certification authority (OECD, 2010a).

A partnership between the European Commission and the Slovak authorities has been established to discuss and monitor further the reasons behind the low absorption of EU funds (EC, 2010). The system for EU funds' management should be reformed based on this analysis. Also, the administrative procedures should be simplified to remove hurdles to the submission of projects while remaining in line with EU regulations. Guidance for the preparation and the selection of projects should be improved to raise the quality of projects applications, increase the transparency of the selection process and reduce the assessment time of the certification authority.

Strengthening the role of public administration for successful spending programme implementation

Effective prioritisation, administration and programme control requires an efficient administration, where objectives are set unambiguously and results appraised. In these respects, according the Worldwide Governance indicators produced by the World Bank, the level of effectiveness of the public administration is low. In 2010, Slovakia ranked 19th among EU countries. This suggests that public administration effectiveness could be improved by adopting international best practices.

Improving budgeting procedures

Within the ambit of binding expenditure ceilings, where high-level budgetary allocations are made centrally and reflect political priorities, budgets need to be implemented flexibly to ensure efficiency and service quality, based on results. This requires a degree of "top-down" budgeting, which would involve each ministry being allocated funds (typically ring-fenced into economic categories) while being given more freedom in allocating them among agencies and programmes. Slovakia already implements top-down budgeting and responsibilities delegated to line ministries are close to international norms. As in most other OECD countries, line ministries cannot decide on the allocation of the budget envelope between payroll and other expenses, and on the number and types of posts in organisations. Capital expenditures are allowed to be carried forward but the carry-forward of current expenditure is permitted only in a limited number of cases.[3] Consideration should be given to expanding these responsibilities further to increase managerial flexibility. Typical elements in a programme to devolve decision-making would include increasing end-of-year flexibility (carry forwards).

A focus on performance and results is the necessary accompaniment to greater managerial flexibility and a robust system of internal and external controls needs to be in place to prevent abuse. Administrative capacities are too weak to ensure the effective implementation of public spending programmes and related follow-up assessments. Such capacities dedicated to the evaluation of policies should be expanded, for instance by appointing analysts to assess the economic, social, and environmental impact of public policies. The government has appropriately planned to develop evaluation in each line Ministry and the Fiscal Responsibility Board will be in charge of assessing policies in parliament. The use of performance assessments in promotion, contract renewals and compensation of public sector employees is limited and there is room for improvement regarding the strategic use of human resource management in central government.

Appropriate performance and results information should be included in the annual budget documentation. Such indicators offer an understanding of how the goals of various governmental policies and spending programmes are being achieved and could be used to assess spending effectiveness. This is an essential aid to expenditure prioritisation, which, as noted, is particularly important during a period of fiscal consolidation. Performance reporting should be carried out in a transparent manner and in a user-friendly format to avoid a useless swelling-up of budget documentation. The Slovak authorities could draw on OECD countries' experience in conducting their own performance evaluations. For example, Australia's Productivity Commission publishes an annual review of government programmes that is used in the budgetary formation process.

External control should be expanded. The Supreme Audit Office started providing value-for-money audits only in 2011 and the outcomes of these audits are not yet used in budgeting procedures. Despite some progress, corruption remains an issue in the public sector. The *ex post* audit processes should be improved by allocating more resources to the monitoring of programmes and evaluation outcomes should be taken into account in budget allocation. Budgeting procedures could make better use of international benchmarking by identifying best practices in this regard.

Enhancing transparency and public oversight

With its Public Finance Management reform, Slovakia has clearly achieved a higher standard of fiscal reporting and transparency (Horvath and Odor, 2009). Important progress has been made notably in respect of standardising accounting procedures, shifting from the cash principle to accruals, improving the content of budget documents, and abolishing non-systemic state funds. Public procurement has become more transparent and contracts signed by general government organisations and municipalities, as well as any contracts involving public funds, become effective only after their publication. The government has also enhanced transparency on the healthcare market and information awareness of patients by obliging health insurance companies to publish all contracts with healthcare providers.

However, there are areas where the current framework is still not satisfactory. The "Open Budget Initiative 2010" ranked Slovakia behind the neighbouring Czech Republic and Poland in the provision of satisfactory information on public finances (International Budget Partnership, 2010). For instance, this study points out that the relationships between the macroeconomic situation and the public finances are not well communicated to the public. To improve information on public finances, the Institute for Financial Policy has issued policy briefs providing various fiscal indicators on the Slovak fiscal policy. This practice should become routine, including explicit disclosure of the assumptions used in applying the new fiscal rules strategy. Also this publication should be under the responsibility of the *Fiscal Responsibility Board* as it overlaps with its functions. Publishing a citizen's guide to the budget should also be considered. It is a good practice in international fiscal transparency initiatives as it increases accountability for individual spending areas (IMF, 2007).

Box 1.5. **Recommendations for improving the fiscal framework**

Restoring debt sustainability

- Further strengthen the medium-term budgetary framework by introducing spending ceilings as planned, and adhere to them.
- Ensure consistency between the debt rule and the European fiscal discipline requirements, for instance by introducing spending ceilings into national legislation consistent with reaching a structural balance in the medium term.

Prioritising and maintaining a sustainable public expenditure path

- Provide an adequate degree of transparency throughout the entire public procurement cycle, notably by publishing justifications for awarding a contract to a selected contractor and allowing tracking of public procurement spending online. Amend the Public Procurement Act to ensure that the tender achieving the best value for money is selected and that the competitive dialogue procedure can be used for complex projects. Systematically record problems with public procurement and implement a task force to provide recommendations on making procurement rules easier to apply without undermining their intentions of fighting corruption and increasing efficiency.
- Continue efforts to improve tax collection by implementing the transition towards an integrated tax collection system. Further combat tax evasion by strengthening monitoring activities.
- Reform the structure of taxation to make it less harmful to growth notably by increasing real estate and environmental taxes and lowering labour taxes paid by employers at lower wage levels to encourage greater labour demand.
- Direct more resources towards growth enhancing areas such as education, research and development, and infrastructure. Establish an effective framework for assessing and selecting infrastructure projects, using tools such as cost-benefit analysis. Follow the OECD recommendations for the public governance of PPPs.

Box 1.5. **Recommendations for improving the fiscal framework** *(cont.)*

- Raise the absorption of EU funds by reducing the administrative hurdles to the submission of projects.

Strengthening public administration

- Increase the scope for monitoring and evaluation of spending programmes. Swiftly appoint analysts in each Ministry to assess the efficiency of policies as planned and allocate adequate resources to evaluation activities. Widen the use of performance elements in promotion, contract renewals and compensation of public staff. Establish a robust system of internal controls and include appropriate performance and results information in annual budget documentation. Allocate more resources to ex-post audit and take into account evaluation outcomes in budget allocation.
- Regularly issue policy briefs on the fiscal policy. Publish a citizen's guide to the budget.

Notes

1. See OECD, *Purchasing Power Parities and Real Expenditures, 2005 benchmark year*, which shows the relatively low price levels for collective compared with private consumption in the Slovak Republic.
2. The amount specified includes the contribution from the state budget of the Slovak Republic (around EUR 2 billion).
3. Carry forward is allowed for military expenditure and transfers, which were realised after 1st October and may be used until the 31st March of the next year.

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Chapter 2

Investing efficiently in education and active labour market policies

Educational outcomes are below the OECD average and are too dependent on the socioeconomic background of students. Unemployment is high and the school-to-job transition process does not work well. Spending on education and active labour market policies are very low by international standards. While reforms are under way in both areas, further efforts are needed to support the domestic drivers of growth. At a time of fiscal consolidation, these two policy areas should at the least be protected from budgetary cuts while every opportunity for efficiency gains should be seized. Not least because of the high level of long-term unemployment, more emphasis should be placed on activation policies, particularly on placement services, which are currently underfinanced but also insufficiently evaluated. Educational achievements and thus future labour market outcomes could be improved by re-allocating resources to teaching activities, in particular for disadvantaged pupils. Developing work-based vocational education would also facilitate the transition from school to work.

Improving the labour market outcomes is crucial to facilitate fiscal consolidation, boost long-term growth and reduce existing inequalities, thereby fostering sustainable growth and improving social cohesion. Growth in Slovakia is held back by a high and persistent level of structural unemployment, worsened by large pockets of underperformance. Long-term unemployment increased in the aftermath of the crisis to record levels, youth unemployment is among the highest in the OECD and the Roma minority is largely excluded from the labour market. Innovative capacities are also low by international comparison, hampering job creation in domestic firms (OECD, 2010b). Eliminating these hurdles to higher growth would considerably facilitate fiscal consolidation and improve the sustainability of public finances (see Chapter 1). Increasing employment rates would extend the fiscal base, reduce benefit dependency, and limit public costs related to social exclusion.

Reforming the education system and stepping up active labour market policies would help to improve labour market outcomes. The school-to-work transition is weak and the education system is not responding to labour market needs. Increasing the quality of education would significantly boost growth but few resources are currently allocated to schools and teachers to improve outcomes. Similarly, while well-designed active labour market policies could contribute to reducing long-term unemployment and increasing the employability of disadvantaged job seekers, such measures are currently underdeveloped. In times of consolidation, resources are limited requiring careful prioritisation of spending and ensuring the cost efficiency of implemented measures. This chapter presents some options for phasing out existing inefficiencies while further developing education and labour market policies.

Labour market performance is weak

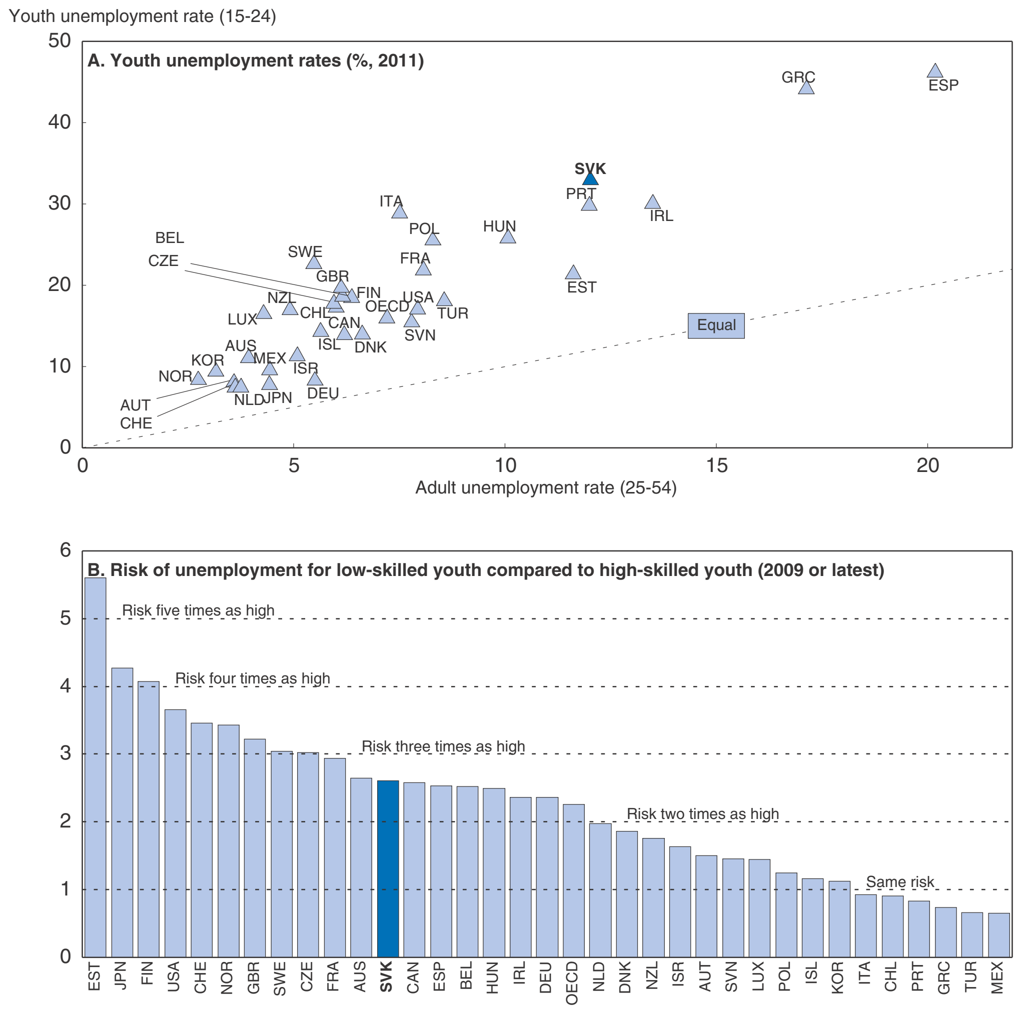
Long-term unemployment is prevalent

The unemployment rate is the fifth highest in the OECD and is set to remain high in the coming years. With a share of long-term unemployed at around 64% of jobseekers, almost twice the OECD average, the incidence of long-term unemployment was among the largest in the OECD in 2011 and is expected to increase further because of hysteresis effects. Furthermore, matching frictions have developed, with a job filling rate (ratio between the number of hiring and the average stock of unfilled vacancies) below its pre-crisis level (OECD, 2012a).

