OECD ECONOMIC SURVEYS

2001-2002

Slovak Republic

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

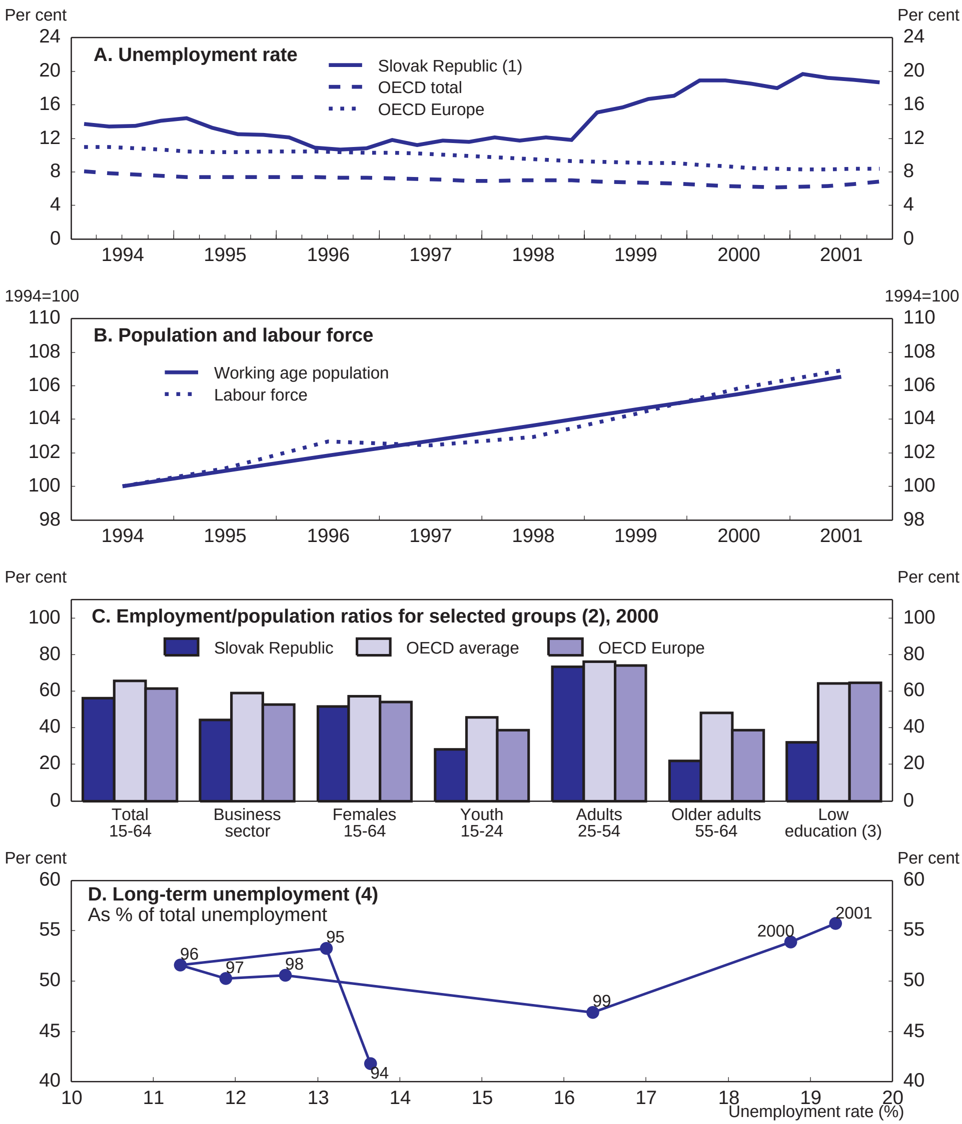
III. The labour market: addressing high unemployment and developing human capital

High and persistent unemployment during the transition to a market economy has been a major economic and social problem for the Slovak Republic. At 19 per cent, the unemployment rate is currently among the highest in the OECD area, while the employment to population ratio is one of the lowest (Figure 17). The under-utilisation of labour lowers the country's growth potential and long unemployment spells are eroding human capital. Given the slow pace of job creation and the low probability of finding jobs, many working-age persons have left the labour force and rely on the extensive social safety net. The absence of a time limit on the duration of income support tends to perpetuate the problem.

As noted in the OECD *Jobs Study*,[29] the principal cause of unemployment is the failure to adapt effectively to rapid structural change. To improve labour-market performance, it is necessary to identify the institutions, regulations, practices and policies that weaken the capacity of a country to adapt. In the Slovak Republic, policy priorities should target reforms in diverse areas, including the social welfare system, the housing market, the education system and the entrepreneurial climate, as well as in labour market policies and wage-setting practices. At the same time, appropriate macroeconomic policies, notably fiscal consolidation, are needed to create a stable environment to promote growth of private investment, output and employment and attract foreign direct investment (see Chapter II). Although some measures have already been implemented and additional steps are under consideration, it is essential that action be taken simultaneously across a wide range of areas since any reforms pursued in isolation would be unlikely to lower unemployment significantly.

The objective of this chapter is to provide specific recommendations for the Slovak Republic based on the strategy outlined in the OECD *Jobs Study* as enriched and refined by the experience of individual OECD countries in implementing the strategy. The first section provides an overview of labour market performance in order to identify the main factors hindering adjustment in the face of

Figure 17. **Key developments in the labour market**



1. The Slovak labour force survey began in 1994.
2. Defined as the percentage of each working-age population group.
3. Completed less than upper secondary education, 1999.
4. Long-term unemployment is defined as individuals looking for work for one year or more.

Source: Statistical Office of the Slovak Republic and OECD.

massive job destruction associated with the transition to a market economy. The second section discusses policy priorities to encourage work and promote job creation. The chapter then concludes with an assessment of the priorities for further action.

Labour market and employment performance

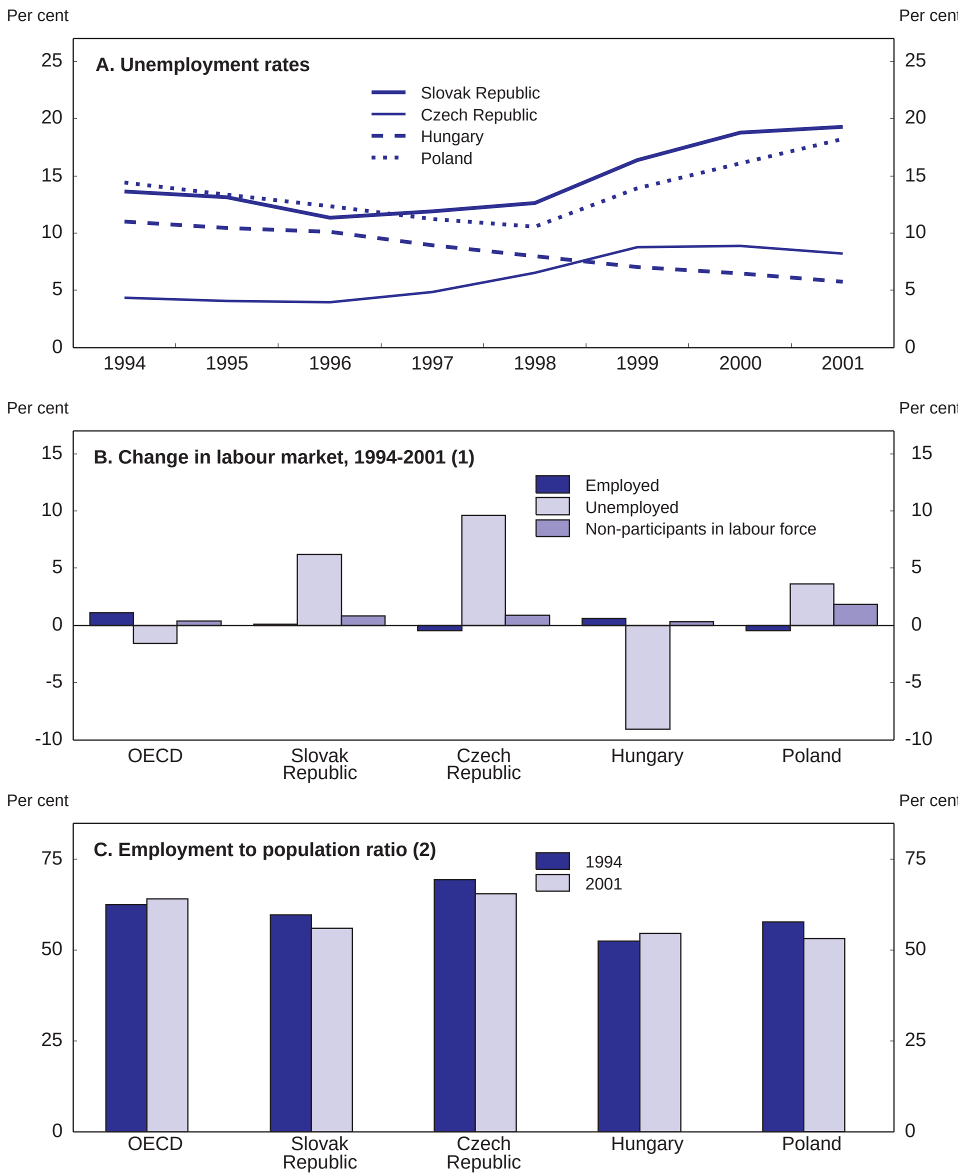
High and persistent unemployment

Slovakia moved from "full employment" at the end of the communist period in 1989 to a situation of persistently large labour market slack. There are currently over a half million unemployed workers, resulting in the highest unemployment rate among the four OECD transition economies (Figure 18). Rapid economic growth in the mid-1990s generated few job opportunities and resulted in only a small decline in unemployment. Subsequently, job destruction caused by the intensification of restructuring in the industrial and financial sectors in 1999 and 2000 boosted the unemployment rate by 7 percentage points. As a result, total employment in 2001 was virtually unchanged from its 1994 level (Panel B). With the working-age population continuing to grow, the employment to population ratio has declined (Panel C).

The unemployment rate varies considerably according to workers' age and education. As in many OECD countries, unemployment is particularly high among young people (Figure 19). Indeed, the rate for workers under 25 years of age was 40 per cent in 2001 compared to 16 per cent for workers aged 25 to 54. Moreover, the severity of unemployment is highest among low-skilled workers (Figure 20). The unemployment rate for workers with only primary schooling is over 40 per cent, compared to 19 per cent for workers with secondary education and 5 per cent for university graduates. The high incidence of unemployment among low-skilled workers reflects, in part, the on-going structural shift in labour demand towards higher skills. Unemployment is particularly severe among the Roma population, many of whom have a very low level of education and are subject to discriminatory practices (Box 5).[30]

The incidence of long-term unemployment in Slovakia is one of the highest in the OECD area (Figure 21). Indeed, about three-quarters of the unemployed have been jobless for more than six months and about half for more than one year (Figure 17, Panel D), despite a public-works programme aimed at the long-term unemployed. The average unemployment period is 13 months. While the incidence of long-term unemployment is highest among those with primary education, it is more than 40 per cent for every level of educational attainment, including tertiary (Figure 20, Panel B).[31] Unlike the overall unemployment

Figure 18. **Labour market developments in the transition economies**

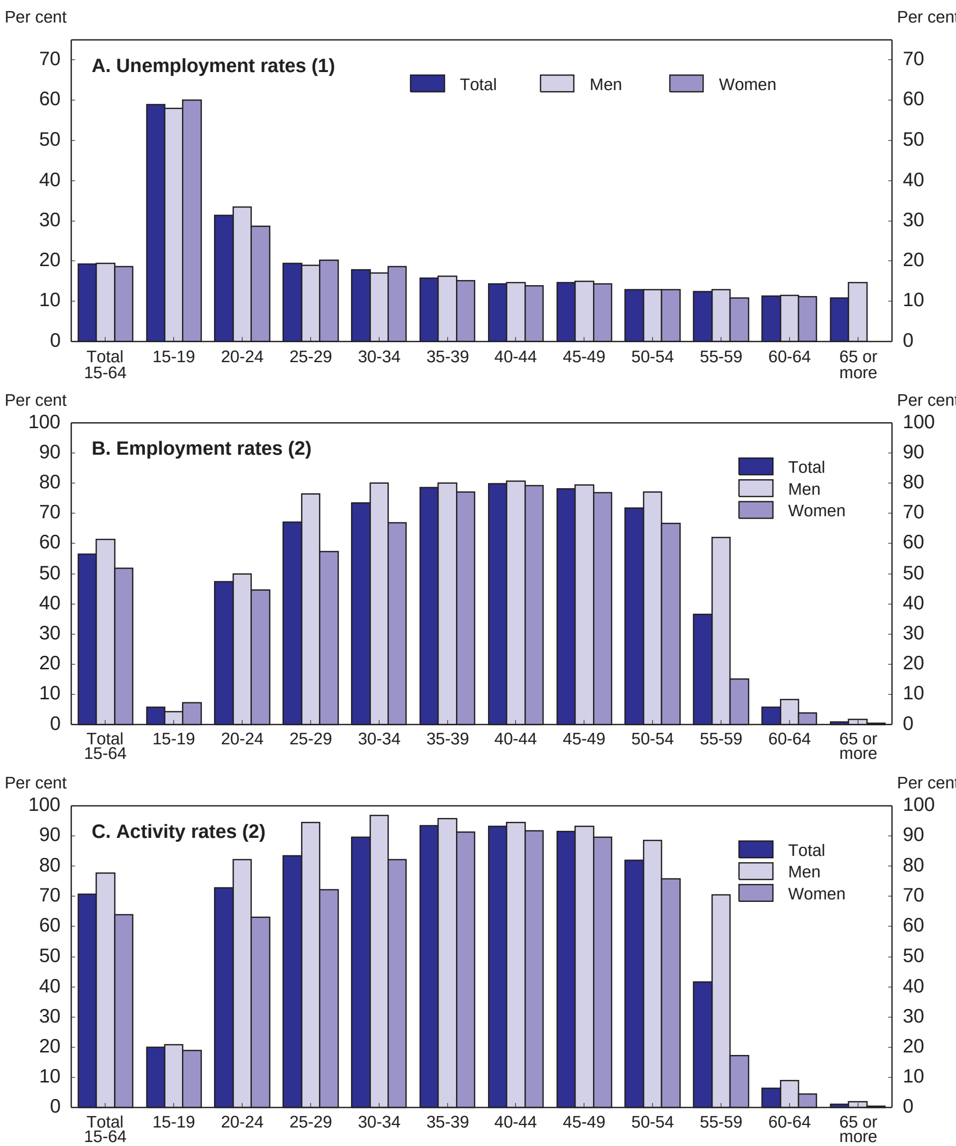


1. At annual rates.
2. As proportion of population aged 15 to 64.

Source: OECD.

