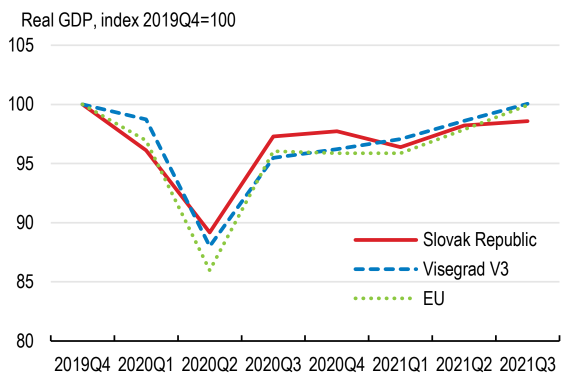
Executive Summary

The economy is recovering from a deep shock

Activity has rebounded after a deep economic contraction, but risks to the outlook remain high. The overall impact on employment has been limited thanks to timely policy support, in particular job retention schemes.

Figure 1. Activity has rebounded



Note: Visegrad V3 includes Czech Republic, Hungary and Poland.
Source: OECD Economic Outlook database.
StatLink https://doi.org/10.1787/888934296116

The impact of the crisis differed significantly over time and across sectors, firms and workers. Manufacturing output recovered quickly in 2020 but the recovery has been interrupted recently due to supply shortages, notably in the automotive sector. Due to the long-lasting restrictions, the economic fallout and job losses were more pronounced in the services sectors, disproportionally affecting low-skilled workers and youth. Employment among these sectors and groups remains well below the pre-pandemic levels.

The recovery is set to accelerate (Table 1). The latest pandemic wave, a relatively low vaccination rate and supply disruptions will weigh on private consumption and export growth in the near term. The recovery is projected to accelerate in 2022 and 2023, on the back of strong investment growth, aided by EU structural funds and the new EU Recovery and Resilience Facility. Risks surrounding the outlook remain high.

Table 1. The recovery is set to accelerate

	2020	2021	2022	2023
Gross domestic product	-4.4	3.2	5.0	4.8
Unemployment rate (%)	6.7	7.0	6.4	5.8
Consumer price inflation	2.0	2.8	5.4	2.6
Fiscal balance (% of GDP)	-5.5	-6.7	-4.4	-2.5
Public debt (Maastricht, % of GDP)	59.7	60.5	58.2	56.7

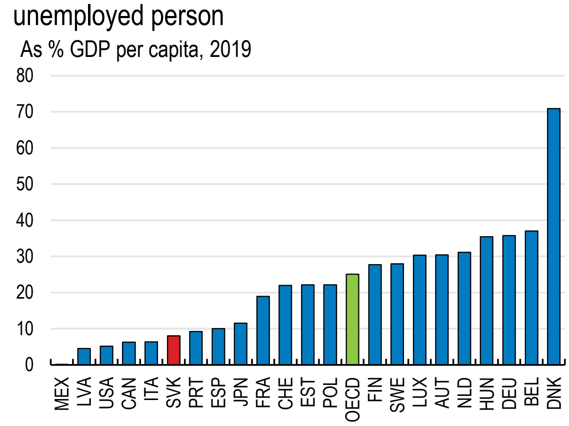
Source: OECD Economic Outlook: Statistics and Projections database.

Risks in the financial sector should be closely monitored. Adequate capital and liquidity buffers in the Slovak financial system are contributing to stability. Yet, credit defaults and market corrections may materialise once policy support is fully withdrawn. The build-up of imbalances has continued in the housing market, partly as a side effect of low interest rates, raising risks.

Targeted policy support should be maintained until the recovery is well underway to avoid long-lasting scars from the pandemic. Spending on active labour market policies is low and not sufficiently directed towards training measures (Figure 2). Stepping up training, including for workers on short-term working schemes, is crucial to help job transitions and reduce long-term unemployment, which is particularly prevalent among the low-skilled and Roma.