Youth unemployment is widespread

As in past recessions, the prospects of the youth have significantly deteriorated in the wake of the crisis. The unemployment rate among young people aged 15-24 increased by almost 15 percentage points between 2008 and 2010, more than three times as much as for adults. Also, as job opportunities have been scarce during the recovery, youth have difficulties to find their way into work. As a result, the youth unemployment rate in Slovakia was the third highest in the OECD in 2011 (33%) and exceeded twice the national rate. The risk of being unemployed for youth compared to adults is higher in Slovakia than in the OECD on average, with a relatively large youth/adult unemployment ratio (Figure 2.1, upper panel). The spell of unemployment for youth is also high by international comparison. 50% of youth unemployed are long-term unemployed while the incidence of long-term unemployment for youth stands at 21% in the OECD.

Figure 2.1. **Youth unemployment rates**



Source: OECD, *Labour Force Statistics Database;* and Scoreboard for youth aged 15-24.

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Low-educated and Roma are particularly vulnerable

Labour market performance is strongly linked with the level of education. The employment rate of the low educated (below upper secondary education) was only half the OECD average in 2010 while the employment rate for tertiary educated was not significantly different (Table 2.1). The lack of qualification considerably increases the probability of being unemployed, especially for the young generation. In 2010, the low-skilled youth (without an upper secondary education) had a risk of being unemployed more than double the high-skilled youth (with a tertiary education) (Figure 2.1, lower panel). Overall, around 60% of the unemployed are low skilled.

Table 2.1. **Employment rates and educational attainment, 2010**

	Pre-primary and primary education	Lower secondary education	Upper secondary education		Post-secondary non-tertiary education	Tertiary education		All levels of education
			ISCED 3C Long/3B	ISCED 3A		Type B	Type A and advanced research programmes	
Czech Republic	–	44.0	72.3	76.9	–	–	83.3	73.5
France	41.4	64.2	73.9	75.7	–	84.7	82.9	71.5
Germany	45.3	58.6	76.3	59.8	83.0	86.7	87.0	76.2
Hungary	15.3	39.4	64.5	67.6	71.2	81.6	78.5	63.4
Poland	–	39.9	62.9	67.8	69.2	–	84.8	67.0
Slovak Republic	**–**	**31.4**	**65.2**	**74.2**	**84.6**	**69.9**	**82.8**	**68.4**
United States	52.4	51.9	–	67.9	78.9	76.1	81.2	71.2
OECD average	**46.6**	**59.0**	**73.4**	**72.7**	**77.9**	**80.9**	**84.0**	**72.4**
EU21 average	**42.2**	**55.8**	**71.9**	**73.2**	**75.4**	**80.7**	**84.5**	**71.5**

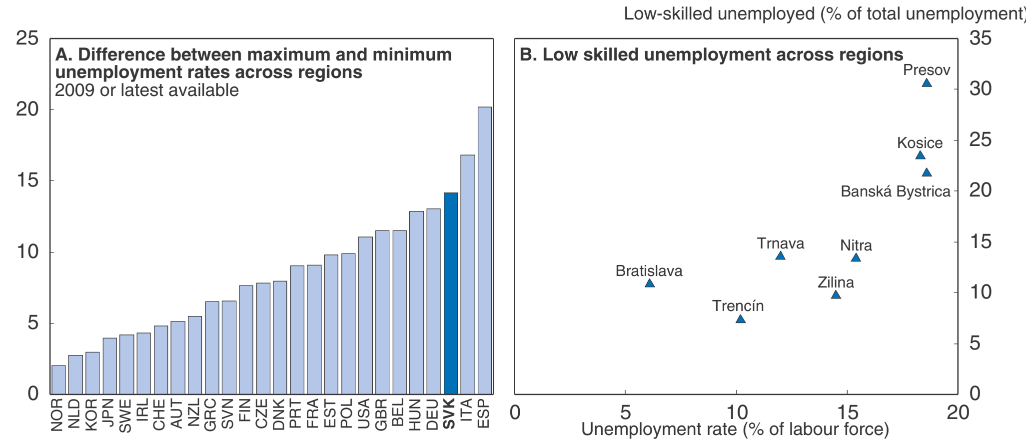
Note: Number of 25-64 year-olds in employment as a percentage of the population aged 25 to 64, by level of education attained.
Source: Education at a Glance 2012, Table A7.1b.

Roma are also particularly disadvantaged on the labour market, with an unemployment rate above 73% (UNDP, 2012). Their educational outcomes are relatively poor: around 70% of the Roma population have less than upper secondary education (*vs.* less than 10% of the total population). However, their low level of education only partly explains their labour market outcomes. At the same level of education, the unemployment rate of Roma is between two to eight times higher than for non-Roma living in the same region. A limited access to job opportunities due to remote settlement structures and discrimination on the labour market are playing a great role in the social exclusion of the Roma population (World Bank, 2012a). Data on Roma are scarce but estimates tend to show that Roma account for a large and increasing share of the unemployed labour force in Slovakia. According to a World Bank study, Roma account for more than 13% of new labour market entrants (World Bank, 2012b). As a consequence, the cost of non-inclusion of Roma induced by higher spending on social assistance and tax revenues losses is significant: the fiscal gap is estimated at around 3% of government spending (World Bank, 2012b). Marcinčin and Marcinčinová (2009) estimate that the total economic cost of Roma non-inclusion amounts to 8% of GDP.

Unemployment is concentrated in remote regions

Regional disparities in unemployment are among the highest in the OECD (Figure 2.2, left panel). The unemployment rate in the highest-unemployment regions (Banská Bystrica and Presov) was more than three times that in the lowest-unemployment region (Bratislava) in 2010. This reflects low labour mobility, hampering labour market adjustments at the national level (Paci *et al.*, 2007). Low-skilled unemployment is more prevalent in regions with a high share of unemployment (Figure 2.2, right panel). This is partly due to the low availability of affordable housing in dynamic regions. The rental housing market is under-developed, undermining the mobility notably of low-paid workers whose wage gains from moving to take up work may not sufficiently exceed the additional housing costs (OECD, 2009b).

Figure 2.2. **Regional disparities in unemployment rates**



Source: *OECD Regional Database* and Central Labour Office.

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Developing active labour market policies

Spending on active labour market policies is low

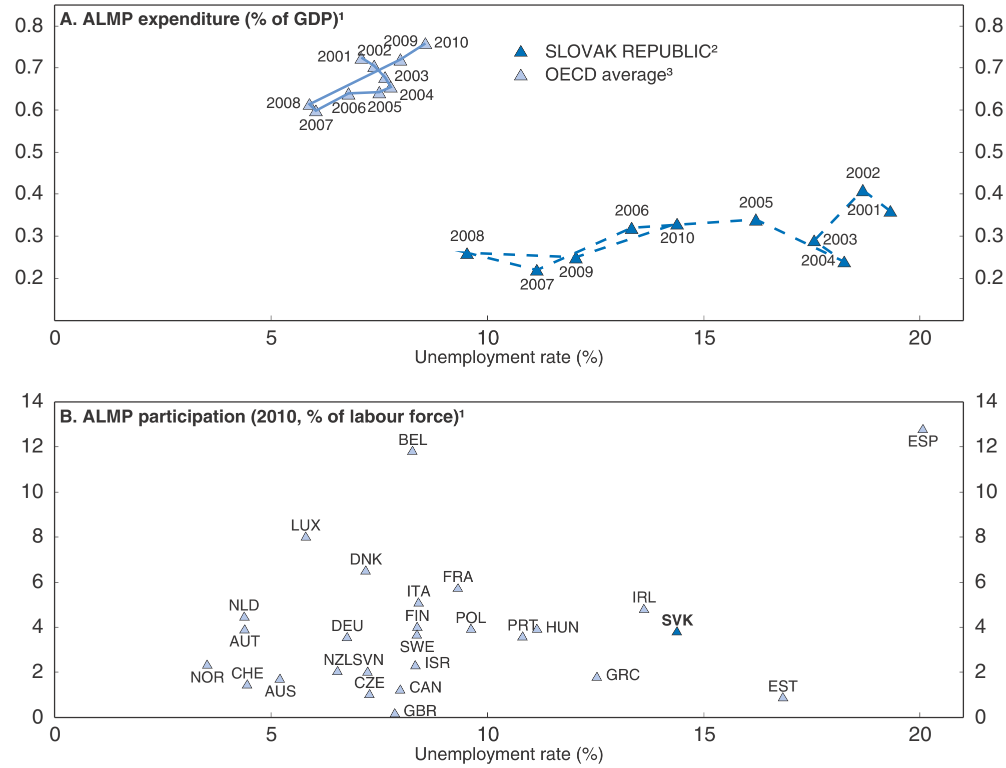
High unemployment and the increasing exclusion of at-risks groups from employment require strong activation policies to minimise the increase in structural unemployment. Efficient active labour market policies can also contribute to reducing under-employment and stimulate potential growth by ensuring a better use of the labour force through better matching, improved mobility, and co-operation with potential employers. Particular attention should be devoted to reduce youth, low skilled and Roma inactivity and unemployment as they constitute persistent pockets of underperformance in the labour market.

Slovakia's spending on active labour market policies (ALMP) is one of the lowest in the OECD. In 2010, it accounted for only 0.3% of GDP, less than half the OECD average (0.7% of GDP). This is mainly due to a low level of spending per participant, but a relatively low participation of the unemployed also plays a role (Figure 2.3, lower panel).[1]

Spending on ALMP has been very volatile in the last years and has not reflected labour market developments. While in the average OECD country the expenditure on ALMP is positively correlated with the unemployment rate, this is not so for Slovakia (Figure 2.3, upper panel). In particular, during the crisis ALMP were implemented with some delays. While most other OECD countries increased their expenditures in response to the crisis in 2009, spending on ALMP increased only from 2010 onwards in Slovakia. Furthermore, despite a strong increase in 2010 (+38%), the additional spending on active labour market programmes in response to the crisis – as reported in the OECD database – was only about half the OECD average (OECD, 2010b).

ALMPs are mainly financed through EU funds (51% in 2011). This partly explains the low reactivity of ALMP to labour market developments. The absorption of EU funds induces some burdensome procedures creating delays between the conception and the implementation of a measure. In addition, budget planning has been weak, in particular regarding the capacity to use EU resources. Mandatory measures (according to law) receive funding priority. As a result, if the budget for these measures is insufficient, for instance

Figure 2.3. **Spending on and participation in ALMPs by level of unemployment**



1. The ALMP expenditure total shown includes the category "Public Employment Service and administration", whereas the ALMP participant total does not include this category.
2. Data for other OECD countries often include training allowances, wages or other forms of income support paid to programme participants: Slovak data include some types of income support payment but not the "activation allowance" or regular social benefits that are paid to ALMP participants in some cases (see main text).
3. OECD average is computed as unweighted average for expenditure in ALMP and for the unemployment rate. Country coverage is based on continuity and availability over the time period; it excludes Chile, Estonia, Greece, Hungary, Iceland, Israel, Italy, Japan, Luxembourg, Norway, Slovenia, Switzerland, Turkey and the United Kingdom.

Source: *OECD Economic Outlook Database* and OECD, *Labour Market Programme Database*.

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because EU funds were not used or budget planning was inappropriate, funds initially allocated to non-mandatory measures (*e.g.* training) are used to finance mandatory measures, thus limiting the implementation of non-mandatory programmes. Expenditure planning should be improved to ensure that spending on ALMP adequately reflects the labour market needs. Also, the absorption of EU funds should be increased by reforming the system of funds management and reducing the administrative hurdles to the submission and the selection of projects as recommended in the last *Survey* (OECD, 2010b) and in the Chapter 1.

The low level of spending on ALMPs may relate to the fact that the unemployed are insufficiently encouraged to participate in programmes. The eligibility for the unemployment insurance benefit is very strict and the benefit is of short duration (Venn, 2012). As a consequence, only around 10% of the unemployed receive unemployment insurance benefits and are thus required to actively search for a job. Also, when meeting the eligibility criteria, the unemployed receive social assistance benefits. Entitlement to the basic amount of social assistance (benefit in material need) is not formally conditioned to work availability. Recipients with work ability who account for a large share of benefit recipients are not obliged to register in the labour office (World Bank, 2012a). If not registered, they are not directly informed about available vacancies and activation or training opportunities and progressively get detached from the labour market. Some incentives to register in labour offices exist as free health insurance is provided only to registered unemployed. Nevertheless, participation in ALMP and job search activities of social assistance recipients with some work ability should be fostered further by, at least, obliging them to register as jobseekers and to participate in activation measures. The local labour offices should take particular attention to maintaining the link between social assistance recipients and the labour market.

Programmes are insufficiently oriented towards labour market needs

According to law, ALMP should be targeted to "disadvantaged jobseekers", but the definition of a disadvantaged jobseeker is very broad.[2] It includes notably the long-term unemployed, the older and disabled jobseekers and the school graduates without a regular job two years after graduation. These groups account for around 80% of the registered unemployed. Nevertheless, disadvantaged job seekers are under-represented in certain programmes, including the largest one: in the start-up incentives programme which accounts for around 40% of the ALMP budget for programmes (excluding public employment service), disadvantaged job seekers account for only 42% of participants (*vs.* at least 80% in total unemployment). Overall, participation of at-risk jobseekers in ALMP is quite low (Table 2.2). In particular, 40% of ALMP participants are low-skilled while they account for 60% of the unemployed and have higher risks of being excluded permanently from the labour market.