Figure 19. **Labour market indicators by age and gender**

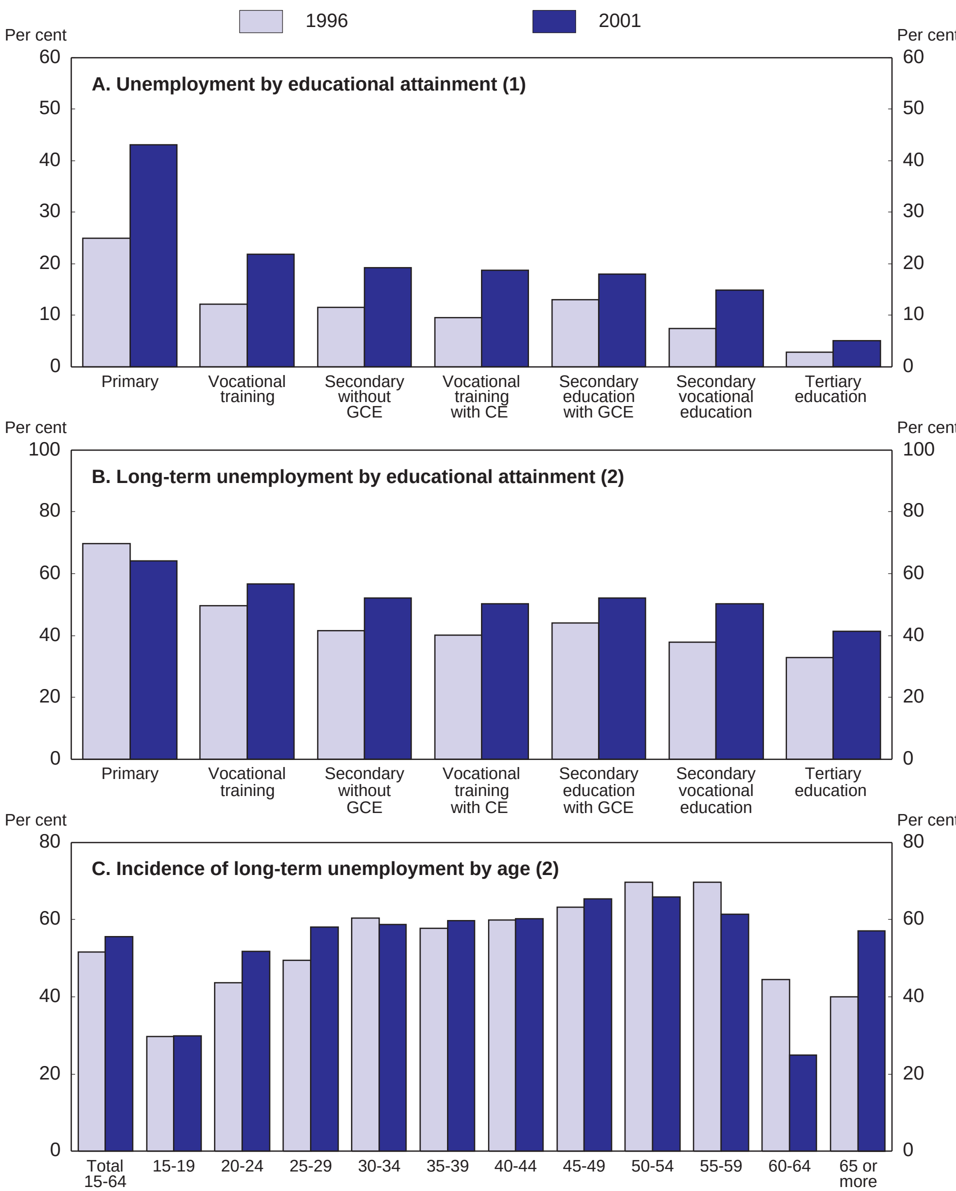
2001



1. As per cent of the age group labour force.
2. As per cent of the age group population.

Source: Statistical Office of the Slovak Republic and OECD.

Figure 20. **The structure of unemployment**



1. As per cent of the labour force in the category.
2. As per cent of unemployed in the category.

Source: Statistical Office of the Slovak Republic and OECD.

Box 5. The Roma population and the unemployment problem

One very difficult social problem that is often linked to unemployment is the situation of the Roma population. There is an overrepresentation of this ethnic group among the unemployed and long-term unemployment is widespread. The same factors explaining high unemployment generally in Slovakia – namely a large number of poorly-educated persons and levels of social assistance that discourage work – are also evident among the Roma population. But two additional factors – discriminatory practices in hiring and the concentration of Roma in isolated settlements without good road access – make the unemployment problem especially severe for this minority group. In these settlements, unemployment reaches 90 per cent .

The size of the Roma community in Slovakia is uncertain, but current estimates put it at around 10 per cent of the population. While a portion of the Roma population is integrated in the Slovak society, there are serious problems of poverty and exclusion for those living in Roma settlements. A large number of Roma became unemployed in the early 1990s following the closure of the co-operatives that had employed them. They continue to reside in the same regions, mostly in the eastern and southern parts of the country, despite a near total lack of job opportunities.

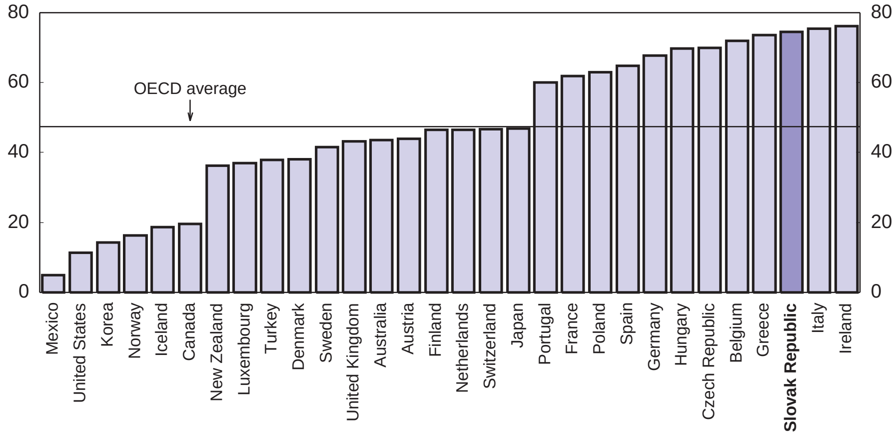
OECD experience shows that the largest differences in employment performance among countries relate to job accessibility by workers at the margin of the labour market, primarily young people, older workers and prime-age women. In the case of Slovakia, this can be extended to the Roma minority. As it accounts for about a fifth of the unemployed, a substantial reduction of Roma unemployment is a prerequisite for a significant reduction of the overall unemployment rate.

Effectively addressing the Roma unemployment problem requires the same policies examined in the main text for solving unemployment in general. In particular, the poverty trap created by the welfare system is especially severe for the Roma population, reflecting the fact that their families are typically very large and the Minimum Subsistence Income depends on family size. Consequently, social assistance benefits are relatively high and, given the low level of skills of the Roma population, they have little chance of finding a job that pays as much as social assistance. Additional specific measures are required to tackle the Roma unemployment problem, such as enhancing access to education and healthcare and improving housing conditions. Schooling should be made a responsibility and an obligation for parents. Incentives to promote school participation, such as making income assistance conditional upon their children's enrolment in school, might be beneficial.[1] It is also necessary to discourage discriminatory practices so that Roma searching for jobs are ensured equal opportunities.

In 1999, the government established the post of Governmental Plenipotentiary for Addressing Roma issues and announced a plan – A Strategy for Addressing the Roma Minority Problems in 2000 – covering education, employment, housing and health issues. Total resources for its implementation amount to SKK 10 million. The programme is a first step in the right direction but more extensive efforts will be needed to deal with this difficult problem.

1. Brazil implemented a programme (*Bolsa Scola*) that was very successful in increasing school enrolment and attendance by linking family income assistance to children's school attendance. See OECD (2001*b*).

Figure 21. **Incidence of long-term unemployment**[1]
Per cent of total unemployment in 2000



1. Unemployed more than six months.
Source: OECD, *Employment Outlook, 2001*.

rate, long-term unemployment tends to rise with age, reflecting the large number of prime-age and older workers who have been displaced by industrial restructuring or the closure of agricultural co-operatives (Panel C). This suggests that labour market rigidities and the disincentives embedded in the tax and social welfare systems make it difficult to recycle displaced workers and that the level of structural unemployment is high. Moreover, many employers are reluctant to hire older workers.

Unemployment exhibits marked regional disparities, with the highest rates concentrated in the eastern and central areas of the country (Table 14). To some extent, this reflects their economic specialisation and productive structures, such as agricultural co-operatives and armament factories that became obsolete with the transition. The difference in unemployment rates between Kosice – the worst region at 23 per cent – and Bratislava was 16 percentage points in 1999. However, these disparities have not encouraged migration. The lack of labour mobility reflects problems in the housing market and social assistance benefits that are uniform nation-wide despite large regional differences in the cost of living.

Table 14. **Labour market indicators by region**

Per cent in 1999

	Population	Employment rate[1]	Unemployment rate	Activity rate[1]
Bratislava	11	60.4	7.4	65.6
Trnava	10	51.7	12.3	59.9
Trencin	11	51.5	11.4	58.9
Nitra	13	45.8	17.8	56.4
Zilina	13	50.9	15.9	61.5
Banska Bystrica	12	46.2	21.1	58.9
Presov	14	48.3	19.1	60.5
Kosice	14	44.7	23.1	58.7
Slovak Republic	**100**	**49.7**	**16.3**	**60.0**
European Union	..	50.7	8.7	55.6

1. As a per cent of the population aged 15 and over.
Source: Statistical Office of the Slovak Republic.

Sluggish employment creation

Dependent employment fell by 6 per cent between 1994 and 2000 (Table 15). By sector, net job creation has been confined to the public sector (a 7 per cent increase over that period) and to the electricity, water and gas utilities (a 2 per cent increase), which are state-owned. In the other sectors, labour shedding

Table 15. **Employment trends by sector**

		Cumulative change			Distribution of employees[4]	
	1994[1]	1994 to 1997	1997 to 2000	1994 to 2000	1994	2000
Agriculture	183	–23.5	–30.7	–47.0	12.1	7.2
Industry	517	–3.9	–10.5	–13.9	34.1	33.1
Mining and quarrying	21	0.0	–28.6	–28.6	1.4	1.1
Manufacturing	451	–4.4	–10.9	–14.9	29.8	28.6
Electricity, water, gas	45	0.0	2.2	2.2	3.0	3.4
Construction	93	–8.6	–30.6	–36.6	6.1	4.4
Market services	312	–1.9	–1.0	–2.9	20.6	22.5
Public employees	410	2.4	4.8	7.3	27.1	32.7
Education	172	1.2	1.7	2.9	11.4	13.2
Health	127	–13.4	8.2	–6.3	8.4	8.9
Other	111	22.5	50.0	83.8	7.3	15.2
Other[2]	107	44.9	16.1	68.2	7.1	13.4
Total employees[3]	**1 622**	**–1.2**	**–4.9**	**–6.0**	**100.0**	**100.0**

1. Number of employees at year-end in thousands.
2. Unclassified enterprises of 20 employees or less.
3. Excluding women on maternity leave, apprentices and those in the armed forces.
4. At firms with 20 or more employees.
Source: Statistical Office of the Slovak Republic.

resulting from privatisation and restructuring has dominated movements in employment. In particular, construction and manufacturing recorded large falls.

The trend in the number of employees, though, can be divided into two periods. Between 1994 and 1997, while the unemployment rate was falling from 13.8 per cent to less than 12 per cent, the decline in dependent employment was only 1 per cent, reflecting the slow pace of restructuring, due in part to delays in privatisation. Even in 2000, private-sector workers accounted for only 67 per cent of total employment in the Slovak Republic compared to more than 75 per cent in the other OECD transition economies and an average of 87 per cent for non-transition OECD countries (Table 16). In addition, employment was sustained by requirements that the owners of newly-privatised firms maintain staff and investment at certain levels. While the slow pace of restructuring moderated job destruction between 1994 and 1997, its effect on corporate profitability had a negative impact on job creation after 1997. Moreover, the failure to establish a clear regulatory framework and a lack of transparency regarding ownership structures resulted in the postponement of investment decisions that would have created new jobs.

Table 16. **Structure of employment by status and ownership**

Per cent of total employment in 2000

A. Ownership[1]

	Private	Public
Slovak Republic	**66.8**	**33.2**
Czech Republic	77.8	22.2
Hungary	92.8	7.2
Poland	81.6	18.4
Korea	88.5	11.5
Mexico	86.8	13.2
Other OECD[2]	86.8	13.2

B. Employment status

	Self-employed[3]	Part-time
Slovak Republic	**7.7**	**1.9**
Czech Republic	15.2	3.3
Hungary	15.2	3.2
Poland	27.4	12.8
Korea	37.6	7.1
Mexico	41.5	13.5
OECD average	17.3	15.3

1. Figures for Hungary, Poland and Mexico are for 1997.
2. Average based on 1997 data except for Portugal (1995), Switzerland (1995) and the United Kingdom (1996); data for Turkey not available.
3. Includes unpaid family workers. The data for Denmark, Iceland, Ireland, Mexico and the Slovak Republic are for 1999.

Source: OECD and Statistical Office of the Slovak Republic.

Privatisation and restructuring was particularly slow in the banking sector (see Chapter IV), resulting in a misdirection of credit and a lack of finance to support private-sector activities and job creation. During the second period covering 1998 to 2000, the renewed momentum of restructuring led to a nearly 5 per cent fall in dependent employment.

With total employment stagnant between 1994 and 2000, the 0.9 per cent average annual growth in the working-age population implied a decline in the employment to population ratio to 56 per cent, well below the 66 per cent average rate for OECD countries (Figure 17, Panel C). This ratio is less than the OECD average for all categories of workers, highlighting the extent of under-utilisation of labour. Employment rates are particularly low for young people and for those aged 55 to 64, reflecting the low age of retirement.[32] The rate for women, which was above the OECD average at the beginning of the 1990s, has fallen, due in part to the fact that childcare is no longer provided at no cost to working parents.

The productive structure of the economy and thus the sectoral distribution of workers is not conducive to rapid employment growth in the future. In particular,

Table 17. **Sectoral composition of employment**

A. Per cent of civilian employment

	Agriculture	Industry	Construction	Services
Slovak Republic	**8.2**	**30.1**	**9.3**	**52.3**
Czech Republic	5.5	31.5	9.8	53.2
Hungary	7.7	28.3	6.4	57.6
Poland	19.2	25.0	7.0	48.8
Korea	12.2	19.9	7.9	60.0
Mexico	19.4	19.2	5.6	55.8
Other OECD[1]	6.3	19.6	7.6	66.5

B. Percentage point change in sectoral composition 1989-98[2]

	Agriculture	Industry and construction	Services
Slovak Republic	**–8.1**	**–5.0**	**13.1**
Czech Republic	–6.4	–5.8	12.1
Hungary	–5.6	–1.4	7.0
Poland	–10.6	0.6	10.0
Korea	–8.2	–7.3	15.5
Mexico	–8.2	1.8	6.4
Other OECD[1]	–2.4	–0.6	3.0

1. Countries that were OECD members before 1994, except France and Luxembourg. Averages based on 1998 data except for Belgium (1996) and Greece (1997).
2. Figures are approximate. Periods differ for Korea (1990-1998), the Slovak Republic and Mexico (1991-1998), Hungary (1992-1998), and Poland (1993-1998).

