Economic Reforms in Slovakia

(introduction)

A really fascinating outcome of the Slovak reforms is that major economic improvements could be achieved in a very short time. The aim of the special issue of this journal on the Slovak reforms is to provide all those, who are concerned with the public sector, an evaluation of selected reforms in Slovakia and relevant policy recommendations.

The issue thus contains an evaluation of the tax reform against the optimal taxation and optimal tax systems theory by Radovan Chalupka, evaluation and recommendations for improvement of the newly adopted pension scheme by Igor Melicherčík and Cyril Ungvarský, analysis of the first results of stabilization changes and proposed systemic changes in health care by Rudolf Zajac, Peter Pažitný and Anton Marcinčin, and an assessment of the welfare – damaging consequences of adopted Common Agricultural Policy by Ján Pokrivčák and Pavel Ciaian. Then we study the reaction of the enterprise sector: company growth by Ivana Studená and a positive effect of the EU accession on the foreign direct investments in Slovakia by Beata S. Javorcik and Bartlomiej Kaminski.

Political Background

The great beginning happened in the 1998 general elections, when a left-right coalition was formed. Despite many problems between the coalition parties, and a delay in the preparation and implementation of the new economic program, the government was able to restructure and privatize the banking sector, and initiate several reforms (including of creditors' rights).

In the 2002 general elections, to the surprise of all, the positions of the centre and the right were strengthened. The government learned from the previous four years one main message: do reforms immediately, i.e. in the first half of the election cycle, and forget about the second half. Fast reform proposals were connected to a needed fiscal contraction: tax reform and public finance management led by the Finance Ministry; pension, labor market and social assistance reforms led by the Labor Ministry; and health care reform led by the Health Ministry. The decentralization (which implied a cross-ministerial agenda) was coordinated by a state plenipotentiary. Several other reforms were initiated and led by other ministries (for example restructuring of the railways, issuing of licenses, and new bankruptcy legislation).

Fast reforms may not always bring the best results, however, the Slovak experience seems to indicate that they are preferred to no reforms. Prepared and implemented with very limited human and technical capacities, reforms now require fine-tuning and their sustainability depends also on whether the ministers succeed to enhance the quality of public administration.

The European integration played first a positive, then slightly uncertain role. While EU membership was a target for all political parties and EU served as a conjuration word whenever there was a need to pass some legislation quickly, after May 1st the atmosphere has slightly changed. The trade-off between – on one hand –, what some may see as drastic reforms and percentage points of GDP saved on fiscal expenditure, and – on the other –, early adoption of the Euro, is not so clear to all parties anymore. Especially, as the second half of the government term approaches.

Economic Background

The evaluations of the Slovak economic development are generally very positive, while the exception is high inflation and still a high fiscal deficit. However, the headline inflation is too high for delayed deregulation of prices, and next year should get closer to the core inflation (currently at 2.7 % y/y).[1] The fiscal deficit, at below 4 % of GDP in ESA95, shall decline to 3 % in 2007, including extra spending resulting from the pension reform.[2] The IMF[3] sees favorable prospects for over-performance – certainly, conditional on the implementation of all the expenditure policies.

The negative feature of the Slovak economy and its delayed restructuring through the nineties is a persistently high unemployment rate. Although changes in unemployment insurance policies helped to reduce unemployment by those working in the shadow economy (the number of visits of the labor offices increased, so that especially those working abroad de-registered), changes in social security improved incentives to find and remain in work, and the number of new jobs grew, the unemployment rate remains high between 13.9 %[4] and 19.3 %.[5] The composition of unemployment is more in favor of the long term unemployed, which poses questions of its structural nature and of the possibility to generate any suitable jobs to cut the unemployment rate significantly in the following years.

Risks to the rosy pictures of the Slovak future include, except of obvious political risks, also further delays in the adoption (or total refusal) of health care reform, the easing of adopted social welfare policies and low collection of tax revenues.

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[1] According to the May 2004 staff visit to Slovakia, further cuts of key interest rates by the central bank may lead to a higher inflation, as domestic demand recovers and investment grows. (IMF, 2004).

[2] See Ministry of Finance of SR: „Convergence Program“ (available at www.finance.gov.sk), submitted to the EC in May 2004. The Committee for Macroeconomic Forecasts, which consists of six independent members, the central bank and the Ministry of Finance, called official forecasts conservative.