Table 2.2. **Participants in ALMP, 2010**

	Share among ALMP participants	Share in total unemployment
Youth (aged < 25)	16	21
Low skilled	40	60
Long-term unemployed	55	60

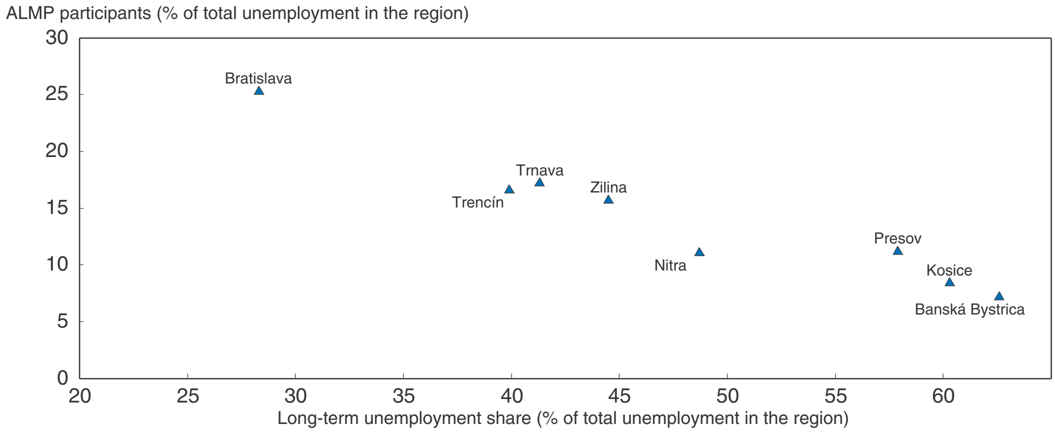
Source: Central Labour Office.

The share of the ALMP participants among job seekers is significantly lower in regions with higher unemployment rates. While 12% of the unemployed were participating in programmes on average in 2010, this rate reached around 25% in Bratislava region and 10% in the eastern regions. This partly reflects the low participation rate of low-skilled and long-term unemployed in the programmes (Figure 2.4).

The low participation of disadvantaged jobseekers in ALPMs may be due to the fact that out of 29 programmes only nine are targeted to a specific group (one to the youth, one to social benefit recipients and seven to disabled jobseekers). Targeting of ALMP should be improved and programmes should be made more client-oriented to effectively support the more in-need groups. Doing so would require identifying the pockets of underperformance and further analysing the labour market outcomes of at-risk groups. Such information is important for designing the programmes in a client-oriented manner and is lacking in Slovakia. Setting specific performance targets regarding disadvantaged groups could also help to prioritise policy actions and induce efficiency gains (see Chapter 1). For instance, youth became a specific target for labour market policies in Japan in 2000 and the

Figure 2.4. **Participation in ALMP by region**

2010



Source: Central Labour Office.

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reorientation of policy appears to have had a significant positive impact as the unemployment rate of this group declined by 20% in four years (Duell, 2010b). The performance targets could be defined at the local level to better reflect the local labour market issues and elaborated by a close co-operation between the central and local authorities and the local labour offices.

Comprehensive evaluation is lacking

ALMP are not deeply enough evaluated and their impact on the labour market outcomes remains unclear. The few available evaluations point to their low effectiveness (*e.g.* Harvan, 2010; Vagac, 2010) as well as low participation in some programmes. Among the 29 existing programmes in 2011, only 22 were used and only 12 have more than 1 000 participants (World Bank, 2012a). In 2011, a few programmes have been phased out due to their low rate of use. However, the reasons behind their lack of success were not investigated. Because of the lack of monitoring, inefficient programmes may continue to operate. While the low level of spending on ALMP suggests more resources should be allocated in this area, spending on these programmes should only be increased after a proper evaluation of their impact has been made available. Also, as financial resources are scarce, new programmes could be tested with pilot projects before being implemented at the national level.

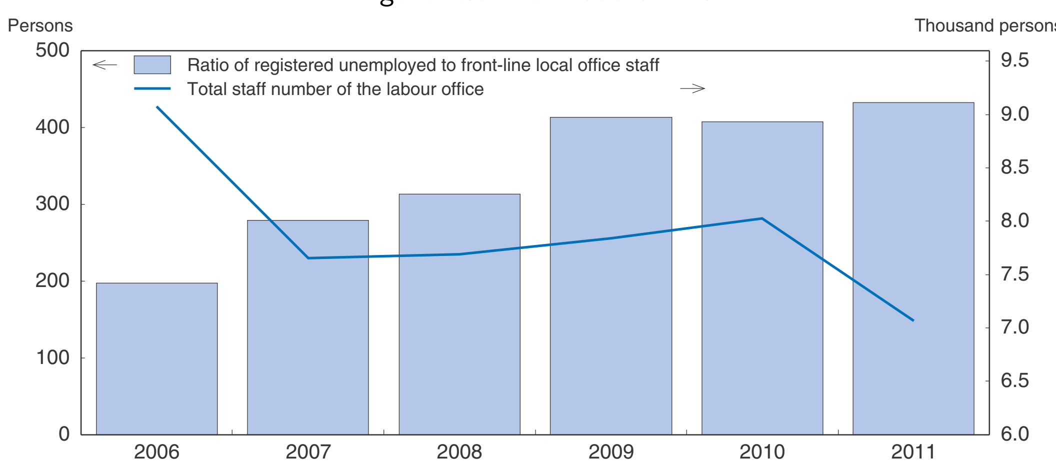
Data on programme outcomes are lacking. Evaluation of active labour market measures is currently undertaken semi-annually and only two indicators are systematically used (the number of participants and the cost of the programmes). The central labour office provides some indicators on the labour market position of participants after the termination of some specific programmes but without detailed information on the participants themselves (necessary to estimate the effectiveness of these programmes and to correct the selection biases). Data gathering is administratively burdensome and decentralised (done by the regional labour offices). A comprehensive analysis of ALMP requires harmonising and extending data collection. Measures going in this direction have been designed. The planned data collection and systematic evaluation of ALMP should be implemented urgently while making sure that all necessary technical elements are in place. In particular, to assess the net effect of programmes on the labour market and on public finances, employment and income of the ALMP participants should be tracked, for instance by matching benefit, tax and social insurance databases (OECD, 2005a).

Strengthening public employment services

The Public Employment Service (PES) has a key role to play in reducing unemployment. Empirical evidence suggests that services provided by PES, such as job search assistance and counselling, have the largest positive impact on labour market outcomes (OECD, 2005a; Kluve, 2010). Regular reporting creates opportunities for the PES to encourage job search and to share up-to-date information on vacancies. Even when employment opportunities are scarce, contact with PES helps to retain labour market attachment, can damp the hysteresis effects, and thus limit the built of long-term unemployment (OECD, 2010f).

Spending on PES did not adapt to the greater demand created by the increase in unemployment. The rise in PES staff in response to the crisis was half the OECD average while the increase in registered jobseekers was 5 percentage points stronger (OECD, 2010f). Also, as part of fiscal consolidation measures, the number of staff was cut significantly in 2011 while the number of registered unemployed kept rising. As a result, the workload of PES staff has been increasingly large, which hampers the provision of high quality, targeted and individualised services. The caseload, estimated by the number of registered job seekers per front line local staff, has more than doubled since 2006 (Figure 2.5). In 2010, a front line local office staff worker had to deal with around 410 jobseekers. It is almost three times more than in France and eight times more than in Germany (Hespel *et al.*, 2011). In addition, the caseload varies significantly across regions, suggesting that resources are not adequately distributed across local labour offices (Nádaždyová, 2011).

Figure 2.5. **Workload of PES**



Source: Central Labour Office.

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Slovakia has rightly introduced a profiling system of jobseekers and has implemented detailed registration interviews followed by regular reporting. Such initiatives, including the introduction of Individual Action Plans, are not bearing fruit due to limited capacities in PES. A relatively low share of resources is dedicated to placement and ALMP-related services (around 50%). In Switzerland, placement services and ALMP account for 66 % of resources, and this ratio reaches around 80% in Norway and Luxemburg (Duell *et al.*, 2010a).

In view of the level of unemployment and the increase in long-term unemployment, more resources should be allocated to the PES. Also developing the accountability of public administration for instance by extending the use of performance assessment in financing, contract renewals and staff remuneration from current low level could help to achieve efficiency gains (Chapter 1). These changes could be inspired by successful international experience. As an example, the German PES achieved large efficiency gains with the 2005 Hartz IV reform, by improving co-operation between services in charge of active and passive labour market policies, reducing the caseload per PES staff and developing the results-based accountability of local employment agencies (Jacobi and Kluve, 2006).

The local labour offices in charge of the placement services and the implementation of ALMP also administer social assistance benefits and public social support. Placement and social services are not co-operating, inducing work duplication and inefficiencies. For instance, as mentioned above, social benefit recipients with work ability are not in touch with placement services, as registration in the PES is not compulsory and services are formally separated. Efficiency gains could be made by creating one stop shops for jobseekers as initially planned when the two services were merged in 2004.

PES employees are also in charge of registering vacancies and collecting information on labour market developments. The labour offices are the main sources of information for jobseekers: almost 80% unemployed consider contacting the labour offices to seek for a job compared to 56% in the EU. At the same time, the number of reported vacancies by the labour offices has significantly decreased over time, not least due to the 2004 reform regarding the registration of vacancies (Kaluzna, 2008). Before 2004, employers were obliged to notify vacancies to the local labour office. Since 2004, the labour offices are responsible for the collection of job offers. This reform led to a significant reduction of communication between the labour offices and employers and to less information about local labour demand (Hanzelova and Kostolna, 2006). As a consequence, registered vacancies as a share of employment dropped from 10 to 4% between 2003 and 2004. The number of unfilled vacancies reported by the labour offices was almost half the number of those reported by the Statistical office in 2011.

Improving the information of the PES on vacancies is crucial as it facilitates the placement of jobseekers but would also improve the matching of demand and supply in activation programmes. The registration of vacancies should thus be strengthened both quantitatively and qualitatively and more resources should be allocated to collect information on labour market developments. The collection method could also be changed to lighten the workload of PES employees. Around 65% of vacancies in 2010 were collected through personal, mail and telephone contacts (Central Labour Office, 2011). As in many OECD countries, effective online collection of job offers should be established, for instance by encouraging employers to publish vacancies online on a dedicated website. The Finnish PES has actively promoted the use of the online services both for employers and job seekers, resulting in a reduction of PES intervention in the screening and the matching of job seekers to vacancies (Duell *et al.*, 2009). In Ireland, the introduction of the National Contact Centre is considered to have played a crucial role in doubling the number of registered vacancies since 2000 (Grubb *et al.*, 2009).

Improving the effectiveness of the activation programmes

Better targeting start-up incentives

Start-up incentives consist in one-off subsidies allocated to the unemployed starting a business and are covered by two programmes in Slovakia: the contribution for self-employment and the contribution for self-employment to disabled citizens. A relatively large share of spending on ALMP is allocated to these measures. 30% of ALMP participants were receiving start-up subsidies in 2010 (*vs*. only 6% on average in the OECD). Spending on these programmes has continued to increase in recent years as the conditions for receiving the subsidies were temporarily widened in the wake of the crisis (+15% between 2008 and 2010, from EUR 35 million to EUR 40 million). However, they increased less than the total spending on ALMP.

The effectiveness of these programmes is highly variable and available evidence tends to show that the net positive impact of these measures on employment is rather low (Martin and Grubb, 2001, Dar *et al*., 2009). These programmes are associated with high deadweight losses and displacement effects. While a proper evaluation measuring the effectiveness of the programme in Slovakia has not been carried out yet, it is likely that it induces large deadweight losses, because start-up incentives are not targeted and are not carefully monitored.

- The programme has wide eligibility criteria and is not enough monitored. The subsidy is provided to every jobseeker after 3 months of unemployment, providing a business plan and running a business for at least two years. In comparison, in Finland, the start-up grant is given in two periods, the second being conditional upon sufficient income and activities in accordance with the business plan. Such *ex post* monitoring could limit abuses with the unemployed benefiting from the subsidy without effectively running a business.
- The measure is not means tested and is not benefiting the most in-need groups. The participation of youth and long-term unemployed is very low (13% and 22% respectively in 2010) compared to their share in the total unemployment (21% and 60% respectively). Highly educated unemployed are over-represented; 20% of the new recipients had a tertiary education level *versus* only 7% among the unemployed in 2010 (Figure 2.6, upper panel). The measure is mainly used in regions with low levels of unemployment. In Bratislava, the economically most developed region, almost every fourth unemployed received the start-up benefit. By contrast, in the Kosice region, where unemployment is three times higher than in Bratislava, fewer than 5% of the unemployed used this programme (Figure 2.6, lower panel).