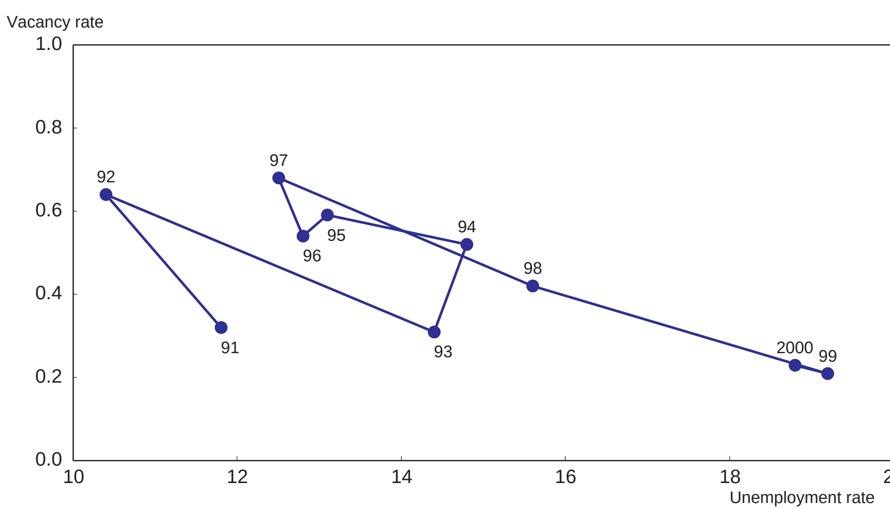
Source: OECD.

the relatively high shares of agriculture and industry (Table 17), despite large falls during the 1990s (Panel B), suggest that further declines in employment in these sectors might be expected as the structure of the Slovak economy gradually converges to that of more advanced countries. More dynamic job creation in the service sector is needed to absorb workers from agriculture and industry. Training of displaced workers may be necessary, since skills required in the service sector are substantially different from those in industry and agriculture.

The small number of vacancies reported to the labour offices illustrates the sluggishness of employment creation and the difficulties that the unemployed face in finding jobs. The average number of registered unemployed workers per vacancy, which ranged from 20 to 94 during the period 1993 to 2000, stood at 50 in June 2001. For low-skilled workers, the rate was even higher.[33] The relationship between the number of vacancies and unemployment – the Beveridge curve – has shifted over time, with a given level of vacancies compatible with higher levels of unemployment (Figure 22). This may indicate an increasing mismatch between the demand and supply of skills, as well as reduced willingness on the part of unemployed persons to accept jobs.[34]

The lack of flexibility and adaptability of the labour market is also reflected in very low levels of self-employment and part-time employment

Figure 22. **The Beveridge curve**



Source: Statistical Office of the Slovak Republic and OECD.

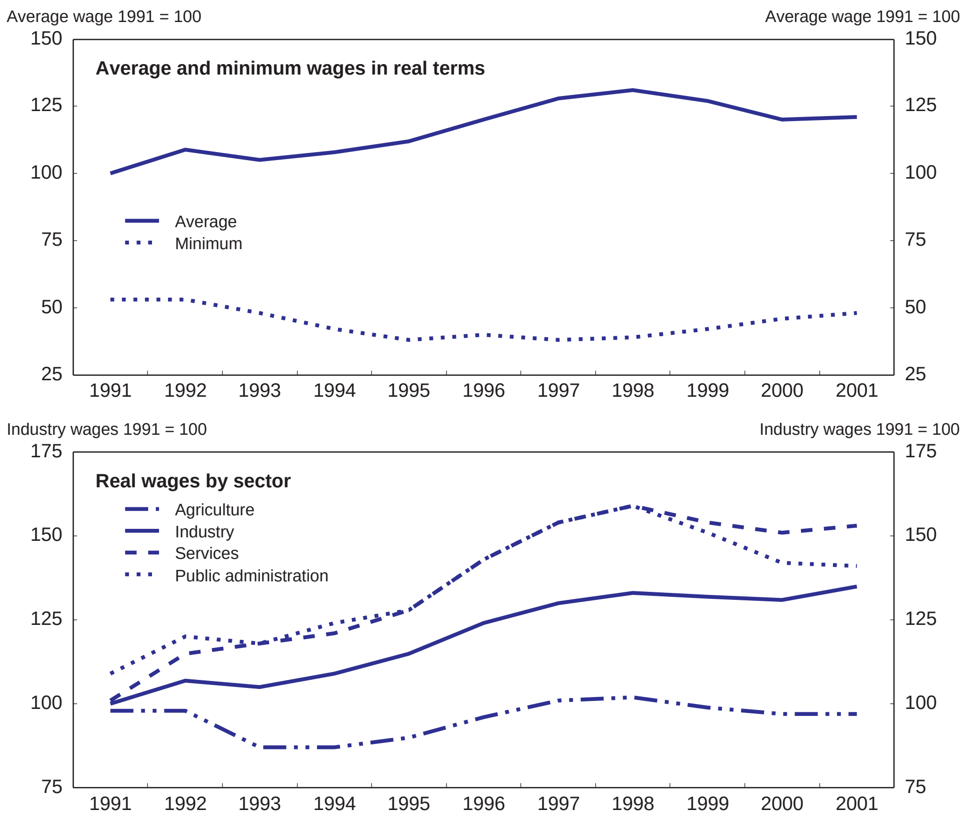
(Table 16, Panel B). The share of self-employed in total employment is less than half the average in OECD countries, suggesting weak entrepreneurship. This may reflect the generous social assistance available, as well as the fact that small-scale enterprises largely disappeared during the communist era, in contrast to Poland and Hungary. Part-time employment accounts for less than 2 per cent of employment, well below the 15 per cent average in the OECD area. This difference is even more striking for women, with part-time jobs accounting for 3 per cent of female employment, compared to the 26 per cent average for the OECD area. The small share of part-time employment may be related to the underdevelopment of the service sector.

The wage-setting framework

During most of the 1990s, the large degree of slack in the labour market did not put downward pressure on real wages, suggesting a large part of unemployment was structural in nature (Figure 23). An average unemployment rate of 12½ per cent over the period 1993 to 1998 was compatible with real wage growth of 4½ per cent per year. Real wages grew most rapidly in the service sector, averaging 6 per cent, perhaps reflecting a shortage of skills due to the difficulty of adapting workers leaving agriculture and industry to the needs of this sector. However, the recent surge in unemployment seems to have had a moderating impact on real wages, leading to a decline of 7½ per cent over the period 1998 to 2001.

A highly centralised wage-setting process in the Slovak Republic limits the responsiveness of wages to specific conditions of depressed regions or low-profitability enterprises. It also helps explain the weak responsiveness of wages to high unemployment, at least until 1999. Collective bargaining is conducted at the national, sectoral and firm level. At the national level, negotiations take place in the Council for Economic and Social Accord, which sets a minimum nation-wide wage increase by sector. The Council is a tripartite body composed of members of the trade unions, the employers' associations and the government. Negotiations at the sectoral level are held between sectoral labour unions and employers' associations. The Ministry of Labour, Social Affairs and Family can make the outcome of these negotiations binding for employers not represented in sectoral agreements, and this was the common practice, at least until recently. Negotiations at the firm level take the sectoral agreement as a floor in setting wages. The new Civil Service Act and the new Public Service Act change the way wages are set in the public sector beginning in 2002. *First*, it introduces specific wage tariffs (see below) for a wide range of public-sector occupations. The tariffs imply significant increases from 2001 wage levels. *Second*, wages are now subject to collective agreements between the trade unions and the corresponding government units, rather than being set by the government in the context of the budget.

Figure 23. **The evolution of real wages**

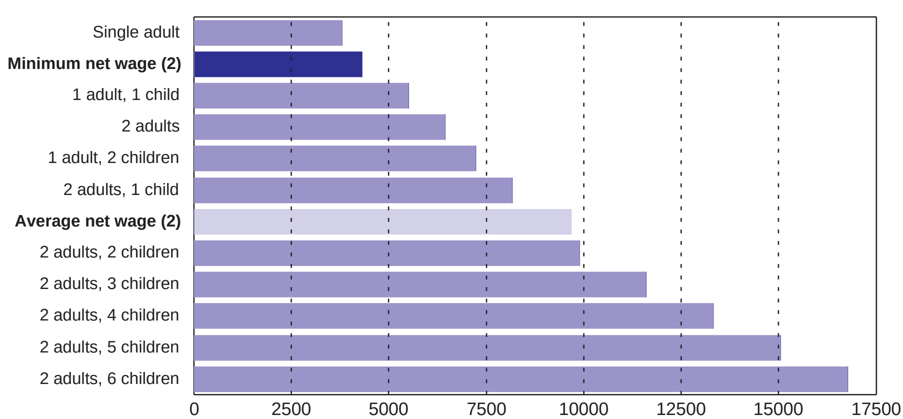


Source: Statistical Office of the Slovak Republic.

A statutory minimum wage is proposed by the Ministry of Labour, Social Affairs and Family based on recommendations by the Council for Economic and Social Accord. The minimum wage applies directly to very few workers – only one in two thousand as of 1998 – but is used as reference point. In particular, it is the basis for the system of "wage tariffs" – a scale of minimum salaries based on the difficulty of the job – for workers not covered by collective bargaining. There are six tariffs ranging from 100 to 200 per cent of the minimum wage. For example, jobs that require the level of knowledge of a university graduate must pay wages of at least 180 per cent of the minimum wage, while those requiring the skills equivalent to high school vocational education must pay 140 per cent. Wage tariffs are relevant for the 40 per cent of workers who are not covered by collective bargaining. The system sets an effective floor on wages. Given the low minimum wage, which remained less than a third of the average wage until 1998 (Figure 23), the wage tariff system does not appear to have been constraining thus far. However, the 64 per cent rise in the minimum wage in nominal terms between 1998 and 2001 may have increased the impact of the wage tariff system. Moreover, it has the potential to become a significant distortion if the minimum wage continues to increase rapidly.

In addition to the wage tariff system, the social assistance scheme also creates an effective floor for wages. Slovak families whose income falls below a Minimum Subsistence Income (MSI) are deemed to be in material distress and become eligible for social assistance benefits. The MSI is calculated according to family size, rising by a fixed amount per dependent child, with no cap. Moreover, it is applied uniformly across the country, despite significant differences in the cost of living. The MSI for all households, except that of a single individual, exceeds the minimum wage (after deducting social contributions), which helps explain why few workers are willing to work at the minimum wage. For example, the MSI for a family with two children was 2.3 times the minimum wage in 2001, and slightly more than the average wage on a net basis (Figure 24). Until June 2001, the actual amount of benefits granted was equal to the difference between the family

Figure 24. **The Minimum Subsistence Income by household composition**
SKK per month in 2001[1]



1. The benefits provided to bring an individual or household up to the MSI are not taxed.
2. On a net basis. For the minimum wage, social contributions (12.8 per cent of gross wages) are deducted. For the average wage, social contributions and income tax are deducted.

Source: Ministry of Labour, Social Affairs and Family.

income and the corresponding MSI, unless the situation of material distress is due to subjective reasons. In this case, benefits were cut to one-half of the family's MSI. Since June 2001, the level of income granted to households in distress for objective reasons was frozen and, in the future, it will be revised independently of the MSI. Means-tested assistance is provided as long as the "material distress" persists, which often translates into an unlimited duration.

Policy requirements

With the highest rate of unemployment in the OECD area since 1998, policies to improve labour market performance should be a priority. Moreover, the growth in the working-age population that is projected through 2010 may tend to exacerbate the problem in the absence of reform. This section identifies the key policy areas where action is needed to improve labour market performance and recommends policy responses. The set of policy measures proposed can be grouped into three categories (Box 6).

– The high level of social assistance benefits weakens incentives to search actively for jobs and accept offers. Reducing benefits is thus a priority to make work more attractive. To the extent that such reductions are not socially acceptable, other measures to lower the impact of social assistance on work incentives need to be introduced. In particular, making benefits dependent on participation in active labour market activities and ensuring tight control of eligibility requirements would be beneficial. In the long run, education is the key to increasing labour productivity and wages relative to social assistance benefits.
– Measures to encourage firms and entrepreneurs to create jobs are essential. Most importantly, wage and non-wage labour costs, as well as employment practices, need to become more flexible if labour demand is to absorb the large excess supply. In particular, non-wage labour costs should be reduced to help break the vicious circle in which high payroll taxes are needed to support an inactive population that remains large due in part to high payroll taxes. Finally, employment creation also requires improving the entrepreneurial climate.
– Policies to ensure steady and sustainable growth are a prerequisite for investment and employment growth. This, in turn, requires a sound macroeconomic policy framework characterised by prudent fiscal and monetary policies (see Chapter II).

Box 6. Synopsis of recommendations for the Slovak Republic's labour market

The OECD *Jobs Study* sets out a strategy based on specific recommendations for improving the ability of OECD economies to cope with structural change, by enhancing the ability to adjust and adapt, and by increasing the capacity to innovate and to be creative. A wide range of policy areas is covered with a focus on each country's particular institutional, cultural and social characteristics.

The review of labour market and employment performance in the Slovak Republic suggests the following priorities for policy action:

Measures to encourage work and job search

Reform the social welfare system

- Break harmful links between unemployment and social protection that weaken incentives to search for work and to accept jobs.
- Ensure that social assistance to working-age people focuses on putting people back to work, in part through the introduction of activity-tested income support.
- Streamline social programmes to increase transparency and the ability to control expenditures.
- Tighten eligibility conditions for sickness benefits and their generosity.

Lower the tax burden on labour

- Overhaul the social insurance systems to allow a reduction in payroll taxes.
- Finance social welfare aspects of social insurance systems through general taxation.
- Beyond this, consider shifting further some of the burden of financing social insurance programmes to general taxation.

Shift emphasis to active labour market policies

- Place greater emphasis on active policies as part of a policy of making social assistance "activity-tested".
- Improve public job placement services, while increasing the use of private job placement agencies.
- Involve enterprises in the design and funding of training programmes.
- Monitor closely the effectiveness of active labour market programmes.

Lift barriers to labour mobility

- Remove distortions in the housing market.
- Improve the transport system.
- Adjust social assistance benefits for regional differences in the cost of living.

