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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Slovakia

and delivering a Council opinion

on the updated Stability Programme of Slovakia, 2011-2014

{SEC(2011) 733 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and on 21 October 2010, adopted a decision on Guidelines for the employment policies of the Member States[3], which together form the "Integrated guidelines". Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ C , p. .
3 Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.

(6) On 28 April 2011, Slovakia submitted its 2011 Stability Programme update covering the period 2011-2014 and on 2 May its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) Given its large trade openness and specialisation in durable manufacturing goods, the Slovak economy was strongly hit by the collapse in world trade and aggregate demand which followed the financial crisis. As a result, in 2009, GDP contracted by 4.8% and unemployment rose to 12%. In 2010, mostly on account of the recovery in external demand, the economic situation significantly improved in terms of output growth (4.1% increase in GDP), but it continued to deteriorate in terms of jobs with unemployment reaching 14.4%, one of the highest levels and largest increases in the EU. Employment will remain well below the pre-crisis levels in 2011-12. The crisis induced a significant deterioration of public finances and the general government deficit increasing from 2% of GDP in 2008 to 8% of GDP in 2009-10. While still at a relatively low level, the debt-to-GDP ratio also increased by 15 percentage points, reaching 41% of GDP in 2010.

(8) Based on the assessment of the updated Stability Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underlying the programme is plausible for the initial two years but too favourable towards the end of the programme period. The programme plans to bring the deficit below the 3% of GDP in 2013, in line with the deadline set by the Council and further to 2.8% of GDP in 2014. Beyond 2011, the adjustment is broadly expenditure-based. There are downside risks to budgetary targets mainly due to the implementation of proposed measures. The programme does not foresee the achievement of the Medium Term Objective. Meeting the budgetary targets would imply for the period 2011-2013 an average annual fiscal effort of around 1.4% of GDP.

(9) The deficit is expected to decline substantially in 2011 thanks to consolidation measures estimated in the Slovak Stability Programme at some 2.5% of GDP. The adjustment is expected to continue further in 2011 and 2013 through a reduction in the

deficit by around 1 percentage point of GDP each year. The consolidation effort focuses primarily on the expenditure side, through savings in expenditure on goods and services and on the wage bill, which may however be difficult to pursue further on a sustainable basis. Overall, the challenge for Slovakia is to ensure that consolidation safeguards and even increases expenditure in growth-enhancing items, such as education and transport infrastructure. In particular, the low government gross fixed capital formation, which is expected to decrease further, is a matter of concern. There is scope to increase revenues from taxes that are least harmful to growth, such as property and environmental taxes, and to improve the efficiency of tax collection, especially in view of the large VAT gap.

(10) Thanks to the reform of 2005, which introduced multi-annual planning, programme budgeting and several fiscal rules, Slovakia significantly improved its fiscal framework. However, the current set-up has not prevented the government from running deficits even in years of high economic growth. Among the main weaknesses is the fact that the fiscal targets for the outer years can be easily amended and do not therefore serve the purpose of anchoring the budgetary process in the years ahead. Expenditure ceilings as proposed in the Stability Programme update and in the National Reform Programme could overcome this flaw, provided they embrace the largest possible share of the general government spending. The current lack of timely published information in particular for local government and social security funds is an additional obstacle for the within-year monitoring of fiscal developments and the enforcement of fiscal rules. Finally, Slovakia lacks an independent institution, which could be directly involved in preparatory works, monitoring, and assessment mechanisms related to the budget.

(11) Slovakia is among the Member States that face significant challenges with regard to the long-term sustainability of public finances. Ageing-related expenditure is projected to grow faster than the EU average over the next decades. Pensions would be the main source of this increase, despite a major reform implemented in 2004-06. The reform did not address systematically the projected future increases in life expectancy. Additional future pressures on the pay-as-you-go pillar may come from a strong merit component for the calculation of pensions and the indexation mechanism. Changes to the fully-funded pillar in 2008-09, including the requirement for pension funds to cover incurred losses and the removal of compulsory participation for new labour market entrants, undermined its viability. The National Reform Programme and the Stability Programme envisage several adjustments to the pension system that would address its current shortcomings.

(12) Tackling sizable increases in unemployment before it becomes structural is another major challenge. The unemployment rate currently stands at over 14%. The long-term unemployment rate of 9.2% remains the highest in the EU and it coexists with strong regional disparities and skill mismatches. Although the labour market in Slovakia operates under relatively flexible conditions, the Government plans to increase this flexibility further through amendments to the Labour code. The unemployment rate is particularly high amongst low-skilled workers, and their employment rate is one of the lowest in the EU. This may partly be due to a relatively high tax wedge of 34% for the low paid (67% of the average wage), reducing incentives to hire low-skilled workers. In addition, targeted and well designed active labour market policies can play a major role in getting the unemployed back into work. At present, expenditure and participation in such policies are among the lowest in the EU and there is little

monitoring or evaluation of their effectiveness. A reform of labour market services and active labour market policies is planned by the Government by the end of this year.