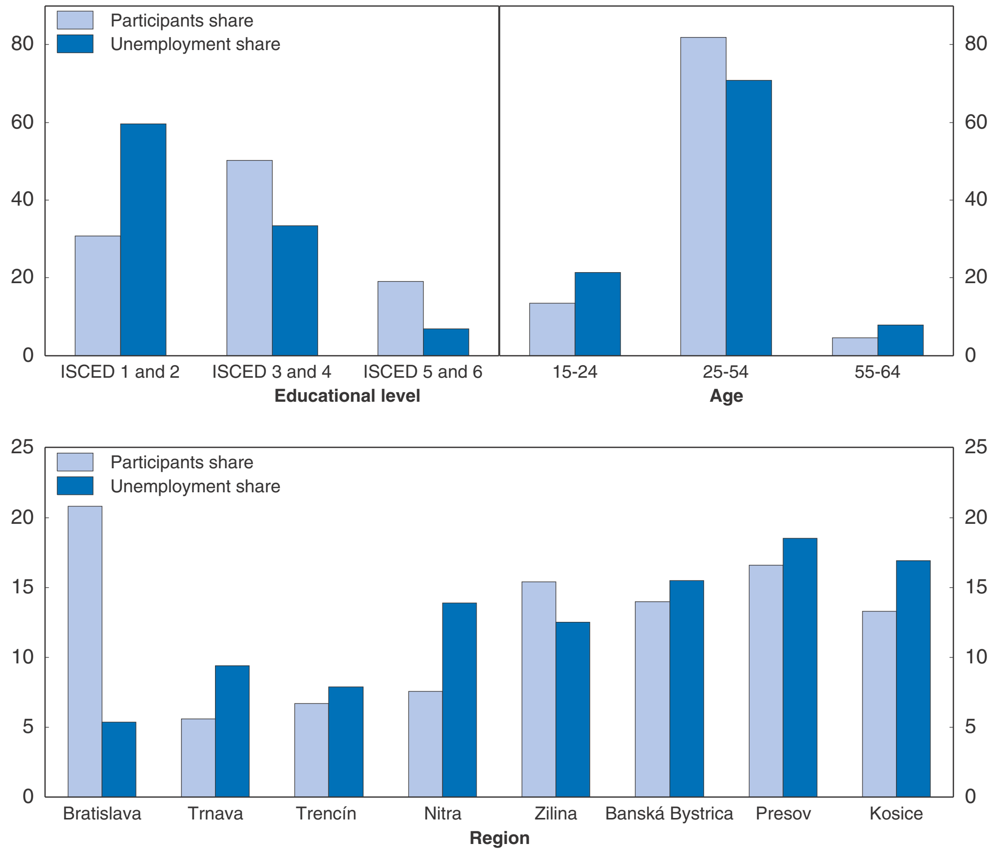
There were a several attempts to improve the effectiveness of the start-up incentives. In 2012, a draft amendment to the Act on Employment Services set stricter eligibility conditions by extending the mandatory period of time of running the business from two up to three years and by introducing the obligation to prove a positive tax income after the first year. It is unfortunate that this amendment was not passed. Eligibility criteria should be made stricter, for instance by means testing the provision of the allowance, while the monitoring of the measure should be strengthened.

Limiting the use of temporary activation works

While direct job creation is among programmes with the worst outcomes (Kluve, 2010, Card *et al.,* 2009), it is widely used in Slovakia. The participation rate in these programmes is very high by OECD standards (Figure 2.7, upper panel). One third of ALMP participants

Figure 2.6. **Participants in start-up incentives by educational level, age and region**

2010, in percentages



Note: The participant share is the share of a given group (*i.e.* 15-24 aged) in the total number of participants. The unemployment share is the share of a given group in total unemployment. For instance, 13% of participants and 22% of unemployed are aged 15-24.

Source: Central Labour Office; Statistical Office of the Slovak Republic, *Regional Database*.

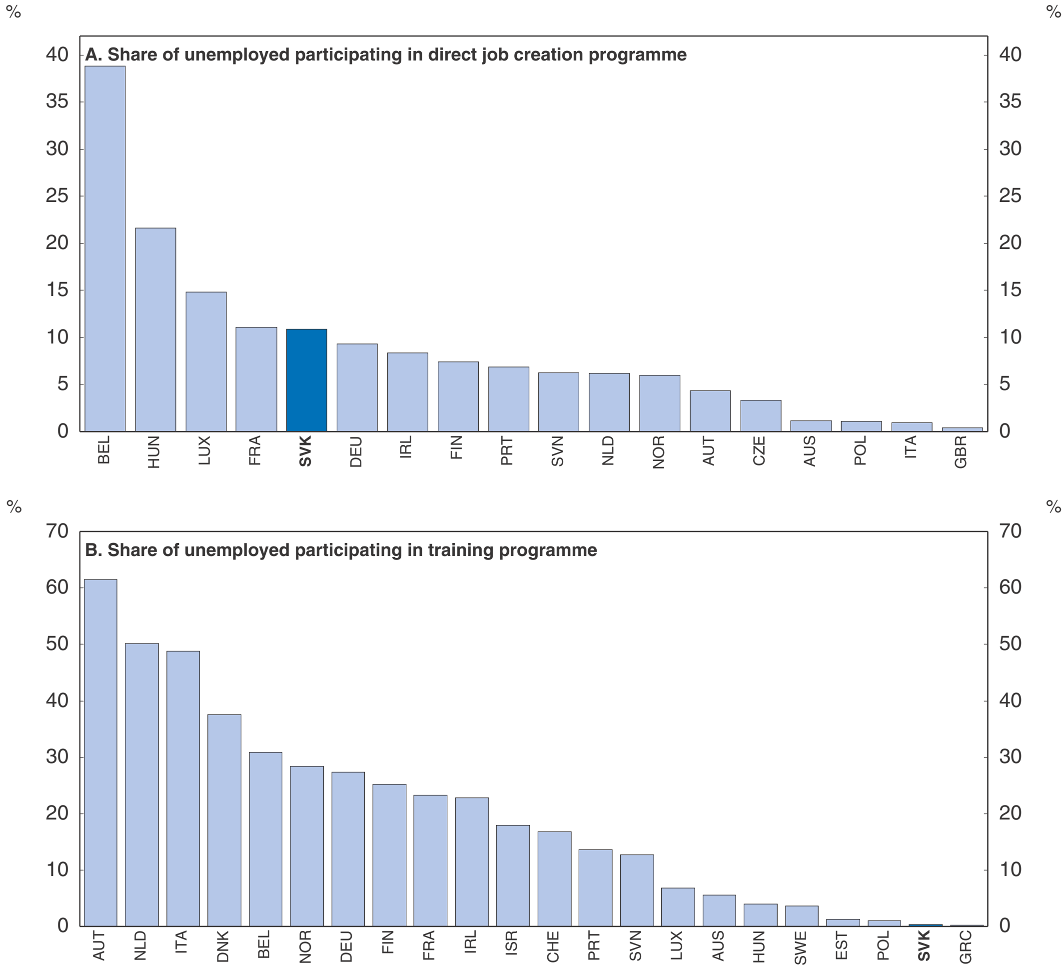
StatLink http://dx.doi.org/10.1787/888932748821

were involved in job creation measures in 2010. At the same time, spending on the job creation measures is limited (only 4% of total spending on ALMP) but this is due to the fact that the allowance paid to participant is not included in the data (see endnote n° 1). Direct job creation in Slovakia covers mainly community activation works (small municipal works) and contributions for voluntary service. Subsidies are allocated to municipalities and NGOs which provide part-time jobs (maximum 20 hours per week) to disadvantaged jobseekers (mainly social benefits recipients). Participants receive a lump sum benefit. These programmes last between 6 and 18 months and aim at broadening the skills and work routine of participants.

Empirical evidence suggests these programmes are not effective in reducing unemployment, as participants rarely get a permanent job in the regular market (Card *et al.*, 2009). Harvan (2010) even finds that the community activation work programmes in Slovakia reduce the chances to get a job after programme completion. In 2010, only 4.4% of participants could find a job within 6 months after leaving the programme (World Bank, 2012a). International experiences suggest that the competences gained in these jobs are not relevant for private-sector jobs and lead to poor performance after the end of the

Figure 2.7. **Participation in direct job creation and training programmes**

2010, in percentage of unemployment



Source: OECD *Economic Outlook Database* and OECD, *Labour Market Programme Database.*

StatLink http://dx.doi.org/10.1787/888932748840

programme (Duell *et al.*, 2010a). In particular, the activation work programmes are not providing the skills and work experience that young people need to successfully integrate into the labour market and could lead to a long-term exclusion of schools leavers from employment (World Bank, 2012a). Direct job creation also induces lock-in effects by reducing the incentive to exit unemployment through job search or training.

In Slovakia, the risk is particularly high that the measures lock in participants in economically less developed regions given the low geographical labour mobility. As a result, these measures are likely to limit labour market adjustment and foster the persistence of regional disparities. Thus, job creation programmes should be proposed only when no other options are available, for instance for job seekers facing severe obstacles for employment as it provides at least some connection with the labour market. These programmes should not be allocated to early school leavers or young unemployed who have shown major difficulties in finding a job as these essentially need to acquire skills that would be transferable to private sector jobs and hence boost their employability (OECD, 2010a). The job creation programmes should at least be complemented by other activation measures, improving the employability of the participant and limiting lock-in effects. Participants should be encouraged to continue with job search and other assistance services. Also some financial benefits could be provided for activation work providers to engage the participants in training as suggested in OECD (2009a).

Other job creation programmes have been developed recently. Job creation measures in flood prevention and restoration of cultural heritage have been implemented since 2010. Contrary to community activation work, they lead to formal job contracts. While it is too early to assess their impact, these measures may help as they offer an outlook for real jobs to the participants. Nevertheless, these programmes should be carefully monitored. Also, additional EU funds (EUR 20 millions) will be allocated to finance community-based jobs in municipalities. The jobs created need to effectively increase the employability of participants by raising their qualifications and providing skills that are demanded in the private sector.

Expanding employment incentives

Employment incentives for employers – wage subsidies in particular – are found to foster employment but also to induce high deadweight losses when not targeted (Kluve, 2010; Martin and Grubb, 2001). For instance, evaluations of wage subsidies in Australia, Belgium, Ireland and the Netherlands have suggested combined dead-weight and substitution effects amounting to around 90%, implying that for every 100 jobs subsidised by these schemes only ten were net gains in employment. Hiring subsidies are more effective when they compensate for shortfalls of individual productivity and encourage employers to supply jobs for the most disadvantaged jobseekers.

In Slovakia, labour taxation is relatively high for low-paid jobs: the tax wedge for a single person earning 67% of the average wage is 4 percentage points higher than the OECD average. This limits the employment chance of low-productivity workers, who make up the largest share in the unemployment pool. Measures aiming at subsidising firms for employing disadvantaged jobseekers – the Allowance to support employment of a disadvantaged jobseeker and the Allowance for induction of a disadvantaged jobseeker – have been implemented but have not been extensively used. Only around 700 jobs were created under these measures in 2011. The reasons behind this low pick-up should be assessed and the measure should be amended based on this analysis. It is planned that EUR 50 million (EU funds) will be allocated to support employment. Wage subsidies should be extended as planned but should also be tightly targeted to long-term jobseekers with low productivity. Placement of long-term unemployed into firms could be also directly promoted, for instance by reducing hiring costs (PES staff select and train disadvantaged job seekers for the firm). Such initiatives proved to be effective in the past (*e.g.* US Steel in Kosice implemented a programme for Roma employment in co-operation with local authorities).

Employment incentives also include the "Graduate Practice" a measure targeted at youth employment. This programme offers to every youth unemployed for at least 3 months irrespective of its qualification level or work experience a three to six months internship to acquire and improve professional skills and practical experience (maximum 20 hours per week). It is financed by an allowance paid by the labour office at the minimum subsistence level (EUR 195 per month since July 2012). According to available evidence, around 42% of participants found a job after the programme in 2011. However, Harvan (2010) points to a low net positive effect of the measure on the employability of participants: participation in this programme increase the chance of getting into employment on average by 3 percentage points. This may be due to the fact that firms select candidates they may have hired even in absence of programme (World Bank, 2012a). The impact of the measure on the level of qualifications and on the quality of jobs participants get after the programme is unknown. The programme does not require firms provide formal training and this may limit the positive effect of the measure on the employability of participants. As recommended in OECD (2007a), the programme should offer certified qualifications.

Putting more emphasis on training measures

According to available evidence, well-designed training programmes contribute to reducing unemployment. Studies on aggregate data show that spending on training is associated with better labour market outcomes (*e.g.* Boone and van Ours, 2004). Bassanini and Duval (2006) find that increasing ALMP spending on training programmes per unemployed as a percentage of GDP per capita by 4 percentage points would reduce unemployment by at least 0.2 percentage points in the average OECD country. By broadening the availability of skills on the labour market, training could help to address labour shortages and to reduce skill mismatch. Also, by improving the adaptability of workers and avoiding the erosion of their competences, training may reduce the risk of future unemployment spells and open new job opportunities to the job seekers. Finally, these programmes help to maintain job seekers in contact with the labour market and may reduce drops-out from the labour force.

Training accounted for only 2% of total spending on ALMP in Slovakia in 2010, reaching 0.01% of GDP, among the lowest amounts in the OECD. Spending on training declined to a level close to zero in 2011 and the participation rate had been divided by four between 2004 and 2010 (Figure 2.7, lower panel). The low level of spending on training has three main causes:

- *First*, not enough stable funds are available for labour offices to finance training measures. As mentioned above, funds are allocated in priority to mandatory programmes (programmes that must be systematically provided to jobseekers according to law) and training is optional. The under-funding of ALMP, partly due to the low absorption of EU funds, requires financing mandatory programmes with funds initially allocated to training.
- *Second*, the provision of training programmes is undermined by burdensome procurement rules and the low administrative capacities of PES. Thus, training should be supported by simplifying public procurement procedures and training PES staff in procurement law. The relaxation of procurement rules should be accompanied by the introduction of outcome-oriented funding. For instance, the certification of acquired competences should be required or employment outcomes monitored. This would encourage suppliers to improve the quality of training and facilitate the recognition of the qualification acquired during the training on the labour market.
- *Third*, programmes are designed at the central level and do not appropriately reflect specific local needs. Also, the delay in delivery contributes to the mismatch between supply and demand of training. The determination of programmes should be decentralised and a sufficiently large range of programmes should be made available to adapt to individual needs (from basic life-skills to specialised competences) and encourage the participation of long-term job seekers to such activation programmes.