Box 6. **Synopsis of recommendations for the Slovak Republic's labour market** (*cont.*)

Measures to promote hiring and job creation

Improve labour force skills and competencies

- Upgrade the education and training systems.
- Expand the proportion of students entering tertiary education.
- Facilitate mobility between education programmes and cycles.
- Adapt curricula of vocational schools to the needs of enterprises.

Enhance flexibility of wages and labour relations

- Eliminate the extension of collective agreements reached at a regional or sectoral level to firms not involved in the negotiations.
- De-centralise wage bargaining to allow agreements to better reflect changing conditions at the firm level.
- Eliminate the wage tariff system.
- Relax employment protection provisions in the legal code.
- Ease regulations on working time.
- Revise the new labour code to reduce the excessive power of trade unions in management issues and their role in inspecting the compliance of firms with the labour code.
- Remove the rule requiring new owners of firms to honour existing agreements with the workforce.

Improve entrepreneurial climate

- Continue financial-sector reform to improve private borrowers' access to credit.
- Continue to reduce tax pressure.
- Simplify regulations and administrative procedures for starting new companies.

Measures to encourage work and job search

Reform the social welfare system to strengthen the incentive to work

An exceptionally generous social safety net (Box 7) has helped mitigate the hardship imposed by the transition and maintained social cohesion during a period of dramatic structural changes. *Social support* is based on the MSI, which is

Box 7. The social safety net in the Slovak Republic

The Slovak Republic has one of the most extensive and comprehensive systems of social welfare in the OECD area. Indeed, the Slovak Constitution establishes the right to basic living conditions. Social protection is provided by three types of schemes: insurance, social support and social assistance. The latter two use the "Minimum Subsistence Income" (MSI) to define entitlement conditions and the amount of benefits. The MSI is the level of income below which an individual or family would be in material distress. The MSI is set by law according to family size and increases with the number of children without a ceiling. However, social assistance and social support differ in their coverage. While social support is intended to assist households with children and those facing exceptional expenses, social assistance seeks to ensure a minimum income level to all Slovaks.

Social insurance

Social insurance covers unemployment, sickness, pensions and healthcare (which are discussed in the context of fiscal policy in Chapter II).

Unemployment insurance

Unemployment insurance is available to jobless workers for six to nine months depending on the number of years of contributions. To be eligible, an unemployed person must have contributed during 24 months during the three years preceding the claim.[1] Until 2000, the maximum replacement rate for the first three months was 60 per cent of average gross income during the last six months of work and 50 per cent for the remaining entitlement period. A reform at the end of 2000 reduced that to 50 per cent during the first three months and 45 per cent for following months. Benefits are subject to a ceiling of 1.5 times the MSI of a single person, or about half of the average wage. Consequently, the replacement rates for those earning above the average wage are below the 50 per cent figure set for the first three months.

Sickness insurance

Sickness insurance compensates workers for loss of income due to sickness, the need to care for an ill family member, pregnancy, maternity leave and treatment in spa facilities. Eligibility for sickness benefits is subject to medical certification. Benefits amount to 70 per cent of the net daily wage for the first three days and 90 per cent thereafter.[2] Benefits are paid for up to one year in case of sickness, seven working days for care of an ill family member (13 working days for single parents caring for a sick child), 28 weeks for maternity (37 for single mothers or multiple birth), and 21 to 28 calendar days for spa treatment.

Pensions

Old-age pensions are granted to men between the ages of 55 and 60 – depending on the job performed – and to women between the ages of 53 and 57 – depending on the number of children raised. The minimum contribution period is 25 years.

Box 7. The social safety net in the Slovak Republic (*cont.*)

Alternatively, *proportional old-age pensions* are granted to those with ten years of contributions, conditional on retiring at age 65. Women are also eligible to receive a pension at age 60 after 20 years of contributions. Those who do not qualify for any of the above-mentioned pensions are granted a *social pension* at age 65. Pension insurance also covers disability and provides benefits to widows and orphans.

Healthcare

Healthcare is universally provided through mandatory health insurance. Contributions are levied on workers' salaries and the state contributes on behalf of economically-inactive persons. Individuals have access to a wide range of healthcare services with costs fully covered by the insurance fund.

Social support

Social support provides transfers to households with children, as well as one-time lump-sum payments to those facing extraordinary expenditures.

Monthly transfers

A *parental allowance* is provided to parents caring full-time for children less than three years of age and for sick children under the age of seven. The allowance is set at 91 per cent of a single person's MSI. Monthly *child allowances* are granted to cover the expenses of dependent children. The amount depends on the age of the children and the level of family income, including the parental allowance, relative to the MSI (see Table 18). For a couple with two children, the allowance ranges from 5 to 10 per cent of the MSI. Finally, a *subsistence income and housing allowance* is granted for members of the military and those engaged in civilian service.

Table 18. **Child allowances**
Per cent of net average wage

Number of children[1]	Income less than 1.37 times the MSI[2]	Income between 1.37 and 2.1 times the MSI[2]
1	8.6	6.1
2	17.1	12.2
3	25.7	18.3
4	34.3	24.4
5	42.8	30.4
6	51.4	36.5

1. For a child between 6 and 15 years of age. For children in this age group, the benefit is SKK 830 for the low-income group and SKK 590 for the high-income group. For children under 6, the low (high) income group's benefit is SKK 680 (SKK 480). For children over age 15, the low (high) income group's benefit is SKK 890 (SKK 620).
2. The MSI ranges from SKK 8 160 per month (84 per cent of the average wage) for a couple with one child to SKK 16 760 (173 per cent of the average wage) for a couple with six children.

Source: Ministry of Labour, Social Affairs and Family and OECD.

Box 7. The social safety net in the Slovak Republic (*cont.*)

One-time benefits

Situations demanding once-and-for-all exceptional expenditures are the birth of a child, a funeral or the placement of a child in foster care. In these cases, a lump-sum payment is made to help families with the extra expenses. Benefits range from 0.7 of the MSI of a single person for contributing to funeral expenses to 2.3 times the MSI of a household for the birth of a child.

Social assistance

Social assistance provides cash benefits and social services to households whose income, including social insurance and social support, is below the MSI. To receive such assistance, a person must be either working, retired or registered as unemployed, which is a simple formality. At the end of 2001, more than 324 000 households (more than 614 000 persons) received social assistance.

Income assistance

When a household's income fell below the MSI, a cash benefit equal to the difference between the household's income and the level of MSI was granted. However, in June 2001 social assistance granted to those in distress for objective reasons was frozen and in the future it will not follow the revision of the MSI each July. When the low level of income is due to "subjective reasons", the income benefit granted will continue to be set at half the gap between the household income and the MSI. The criteria for classifying a person in need for subjective reasons were widened considerably in 2001. As a result, about half of the recipients of social assistance benefits fell in this category in 2001 compared to 1.5 per cent in 2000. The main criteria for determining a situation of material distress for subjective reasons include: voluntarily leaving a job; refusing to co-operate with the National Labour Office in job-search; failing to participate in public-work programmes; staying in the unemployment registry for more than 24 months; having contributed less than 3 months to unemployment insurance; losing a job for disciplinary reasons; refusing to pay child support or alimony; and failing to apply for child allowances. Until recently, school leavers were automatically granted the MSI of a single person until they found a job. Now, however, they are considered as subjectively in need and thus receive half the MSI. There are also special income benefits for handicapped persons to cover expenses aimed at improving their living conditions.

Social services

Advisory and psychological services are provided to persons receiving income assistance to help them overcome poverty. There are social and legal services aimed at protecting the rights of minors and to place children in foster care. Other services include the provision of meals, transport, institutional care or in-house care.

1. The National Labour Office pays the social insurance contributions, including for unemployment, for persons employed in public-works jobs, helping such workers qualify for unemployment insurance at the end of the public-works job.
2. There is a cap of SKK 350 per working day for employees and SKK 250 per calendar day for the self-employed.

used to calculate means-tested child and parental allowances. S*ocial assistance* is the main source of income support for the unemployed. At the end of 2001, 324 000 households, comprising 614 000 individuals, received such benefits. This included about 60 per cent of the registered unemployed, with support concentrated among the long-term unemployed. In the first half of 2001, 92 per cent of the recipients of social assistance were registered unemployed.

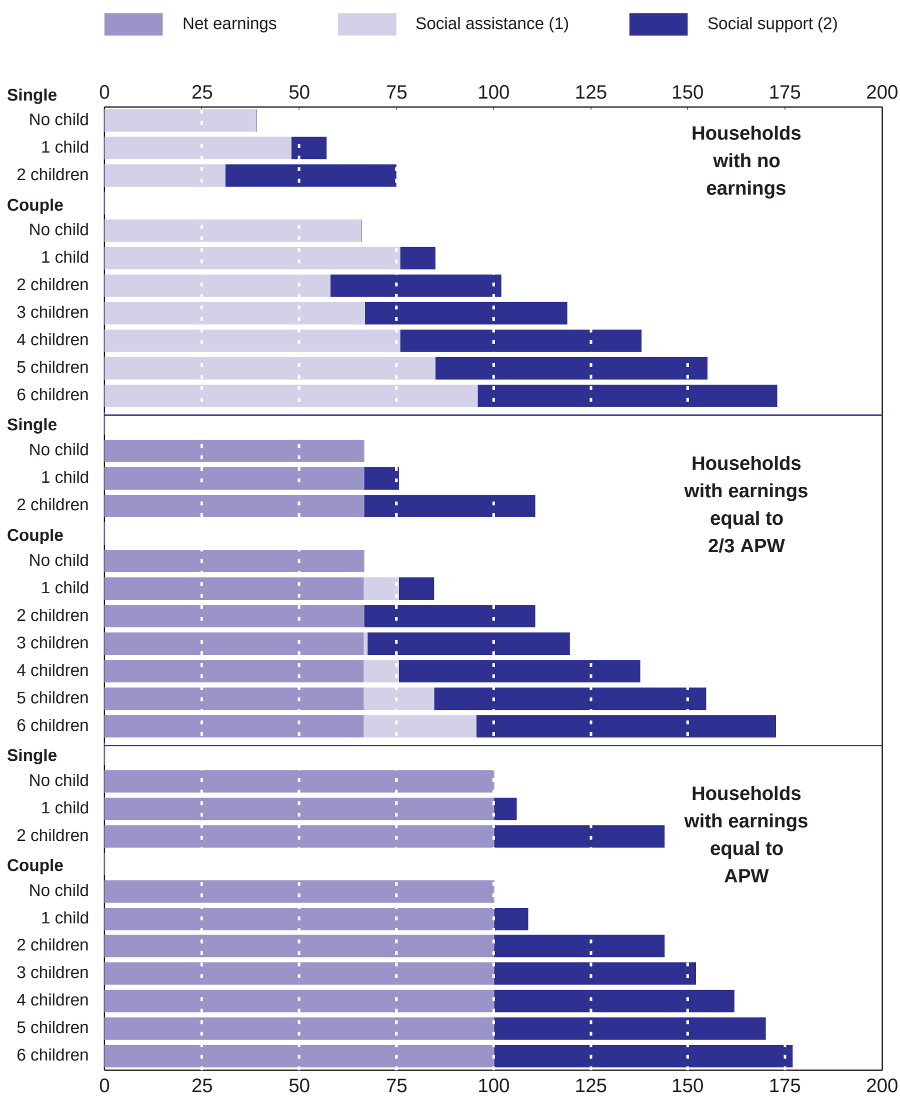
However, the social assistance system weakens incentives to take up jobs or actively search for employment by providing benefits for an indefinite duration. High benefit levels raise the reservation wage for the unemployed. In particular, specialised workers displaced by industrial restructuring are unlikely to accept lower wages in low-skill occupations. The negative effect of social assistance on work incentives is strongest for the heads of large families, since the MSI is based on the number of children. Indeed, families with two or more children that have no income receive cash benefits (which are not taxed) exceeding the average production worker's net wage in 2001 (Figure 25). For a family with four children, benefits are 37 per cent higher than the average net wage. The withdrawal of benefits, combined with the tax system, results in a very high effective marginal tax rate on income from work, particularly for families with children. Consequently, parents are discouraged from accepting any job that does not pay above the average wage. The disincentives to work are less for a single person than for those who are married. Indeed, there is empirical evidence that an unemployed single person is more likely to begin work than one with an unemployed spouse.[35] However, the pressure on young people to find a job was reduced by the fact that until 2000 all school leavers or graduates were automatically granted the MSI, which was 2 per cent above the minimum wage on a net basis for a single person.

The government introduced the concept of "material distress for subjective reasons" in 1999 and broadened the criteria for this classification in 2001 (see Box 7). Social assistance benefits to such persons are reduced by half.[36] As of the end of 2001, 167 000 recipients from a total of 324 000 were thus classified. Three months of employment in public works (see below) is sufficient to re-qualify such persons as "objectively in need", entitling them to full benefits. School leavers, who had previously been granted full social assistance, were categorised as in need for "subjective" reasons beginning in 2001, leading to a halving of their social benefits and encouraging job search.

In addition to social assistance, provisions for early retirement and the generosity of sick-leave benefits have also weakened incentives to work. Early retirement was widely used during the 1990s to ease labour market pressures. The number of workers opting for early retirement between 1991 and 1999 amounted to 6.5 per cent of the 1999 labour force and the cost of early retirement pensions amounted to 0.2 per cent of GDP in 1999. Early retirement was phased out in 2000 and the government has proposed raising the retirement age for women to

Figure 25. **Net earnings and social welfare**

Per cent of average production workers (APW) net earnings in 2001



1. Social assistance is set so as to bring a household's income up to the level of the Minimum Subsistence Income.
2. Includes parental and child allowance, which depends on the ages of the children. The assumptions used in this figure are explained in the text.

Source: OECD, based on data from the Ministry of Labour, Social Affairs and Family.

60 by 2010. Nevertheless, the retirement age would still be low in comparison with most OECD countries. As for sick leave, payments are set at 70 per cent of the net daily wage for the first three days and 90 per cent thereafter. These benefits are higher than those under unemployment insurance, making sick leave an attractive alternative to unemployment. Moreover, the duration is potentially longer as it is based on a medical certification.