Figure 2. Spending on active labour market policies is low

Spending on active labour market programmes per unemployed person



Source: OECD Labour Market Programmes database.
StatLink https://doi.org/10.1787/888934296135

The authorities' have supported firm liquidity but companies may still face deteriorating balance sheets. Speedy restructuring of viable firms in temporary distress can prevent their unwarranted liquidation, and should be facilitated outside courts. Further streamlining insolvency procedures can facilitate necessary economic adjustments.

The government has set up an ambitious recovery programme, emphasising reforms and investment in education, health care, a greener economy and innovation**.** To ensure swift and effective implementation, further efforts are needed to raise Slovakia's chronically low absorption rate of EU funds by streamlining public procurement and enhancing public investment governance.

Fiscal consolidation should be gradual. In the medium-term, the planned multi-annual spending ceilings, together with the existing national debt brake, can help bring public finances back on a more sustainable path, but should be set in a way that avoids derailing the economic recovery. Better integrating spending reviews into the budget process can improve spending efficiency, while safeguarding growth-enhancing investment.

Preparing for rapid population ageing

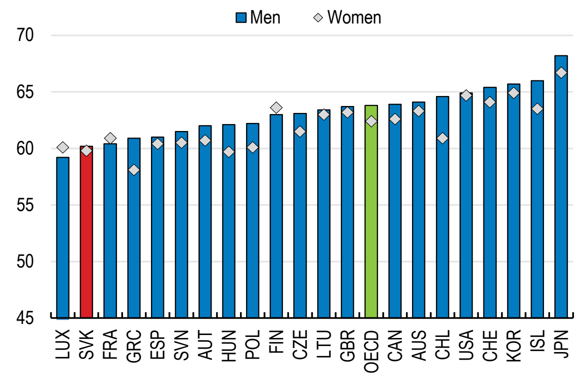
Rapid population ageing will exacerbate fiscal challenges and weigh on long-term growth. Addressing these pressures will require pension, health and long-term care, and labour market reforms.

The ratio of retirees to the working-age population will more than double in the next 30 years. On current policies**,** ageing will increase spending on pensions, health and long-term care by over 10 percentage points, more than elsewhere in the EU. Together with falling revenues, this will jeopardise fiscal sustainability. In addition, a shrinking working age population will weigh on growth.

The effective retirement age is among the lowest in the OECD (Figure 3)**,** reflecting a low statutory retirement age and many pathways to early retirement. Extending working lives by linking future retirement ages to increases in life expectancy, as planned by the government, would significantly improve the sustainability of the public pension system and ensure adequate pension income in the future.

Figure 3. The labour market exit age is low

Effective labour market exit ages by sex, 2020



Source: OECD Pension at a Glance database.

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The government should close pathways to early retirement. The early retirement option for mothers should be phased out. Access to disability pension should be tightened including by updating assessment criteria.

Improving health outcomes is essential to prolonging working lives. Life expectancy is three years lower than on average in the OECD, reflecting high preventable mortality. Preventive care is weak, due to an insufficient number of general practitioners, their narrow set of competencies, and an ineffective payment system. Overlapping tasks across many small hospitals contribute to inefficiencies, recurrent over-indebtedness of hospitals, and suboptimal performance.

The long-term care sector is ill-prepared for future demand increases. The sector is over-reliant on informal and institutional care. The provision of long-term care services is fragmented between the health and social care sectors, as well as between different government levels, creating inefficiencies and reduced access. Moreover, the long-term care system lacks a dedicated and sustainable funding source.

Older people face a range of labour market barriers. They experience higher job strain than in other OECD countries, partly due to inflexible working arrangements. Older workers also benefit less from training opportunities, even though the risk of their skills becoming obsolete due to technological change is highest.

Increasing employment rates of mothers with young children, the low-skilled and Roma, together with older workers, is essential to mitigate the impact of a shrinking work force. Government plans to enhance access to pre-school facilities are welcome. Family benefits need to be reviewed with a view to reduce incentives for mothers with young children to stay at home. The tax-wedge for low-income earners is high, reducing employment opportunities for the low-skilled. Integrated policy responses are needed to improve employment of the Roma.