Among training programmes, job-search courses (CV writing, preparing for a job interview, building a network) are found to be quite effective even in the short run (OECD, 2007c). In Finland, job-search assistance courses increased employment probabilities by 4 percentage points on average, with relatively greater impact for individuals who have less education (Duell *et al*., 2009). In Austria, a job-search training programme was estimated to reduce the remaining duration of the unemployment spell by about one third (Grubb *et al*., 2009). Thus, job-search training programmes should be provided in particular to those unemployed without any experience of job search (*e.g.* school leavers). By contrast, the positive impact of some training programmes on employment, including on-the-job training programmes, only materialises after some time (Card *et al*., 2009). Such programmes may not be efficient for reducing unemployment in the short run. Also, given the relatively high cost of training, the effectiveness of the programmes should be carefully assessed before being provided.

The impact of training programmes on labour market outcomes depends significantly on their design (Martin and Grubb, 2001). Some best practices could be drawn from international experience:

- Training should be well targeted and the programmes should also be tailored at the specific needs of targeted groups (Meager, 2009). In Slovakia, training is mainly provided to unemployed who have found a job but need a training to be hired. Van Ours (2000) points out that the positive effect of training measures on the job finding rate of participants may be due to this selection bias. Disadvantaged jobseekers are under-represented in the training programmes. 39% of the participants were low skilled (*vs*. 60% overall), 30% were long-term unemployed (*vs*. 60% overall) and 12% were young (*vs*. 21% overall).
- Programmes should include a significant on-the-job component (Martin and Grubb, 2001). International experience also suggests that training is more effective when addressing the needs of local employers (Duell *et al*., 2009). A close link between the PES and local companies is advisable to monitor closely the required skill development. In Austria "placement foundations'" were set up to identify skill shortages at the regional level and provide adequate training to the unemployed. These foundations involve a close co-operation and networking between PES, employers and training providers (Duell *et al.,* 2009). For youth, good practice is also to combine training with an experience of second-chance education, which provides a mix of adult mentoring, work experience and remedial education (OECD, 2010a).
- Training should provide participants with qualification standards, which could be easily recognised by the employers and prove achieved skills and qualifications (Poppe *et al.,* 2003). In Germany, some training programmes (the specific professional skills and technique training programme) including workplace experience and the certification of acquired competences has been found to improve the employment rate by about ten percentage points a year after the beginning of the programme (Meager, 2009).

Box 2.1. **Recommendations for improving active labour market policies**

Make activation policies more widely available for those in need

- Encourage job search activities and participation in Active Labour Market Policy (ALMP) by all benefit recipients with some ability to work by making their registration in placement services and participation in activation measures mandatory.
- Increase spending on those ALMPs whose effectiveness has been demonstrated. Implement the planned data collection and systematic evaluations of ALMP. Consider testing new programmes with pilot projects before implementing at the national level.
- Target ALMP towards those who are more in need and make programmes more client-oriented. Identify the pockets of underperformance and analyse the labour market outcomes of at-risk groups. Set specific performance targets regarding disadvantaged groups at the local level.

Strengthen the Public Employment Service

- Allocate more resources to placement services in Public Employment Service (PES). Develop accountability of local labour offices for instance by increasing the role of performance in contract renewals and staff remuneration.
- Reorganise the PES by creating one-stop shops. Strengthen the registration of vacancies and increase resources allocated to collect information on labour market developments. Establish an effective online collection of job offers.

Improve the effectiveness of activation programmes

- Develop employment incentives targeted towards long-term job seekers with low-productivity. Foster the placement of long-term unemployed into firms, for instance by reducing firms' hiring costs.
- Propose job creation programmes only when no other options are available. Exclude early school leavers from these programmes and complement them with other activation measures improving employability.
- Support training by simplifying public procurement procedures and providing adequate training to PES staff. Introduce strong incentives for training providers to offer high quality and job-oriented training, for instance by establishing outcome-oriented funding and requiring the certification of acquired competences. Provide a sufficiently large range of programmes adapted to individual needs. Provide short training on job search at an early stage, in particular to youth unemployed.
- Strengthen eligibility criteria and the monitoring of start-up incentives.

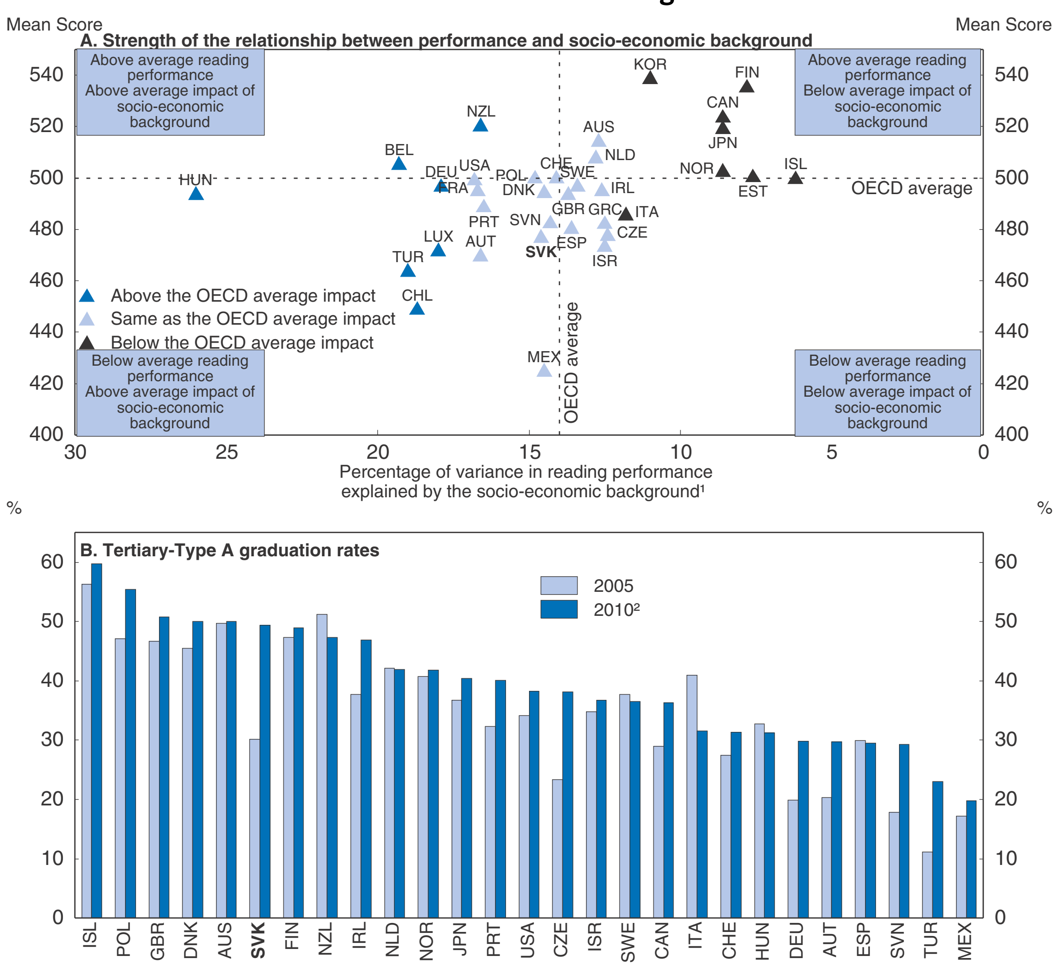
Investing efficiently in education

Educational outcomes are below OECD averages

The performance of the education system is significantly below the OECD average both in terms of education level and education quality. The education level is low, with around 24% of those aged 25-34 with a tertiary education level degree (37% on average in the OECD). At the same time, educational attainment is rising strongly with around 50% of young graduating from tertiary education in 2010 (Figure 2.8, lower panel). Regarding the quality of education, despite some improvement since 2006, indicators point to low performance.

While the aggregate PISA score has improved since 2006, it is still below OECD average (488 *vs*. 497 points). The impact of socioeconomic background on students' results in PISA is close to the OECD average (Figure 2.8, upper panel). However, for some groups, inequalities on the access and the quality of education are substantial. Educational outcomes of the Roma minority are particularly poor: more than 70% of the Roma population have a less than upper secondary education and Roma do not attain tertiary education (Table 2.3). Geographical inequalities are also high. On average PISA scores are around 10% lower for students attending schools located in a village compared to students attending schools located in a city, the fourth highest negative gap in the OECD (OECD, 2011a).

Figure 2.8. **Educational level, average Pisa score and impact of the socio-economic background**



1. PISA index of economic, social and cultural status (r-squared x 100).
2. 2009 for Australia and Canada.

Source: OECD (2011), *Education at a Glance*, Chart A5.2 and OECD (2012), *Education at a Glance*, Table A3.2.

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Table 2.3. **Educational attainment of the Roma population**

	Men		Women	
	Roma	Total population	Roma	Total population
Basic education	5	0	7	0
Lower secondary education	63	4	70	7
Upper secondary	32	74	24	71
Tertiary education	0	22	0	22

Source: World Bank (2012b).

Improving educational outcomes would be highly beneficial

Increasing the education level of the Slovak population is likely to increase productivity and the employability of the working age population. Public and private returns on education are relatively large by OECD standards, especially in the form of finding a job (Šiškovič, 2011). They increase significantly with the level of qualification, reflecting the higher level of remuneration and tax associated with higher educational attainment (OECD, 2011a). The present net value of education is particularly high, public and private internal rate of returns of education being 2 to 22 percentage points above the OECD averages (Šiškovič, 2011).

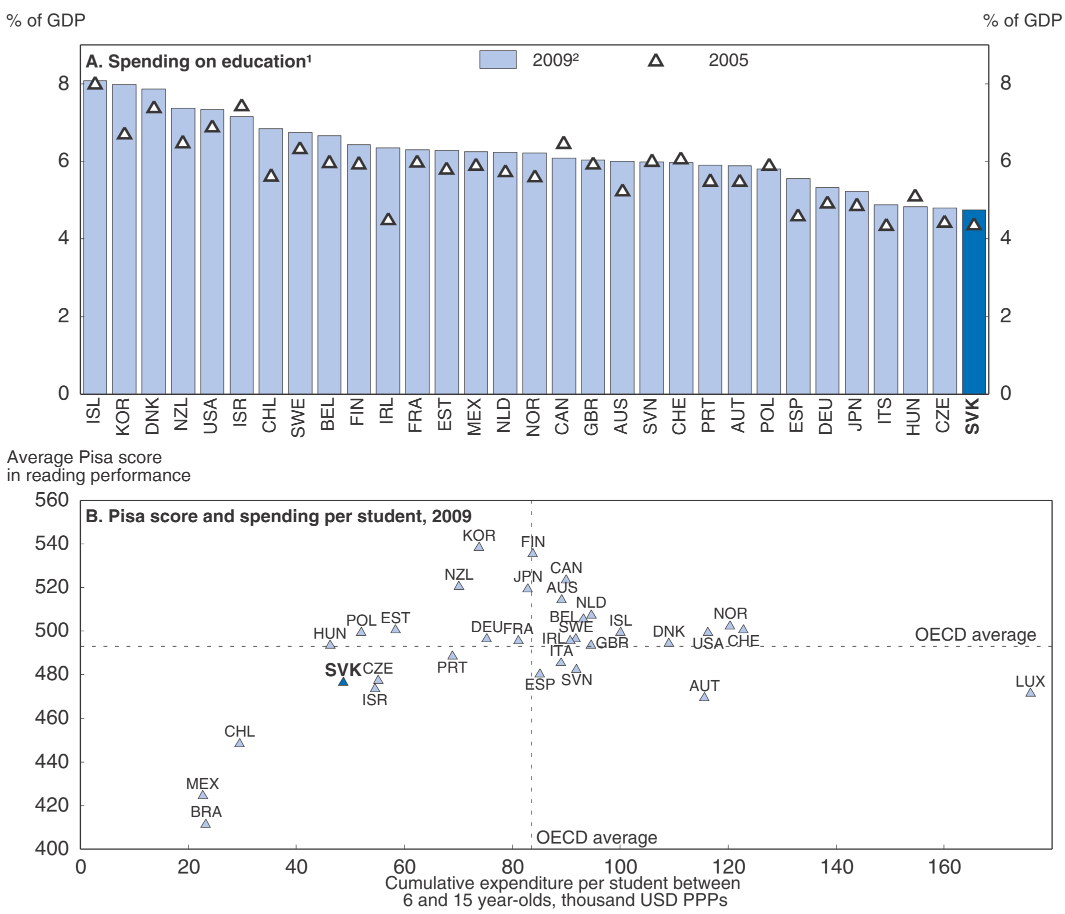
Improving educational outcomes would also have a significant positive impact on economic growth. An additional year of schooling may increase growth in real GDP per capita by 10% (Bouis *et al.*, 2011; Bils and Klenow, 2000; Psacharopoulos and Patrinos, 2004). An OECD study shows that improvements in the education quality can have a very large impact on future economic growth (OECD, 2010c). Increasing average PISA scores to OECD highs (Finland) of all labour force participants would increase GDP growth by 0.9% in Slovakia. Reducing educational inequalities may also contribute to boosting labour productivity and utilisation (Causa and Johansson, 2009). Education is one of the main determining factors of economic and social outcomes thus raising educational outcomes of individuals with disadvantaged socioeconomic background would allow them to fully realise their potential (OECD, 2010d). Finally, increasing the level of education tends to increase public sector efficiency (Afonso *et al.*, 2006) which is helpful in times of fiscal consolidation (see Chapter 1).