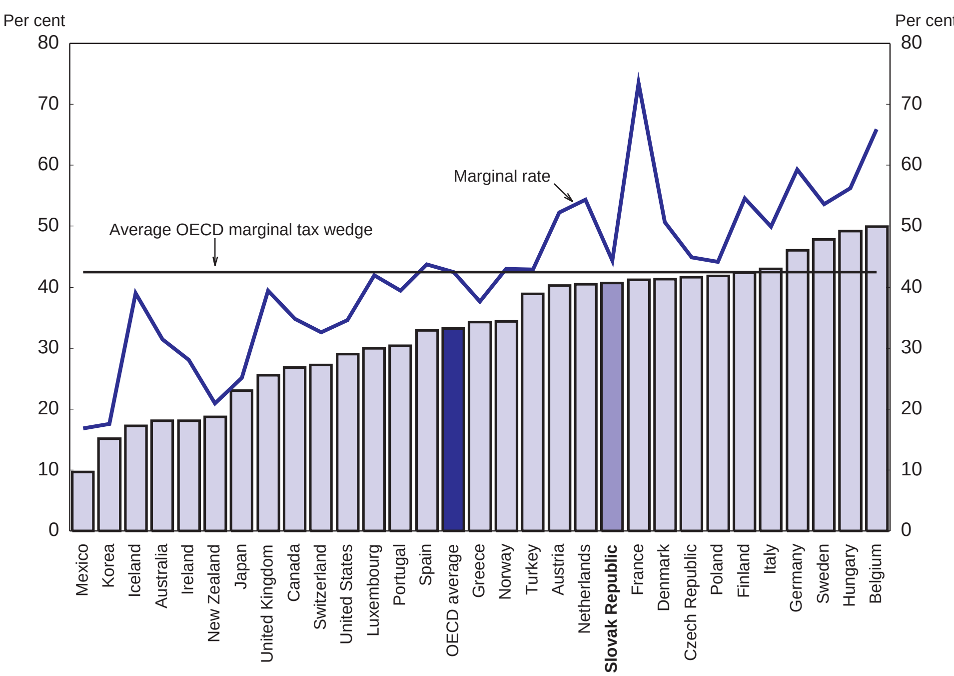
In contrast to social welfare, unemployment benefits are not particularly generous by OECD standards, making them unlikely to discourage job search and employment (Box 7). By the same token, however, the low replacement rates for higher-skilled workers (due to the cap that limits benefits to about half of the average wage) means that the unemployment insurance system may not play the role of supporting efficient job search. Following several reforms during the 1990s to tighten eligibility conditions and reduce benefits, only 15 per cent of the registered unemployed received unemployment benefits in 2000. The average duration of benefits was 5.3 months and the average amount of benefits paid was equal to 66 per cent of the minimum wage or 29 per cent of the overall average wage. Consequently, unemployment benefit payments were limited to 0.6 per cent of GDP. If the unemployment benefit for a household does not reach the MSI, social assistance is used to top up incomes. Unemployment insurance is administered by the National Labour Office (NLO), a tripartite organisation that includes workers, employers and the government.[37] The NLO also pays the health and sickness insurance premiums and old-age pension contributions for those receiving unemployment benefits through its network of eight regional offices and 79 district offices.

In summary, the availability of social assistance at a level near the average wage or even above it, depending on family size, weakens work incentives and helps explain the low employment to population ratio in the Slovak Republic. The key priority should be to reform the social welfare system to strengthen incentives. The level of benefits, particularly for large families, should be reduced towards levels that encourage work. To the extent that cuts in benefit levels are judged to be socially unacceptable, other reforms to strengthen work incentives should be introduced. Eligibility conditions for prime-age workers should be further tightened and tied to some form of activity. Indeed, activity-tested income support is proving to be effective in other OECD countries in making work more attractive, improving the skills of job seekers and preventing their withdrawal from the labour force.[38] In addition, the diverse programmes providing assistance under social support should be streamlined to enhance transparency regarding overall support, while improving programme administration would lower costs and prevent fraud. Moreover, the sick-leave benefit formula should also be revised to make benefits less generous relative to unemployment insurance. Finally, the authorities should avoid going back to using early retirement as a labour market instrument since it has proven to be largely ineffective in solving the unemployment problem and is expensive for the public budget.

High payroll taxes discourage employment

Income taxes and social security contributions have a negative impact on both the demand and supply of labour. The average and marginal tax wedges in the Slovak Republic are above the average in the OECD area (Figure 26). Approximately 40 per cent of employees' gross earnings on average are paid in taxes and

Figure 26. **Average and marginal tax wedges**[1]
Single person receiving 67% of an average production worker's income



1. Data refer to 2000. The average wedge is the sum of employees' and employers' social security contributions and personal income tax as a percentage of gross labour costs, *i.e.* gross wages plus employers' social security contributions.The marginal tax wedge is the percentage of gross labour costs represented by increased employees' and employers' social security and income tax contributions, following a rise in net wages.

Source: OECD, The Tax/Benefit Position of Employees (2001).

social contributions (excluding indirect taxes). The Slovak Republic has the highest rate of social security contributions among OECD countries at a flat rate of 50.6 per cent, with 37.8 per cent paid by employers and the remaining 12.8 per cent paid by employees (Table 19). Workers' contributions go to finance old-age pensions and insurance for health, sickness and unemployment. Social contributions are paid on wages up to SKK 32 000 per month (about three times the average wage). However, there is no global cap on contributions, so workers with more than one job pay social contributions on an amount exceeding that ceiling. For low-skilled workers, social assistance benefits introduce a floor for wages, thus limiting the scope for wage adjustment to offset payroll taxes. This has a negative effect on the demand for such workers.

High payroll taxes also encourage workers to join the underground economy, while making such arrangements attractive to employers. The underground economy is also promoted by the fact that formal employment is not required for access to health benefits and old-age pensions. Estimates of hidden or informal employment by Slovak authorities range from 66 000 to 71 000, or between 12 and 13 per cent of the registered unemployed.[39] The significant size of the informal sector, in turn, reduces the tax base, thus boosting the burden in the formal sector.[40] To reduce the negative impact of high payroll taxes, the authorities should aim to reduce them to the norms in the European Union using two approaches. *First*, it is important to overhaul the social insurance programmes to make them more efficient. Indeed, given the financial difficulties of the health insurance companies, reductions in contributions need to be done in tandem with reforms to improve contribution compliance and better control spending by insurance companies (see Chapter II). In addition, tightening the sickness insurance eligibility conditions and benefits would allow sickness and unemployment insurance contributions to be reduced.[41] *Second*, social welfare aspects of the insurance systems, such as the social pension for the elderly and the health and sickness contributions

Table 19. **Contribution rates for social insurance programmes**
As per cent of wages

	Paid by employee	Paid by employer	Combined
Pensions insurance	6.4	21.6	28.0
Sickness insurance	1.4	3.4	4.8
Healthcare insurance	4.0	10.0	14.0
Unemployment insurance	1.0	2.8	3.8
Total	12.8	37.8	50.6
European Union average	10.3	18.5	28.8
OECD average	8.6	14.8	22.3

Source: Ministry of Labour, Social Affairs and Family and OECD.

for the unemployed, should be financed by general taxation. *Third*, the authorities might want to consider shifting some of the burden of financing social insurance programmes to broader taxes in order to reduce the tax on labour.

Shift emphasis of labour market policy towards active labour market policies

Total expenditure on labour market programmes was 1.2 per cent of GDP during the period 1998 to 2000, about two-thirds the average in OECD countries (Table 20).[42] About 84 per cent of those expenditures were for passive policies, notably unemployment insurance and early retirement, leaving a much smaller share for active labour market policies (ALMPs), which include placement services, job-search counselling, training and retraining, direct job creation and employment subsidies. The emphasis on passive policies reflects a number of factors. *First*, such expenditures are guaranteed by the state,[43] while ALMPs depend on the availability of funding. *Second*, the NLO, which is responsible for all labour market programmes, is burdened by the tasks of administering passive policies for the large number of unemployed and collecting labour market statistics. In particular, the administration of unemployment insurance is costly due to the need to enforce eligibility requirements, leaving few resources for active programmes. *Third*, the NLO pays health and sickness insurance premiums and pension contributions for those receiving unemployment benefits. Such expenditures account for nearly 30 per cent of total spending on labour market programmes (Figure 27). As NLO outlays are funded by payroll contributions, this raises the burden on employed persons.

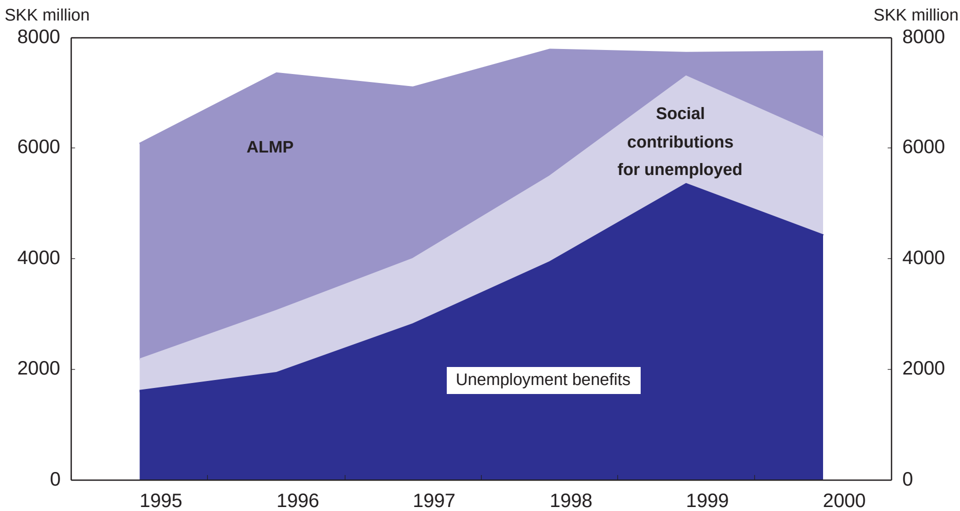
The bulk of resources for active labour market policies are concentrated in financing jobs for young workers and the long-term unemployed. In 2000, nearly

Table 20. **Spending on labour market programmes**
Annual average in per cent of GDP

	1992-1994	1995-1997	1998-2000	OECD average[1]
Passive programmes	0.43	0.66	0.98	1.06
of which:				
Unemployment	0.30	0.34	0.63	0.93
Early retirement	0.13	0.16	0.18	0.13
Other	0.00	0.16	0.17	0.00
Active programmes	0.39	0.61	0.18	0.68
of which:				
Training	0.03	0.03	0.01	0.18
Job creation	0.35	0.56	0.15	0.19
Measures for the handicapped	0.00	0.02	0.02	0.12
Total spending	0.82	1.27	1.16	1.74

1. Excludes Iceland, Ireland, Luxembourg and Turkey. Data is for the most recent fiscal year available.
Source: National Labour Office and OECD.

Figure 27. **Expenditures of the National Labour Office**



Source: National Labour Office.

68 000 persons – 12 per cent of the unemployed – participated in the *Public Beneficial Work* programme (Table 21), which provides short-term employment for the long-term unemployed, mainly for local public works. These jobs, which are financed by the central government, generally involve unskilled work and last an average of 6.4 months. In most cases, the wage is not much higher than the minimum wage. Increasingly, this programme includes persons who have been classified as "subjectively in need" as a result of refusing a job offer or moving voluntarily to unemployment and, as a result had their social assistance benefits halved. As noted above, three months of employment in public works is sufficient to entitle such persons to full benefits. In contrast to the emphasis on public-works jobs, the share of ALMP spending on supply-side programmes to increase the skills of the unemployed has been declining since the mid-1990s and in 2000 it accounted for 4 per cent of outlays. As a result, only 1.1 per cent of the unemployed participate in training, which is usually offered to meet the needs of a specific employer.[44]

The NLO also supports job creation by providing public loans or subsidies for new jobs filled by persons who are registered unemployed, the filling of vacancies with recent school graduates and helping the unemployed become self-employed. The use of wage subsidies has largely been phased out in recent years, with the number of participants falling from more than 33 000 in 1993 to less than

Table 21. **Jobs created by active labour market policies**

	2000	2001
Supported Jobs		
Self-employment	113	2 434
School leavers	2	182
Agreed with employer	1 015	5 187
Invalid or handicapped workers	790	1 359
Sub-total	1 920	6 910
Per cent of registered unemployed	0.4	1.3
Public Beneficial Work[1]		
Short-term	2 062	4 407
Specially agreed	3	147
For long-term unemployed	65 626	38 446
Sub-total	67 691	43 000
Per cent of registered unemployed	13.4	8.3
Enrolled in training programmes	**1 500**	**24 558**
Per cent of unemployed	0.3	4.7
TOTAL	**71 111**	**74 468**
Per cent of unemployed	14.0	14.3
Memorandum items:		
Registered unemployed[2]	506 497	520 642
of which:		
Under 25	160 560	167 251
Long-term (more than 1 year)	220 816	219 713

1. The persons with these jobs are not included in the registered unemployed. Supported Jobs are created by subsidies to private-sector firms while Public Beneficial Work refers to public-sector jobs.
2. End of period figures.

Source: National Labour Office.

2 000 in 2000. Such a decline is appropriate, as evidence from other OECD countries shows that subsidised employment has large dead-weight costs and substitution effects that imply small net job creation.[45] This appears to be the case also in Slovakia where the programmes are only loosely targeted. Moreover, there is evidence that the wage subsidy and public employment programmes exert significant upward pressure on real wages (Huitfeldt, 2001). By easing the income loss resulting from unemployment, these programmes boost the reservation wage of the unemployed. On the positive side, though, these demand-side programmes may have the beneficial impact of maintaining the attachment of the unemployed to the labour force. In any case, budget constraints make the size of the programmes negligible relative to the large stock of unemployed.

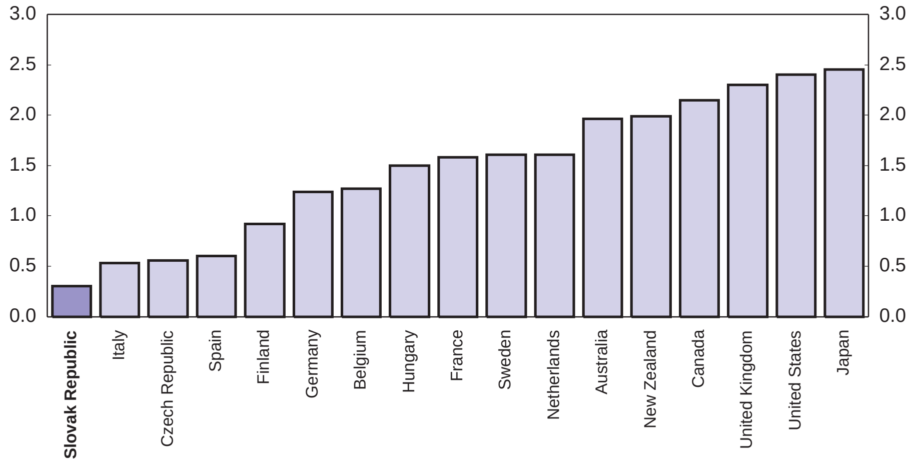
The public employment services of the NLO are largely inadequate to assist the large number of unemployed. Indeed, at the district office level, there were 399 registered unemployed per official in 2000, though this represents a decline of 50 from the previous year. Reducing this number is important to improve the quality of assistance to the unemployed by identifying and targeting those with the greatest difficulty in finding employment. Another challenge is that district offices in charge of placement services lack technological equipment. It is important to improve the nation-wide network to publicise job vacancies and ensure continuous evaluation of the effectiveness of employment services. The share of the NLO in job placement varies from 7 to 12 per cent, with bilateral contacts between employers and employees accounting for the remainder. Private job placement agencies are allowed, subject to authorisation by the NLO, and there were 159 in operation at the end of 2000. Most of their placements – 94 per cent in the first half of 2001 – were for jobs in foreign countries, primarily the Czech Republic.