[3] IMF: „Slovak Republic – Staff Visit Concluding Statement“. May 27, 2004. Available at www.imf.org.

[4] The highest rate was registered in the Kosice region, 20.5 %, while the lowest was in the Bratislava region, 3.7 %. Figures for June 2003 and June 2002 are: 21.9 % and 24.4 % for the weakes, the Kosice region, 3.7 % and 5.6 % for the strongest, Bratislava, and 14.6 % and 17.6 % for the Slovak average (National Labor Office, 2004. Available at www.upsvar.sk).

[5] This is more than 1Q2003 18.4 %, and almost equal to 1Q2002 19.4 % unemployment rate. (Statistical Office of SR: „Labor Force Survey 1Q2003“. Available at www.statistics.sk)

Conclusions

Any research on the Slovak economy has to face at least two major problems: availability and creditworthiness of domestic statistics and a lack of other studies (including comparison) on Slovakia. A combination of reasons are behind these two: the country is small and till 1998 pursued non-transparent policies; *the restructuring of domestic academia remains in its early stages*; *and attention of domestic policy makers often has been far from the analytical pieces. (Is the latter one of the conditions behind the successful reforms?)*

The help shall, perhaps surprisingly come from politics. While current reformers set decent standards for many documents submitted to parliament, the opposition correctly asks for better quality impact assessment analyses. It seems the demand is being created and, given good progress in new centers such as the Financial Policy Institute[6]*, one can also expect gradual progress in statistics and analyses.*

In this special issue of the journal „Finance a úvěr – Czech Journal of Economics and Finance" we cover tax reform, pension reform, health care reform and agriculture, and the reaction of the enterprise sector (including the FDI).

Radovan Chalupka *tests the magic nineteen percent tax formula (PIT, CIT and VAT) on the theory of optimal taxation and optimal tax systems. He concludes that the adopted flat rate of physical and corporate income taxes is consistent with optimal taxation, and the establishment of a single VAT rate is also consistent with optimal taxation. The new tax system is also Pareto optimal.*

Igor Melicherčík *and* ***Cyril Ungvarský*** *assess the new three pillar pension scheme. Changed indexation, increased retirement age and the introduction of second pillar help to decrease the burden on the first pillar. However, the first pillar will require further restructuring to avoid generating a new deficit. Also, proceeds from the second pillar may not be able to outperform those from the first pillar.*

Rudolf Zajac, Peter Pažitný *and* ***Anton Marcinčin*** *briefly describe initial conditions for the health care reform, stabilizing and systemic measures and the first results of the reform. While co-payments by patients helped to decrease moral hazard and resulted in large savings, the major commercialization of the sector is yet to come and depends on the approval of a package of new legislation.*

Ján Pokrivčák *and* ***Pavel Ciaian*** *model formation of the agricultural policies (where economic efficiency remains a secondary goal), analyze the development of the Slovak agricultural sector in the pre-accession period and draw consequences of the adoption of Common Agricultural Policy (CAP). Despite some gains in efficiency, CAP will result in higher prices of food (party because of higher safety and improved quality), higher income of farmers, while lower welfare of consumers.*

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[6] A research institute of the Finance Ministry has been completely restructured since April 2003. The quality of its recent outputs and communication is acknowledged by the whole research community.

Ivana Studená *analyzes the survival process of firms, adjusting for sample selection bias. While the number of smaller firms have a tendency to grow, the number of larger firms is reduced especially by privatization. She did not find any general form of systemic relationship between the firm size and growth, although privately and foreign owned small firms appear to grow faster than the larger ones.*

Beata S. Javorcik *and* ***Bartlomiej Kaminski*** *focus on the effects of the post-1998 reforms on Slovakia's participation in the global economy through integration with the EU. The credible political commitment to adopt the acquis communautaire has led to a dramatic increase in inflows of foreign direct investment in 2000–02. The FDI have had beneficial impact on the economy (including growth in exports) and, possibly, boosted the productivity of domestic firms through knowledge spillovers and helped the continuation of structural reforms.*

We believe the papers presented in this volume will help to extend knowledge on several much needed reforms.

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