While Slovakia implemented a large number of measures aiming at improving educational outcomes, most of the issues identified in past *Surveys* remain (Chapter 3 of OECD, 2007b). The benefits of the reforms may take time to materialise. Nevertheless, additional effort needs to be made to ensure that education services are provided in the necessary quantity and quality. This includes reforming the allocation of funds in the education system by more directly taking into account performance and efficiency elements, increasing resources allocated to teaching activities, in particular for disadvantaged pupils, adapting vocational education to labour market requirements and developing the pre-conditions for lifelong learning. Some savings could be achieved by adopting best practices but they may not be sufficient or fast enough to finance the measures mentioned above. Thus, the education budget should at least be sheltered from budget cuts and consideration should be given to allocating additional funds to education.

Public spending on education is low

Despite increases over the past decade, spending on education is low by international comparison both in relation to GDP and as a share of total public spending. Between 2000 and 2008, expenditure per primary, secondary and post-secondary non-tertiary student increased by more than 40%. However, in 2009, annual spending per student was only half the OECD average and Slovakia was the country which spent least on education in the OECD (Figure 2.9). Studies do not find a close relationship between the level of spending and the quality of education (OECD, 2012b). This suggests that increasing spending on education alone will not be sufficient to improve educational outcomes, but must be accompanied by structural reforms of the education system.

Figure 2.9. **Spending on education and Pisa score**



1. Public expenditure only for Hungary; for Switzerland, in tertiary education only; and for Norway, in primary, secondary and post-secondary non-tertiary education only.
2. 2008 for Canada and 2010 for Chile.

Source: OECD (2012), *Education at a Glance*, Tables B2.1 and B1.3b; and *PISA 2009 Database*.

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Achieving efficiency gains in the primary and secondary education systems

The primary and secondary education systems are quite efficient by international comparison with relatively high PISA scores for a low level of spending (Sutherland *et al.*, 2007, Grigoli, 2012). As a result, few gains can be made from moving to best practices, and the room from increasing educational outcomes without increasing resources is limited. At the same time, studies show that efficiency gains are possible (Mandl *et al.*, 2008) and given the consolidation needs, every opportunity for efficiency gains should be seized.

Well designed institutional and policy settings of primary and secondary education can result in higher public sector efficiency (Joumard *et al.*, 2003). Three main characteristics of public institutions are identified as having an impact on efficiency: the capacity to allocate available resources efficiently; the efficiency of budget management once priorities are set; and the efficiency of services provision (Gonand *et al.*, 2007). According to available indicators, the funding system of primary and secondary education could be improved in Slovakia, while the institutions dealing with the budget management and the provision of educational services at the local level are well-designed and should thus be cost-efficient.

Reforming the funding system

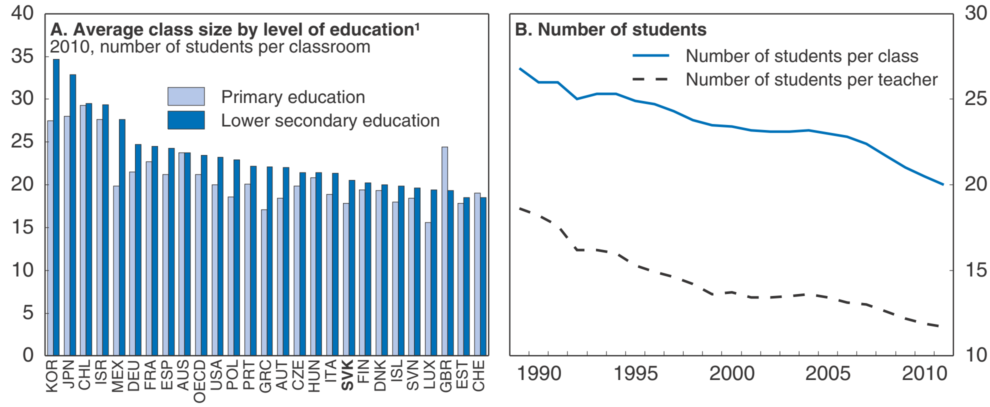
The allocation of funds in the education system could be improved as it is not sufficiently oriented towards quality improvement. The responsibilities for budgetary allocation are not fully decentralised. The funding of schools is mainly determined by the number of pupils and the amount of funds allocated per pupils does not depend on outcome-related criteria. Schools funders have some room to distribute funds to address specific needs. A share of funds can be redistributed among schools at the local level (10% of the wage costs and 20% of the non wages costs). Also, some additional funds could be allocated on demand of the school funder (pupil transportation costs, teaching assistants, exceptional achievements of pupils, emergency situation) but there are limited.

The funding formula encourages the separation of pupils according to their educational achievement. Premiums are allocated to eight-year grammar schools (schools for the best pupils selected at age 10) which receive around 12% funding premium. Additional funds are also provided for children with special needs but they are not sufficient to encourage the integration of these pupils in standard classes or schools (Friedman and Suru, 2009). As a result, the funding system encourages the creation of special schools either for the best pupils or for those with difficulties. This is inefficient as regrouping pupils according to educational outcomes may have no impact on overall educational outcomes and by contrast tends to increase the influence of socio-economic background on learning outcomes (OECD, 2010d). The funding of basic schools and eight-year grammar schools will be harmonised by removing premiums to eight-year grammar schools in 2013. This is a first step in the right direction. One step further would be to delay the age at which first selection into education tracks is made as recommended in the 2007 *Survey* (OECD, 2007b). Also, incentives to integrate pupils with special needs in standard classes should be strengthened.

Revising the network of primary and secondary schools

The network of primary and secondary schools could also be revised. Demographic change has lead to a decline in the number of pupils since 1990. However, the number of schools did not follow and the number of students per school decreased by one third between 1989 and 2011. The class size and the number of students per teacher also declined and the class size is now below the OECD average (by around 3 students per class, Figure 2.10). Some economies of scale could be reaped by reducing the number of classes and schools (OECD, 2011a). When possible, schools should be encouraged to merge as this

Figure 2.10. **Average class size and student-teacher ratio in primary and secondary education**



1. Public institutions only for Switzerland.

Source: OECD (2012), *Education at a Glance*, Chart D2.2; OECD calculations based on data from the Institute of Information and Prognoses of Education.

StatLink http://dx.doi.org/10.1787/888932748897

will contribute to reducing sunk costs and to improving efficiency: small schools tend to be less efficient than larger schools (Sutherland *et al.*, 2007). Yet, the current funding formula discourages economies of scale. Additional funds are allocated to small schools, with the premium decreasing with the number of pupils. Replacing the premiums to small schools by grants not linked to the size of the schools would foster the merger of schools. The impact of the merger of schools on local development should be taken into account and the in-charge authorities should ensure the costs of the restructuring of the school network do not exceed the benefits. Increasing the size of classes would also free resources for more effective measures without damaging education quality: empirical studies indicated that the size of classes has no impact on educational outcomes (OECD, 2012b). To do so, the upper limit on size of classes fixed by law should be increased.

The structure of the secondary education network should adapt to the increase in tertiary education attainment. The government is planning to strengthen the selection of pupils entering grammar schools to avoid a "dumbing down" of general education. The government should make sure that the reforms envisaged do not undermine tertiary education attainment and that vocational schools are adequately preparing pupils to succeed in tertiary education (by providing sufficient general education). An option would be to integrate vocational secondary schools and grammar schools, with the general education courses common to both tracks being offered jointly, as recommended in OECD (2007b).

Improving the evaluation of schools

Recent reforms providing more autonomy to schools should improve the efficiency of budget management at the local level. Schools have total autonomy in spending their budget, hiring collaborators and defining the learning methods and the education programmes.[3] Measures should be implemented to ensure that the high level of autonomy generates high quality outcomes and to monitor its impact on equity across schools. The accountability of the educational staff should be developed and incentives for improvement should be introduced (Gonand *et al.*, 2007). Internal and external evaluations have been developed recently and are partly used to encourage performance. *First*, national examinations were established at the lower and upper secondary level. The government also envisages implementing evaluation of pupils at the primary level, allowing to assess the "value added" of schools. *Second*, the Ministry of Education is working on new rules for self-assessment of schools to increase accountability of the education system. *Third*, many output and outcome indicators about primary and secondary schools were published to increase public awareness about schools results, thus encouraging high performance.

The developments of assessment tools, targeted funding with allocation of resources to the areas with the highest needs, and an increased accountability of principals for the educational outcomes have a positive impact on educational outcomes (Mc Kinsey, 2010). Available evaluations should be used to identify dysfunctions and best practices, adapt and better target education policies. However, the Inspectorate only checks the compliance of education programmes with regulation, and information from internal assessment – often considered as an administrative burden – is not used to improve the quality of teaching. Also, published outcomes of schools are not relevant to assess the quality of teaching as they do not take into account the context of each school. Thus publishing these evaluations only generates superficial competition between schools and may finally lead to misinterpretation and cream skimming. More accurate information about the quality of schools could improve parents or/and students decisions about school selection, especially where funding follows students (OECD, 2011a). Also, it would help to target schools with difficulties and encourage the diffusion of best practices.

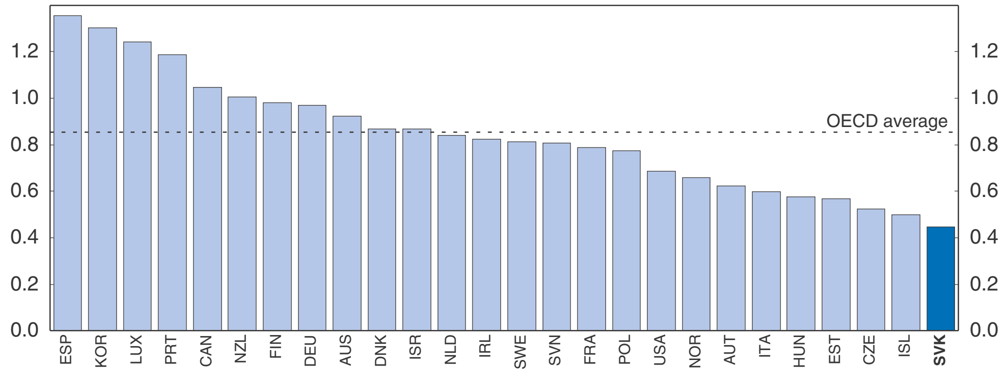
Increasing resources allocated to teaching activities

The share of funding allocated to teaching activities and to the remuneration of teachers is low by international comparison. Relative wages of teachers are the lowest among OECD countries (Figure 2.11). Teachers' wages were only 44% of the average earnings of tertiary education graduates in Slovakia, while in the OECD average they varied from 77% and 89% depending on the education level in 2009 (OECD, 2011a).[4] This is unfortunate as PISA results show that the best performing countries tend to invest more in teachers offering them higher salaries and greater professional status. By doing so, they tend to attract the best students into the teaching profession and then increase the quality of education (OECD, 2012b). In Slovakia, the low attractiveness of teaching positions causes difficulties in recruiting and retaining teachers with skills that are valued in the private sector, notably fluency in foreign languages (especially English). For example, 48% of English lessons were taught incorrectly in the academic year 2010/11, and not all teachers were actually able to communicate in English (State School Inspection, 2011). Bringing up teacher remuneration to 75% of the average wage of a tertiary graduate would require a pay rise of around 50%, costing around 0.5% of GDP.[5]

The remuneration system of teachers is not creating incentives to improve educational outcomes as a very low share of teacher remuneration is outcome-based. School principals decide on the teacher remuneration for a small variable part (around 11% of the wage bill in 2011) and the wage is mainly determined by the seniority of the teacher (for the same education level) and not by performance. By reviewing the successful experience in improving educational outcomes across the world, a McKinsey study identifies best practices regarding management of educational staff. It shows that, for schools with low performance in PISA, teacher accountability should be improved (McKinsey, 2010). To increase performance, teacher and school leadership professions should be made more attractive and collaborative practices between teachers and between schools should be valued to encourage sharing of best practices. The wages of teachers

Figure 2.11. **Teachers' remuneration**

2010 or latest available year



Note: Ratio of teachers' salary after 15 years of experience to earnings of full-time, full-year workers aged 25-64 with tertiary education.

Source: OECD (2012), *Education at a Glance*, Table D3.1.

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should be increased while at the same time creating incentives for quality improvement. This should be accompanied by a widening of performance monitoring and pay. Also, new career path for teachers should be created to improve the attractiveness of teaching positions. Senior teachers should be given the opportunity to have new responsibilities, such as supervising less experienced teachers.

Teachers have the opportunity to participate in some training during their career (including free training) and to receive premiums when they acquire new competences. However, Slovakia has the second lowest participation rate of teachers in professional development (after Turkey) among countries participating in the OECD Teaching and Learning International Survey (TALIS). Around 25% of teachers did not participate in professional development in the previous 18 months in 2007-08, 14 percentage points more than the panel average (OECD, 2009c). The low participation is due to the low availability of adequate training: 60% of non-participants state that they did not participate because of a lack of suitable training (*vs.* 40% on average) while only a minority mentioned the cost of training and conflicts with work schedule as the main hurdles to participation. This suggests that training of teachers could be improved by providing adequate lifelong learning opportunities.