The introduction of activity-tested income support would help limit the disincentive effect of the social assistance programmes. Making such benefits conditional on work availability and participation in ALMPs would tend to promote employment. Moreover, they would help overcome the difficulties of closely monitoring job-search and availability conditions for unemployment insurance when the unemployment rate is very high. In addition to linking active and passive measures, implementing activity-tested income support would require a shift from passive to active policies. As noted above, only 16 per cent of labour market spending is devoted to active programmes, compared to an average of 37 per cent in the OECD area. Additional resources for active programmes could be obtained by eliminating the contributions from the NLO for sickness insurance, health and old-age pensions on behalf of those who are unemployed. Outlays for sickness insurance alone amounted to SKK 700 million in 2000 (6 per cent of labour market expenditures). However, there is no rationale for contributions on behalf of the unemployed for sickness insurance, which pays a worker's salary during absence from work due to illness.[46] As for health insurance for the unemployed, this is financed from general taxation in many other OECD countries. Finally, pension rights should be linked to labour income.

Lift barriers to labour mobility

Despite the large differences in job opportunities across regions in Slovakia (Table 14), internal migration is extremely low and fell further during the 1990s. By 2000, three persons per 1000 population moved between regions in Slovakia,[47] the lowest rate among OECD countries (Figure 28). Apart from Italy, the Czech Republic and Spain, regional mobility rates in OECD countries range between 10 to 25 migrants per 1000 population.[48] The factors hindering labour mobility include high transactions costs associated with moving and insufficient information about job opportunities in other regions. Moreover, social welfare benefits, which are the same throughout the country in nominal terms, also have a negative impact on mobility. An unemployed person is discouraged from moving

Figure 28. **Internal migration in selected OECD countries**
Per cent of total population, 1998



Source: OECD, *Employment Outlook, 2000*.

to a higher-cost area where jobs are more numerous, knowing that the real value of social assistance and support will be lower. Adjusting benefits for cost-of-living differences would remove this consideration.

The lack of a well-functioning housing market is the strongest deterrent to regional mobility. The most important problem is the persistence of extensive price controls on both the rental and purchase of housing. These controls stem from the process of privatising state-owned housing, which sold dwellings to occupants at prices well below market levels. To prevent speculation, the transfer of property was accompanied by constraints on reselling and on rents. Housing units still owned by the government are also rented at prices well below the market level. As a result, there are strong incentives not to move as it implies giving up a residence at a low, controlled price and paying high, free-market prices for new lodging. Extensive regulations also keep the size of the market for new houses very small, thus boosting the gap between controlled and free-market prices. Efforts should be made to gradually eliminate controls on prices and restrictions over the transfer of property.[49]

Commuting could help overcome the problems posed by the housing market. Nevertheless, an inefficient infrastructure and a rise in transport costs in recent years, particularly following the liberalisation of energy and transport prices, has reduced the already low number of commuters. As commuting costs are particularly burdensome for low-paid workers, the government introduced in 2002 transport allowances for unemployed workers taking up jobs with a maximum duration of twelve months. The allowance is capped at SKK 1 500 per month.[50] This, however, should be a temporary remedy as the transport infrastructure develops.

Measures to promote hiring and job creation

Enhance the flexibility of wages and employment

As noted above, a number of factors contribute to wage rigidity, such as highly centralised wage-setting procedures and a social welfare system that raises workers' reservation wages and sets a floor for all workers. One aspect of increasing flexibility is reducing the generosity of social assistance. In addition, wage outcomes at the firm level should not be constrained by higher-level agreements, and the obligation to extend agreements to enterprises not represented in the negotiations should be eliminated. Finally, the wage tariff system, which poses a serious potential constraint on wages, should be abolished.

Labour legislation regulates a wide range of details concerning employee-management relations, reducing the scope for contractual negotiations. Working time is closely regulated and the use of fixed-term contracts is limited to three years. While the criteria for contract termination are not very restrictive, the need for approval by trade unions[51] and the consequent delays, together with severance payments, make dismissals rather costly. The details of labour legislation are discussed in Box 8.

The large-scale redundancies associated with industrial restructuring suggest that employment protection is not significantly hindering labour adjustment thus far. However, the experience of other OECD countries indicates that employment protection rules like the ones in Slovakia can have important distortionary impacts on the labour market by discouraging forward-looking employers from hiring new workers. The potential costs associated with future dismissals are added to the actual labour costs for comparison with the anticipated marginal productivity of the new workers. Such costs arise not only from high severance payments but also from the obligation to undertake lengthy or complex procedures in order to dismiss workers or to reallocate them geographically or functionally. Strict labour market regulations are particularly burdensome and costly for small firms, thus discouraging the creation of new businesses.

Box 8. Labour legislation in the Slovak Republic

Labour legislation includes a labour code introduced in 1965 and repeatedly amended since 1990 at the time of the transition. In 2001 a new labour code was adopted, which entered into effect in April 2002, together with the Civil Service Act and the Public Service Act. This legal framework imposes detailed regulations covering a wide range of areas, including dismissals and severance payments, the duration of contracts, working time and overtime hours.

The criteria for *dismissing workers* are relatively broad and flexible. The minimum notice period is normally two months, but is extended to three months in case of relocation or closure of a firm. *Severance payments* must match two months of net average earnings.[1] Dismissal of 20 or more employees over a period of 90 days is considered to be a collective redundancy and requires one-month advance notice to the NLO and the trade unions. Prior to letting workers go, the firm must negotiate with the trade union to seek all possible measures to minimise redundancies. Employers are no longer obliged to help dismissed workers look for a new job, in co-operation with the local labour office, or to keep workers on the payroll until a job is found.[2]

The *duration of contracts* is assumed to be indefinite unless otherwise specified. Fixed-term contracts can be signed or extended for a maximum of three years, with new contracts signed with a former employee within one year of leaving the firm considered to be extensions. The three-year limit does not, however, apply to firms with less than 20 employees. The maximum duration of probation is a non-renewable three months.

Maximum *working hours* are set at 40 per week and nine per day. Lower limits are applied to youth under 16 years of age (30 hours) and to adolescents over 16 (37.5 hours), thus reinforcing the negative effect of the minimum wage on the demand for young workers. Working time has to be evenly distributed, with the difference in weekly schedules not exceeding three hours. However, the employer may introduce a flexible working time system if the hours of work are set by the employee. Employees must receive at least two consecutive days off per week. A wide range of other working conditions are specified, such as resting time between shifts, break time at work and the length of annual holidays. While such restrictions are aimed at protecting workers, taken together, they may pose a constraint on the contractual autonomy of firms and their employees.

Maximum *overtime work* is eight hours per week and 150 hours in a calendar year and overtime pay is set at a minimum of 25 per cent over regular earnings. Night-shift work (from 10 p.m. to 6 a.m.) must be paid 20 per cent more than daytime work.

Disabled persons must account for at least 3 per cent of employees at firms with 20 or more employees and severely disabled persons must account for 0.2 per cent.[3] In addition, workers with disabilities can only be dismissed, regardless of the reason, with the consent of the District Labour Office, unless entitled to old-age pension.

Box 8. **Labour legislation in the Slovak Republic** (*cont.*)

A new Labour Code was introduced in April 2002. The major changes in this new legislation are discussed in the main text.

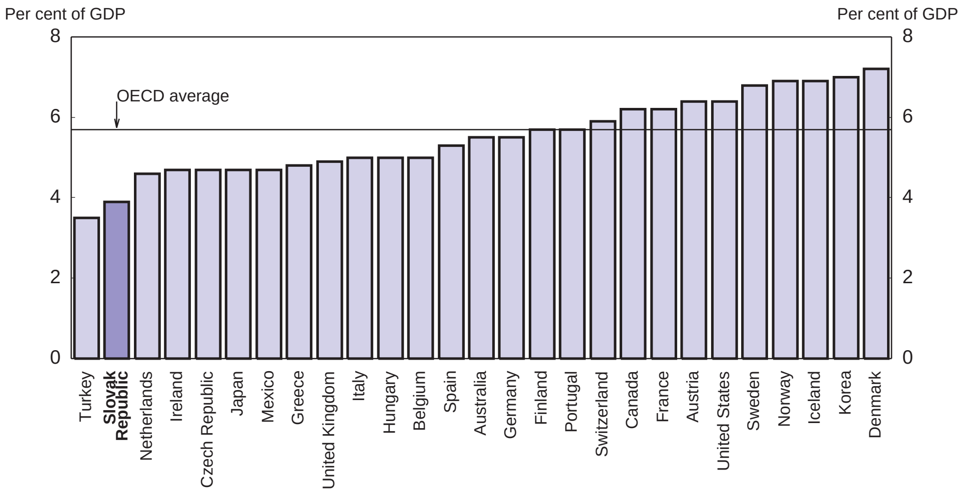
1. Higher levels of severance pay can be set through collective bargaining.
2. This obligation, however, remains in the case of dismissals related to the threat of occupational disease.
3. This requires enterprises with 20 to 50 employees to hire at least one disabled and one seriously disabled worker. Fines for non-compliance amount to SKK 16 200 per missing disabled worker and SKK 32 400 per missing seriously disabled worker.

Improve labour force skills and competencies.

A lack of highly qualified human capital appears to be a major factor hindering progress in Slovakia. In particular, the relatively small proportion of university graduates limits the scope for more technology-intensive industries. Moreover, a lack of skilled professors and teachers constitutes a severe constraint for improving the education system. Upgrading the education and training systems should have a high priority in the policy agenda and may require devoting greater resources for education. Total expenditure on education was 3.9 per cent of GDP in 2000, the second-lowest in the OECD area and well below the 5.7 per cent average (Figure 29). The educational level of the labour force is low and has risen only gradually in recent years. School enrolment rates, which are nearly 100 per cent for primary and lower secondary school, are relatively low at 73 per cent for upper secondary school and less than 20 per cent for university or higher education. In addition, the curriculum at the university level has failed to adapt to demands for new knowledge. To the extent that this might reflect a lack of human capital capable of developing new educational programmes, the government might consider increasing grants or loans for post-graduate studies abroad.

The main shortcomings of the education system are found at the secondary level, where only 17 per cent of students attend grammar schools preparing them for higher education. The remainder are in specialised or vocational schools providing narrow technical skills and these students have little opportunity to change skills. More than a third of technical and vocational schools focus on skill training for branches of industry that are declining, helping to explain why nearly 80 per cent of the registered unemployed have a primary or vocational education. A greater proportion of students should be given a general education, which is

Figure 29. **Expenditure on education in OECD countries**



1. Data refer to 2000 for the Slovak Republic and 1998 for other countries.
Source: OECD, *Education at a Glance* (2001).

necessary to advance to university and perhaps more importantly, promotes life-long learning.

While reforming the education system is a priority over the medium term, meeting the demand for improved human capital in the short term depends on improving training and re-training programmes. This requires increasing the involvement of enterprises in designing courses and their contents, as well as in the provision of practical training. Only 2.7 per cent of students are trained in enterprises. Since the responsibility for training is dispersed among several layers of government and several ministries, co-ordination among them is essential. Moreover, given the lack of qualified professionals to provide training in some areas, it might be useful to introduce some degree of administrative centralisation.

Improve the entrepreneurial climate

According to a 1999 survey of small firms in the Slovak Republic, the four main obstacles limiting their development are high credit costs, the heavy tax burden, complex tax regulations and entry barriers, some of which have been addressed in the meantime.[52] The high cost of financial capital reflects the fragility of the banking system and the absorption of resources by large ailing public enterprises during the second half of the 1990s, which limited the supply of credit to the private sector. The lack of a legal framework providing guarantees to lenders also discouraged the growth of credit. More recently, though, the privatisation and restructuring of the banking system has put banks in a better position to supply funds, while the new bankruptcy law provides the necessary guarantees (see Chapter IV). However, cautious lending policies adopted while banks designed new credit strategies, as well as unfamiliarity with the new legal framework, kept credit growth sluggish through 2001.

The second obstacle cited – the high overall tax burden – reflects low employment rates and a sizeable informal economy that reduces the tax base. In turn, high taxes encourage enterprises to engage in unregistered activities. As noted above, the tax wedge in Slovakia is somewhat above the average for OECD countries (Figure 26), reflecting social charges set at 50.6 per cent of wages. Given the observed low responsiveness of wages to unemployment in Slovakia, high taxes are likely to translate into high labour costs and lower demand for labour. To the extent that the demand for low-skilled workers is more cost-elastic than for more educated workers,[53] cuts in payroll taxes targeted on the low-paid might have a considerable effect on employment and may also promote the creation of small and medium-sized enterprises.[54] However, there has been progress recently in reducing income tax rates. The corporate rate was reduced to 29 per cent in 2001 and then to 25 per cent in 2002, while tax compliance for small enterprises was simplified by allowing them to apply a flat tax rate estimated on the basis of revenue.[55] This also reduced the tax burden for such firms. Personal income tax rates were also reduced, from 42 to 38 per cent at the high end and from 15 to 10 per cent at the low end.

More generally, rules governing the creation of firms are complex and registration procedures are still time-consuming (see Chapter IV). This is particularly burdensome for small and medium-sized enterprises that cannot afford to hire specialists. The process needs to be further streamlined, with better co-ordination between agencies and a centralisation of procedures.

Priorities for action

With one of the highest rates of unemployment in the OECD area, the labour market ranks perhaps as the most serious problem in the Slovak economy. Policies to improve labour market outcomes should be a top priority. The central challenge that emerges from the analysis above is that the high level of social assistance benefits, and the taxes used to finance social insurance programmes, weaken incentives to work, especially for those with large families and with low levels of education. At the current level of labour productivity, the wage rates needed to make work attractive for a significant portion of the workforce is beyond the capacity of firms to pay. One option is to reduce social assistance levels, although this might not be socially acceptable. However, the introduction in 1999 of the category of "in need for subjective reasons", which allows social assistance benefits to be cut by half, and the broadening of the criteria for this category in 2001, suggest that there is scope for such reductions.

To the extent that cuts in social benefits are not socially acceptable, it is essential to reduce the distortionary effects of social assistance through other reforms. One aspect of limiting the impact of social assistance on work incentives is to ensure that the eligibility conditions – namely job search and the willingness to accept a position – are strictly enforced. Adequate enforcement, though, is complicated by the fact that there are more than half a million unemployed persons and only around a thousand job placement officials to assist them. In practice, implementing an "activity-tested" approach to benefits requires additional resources, as well as increased co-operation between ministries involved in social policies. The National Employment Plan issued at the end of 2000 (Box 9) recognises the need to reinforce job placement services by working more closely with the unemployed, assessing annually the performance of labour offices and enhancing information systems. One measure currently under discussion is the introduction of a new layer of labour offices at the local level to improve services for the unemployed. However, there is a risk that this might actually reduce access to information on job opportunities unless greater communication and co-ordination among offices is ensured. Moreover, given the large fiscal deficit, any reform in the NLO network should be undertaken cautiously so as not to increase spending. Greater reliance on private job placement agencies might be a cost-effective way of promoting job search.