Boosting productivity and greening the recovery

Sustaining productivity gains, historically largely based on integration into global value chains, is essential to revive economic convergence and boost living standards in Slovakia's ageing society. This will require strengthening Slovakia's own capacity to innovate and adopt new technologies.

Productivity growth and economic convergence to high-income OECD countries has slowed since the global financial crisis. Strong productivity gains of firms in the competitive manufacturing sectors have not sufficiently spilled over to small and domestic firms in the service sector, reflecting the duality of the Slovak economy. The crisis has accelerated the digital transformation, but the uptake of digital technologies of firms is low and uneven, limiting the potential for future productivity growth.

Improving educational outcomes and investing in skills should be a priority (Figure 4**).** Early childhood education, better training and pay for teachers, and improved opportunities of children from disadvantaged families are key to improving educational performance and inclusiveness. Strengthening the responsiveness of the educational system to labour market needs and investing into adult learning would ensure adequate skills in a globalised and digitalised economy and address the rise of automation, which is more acute in Slovakia than elsewhere in the OECD.

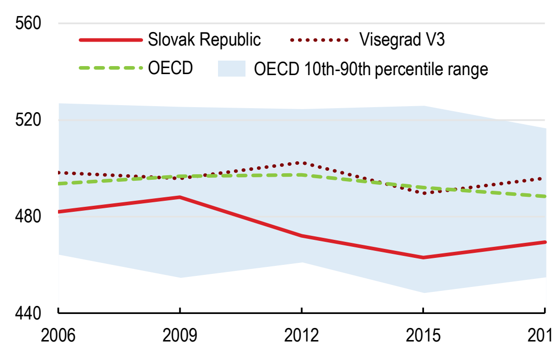
Research and innovation capacity need to be enhanced. Planned reforms of the higher education system can help to improve research quality. Higher, more sustainable and less fragmented support for business research and development can help accelerate technology diffusion. More efforts are needed to attract high-skilled foreign and Slovak workers living abroad.

Deploying reliable digital infrastructure and enhancing digital government services is key to enabling the digital transformation across the economy and society. Improving access to high-speed broadband networks, particularly in rural areas, may require additional public investment. Concerns about the security of digital public services must be addressed.

Further improving the business environment can foster business dynamism. Despite progress to reduce administrative burdens, regulations in a number of areas, especially for start-up firms remain more restrictive than in other OECD countries. Continuing judiciary reforms are needed to fight corruption and foster efficiency and trust.

Figure 4. Educational outcomes are weak

Average reading, math, science PISA score



Note: Visegrad V3 includes Czech Republic, Hungary and Poland.
Source: OECD PISA database; and OECD calculations.

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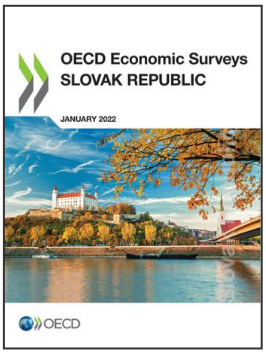
Meeting the new ambitious climate objectives will require sizeable investment and reductions in emissions. Planned investments in housing renovations including replacement of inefficient and high-emission boilers and heaters will improve energy efficiency and reduce air pollution, which remains a serious health concern. More coherently pricing carbon and environmentally harmful activities is needed to reduce emissions cost-effectively.