International experience indicates that apprenticeships and mentorship of educational staff has a positive impact on the quality of teaching (McKinsey, 2010). In Slovakia, co-operation between the school leader and teachers is well developed at the school level and teachers have to complete a year-long adaptive educational programme with experienced colleagues before starting to work. However, co-operation between schools is weak, hampering the diffusion of best practices. Some practices such as having superintendents discussing regularly with principals and teachers on school achievement, suggesting solutions and getting feedbacks could help in this respect. Appointing specialised and experienced teachers to work in different schools and providing recommendations to teachers during a few weeks would also contribute to increasing the quality of teaching.

Concentrating efforts on disadvantaged pupils

Providing a minimum education level to every citizen is crucial to avoid social exclusion and improve labour market outcomes. Individuals with a low performance in basic skills (literacy, numeracy and problem solving) are more likely to be unemployed, permanently detached from the labour market, and not to train during their adult lives (OECD, 2011b). In Slovakia, 85% of the population are graduated from upper secondary education. However, the share of youth who do not have a minimum reading proficiency is large by OECD standards: 22% of pupils achieved only a low level of reading proficiency in PISA, 3.5 percentage points more than in the average OECD country. Literacy skills of Roma are particularly poor, contributing to their detachment from the labour market (World Bank, 2012b). According to PISA scores, best performing school systems are those which commit themselves to ensuring that all students succeed (OECD, 2012b). This suggests that more resources should be provided to ensure a minimum education level for all and should be concentrated on pupils with difficulties, the Roma in particular.

Good-quality early childhood education has a positive impact on future educational outcomes, in particular for children from socio-economically disadvantaged backgrounds (OECD, 2010d). Roma children attending pre-school are less likely to enrol in special school and to be on the social assistance in the future (World Bank, 2012b). Even though several measures were implemented to encourage participation in pre-primary education of children from low socio-economic background, participation of Roma children remains low (Šiškovič, 2012). For example, pre-primary education is free of charge one year before compulsory education starts and for children who come from families that receive material need benefits. However, only 20% of Roma children aged 3-6 years attended kindergarten (*vs.* 55% for children from same area, UNDP, 2012). The pre-school enrolment rate of Roma in Slovakia is low compared to neighbouring countries. In Hungary 76% of Roma children attend pre-school and the gap in secondary school completion rates among Roma and non-Roma neighbours is two-third lower than in Slovakia (World Bank, 2012b). The participation of low income families and Roma in pre-primary education should be further encouraged by making pre-primary education mandatory, as in Hungary.

While it is prohibited by law, segregation of Roma children at primary and secondary school remains prevalent (Amnesty International, 2010; FRA and UNDP, 2012). Roma children are disproportionally placed in special schools or in special classes after being diagnosed as mentally disabled. Despite policy actions preventing unjustified placement of Roma children in special schools, the attendance rate of Roma in special schools has almost doubled in one generation (World Bank, 2012b). This is unfortunate not least because regrouping pupils with special needs undermines their chances to succeed in higher level of the education system. Indeed, educational achievements significantly depend on peer group effects (Sutherland *et al.*, 2007). Roma are particularly disadvantaged due to their low socio-economic background and the lack of language proficiency. Being grouped into special schools or classes, the children have more difficulties in learning the Slovak language in particular. Also, according to PISA scores, best performing school systems do not separate out poor performers or students with behavioural problems or special needs (OECD, 2012b).

Overall, policy initiatives to improve Roma integration in the education system have been largely unsuccessful (Vagac, 2010). However, some measures, following international best practices, are going in the right direction. Schools with more than 100 pupils from low socio-economic background have to use at least 50% of additional funds to remunerate teaching assistants. The appointment of assistants speaking Romani is also very welcome. A new Roma Integration Strategy has been recently defined in collaboration with the EU Commission (European Framework for National Roma Integration Strategies) with promising action programs (Box 2.2). Policy measures defined in this Strategy should be quickly implemented, results should be monitored and programmes should be adjusted accordingly. In particular, plans to reform the tracking system of children into special schools and to increase the number of teaching assistants are very welcome.

Box 2.2. **Policy initiatives to raise educational outcomes of the Roma population**

The main goal of the *Strategy of the Slovak Republic for the integration of Roma up to 2020* (January 2012) in the area of education is to improve access of Roma to quality education from the early childhood to university with special emphasis on removing possible segregation at schools, prevent premature termination of school attendance and ensure a smooth transition from school to work. The main policy objectives are notably:

- Increase the participation of children from socially disadvantaged environment in pre-primary education to 50 % by 2020.
- Improve motivation, school results and attendance of Roma children in elementary schools and ensure that the below secondary education level is reached by 100 % of all pupils.
- Increase the proportion of Roma students who reach upper secondary education level to the level of general population of the Slovak Republic.
- Increase the proportion of teachers and specialists fluent in Romani.
- Exercising the right to education in a Romani language, providing education for teachers of Romani language and preventing all forms of discrimination.
- Improve the process of diagnostics and placement of children into the system of special education and remove sources for unjust placement.

Policies measures are defined in the revised *National Action Plan of the Slovak Republic regarding the Decade of Roma inclusion 2005-15 for years 2011-15* and include notably:

- Develop incentives to participation in pre-primary education by providing free of charge pre-primary education from age 3. Increase pre-primary education capacities in municipalities with high numbers of pupils from socially disadvantaged environment.
- Increase the funding premium for pupils from socially disadvantaged environment by 100%. Increase number of school special educators, school psychologists and teaching assistants.
- Improve the process of diagnostics and placement of children into the system of special education by elaborating socially and culturally relevant tests of schooling competency, during the testing using the child's mother tongue, and if necessary, ensuring the presence of teacher assistant for pupils from socially disadvantaged environment.

Improving the transition from school to work

Transition from school to work is difficult, in particular for youth with basic or below upper secondary education. Graduates from upper secondary schools have also more difficulties in finding a job compared to tertiary graduates. The unemployment rate of 25 to 29 olds not in education or in training was more than seven percentage points higher for those having an upper secondary education level than for those with a tertiary education level in 2010 (13% *vs.* 6%). The gap is significantly lower in the average OECD country (two percentage points).

A large share of the youth population is graduated from vocational schools. In 2009, 72% of upper secondary students were enrolled in pre-vocational or vocational programmes and 64% of the population has graduated from vocational or pre-vocational programmes, 20 percentage points more than the OECD average. The unemployment rate for graduates from vocational schools is close to the unemployment rate of graduates from general education on average (Table 2.4).[6] However, graduates from vocational schools not preparing to enter the university (not preparing the *maturita*), with more vocationally-oriented curricula, face higher risks of being unemployed. Also, the unemployment rate of 24-35 olds graduated from vocational schools is four percentage points higher than for those graduated from general education, suggesting that graduates from vocational schools have more difficulties in finding a first job. This is worrisome as graduates from vocational schools are supposed to enter the labour market directly after graduation.

Table 2.4. **Unemployment rate by educational attainment level**

	2006	2011
Total	**13.3**	**13.5**
Basic education	48.0	42.1
Vocational upper secondary education		
Vocational without maturita	15.4	16.8
Vocational with maturita	12.7	12.2
General upper secondary education	9.5	14.6
Tertiary		
Bachelor degree	4.7	7.8
Master degree	3.2	5.6
PhD. Degree	–	4.2

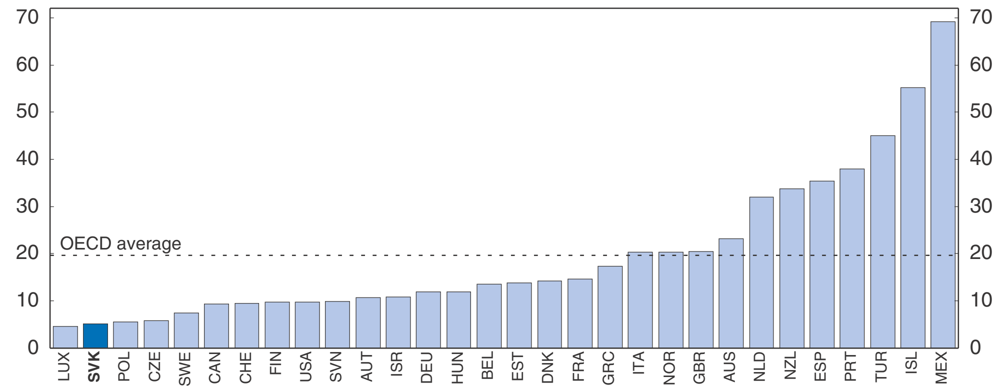
Note: LFS methodology.
Source: National Statistical Office.

The high unemployment rate of graduates from vocational schools is likely to reflect a skill mismatch issue. The increasingly high level of youth unemployment does not coincide with a high school drop-out rate. Graduation rates have significantly improved over the past decade. Most of youth are qualified and graduated at the end of their studies. The enrolment rate at age 16 (the legal age to leave school) is slightly above the OECD average and the school drop-out rate is among the lowest in the OECD (Figure 2.12). According to recent indicators, the level of qualification of the Slovak population (with a high share of graduates from secondary education) fits well with the labour market requirements. The rate of over-qualified or under-qualified is low by international standards (Quintini, 2011) meaning that workers have jobs that correspond to their education levels. However, competences acquired in vocational schools do not match labour market needs as the existing curricula do not sufficiently adapt to the changes in skill in demand and lead to out-dated qualifications (OECD, 2010a).

2006 PISA results show that business and industry had little influence on school curricula in Slovakia compared to countries with a strong vocational education and

Figure 2.12. **Early school leavers**

Percentage of youth aged 20-24 not in education
and without an upper secondary educational attainment, 2010



Source: OECD, *Scoreboard for Youth Aged 15-24.*

StatLink http://dx.doi.org/10.1787/888932748935

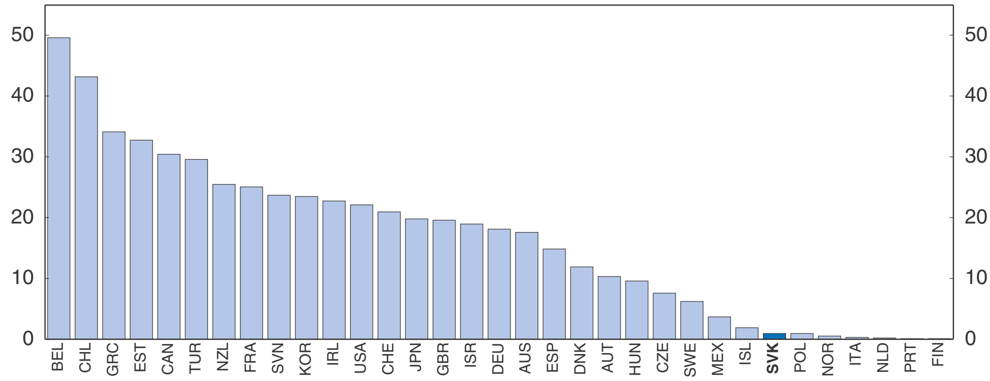
training (VET) system like Germany and Austria. To improve the matching between employers' requirement and vocational education mechanisms to regularly identify current and future labour market needs have been developed since then. VET councils at the national, sectoral and regional levels were established in 2009. These councils, involving employers represented by professional associations, are responsible for reviewing the curricula of VET schools and for defining a list of competences graduates must acquire. While it is too early to assess the effectiveness of these councils, they should be closely monitored and in-charge authorities should ensure a close co-operation between the different councils.

When defining educational programmes, a good balance needs to be found between providing narrow skills that increase the chances for immediate employability and general skills that develop adaptive capacities to structural shifts in the economy (OECD, 2007a). General knowledge should be part of the curricula as they are source of productivity growth and essential to innovation (Hoeckel, 2008). The system of competency-based curricula introduced in 2008 and including transferable knowledge should ensure this balance is found. Firms are increasingly demanding general knowledge, such as digital literacy, business skills and languages. This change in skills in demand towards more general knowledge reflects the upgrade in skills requirements (Handel, 2012). Demand for high skilled workers is likely to further increase in a catching up country like Slovakia. At the moment, tertiary education is characterised by long and academic programmes. Short (2-3 years) and vocationally-oriented tertiary programmes, which would better fit firms demand, are underdeveloped. The share of graduates from tertiary-B programmes among total tertiary graduates is among the lowest in the OECD (Figure 2.13). These programmes should be developed as they could bring tertiary education closer to the labour market needs. They would also reduce the length of studies, while being more accessible to VET graduates willing to pursue their studies.

Studies show that in-work training improves school-to-work transition for VET graduates (Hoeckel, 2008; OECD, 2010e). The learning in the workplace offers several advantages: it allows trainees to develop "hard" skills on modern equipment, and "soft" skills, such as teamwork, communication and negotiation, through real-world experience. Workplace training also facilitates recruitment by allowing employers and potential

Figure 2.13. **Vocational programmes in tertiary education**

Percentage share of tertiary type-B enrolled students in tertiary education, 2010



Source: OECD, *Education Database.*

StatLink http://dx.doi.org/10.1787/888932748954

employees to get to know each other, while trainees contribute to the output of the training firm. Workplace learning opportunities are also a direct expression of employer needs, as employers will be keen to offer opportunities in areas of skills shortage (OECD, 2010e). In Slovakia, only 30% of students in VET schools participated in some form of workplace training, suggesting that the current VET system is not attractive for firms. Recent reforms tend to encourage the involvement of firms in the VET system. The 2009 Act on VET introduced tax deductions for employers participating in training of VET pupils. Acquisition of professional experience during studies should be further fostered.