Other steps to reduce the disincentives in the social assistance system include adjusting social benefits for regional differences in the cost of living. This would encourage labour mobility, especially if accompanied by reforms in the housing market. In addition, the gap between average wages and benefit levels should increase over time so as to encourage work. The authorities might also want to consider some type of "in-work" benefit to make employment more rewarding. In reforming the social assistance system, it is important to draw on the successes achieved in some other OECD countries.

Lowering the disincentives inherent in the social welfare system should be accompanied by measures to reduce the tax burden on labour, particularly for financing the social insurance programmes. The priority is to overhaul these programmes to reduce the growth of expenditures and allow a decline in contribution rates. In addition, the social assistance aspects of these systems should be financed by general taxation. Finally, the authorities might consider shifting some of the funding for social security programmes away from payroll taxes to general taxation.

In the longer term, the key is to raise the productivity of workers to allow higher wages, which will make work more attractive, assuming that social benefit

Box 9. The National Employment Plan

In November 2000, the government announced the National Employment Plan, which sets out a programme for promoting economic growth and employment. Following the European Commission's strategy for employment, the plan is based on four policy objectives: *Enhancing Employability of Workers*, *Promoting Entrepreneurship*, *Improving Capacity of Enterprises to Adapt* and *Strengthening Equal Gender Opportunities*. The plan identifies the necessary measures to meet each objective, including legislative reforms.

The plan proposes to *enhance the employability of workers* by upgrading the skills of the labour force, improving and expanding ALMPs and removing disincentives to work. To raise the level of human capital, the plan calls for improving secondary education and enhancing training and continuing education. The numbeer of jobs created through ALMPs, which currently provide work for 10 per cent of the unemployed, is to be expanded to include 20 per cent of the unemployed. This will be accomplished through the creation of more public-works jobs and increasing wage subsidies, in particular for the young. In addition, job mediation by the NLO is to be improved. The plan also recognises the work disincentives created by the social assistance system. However, raising wages is identified as the primary solution to that problem.

To promote *entrepreneurship*, the plan places great emphasis on providing financial assistance to business and agricultural activities in regions of high unemployment. Indeed, it explicitly states the need to support even non-competitive agricultural activities for environmental reasons. The plan recognises the importance of increasing inflows of foreign direct investment to boost employment, but at the same time, proposes introducing a requirement that foreign investors purchase 30 to 60 per cent of their inputs from domestic producers. Enhancing the legislative framework, facilitating bank restructuring, developing infrastructure and creating industrial parks in economically depressed areas are presented as measures to improve the entrepreneurial climate. Other proposals include the provision of advisory services and special financial support for small and medium-sized enterprises and intensified enforcement of labour regulations.

To *enhance flexibility and adaptability of business and employment*, the plan calls for supporting labour mobility by subsidising commuting costs and the expense of moving to a new residence. It also recognises the need to improve the functioning of the housing market, although no specific steps are proposed. In addition, the plan recommends substituting overtime work with flexible forms of work, such as part-time employment. Finally, it proposes the development of a programme to increase productivity.

Equal gender opportunities are to be re-enforced by intensifying enforcement of regulations on equal opportunities and monitoring compliance with equal remuneration principles. In addition, NLO employees are to be trained to promote equal opportunities for women in their job placement activities and special programmes for educating women for managerial posts are to be created.

Box 9. **The National Employment Plan** (*cont.*)

The National Employment Plan represents an important step in identifying the diverse elements hindering employment growth. However, while problems are well identified, in many areas the plan does not provide concrete solutions that can be implemented by policymakers. This is the case, for example, for the proposal to improve the housing market. In other areas, the measures proposed are not consistent with the stated objective. In particular, the proposal to impose constraints on the activities of foreign firms is unlikely to promote the objective of attracting more foreign investment. In the area of work incentives, the focus on wages would be counterproductive if it led to steps to artificially raise salaries, thus reducing employment. Instead, the government should focus on the areas where it has direct control, *i.e.* the tax and social welfare system. Finally, the plan places too much emphasis on government initiatives to create, subsidise and preserve jobs, invest in infrastructure and create industrial parks. More attention should be focused on creating the economic conditions that favour job creation in the private sector.

levels do not increase by the same amount. Increasing productivity requires strengthening the education and training systems. The National Employment Plan includes a medium-term goal to upgrade the education system by boosting the proportion of young people who complete secondary education from less than two-thirds to 80 per cent. A second objective is to raise the share of 18-year-olds advancing to higher education from a quarter to a third. In addition to these quantitative targets, the government submitted to Parliament a programme in 2001 – *The National Programme for Upbringing and Education* – setting out a strategy for improving the quality of the education and training systems. The main objectives of the programme include raising the overall level of educational attainment, restructuring and rationalising vocational education, enhancing mobility between programmes and cycles and providing access to information technology to all schools. The programme envisages a rationalisation of secondary technical education and seeks to involve the social partners in the design of secondary vocational training. With the downsizing of technical curriculum, participation in general education at the secondary level would be increased. Training efforts in Slovakia are relatively minimal. At present, only 1 per cent of the unemployed receive training, suggesting there may be scope for greater efforts in this area. The success of training, though, will depend on its focus on teaching the skills demanded in the labour market, suggesting an important role for private-sector firms in creating training programmes.

Improvements in the education system will take a considerable time to bear fruit. In the meantime, it will be important to ensure a healthy business climate and a sound financial system (see Chapter IV) to promote job creation. In addition, enhancing labour market flexibility should be a priority. A new labour code was approved by Parliament in July 2001 and took effect in April 2002. However, the new code represents a missed opportunity to remove negative aspects of labour legislation that imposed detailed and restrictive rules, thus impairing labour market flexibility (Box 8). In particular, the new code preserves the wage tariff system, which sets minimum wages for the 40 per cent of employees not covered by collective bargaining. Moreover, despite being implemented during a period of extremely high unemployment, it introduces a number of provisions that are likely to reduce labour market flexibility, exacerbate the unemployment problem and discourage foreign investment. Perhaps most importantly, it maintains the powerful role of trade unions in the management of firms. Employers are required to gain the approval of workers' representatives on such issues as staff training, working conditions and the transfer of a business, in addition to individual and group dismissals. For example, the right of an employer to unilaterally assign a worker to another task or require a business trip is restricted. In firms without trade unions, management is required to consult with work councils, which consist of workers elected by their peers. In addition, the new code allows trade unions to act as inspectors to monitor the compliance of firms with labour regulations. Consequently, union officials unrelated to a firm have the right to enter a company to obtain information necessary to fulfil this role.

Another potentially damaging aspect of the new labour code is that changes in the ownership of an enterprise require at least one-month advance notification to the competent trade union. Moreover, the reason for the transfer and the expected legal, economic and social consequences for labour should be specified. Most importantly, the new management is obliged to assume all the responsibilities of the previous owner with respect to its employees, thus restricting the scope for restructuring through mergers and acquisitions.

One positive effect of the new labour code is that it integrates diverse labour market legislation implemented during the past decade into a single law. In addition, the new code brings Slovak labour legislation into line with the standards of EU countries as another step in the accession process. The code includes some improvements, such as allowing firms with less than 20 employees to use fixed-term contracts beyond the three-year time limit, which will tend to enhance labour market flexibility. In addition, the new code establishes a Guarantee Fund to provide up to three months of back wages to employees at firms that go bankrupt.

In sum, reforms in a wide range of areas are necessary to upgrade human capital and improve the functioning of the labour market. The Slovak authorities have correctly identified the main problems in the labour market and launched proposals, notably the National Employment Plan, to address these issues. However, more progress is needed in developing specific proposals and identifying the necessary resources. Moreover, in some areas, such as the new labour code, policy changes have gone in the wrong direction. The most important finding derived from the experience of OECD countries is that structural unemployment can be reduced when comprehensive reform strategies are well-designed and effectively implemented.[56] Moreover, it is essential that reforms be set in a medium-term framework since it often takes some time before the full benefits of policy changes become visible.

Notes

1. Slovakia had been downgraded in 1998. Standard and Poors raised Slovakia's rating to investment grade in October 2001. It was followed in November by Moody's, which raised Slovakia to Baa3, the lowest investment grade. However, a third agency, Fitch, still rates Slovakia one step below investment grade.
2. These bonds were issued in place of vouchers at the time of the second wave of privatisation so that citizens would be able to get cash rather than property. Roughly half of households sold their bonds on the secondary market to financial institutions prior to their redemption.
3. In 2001, fuel prices slowed core inflation by 0.7 percentage point and headline inflation by 0.4 percentage point. Core inflation slowed from 5.7 per cent in 2000 to 4.3 per cent in 2001, while headline inflation decelerated from 12.0 per cent to 7.3 per cent.
4. Europe, including the countries in the Central European Free Trade Area (CEFTA), accounts for over 90 per cent of Slovak exports. The 12.9 per cent growth in exports (in Slovak koruna value) to the EU in 2001 was slightly above the 10.6 per cent rise to CEFTA, which includes the Czech Republic, Poland, Hungary, Bulgaria, Romania and Slovenia, despite the relatively high economic growth rates recorded in CEFTA. This may reflect the fact that major foreign-owned producers, such as Volkswagen and US Steel, are aimed at the EU market.
5. Export performance is the ratio between the growth of export volume and export markets for total goods.
6. However, the share of short-term liabilities in total debt is lower at 27 per cent.
7. Potential output growth appears to be in the range of 4 to 5 per cent. Inflation in the range of 3 to 4 per cent would produce nominal growth of 7 to 9 per cent. The current account deficit that stabilises net debt as a share of GDP depends on the initial size of the net debt and the growth of nominal GDP.
8. This includes public administration and defence, education, health and social work and other community and social services, including public works.
9. OECD projections are made on the basis of unchanged exchange rates, except in the case of some high inflation countries.
10. Purchasing power parities with a 1999 benchmark are used. For a description, see P. Schreyer and F. Koechlin (2002).
11. Two other motivations for the new Act were to harmonise the legal framework with that of EU countries and to create a framework for bank supervision that complies with Basle principles.
12. The National Bank of Slovakia has announced the objective for the country to join the European Economic and Monetary Union by 2007.

13. Such reserves accumulate interest at a fixed rate of 1.5 per cent. The reduction in the requirement will be accompanied by a modification of reserve base calculation and the introduction of market-related remuneration in 2004.
14. Year-on-year increases in December of each year.
15. The negative real interest rates on bank deposits during the last few years prompted the emergence of non-bank financial institutions offering extremely high returns to attract investors. In fact, many of these institutions are pyramid schemes. A number of these institutions closed in early 2002 (see Chapter IV).
16. Calculated relative to the currencies of 41 other countries.
17. The average daily volume of currency traded in the first ten months of 2001 was $356 million, with spot transactions averaging $55 million and futures and swap operations accounting for the remainder.
18. The GFS methodology is used in the Staff Monitored Programme (see Box 1), except for the exclusion of the operations of the National Property Fund. This results in some discrepancy in the accounts with respect to those produced by the Slovak authorities.
19. The 7 per cent surcharge, which was introduced in June 1999, was lowered in January 2000 to 5 per cent and to 3 per cent in July 2000, before being eliminated in January 2001.
20. As explained in Chapter III, social assistance includes two programmes – *social support* and *social assistance*. This chapter will use the latter term to refer to both programmes.
21. Three of the five health insurance funds are privately-owned. These funds, though, play only a minor role.
22. Since the fiscal performance of state funds, social security funds and local governments is, at this stage, only known from below the line, there is a risk that imbalances might be accumulated in the form of arrears and emerge only in years ahead.
23. According to the preliminary conclusion of the IMF mission in March 2002 to review the Staff Monitored Programme, the deficit could exceed 5 per cent of GDP. On an ESA95 basis, however, the OECD Secretariat estimates that the deficit may remain close to its 2001 level of 6.4 per cent of GDP.
24. Current practice is based on a broad interpretation of Article 40 of the Constitution. It guarantees citizens "the right to free healthcare and medical equipment for disabilities". But since Article 40 also specifies that "on the basis of medical insurance under the terms to be laid down by law", it should be possible to make legal changes to define those services that are fully covered by a basic insurance benefit package.
25. There are currently five funds, of which the two public funds are dominant.
26. Poland embarked on the path towards a model of competing funds but seems to be making a 180-degree turn towards a model with a single national fund. The reform experiment that began in 2000 encountered many difficulties. This was because of the absence of a clearly defined basic benefit package, insufficient risk equalisation, weak regulation and governance of regional funds and a vast diversity of contractual arrangements with service providers that were variously perceived by the public as chaotic and as depriving them of access to needed care.
27. The split between GPs and specialists is roughly 40:60 in Slovakia.
28. The transition process of state healthcare institutions is expected to be completed by January 2003. Of the 77 state-run hospitals (type I, II and III) only 15 will remain under the jurisdiction of the Ministry of Health (type III {regional} hospitals and university

hospitals). Fifteen hospitals will be transformed from state-run into not-for-profit institutions. The remaining 45 hospitals, type I (municipal) and type II (district), will be transferred to the jurisdiction of local governments. This transformation will also enable these institutions to seek financing from sources other than health insurance funds.

29. See OECD (1994), OECD (1997) and OECD (1999*d*).
30. See Revenga *et al.* (2000).
31. However, the incidence of long-term unemployment is significantly higher for those with primary education than for those with tertiary education.
32. Women can retire between the ages of 53 and 57, depending on the number of children born, while the minimum retirement age for men is 60. The government has recently introduced legislation to gradually increase the age for women to 60.
33. The statistics on vacancies are thought to give an accurate indication of job availability because employers have a legal obligation to report vacancies and because active labour market policies, such as wage subsidies and loans, depend on such reports.
34. It may also suggest an increasing unwillingness of employers to hire from the pool of registered unemployed.
35. See Boeri *et al.* (1996).
36. To encourage people to accept jobs, a guaranteed labour income set at 20 per cent above the Minimum Subsistence Income was introduced by topping up earnings with social assistance when necessary. However, this measure was repealed in January 2001.
37. The unemployment insurance fund, which is administered by the NLO, is separate from the state budget. However, the NLO's annual budget has to be approved by Parliament. Moreover, only Parliament can change the level of benefits and eligibility conditions. The director general of the NLO is appointed by the Minister of Labour, Social Affairs and Family, who also serves as chairman of the NLO's Board of Directors.
38. The United States substantially reformed its welfare system during the 1990s with a view to increase the labour market involvement of welfare recipients. Although the impact of the reform is difficult to separate from the benefits of strong sustained growth, poverty rates declined throughout the 1990s, as did the number of welfare recipients. The Australian government introduced in 1998 the "Mutual Obligation Initiative", which is targeted at workers aged 18 to 35. It has been extended in 2001 to the unemployed between the ages of 35 to 49. Workers are proposed a menu of activities and asked to work for six months out of every year in unemployment. Failure to accept work makes the unemployed liable to penalties, including loss of income benefits. The programme is seen as very successful in reintegrating workers into activity (see OECD, 2001*a*).
39. Other estimates vary within a wider range of between 60 000 and 180 000 persons, or between 11 and 35 per cent of unemployed workers.
40. The National Labour Office has presented to the Ministry of Labour, Social Affairs and Family a set of measures, including legislation, aimed at curbing such underground employment.
41. This would lower the sickness insurance contributions for all workers, including the unemployed, whose contributions are paid out of the unemployment insurance contributions of workers.
42. The low figure reflects the fact that most income support for the unemployed is provided through social assistance, which is not included as labour market expenditure.