(13) Given the importance of an adequately skilled workforce for improving non-price competitiveness, Slovakia has put forward an ambitious target to increase higher educational attainment from the current 17.6% to 40% by 2020. With a view to reducing skill mismatches, Slovakia is reforming school education and vocational education and training, as outlined in the National Reform Programme. However, tertiary educational attainment remains well below the EU average, with quality being an issue, as suggested by a variety of existing indicators. The low education achievements of the marginalised Roma communities are a major factor contributing to long term unemployment in Slovakia. Participation of working age people in life long learning remains very low (2.8%) compared to the EU average, which seems to have a negative impact on employability and further undermines efforts to reduce the current high unemployment.

(14) The need to promote a more growth-enhancing business environment in Slovakia is recognised in the National Reform Programme, as are the need to improve the performance of the judiciary, make public procurement more transparent and fight corruption, although there are risks related to implementation. However, the problem of weak public institutions is not sufficiently addressed, and more could be done to strengthen evidence-based policy-making. Within the public administration, insufficient capacity and high turnover of staff tend to lower its effectiveness and transparency, weaken analytical capabilities, and hamper the effective absorption of EU funds and efficient use of public resources in general. These factors hamper the growth potential of economy and its competitiveness.

(15) Slovakia has made a number of commitments under the Euro Plus Pact[4]. The commitments refer to three areas of the Pact that are relevant for Slovakia: public finance sustainability, employment, and competitiveness. On the fiscal side, Slovakia commits to enhancing the long-term sustainability of public finances and strengthening the national fiscal framework by adopting a new legal act on fiscal responsibility. Employment measures concern the planed labour code revision with a view to making the labour market even more flexible. The competitiveness measures focus on reducing the administrative burden, tackling corruption, increasing transparency of public procurement and the judiciary system, and increasing effectiveness of the tax system. The above commitments reflect the reform agenda outlined in the Stability Programme and the National Reform Programme. They step up ongoing reform projects related to business environment and enforcement of rights, as well as open the important issue pensions and long-term sustainability of public finance. These commitments have been assessed and taken into account in the recommendations.

(16) The Commission has assessed the Stability Programme and National Reform Programme, including the Euro Plus Pact commitments[5]. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Slovakia but also their conformity with EU rules and guidance, given the overall need to reinforce the overall economic governance of the European Union by providing EU level input

[4] More details on the commitments made under the Euro Plus Pact can be found in SEC(2011) 733.
[5] See SEC(2011) 733.

into future national decisions. In this light, the Commission considers that there are downside risks to achieving the budgetary targets beyond 2011. The consolidation effort should safeguard spending on growth-enhancing items and be supported by measures to strengthen fiscal governance and long-term sustainability of public finance. Further steps in 2011-12 should focus on strengthening of domestic sources for growth, addressing the recent surge in unemployment in particular through a reduction of the tax wedge for low paid workers and a reform of active labour market policies, addressing skill mismatches, improving the quality of education and training and the business environment, and strengthening public institutions and their governance.

(17) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) Treaty on the Functioning of the European Union of 2 December 2009, the Council has examined the 2011 update of the Stability Programme of Slovakia and its opinion[6] is reflected in particular in its recommendations under (1), (2) and (3) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Slovakia,

HEREBY RECOMMENDS that Slovakia should take action within the period 2011-2012 to:

(1) Implement the 2011 budget as envisaged and introduce the planned specific measures of a permanent nature in 2012 and 2013 to reduce the deficit below 3% of GDP by 2013. Safeguard growth-enhancing expenditure and use available room to increase revenue by increasing efficiency of VAT collection.

(2) Strengthen fiscal governance by adopting in 2011 and implementing from 2012 binding multi-annual expenditure ceilings, covering the central government and the social security system. In addition, introduce an independent Fiscal Council and ensure timely publication of budgetary data at all levels of the government.

(3) Enhance the long-term sustainability of public finances by further adjusting the pay-as-you-go pillar of the pension system, in particular by linking the pensionable age to life expectancy, and by creating incentives to ensure the viability of the fully-funded pension pillar so as to progress towards fiscal sustainability while assuring adequate pensions.

(4) Take steps to support labour demand for the low-skilled unemployed by reducing the tax wedge for low-paid workers. In addition, introduce measures to increase the administrative capacity of public employment services with a view to improve targeting, design and evaluation of active labour market policies, especially for the young and long-term unemployed.

(5) Speed up the implementation of planned education, vocational education and training reforms and take steps to improve the quality of higher education and its relevance to market needs. Develop a framework of incentives for both individuals and employers to encourage participation of the low-skilled in life-long learning.

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6 Foreseen in Article 5(3) of Council Regulation (EC) No 1466/97.

(6) Ensure the implementation of planned measures aimed at a more effective application of public procurement rules, a higher performance and transparency of the judicial system.

Done at Brussels,

For the Council
The President