Dual apprenticeship systems deliver outcomes in terms of skill acquisition that appear to better equip workers to take advantage of changes in labour demand (OECD, 2012a). In this system, pupils alternate work and class and are directly employed by the firm, thus being fully integrated in the labour market while studying. However, conditions to set up an effective apprenticeship may be difficult to meet (Box 2.3). Thus, the authorities should support the development of apprenticeship, for instance in some sectors as pilot projects. At least, a legal framework for a dual apprenticeship system should be established and curricula with training standards should include more compulsory internships. These options are currently envisaged by the government and should be supported further.

A system of certification of competences acquired in the VET system at the national level could facilitate matching on the labour market. Currently, the final assessment of competences is done at the school level. In the absence of national standards for assessment of competences, the tasks defined for the final exam by individual institutions may fit the facilities in schools, and the knowledge of local teachers, but not reflect wider requirements. Consequently, the certificate provides employers with limited information on the nature and level of graduate preparation hampering the recruitment of VET graduates (OECD, 2010e). By contrast, a certificate based on performance in a national assessment is a better predictor of productivity than a diploma obtained in a local assessment (Backes-Gellener and Veen, 2008). Since 2008, competency-based curricula have been established based on national standards and certificates delivered by VET schools include information on the competences acquired. It is also important to provide a consistent method to assess the learning outcomes of vocational programmes to ensure that all those with the same qualification have the same mix of competences, at a similar level.

Box 2.3. **Introducing an effective apprenticeship system**

All OECD member countries offering apprenticeship as a main route from school to jobs (Austria, Germany, Switzerland) have relatively low youth unemployment rates. While this success is well documented (OECD, 2010a), it is not completely clear why not all countries introduce or develop a dual vocational education system. This may be due to the fact that a gradual transition from a school-based to a work-based system is difficult and that some conditions need to be met to ensure the effective implementation of an apprenticeship system.

- Effective apprenticeships provide specialised vocational training to a large part of a cohort. It is not a minority programme for low achievers, but an attractive preparation for gaining a good job. Such programmes, where existing, are therefore an acceptable choice for parents and youth when making decisions about finding their place in life but also for firms in their hiring decisions. In some countries (*e.g.* Germany and Austria), regulation favours graduated apprentices with respect to job search, disability status and employment protection and contributes to the attractiveness of the apprenticeship system.
- It must be profitable for an employer to hire an apprentice, just like for any other hiring decision. In a dual apprenticeship system, an apprentice is employed during the whole time of his/her vocational training period. Practical workplace training does not take place in form of unpaid internships, but is fully integrated into the production process of the firm. The remuneration is usually far below the minimum wage (insofar existing) or the wage for a comparable unskilled worker.
- Effective apprenticeships end with the certification for a qualification in a certain profession. The curriculum and exercise quality control are defined in close co-operation with employers. External exams are implemented to ensure the quality of the training.
- An apprenticeship model seems to work best when structural stability can be combined with flexibility within a firm and on the workplace, as witnessed by the outstanding labour market performance of Germany during the crisis and the persistent low rate of unemployment in Austria and Switzerland. By contrast, rapid structural changes require developing adaptive capacities and a certain level of general skills. Effective apprenticeships offer apprentices the opportunities to further train and to access tertiary education. While still a minority, a "*maturita* + apprenticeship" model is becoming more popular and could combine immediate job market relevance with the ability to cope with structural change.

Developing lifelong learning

Developing lifelong learning is essential to avoid skill mismatch due to structural changes in labour market needs. Lifelong learning is also a way to increase labour productivity by broadening the level of skills and to improve the employment prospects of early schools leavers and low skilled unemployed (OECD, 2011b). In 2007, the participation rate in non-formal education was relatively high in Slovakia by international comparison (41% *vs.* 34% in the OECD on average; OECD, 2011a). However, the number of training hours per participant is relatively weak leading to a smaller number of expected hours in training during a working life (828 hours *vs.* 988 hours on average in the OECD). Strategies aiming at developing lifelong learning were established in 2007 and 2011 but only a few measures have been implemented since then (Box 2.4).

Providing information on the quality and returns of training and ensuring recognition of learning outcomes in the labour market and in the educational system is crucial for the

Box 2.4. National measures to develop lifelong learning

The Slovak government approved the first *Lifelong Learning and Lifelong Guidance Strategy* in 2007. The Act on lifelong learning adopted in 2009 set a new regulatory framework for continuing education, for the accreditation and the assessment of training programmes as well as the basis for the recognition of non formal education. A new *Strategy of Lifelong Learning* approved by the government in 2011 defines new key priorities and some actions plans including:

- Creating a network of legitimate institutions for recognition of qualifications acquired during training.
- Establishing a system of communication between educational institutions and employers for common exchange of information on knowledge, skills and competences needed in the labour market.
- Creating an integrated information system devoted to career guidance providing information on training opportunities.
- Creating a network of career guidance centres enabling direct consultations with professional career advisors.
- Developing a funding tool to support lifelong learning.

No concrete measures have been implemented yet.

good functioning of the training market. Individuals are more likely to invest in training if the competences they will gain with training could be identified and valued by the future employers. In 2009, a regulatory framework for the accreditation and the assessment of training programmes has been created. Some measures aiming at easing the recognition of competencies acquired trough non-formal education and at improving information on training programmes have been phased in. A National System of Occupations describing occupations and qualification they require is being established in co-operation with the private sector. A Further Training Information System is also created to improve access to information on training options. These initiatives might strengthen investment in training by reducing some informational failures and should be pursued further. At the same time, to avoid overlaps and duplications, they should be co-ordinated with other projects dealing with the identification of labour market requirements. In particular, the authorities in charge of establishing the National System of Occupations should co-ordinate with the abovementioned VET sector councils in charge of defining the educational programmes in VET schools.

Private incentives for lifelong learning are weak (GHK and Research voor Beleid, 2011). Adult education is mainly financed with public funds, the private sector being marginally involved.[7] The low share of co-financing suggests that lifelong learning policies are insufficiently oriented towards business needs.

- At the firm level, few incentives are provided to employers for training. To ensure employers get a return on their investment, payback clauses obliging employee to reimburse the training costs in case of voluntary quits have been introduced. Vouchers have also been proposed but were not used by firms. This is partly due to the design of the measure: around 30% of the employers declare not using the voucher because of too burdensome administrative procedures and around 20% because they were not meeting the eligibility criteria.

- For workers, two main barriers limit participation in adult learning: the cost of training and the difficulty of combining training and work (Eurostat Adult Education Survey, 2006). Both obstacles are more widespread in Slovakia than on average in the EU and little has been done to address them.
- Training provided by public and civic institutions does not concentrate on vocational skills and may not respond to the labour market requirements. VET schools are not involved in adult education (1% of adults in further education were trained by secondary schools). Higher involvement of VET schools into adult education could strengthen the link between VET schools and the labour market as well as remove adult education bottlenecks.

Incentives for employers to allocate more resources and time to training should be enhanced and international benchmarking should be used to reform the public support to lifelong learning. Different forms of financing and incentives for training exist in OECD countries. Compulsory contributions (levy as in France or learning accounts as in Denmark) are quite effective in increasing investment in training but are weighing on the labour cost. Deductions of training costs from the corporate tax base, which are less burdensome for the firms, have also proved to stimulate lifelong learning (OECD, 2005b). Consideration should be given to introduce such tax advantages in Slovakia. Also, income contingent soft loans could be allocated to trainees to avoid credit constraints undermine investment in training. Subsidising lifelong learning will require further monitoring the quality of training provided. The accreditation system of training providers is operational but suppliers are not providing data on their outcomes while it is mandatory according to law (GHK and Research voor Beleid, 2011). Non-complying suppliers should be excluded from future procurement and data collection improved to facilitate the assessment of lifelong learning policies.

Participation of low-qualified and older workers in adult education is low. In particular, the number of training hours of adults with an education level below upper secondary is relatively small by OECD standards. Only 14% of low-educated engaged in lifelong learning in 2007, 48 percentage points less than adults with tertiary education. The low-educated participating in non-formal education had three times less training hours than the high-educated. Participation of low-qualified and older workers should be supported, because the social gains of improving the productivity and the adaptive capacities of these two groups of workers may exceed private gains. Workers are expected to stay longer in employment and investing more in their human capital should also have an important signalling effect (Bassanini *et al.*, 2005; Chisholm, Burns, 1999). At the same time, for firms, the return of investing in training of low-educated or older workers may be too low and/or lower than for young high skilled (in the case of older workers because of approaching retirement and in the case of low-educated workers because of the need for general education not directly profitable to the firm). This leads to a sub-optimal investment of low-qualified and old-age workers in further education that should be compensated by policy actions. With a few exceptions, public funds for adult learning are not targeted in Slovakia.[8] Incentives for firms to train low-educated and older workers should be strengthened, as in Austria for instance, where subsidies for trainings depend on the characteristics of recipients and are higher for low-educated (OECD, 2005b).

Box 2.5. **Recommendations for education policy**

Improve allocation of funds and increase targeted spending to improve minimum education outcomes

- Remove premiums to eight-year grammar schools as planned and strengthen incentives for the integration of pupils with special needs in the standard system.
- Increase the wages of teachers together with structural measures increasing the efficiency of the system such as consolidating the network of schools, increasing the classroom size and widening the scope for performance-related pay. Encourage sharing of best practices by rewarding collaborative practices between schools. Develop lifelong learning opportunities and new career paths for teachers.
- Raise support to disadvantaged pupils. Further encourage participation of children from low income families and Roma to pre-primary education by making pre-primary education mandatory. Continue to prevent unjustified placements of Roma children in special schools and to encourage the integration of Roma in mainstream education. Speed up implementation of measures defined in the National Roma Integration Strategy, and regularly monitor them (in particular, reform the tracking system of children into special schools and increase the number of teaching assistants).
- Adapt the network of schools to demographic and skills developments. Encourage merging of schools by providing grants not linked to the size of the schools and by increasing the upper limit on class size fixed by law. Encourage the integration of technical secondary schools and grammar schools with the general education courses common to both tracks being offered jointly.
- Improve the use of available evaluations to identify dysfunctional schools as well as best practices.

Improve the school-to-work transition

- Foster acquisition of professional experience during studies and develop work-based VET by creating a legal framework for a dual apprenticeship system. Consider supporting the development of apprenticeship in some sectors or at least develop compulsory internships.
- Develop the national system of certification of competences acquired in the VET system by providing a consistent method to assess the learning outcomes of vocational programmes.
- Develop short (2-3 years), flexible and more vocationally-oriented tertiary programmes
- Monitor the effectiveness of VET councils and ensure they closely co-operate.

Develop lifelong learning

- Enhance incentives for employers to allocate more resources and time to training, for instance by improving the system of training vouchers or by introducing tax deductions for training costs. Provide income contingent soft loans to trainees. Provide stronger incentives for low-qualified and older workers.
- Pursue further initiatives aiming at easing the recognition of competencies acquired through non formal education and improving access to information on training options. Increase involvement of VET schools in adult education.

Notes

1. Data are from the *OECD Labour Market Programme Database*. Data often include training allowances, wages or other forms of income support paid to programme participants. Slovak data include some types of income support payment but not the "activation allowance" or regular social benefits that are paid to ALMP participants in some cases. The "activation allowance" has a clear activation purpose as it is offered to jobseekers participating in job creation programmes (small municipal works) and thus could be considered as an active labour market measure. Spending on activation allowance amounted to around EUR 10 million in 2009, 6% of total ALMP and 0.02% of GDP. Including such spending in the database is not changing significantly the figures presented in the chapter. The other regular social benefits are not conditioned to work availability or to participation in ALMP (contrary to most other OECD countries) and thus are not considered here as spending on ALMP.
2. According to the Article No. 8 of the Act on Employment Services, the disadvantaged jobseekers include notably: young graduates under 25 years of age who completed full-time vocational training during the past two years and has not found a first paid regular employment; older jobseekers aged more than 50 years; the long-term unemployed registered at the employment services for at least 12 months over the past 16 months; person with health problems; migrants within the European Union; people who have not completed secondary school.
3. Compulsory knowledge is defined at the central level and should be included in education programmes.
4. Also spending on ancillary services is higher than other OECD countries as a share of total expenditures on education. At least 10% of total expenditure by educational institutions is allocated to these services (transports, meals, housing, etc.) in primary and secondary and post-secondary non-tertiary institutions.
5. 0.5 % of GDP corresponds to an increase of the average wage of teachers of 50% multiplied by the total number of teachers in primary and secondary education (including social security contribution). The sources used are the *UOE Database* for the number of teachers and *OECD Education at a Glance 2012* for the average wage.
6. The integration of vocational schools graduates on the labour market depends on their specialisation with unemployment rates varying between 7% in medical and pharmaceutical field and 34% in agricultural and veterinary field in 2011 (Institute of Information and Prognoses of Education, 2011).
7. In particular, it was funded at 9% by participants, 10% by the private sector, and 81% by the public sector in 2010 (almost 70% from EU funds).
8. Some initiatives targeted toward youth and financed with EU funds are implemented. For example, the KomPrax project aims to train 15-17 year olds in project management, problem solving, communication, presentation, financial literacy and teamwork.

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