MAIN FINDINGS	KEY RECOMMENDATIONS
Supporting the exit from the crisis	
The share of the population fully vaccinated is about 25 percentage points below the EU average as of early-January 2022.	Continue efforts to accelerate vaccinations.
The crisis has hit low-skilled workers particularly hard. Long-term unemployment remains high.	Expand active labour market programs, in particular re-training measures for the low-skilled
The crisis has differing impacts across sectors. Too early withdrawal of support would trigger unnecessary bankruptcies and labour shedding, and may result in scarring and increased vulnerability. Ageing will create substantial fiscal pressures in the long-term.	Continue to provide targeted fiscal support until the recovery has become self-sustained. Adopt and stand ready to implement a medium-term fiscal consolidation strategy to prepare for long-run fiscal challenges, including ageing, and strengthen implementation of the savings measures identified in the spending reviews. Strengthen the rules-based fiscal framework by implementing multi-annual expenditure ceilings while adjusting the escape clause of the debt rule to allow flexibility in times of crisis.
The number of firms with liquidity and debt problems may increase and congested courts may prevent a timely restructuring of viable firms.	Promote out-of-court restructuring proceedings, especially for small and medium-sized enterprises.
The ambitious national recovery plan contains numerous reforms and investment of 6.9% of GDP. The absorption rate of EU funds has been historically low.	Streamline public procurement verification and control procedures. Further strengthen cost-benefit analysis and oversight of public investment over the project life-cycle.
The labour tax wedge is high, particularly for low-income earners. Tax revenues from property and environmental harmful activities are low.	Reduce the tax wedge in particular for low-income earners. Shift the tax mix towards property and environmental taxes.
Preparing for an ageing society	
Pension expenditures are expected to rise faster than in most EU countries, partly reflecting the low effective retirement age.	Link the future statutory retirement age and the minimum number of years of contributions required for retirement to life expectancy. Phase out the early retirement option for mothers. Reconsider the planned introduction of the parental bonus.
The gatekeeper role of primary care is hampered by an insufficient number of general practitioners, a narrow set of GP competencies, and an ineffective payment mechanism.	Introduce pay-for-performance payment schemes to increase the attractiveness of the GP profession.
There are many small hospitals, which leads to inefficiencies, recurrent over-indebtedness, and suboptimal performance. The implementation of the hospital network reform has been delayed several times.	Implement the hospital network reform and create a nation-wide centralised system for hospital quality assessments, monitoring and evaluations.
Home and community based long-term care is underdeveloped, reflecting limited financial and human resources.	Improve funding for and quality of home and community based care. Introduce voucher schemes for long-term care. Provide training to informal caregivers.
Paid parental leave is very long, reducing work incentives for mothers with young children. Long absences from the labour force negatively affect their career prospects and earnings, contributing to a large gender wage gap. There is a lack of childcare facilities, especially in some regions. Participation taxes for second earners are high, notably for low-income households, reflecting the high net nursery fee.	Reduce the maximum duration of parental leave and make part of it conditional on the father's participation. Expand the supply of high-quality childcare facilities, especially in underserved regions, and improve affordability of nurseries for low-income households.
Boosting productivity and greening the recovery	
Educational outcomes are weak and strongly dependent on socioeconomic background.	Strengthen initial and continuing teacher training with a focus on methods to identify and address learning weaknesses. Increase the number of teaching assistants speaking Roma, and provide Slovak language support for Roma children.
Business R&D and the share of innovative companies is very low. The share of firms receiving government support for innovation is low.	Expand the use of direct R&D support, such as grants, and make the R&D tax allowance refundable for small and young firms.
The administrative burden on start-ups is relatively high.	Reduce the administrative burden on start-ups by introducing "silence is consent" licensing rules.
Despite recent improvements, perceived levels of corruption are high.	Continue efforts to fight corruption including by adopting and implementing ongoing reforms to strengthen trust in the judiciary and public sector integrity.
Only 30% of carbon emissions were priced above EUR 30 per tonne of CO_2, a low-end estimate of the social costs of carbon. Air pollution remains high.	Introduce an explicit carbon tax in sectors not covered by the EU-ETS and gradually phase out remaining environmentally harmful subsidies. Redistribute revenues towards the most vulnerable households. Accelerate the green transition by investing in energy efficiency renovation in buildings and sustainable transport.



From:

OECD Economic Surveys: Slovak Republic 2022

Access the complete publication at:

https://doi.org/10.1787/78ef10f8-en

Please cite this chapter as:

OECD (2022), “Executive Summary”, in *OECD Economic Surveys: Slovak Republic 2022*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/1e020e41-en