

Executive summary

The global recession affected the Slovak economy to a greater extent than most other OECD countries, primarily owing to its exposure to world trade and its specialisation in cyclical export goods, notably cars. In tandem with developments in its main trading partner economies, the economy is now recovering at an above average pace. Challenges for re-establishing a sustainable high-growth trajectory are countering the risk of increasing long term unemployment, bringing government finances back on a sustainable path and reaping the benefits of a transition to greener growth.

Emerging from the crisis: challenges for the labour market and fiscal policy

The unemployment rate has risen substantially during 2009 by 3 percentage points to 14%, partly mirroring the large output loss. The main challenge is to prevent a further build-up of long-term unemployment, which was already very high before the crisis. To this end, labour market policies need to be adapted by shifting the priority of active labour market programme spending more towards training measures. In addition, there need to be adjustments to minimum wage regulations and legal extension of collective wage bargaining contracts so that they do not hinder the determination of market clearing wages.

In fiscal policy, the budget deficit will reach around 8% of GDP in 2010, and the government rightly plans a major consolidation effort. The focus should be on reducing government spending, including notably reforms to the first pillar of the pension system, but also by making government operations more efficient. In addition, to secure the necessary tax base, consideration should be given to reducing tax exemptions and raising taxation of immobile bases, such as real estate and environmental externalities. Strengthening fiscal institutions, including by implementing spending ceilings which comprise tax expenditures, and setting up an independent fiscal council, would be helpful in achieving the consolidation targets.

Raising public sector efficiency, notably in healthcare

Given the deterioration in public finances, there is now very little scope for higher spending without re-prioritisation. In such a situation, raising public sector efficiency can free up resources and help to stimulate productivity and thus potential growth. *On the spending side*, raising the efficiency in healthcare should be a priority. This involves reducing the excessive pharmaceutical spending, for example by further fostering generic substitution. Impediments to competition among insurance funds, such as the profit distribution ban, should be reconsidered and the risk-equalisation system should be improved. In addition, caps on out-of-pocket payments should be introduced and the remuneration of physicians reformed. *On the revenue side*, raising the efficiency of VAT collection is urgently needed, plans to unify the collection of tax and social security contributions should be implemented swiftly and the drawing of EU funds needs to become more efficient.

Managing the transition to green growth

The transition to a greener economy, supported by international environmental commitments and national policies, will entail structural changes in consumption patterns and industry structures, but also offers new drivers for potential growth. Slovakia will need to build an effective framework for green growth to maximise the exploitation of cleaner sources of growth and seize the opportunities to develop new green industries, jobs and technologies. This requires addressing environmental externalities by extending environmental taxation and removing subsidies, together with improving the adaptive capacities of the economy through eco-innovation. The latter involves reforms to support innovation and R&D spending, strengthening the protection of property rights and developing the venture capital market. Also, reducing administrative entry barriers in product markets, fostering competition in energy markets and telecommunication, reforming the tertiary education system and developing training and lifelong learning should all be part of a package of reforms to bring about high sustainable growth.