43. Were the NLO to have insufficient funds to pay for passive policies, the government would provide loans.
44. Participants receive a benefit that is slightly higher than that offered by unemployment insurance during the training, which usually lasts between a few weeks and a couple of months.
45. According to one study (Martin, 2000), "Most evaluations show that subsidies to private-sector employment have both large dead-weight and substitution effects".
46. If the unemployed fall ill during the "protection period", they can receive the sickness benefit from their former employer. After this period, no benefit is provided despite the premium paid by the NLO.
47. This does not include those who commute to work in different regions, which, in any case is relatively low in Slovakia.
48. It should be noted that international comparisons of regional mobility are inherently difficult to make.
49. The high rate of home ownership in the Slovak Republic may also reduce mobility and boost the unemployment rate. A number of studies have found a positive relationship between the rates of unemployment and home ownership. See Bover *et al.* (1989), Hughes and McCormick (1987) and McCormick (1997).
50. Eligibility requires twelve months on the unemployment register or six months for students after school graduation.
51. If a firm wishes to terminate the employment contract of a trade union member, it must gain the approval of the trade union. If such approval is not given, the employer can request the Labour Inspectorate for approval.
52. The survey, which was conducted by the European Bank for Reconstruction and Development and the World Bank (see Revenga *et al.*, 2001), is consistent with the findings of an OECD survey of the Visegrad countries conducted in 1995 (see Lageman *et al.*, 1996).
53. See OECD (1994).
54. According to an OECD survey conducted in 1996, excessive social security contributions together with lack of credit and difficult administrative start-up procedures were the main obstacles to the creation of new businesses. See Lageman *et al.* (1996).
55. Revenue up to SKK 0.5 million is taxed at 2 per cent, SKK 0.5 to 1 million at 2.25 per cent, and SKK 1.0 to 1.8 million at 2.5 per cent. In addition, firms adopting the simplified system are exempt from bookkeeping and reporting obligations.
56. OECD (1999*d*).
57. Loans are classified as *standard* and *special mention*, which are less than 90 days overdue. Non-performing loans included *substandard* (more than 90 days overdue but not classified as doubtful or loss), *doubtful and litigious* (overdue by 91 to 359 days) and *loss* (overdue by more than 360 days).
58. Všeobecná úverová banka (VUB), Slovenská sporiteľňa (SLSP) and Investičná a rozvojová banka (IRB).
59. According to some experts, "Investment activity in some banks was used as an instrument to finance political parties" (Barto and Kmet, 2000).
60. In January 2001, 87 per cent of SLSP, the largest bank, was sold to a foreign investor. One month later, the European Bank for Reconstruction and Development and the International Finance Corporation each acquired 12.5 per cent shares in VUB, the

second-largest bank. In June, a 69 per cent stake was sold to a foreign investor. Finally, IRB was sold to a foreign investor in April 2002.

61. Excluding two branches of foreign banks.
62. In particular, the maximum period of conservatorship has been reduced from two years to one, and conservators are now obliged to preserve the assets and property of the institutions in order to limit claims on the DIF. In addition, the central bank has been empowered to impose precise guidelines on conservatorships.
63. The only exceptions that require the approval of the MOF are the establishment of a home savings bank and an application of an existing bank to enter the mortgage banking business.
64. These figures exclude the Konsolidačná banka, a state financial institution for workouts, which was dissolved in January 2002. Including this bank, the share of classified loans was 22 per cent. The statutory successor of Konsolidačná banka is Slovenská Konsolidačná, a non-bank agency for problem loans.
65. The experience of the Investicni a Postovni Banka (IPB) in the Czech Republic illustrates that foreign ownership is not a cure-all for problems in bank management (see OECD, 2001*c*). This bank, formerly one of the four large state banks, was sold to foreign investors in 1998. In mid-2000, though, it had to be placed under forced administration by the central bank. The full cost of the IPB losses may amount to as much as 5 to 10 per cent of GDP (Wagner and Iakova, 2001).
66. Implementation of this plan and the increase in the number of examiners is one of the conditions of a Staff Monitored Programme agreed to with the IMF. Another condition was to conduct on-site examinations of at least four banks identified as high risk and implement corrective action plans. The Slovak authorities also agreed to settle the issue of the institutional location of bank supervision. In the end, it was decided to leave it with the central bank until 2005 rather than move it to the Financial Market Authority (FMA), which was established in the Ministry of Finance in the autumn of 2000. Hence, until 2005, a two-pillar supervisory framework will continue, with the NBS responsible for the banking sector and the FMA responsible for the insurance industry and the capital market. A Co-ordinating Commission consisting of members of the NBS, MOF and FMA is to be created to establish, by the end of 2004, the legislative and technical framework for the integration of all supervisory functions in one institution.
67. In July 2001, the Konsolidačná banka transferred SKK 22 billion of such loans to the Slovak Consolidation Agency. This move was aimed at increasing management efficiency since both institutions had common borrowers. Moreover, given the scarcity of workout skills in Slovakia, combining this effort in one institution is likely to be more efficient. As noted above, the Konsolidačná banka was dissolved in January 2002, as it did not meet the criteria to operate as a bank under the new bank act.
68. This company will lose its monopoly in car insurance and in on-the-job accident insurance in 2002.
69. According to one estimate, these assets reached SKK 20 billion (2 per cent of GDP), double the amount invested in the mutual funds of licensed asset management companies (Gajdzica, 2002).
70. The first wave was based on voucher privatisation. Each citizen had the right to purchase a voucher book for 1 000 koruny, with 1 000 coupons that could be invested in the enterprises selected for privatisation. Concerned that this was resulting in an excessively dispersed ownership structure, the second wave of privatisation was based

largely on direct sales. For details, see Niznansky and Reptova (1999) and Marcincin (2000).

71. The law on large privatisations also forbid the privatisation of six companies producing armaments and general machinery, two pharmaceutical firms and 12 enterprises involved in agriculture, forestry and water management.
72. The previous government even initiated a national referendum in 1998 to support a proposed constitutional ban on the sale of these strategic industries. However, the referendum was ruled void as voter turnout was less than one-half.
73. Such problems are described in Pazitny (1999).
74. As part of the restructuring of this sector, the monopoly of Slovak Telecom in the local and international markets will end in 2003. Moreover, Deutsche Telekom is required to invest 1 billion euros in Slovak Telecom's core business and complete full digitalisation of the fixed network by the end of 2004.
75. Natural gas is accessible to 85 per cent of the population, the highest proportion in the OECD area after the Netherlands.
76. At the end of 2001, the government sold a 49 per cent stake in Transpetrol, the oil pipeline, to a Russian company. The new investor promised to boost the utilisation of the pipeline from 40 per cent of capacity at present to 100 per cent by 2006. The government maintains a majority stake as a guarantee for the protection of the strategic interests of Slovakia. The presence of a foreign investor, though, will limit the practice of using transit fees from foreign countries to subsidise the below cost sale of gas to households.
77. Meanwhile, gas prices have increased by 105 per cent for residential use and by 53 per cent for commercial and industrial users.
78. Consumers will be eligible to purchase power from alternative suppliers if their annual consumption is above 100 GWh in January 2002, 40 GWh in January 2003, 20 GWh in January 2004 and 9 GWh in January 2005.
79. This survey, by the Institute for Public Affairs (2001), is based on replies by 64 managers and 13 analysts.
80. Work is underway to supplement the new law with something parallel to the block exemptions adopted under European competition law. These changes will have important effects in terms of fine-tuning and adding greater precision to the general competition law.
81. In comparison, the threshold is set at 4 million euros in Hungary and 50 million euros in Poland, while the Czech Republic does not set a threshold.
82. There was one procedure for health and safety, two for taxes, two for labour and three for screening.
83. Of this amount, SKK 200 million was from the state budget, SKK 200 million from the EU under the PHARE programme and SKK 100 million from commercial banks.

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Annexe I

Chronology of recent events

2001

January

The government issues SKK 83.7 billion in special Treasury bonds to replace state guaranties in the portfolios of three restructured banks, Všeobecná úverová banka (VUB), Investičná a rozvojová banka (IRB) and Slovenská sporitelňa (SLSP).

An 87.2 per cent stake in Slovenská sporitelňa (SLSP), the country's largest commercial bank, is sold to Erste Bank of Austria for SKK 17.7 billion.

The import surcharge introduced in May 1999 is phased out.

February

Parliament passes an amendment to the Slovak constitution allowing the decentralisation of public services and the establishment of regional self-governments.

Regulated prices are increased for a number of items, including electricity (25 per cent for households and 10 per cent for business) and gas (25 per cent for households, 15 per cent for retailers and 30 per cent for large customers). In addition, prices for rail transport are raised by 15 per cent, bus transport by 20 per cent, postal services by 9.9 per cent, water and sewage by 20 per cent, housing rents by 45 per cent and heating by 20 per cent.

March

The government approves the establishment, effective in January 2003, of a regulatory body for energy.

The National Bank of Slovakia cuts official interest rates by 25 basis points. This lowers rates to 6 per cent for overnight sterilisation operations, 9 per cent for overnight refinancing operations and 7.75 per cent for the two-week REPO rate.

The government introduces new bills on the civil and public services, as well as the draft of a new labour code.

The government issues a statement of economic policies in the context of a Staff Monitored Programme with the International Monetary Fund.

April

Parliament amends the Act on the National Bank of Slovakia and the Banks Act in order to harmonise the legal framework with the EC *acquis communautaire*.

May

Four chapters of the *acquis communautaire* required for EU accession – telecommunications, company law, free provision of services and social policy and employment – are provisionally closed.

June

Two chapters covering the free movement of people and capital are provisionally closed as part of the EU accession process. A two-year transition period, renewable for three years and then two years, is agreed to in the chapter governing the movement of people. A seven-year transition period is established for the sale of farms and forestland to EU citizens.

The government adopts an IMF Staff-Monitored Programme, which is a pre-condition for receiving a World Bank Financial Sector Adjustment Loan (EFSAL).

The IMF staff approves the statement of economic policies made by the Slovak government in March 2001.

July

Parliament approves the creation of eight regional self-governments.

September

The World Bank extends a Financial Sector Adjustment Loan (EFSAL) of EUR 200 million with maturity of 14 years and a five-year grace period. The facility is designed to help the government finance its bank-restructuring programme.

The National Bank of Slovakia declares Devin Bank, a medium-sized financial institution, insolvent and starts liquidation procedures.

The customs tariff on imports for personal use and priced between EUR 175 and EUR 250 is lowered from 5 to 4 per cent.

October

Standard and Poor's upgrades Slovakia's sovereign debt to investment grade. The rating on long-term foreign currency denominated debt is boosted to BBB- from BB+, while that for long-term domestic currency debt is raised to A– from BBB+.

November

A 94.5 per cent stake in Všeobecná úverová banka (VUB), Slovakia's second largest bank, is sold to Italy's IntesaBCI. The preliminary purchase price is set at SKK 23.7 billion.

Moody's upgrades the rating for sovereign foreign currency bonds and notes from Ba1 to Baa3 and for foreign currency bank deposits from Ba2 to Ba1.

The National Property Fund completes the redemption of privatisation bonds issued in 1996 and held by domestic residents.

December

With the agreement on the chapter on financial control, 22 of the 31 chapters required for EU accession are provisionally closed.

The 2002 state budget is approved with a deficit ceiling of SKK 38 billion.

Elections are held for chairmen and deputies of the eight new regional self-governments.

2002

January

The corporate income tax rate is cut from 29 to 25 per cent, while personal income tax rates are reduced from 42 to 38 per cent at the high end and from 12 to 10 per cent at the low end. The number of brackets is lowered from seven to five.

The excise tax on tobacco is raised from 29.4 to 32 per cent while the price of gas for business increases by 19.3 per cent.

February

The World Bank grants a credit line of USD 23.5 million, to be released over five years, for reform of the administration of social benefits.

The government approves the Act on Social Security, which permits the opening of individual accounts, a first step toward reform of the pension system.

March

The sale of natural gas monopoly Slovensky Plynarensky Priemysel (SPP) to a consortium of Ruhrgas of Germany and Gaz de France for a price of USD 2.7 billion is approved.

April

The new labour code and Civil Service and Public Service laws take effect.

The National Bank of Slovakia increases interest rates by 50 basis points, thus boosting the two-week REPO rate to 8.25 per cent, the overnight sterilisation rate to 6.5 per cent and the overnight refinancing rate to 9.5 per cent.

The excise tax on cigarettes is hiked from 32 to 36 per cent.

The chapter on transportation – the 24th in the EU accession process is provisionally closed. A two-year transition period will be granted to Slovak companies when they start operating in the unified market.

The Anti-Monopoly Office approves the sale of a 66.8 per cent stake in Slovenska Poistovna (SP), the largest Slovak insurer, to Allianz AG of Germany at a price of EUR 114.9 million.

Hungarian savings bank OTP Bank becomes the owner of 92.6 per cent of Investičná a rozvojová banka (IRB).

May

The sale of 49 per cent shares in each of the three electricity distributors is approved. Zapadoslovenska Energetika (ZSE) is sold to EON of Germany for EUR 330 million, Stredoslovenska Energetika (SSE) to électicité de France for EUR 158 million and Vychodoslovenska Energetika (VSE) to RWE Plus of Germany for EUR 130 million.

Parliament passes a child allowance law, effective in July 2002, which does not require testing of family income.

The government approves a timetable for adjusting tobacco excise taxes to the EU level of 57 per cent over a five-year period. By December 2008 a fixed-rate tax of EUR 64 per 1 000 cigarettes will be introduced.

Parliament passes a law increasing parental allowances from SKK 2 740 to SKK 3 790, effective in November 2002.

The government approves a 5 per cent increase in pension benefits, effective in July 2002.

The government agrees to sell 49 per cent stakes in four bus companies (SADs) to private investors for a total of SKK 488 million.