**Methodology for identifying priority areas**

**in the National Reform Programme of Slovakia**

**(Government´s economy policies)**

The National Reform Programme of the Slovak Republic (NRP) contains measures which the Slovak Government intends to implement under the Europe 2020 strategy.

The objective of the Europe 2020 strategy is to ensure long-term sustainable economic growth and creation of new jobs, including overcoming the economic crisis. Even though structural policies are within the competence of individual Member States, a certain degree of their synchronisation brings benefits to individual Member States. The economies of European Union (EU) Member States are currently extremely interconnected; this is particularly true of the Eurozone members.

**Introduction**

The European Council has requested the Member States to include in its NRP the most severe macro-structural bottlenecks to their growth and to propose policies on their removal with the aim of ensuring appropriate conditions for sustainable and balanced growth and employment in the future.

The NRP priority areas have been identified by way of comparing decomposition of Slovak gross domestic product (GDP) with that of the EU-15 average. However, the priorities also take into account additional factors which do not necessarily contribute to a higher GDP growth, but improve the quality of life. The Slovak Government has also taken into account recommendations made by the European Commission, which are consistent with a number of Organisation of Economic Cooperation and Development (OECD) and International Monetary Fund. recommendations.

The measures also respond to the recommendations contained in the Annual Growth Survey in which the European Commission assessed, under the European semester, major economic challenges faced by the EU and defined priority measures to address them. Based on the aforementioned analysis and recommendations, the Slovak Government has defined the following structural policy priorities:

* **healthy and sustainable public finance;**
* **zero tolerance for corruption and ensuring access to justice;**
* **enough job opportunities that reduce social risks;**
* **encouraging business environment;**
* **educated people and innovative society;**
* **access to quality healthcare.**

These priorities are identical with the priorities set under the Government Manifesto, the objective of which is to improve the quality of life in Slovakia in a sustainable and measurable manner. The Slovak Government also considers it important to take account of the environmental sustainability, with the focus on reducing greenhouse gas emissions and energy intensity of the economy. It is increasingly important to ensure the good quality of the environment; therefore, the economic policy should also pay more attention to environmental costs, especially in the case of large-scale projects.

The political will to implement structural reforms is vital to their success. However, high-quality solutions also require expert capacities to prepare these reforms. The Government will promote the strengthening of an institutional framework with adequate expert and analytical background to produce high-quality measure proposals supported by due analysis.

**A detailed analysis**

Economic development measured by Gross Domestic Product (GDP) growth and improvements in the quality of life are mutually interconnected objectives, because economic growth is also essential to facilitating the non-material sustainable development of countries. To that end, National Reform Programme (NRP) priorities were largely indentified by comparing decomposition of Slovak GDP with that of the EU-15 average. On the other hand, there are many other aspects of life which should be monitored more closely and, where necessary, corrected by public policies; hence, NRP priorities also take into account additional factors which do not necessarily contribute to a higher GDP growth, but improve the quality of life.

GDP was broken down in two steps.

* Firstly, GDP per capita was divided into three basic components:

 (1) labour productivity;

 (2) labour market

 (3) demography.

* Secondly, two of the basic components - labour productivity and labour market - were further subdivided. Consequently, GDP per capita was broken down into ten components. Comparing the level of these components against advanced EU Member States enables us to identify those production factors in which the Slovak economy shows the largest lag and which, therefore, represent the greatest potential for future GDP growth in Slovakia.

Slovakia‟s GDP per capita is considerably lagging behind the EU-15 average. The difference is, to a large degree, caused by lower labour productivity in Slovakia (64% of the EU-15 level). Similarly to other new Member States, the difference in labour productivity reflects lower capital input per employee and a lower level of total factor productivity. The labour market represents the second factor, with a negative impact on GDP per capita, though to a lesser degree than labour productivity (91% of the EU-15 level). The demography component has a positive impact on total GDP per capita (107% of the EU-15 level) due to an above-average share of population at the productive age.

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| **Decomposition of GDP per capita (Slovakia against the EU-15, 2007)**  |
| **GDP per capita**62 % EU-15**Labour market**91 % EU-15**Demography**107 % EU-15**Labour productivity**64 % EU-15Unemployment rate90 % EU-15Capital formation84 % EU-15Total factor producitivy80 % EU-15Employment of the young (15-24)96 % EU-15Employee education101 % EU-15Employment of men (25-54)100 % EU-15Hours worked107 % EU-15Employment of the older (55-64)98 % EU-15Employment of women (25-24)101 % EU-15 |

This GDP decomposition has helped us identify five components which show the largest potential for GDP per capita growth in Slovakia:

* under labour productivity, the components crucial to the convergence of the Slovak economy include *total factor productivity* and *capital formation.* Despite considerable progress, they are still significantly lagging behind the EU-15 level.
* under the labour market, two components require special attention. The first one, *employment rate of young people,* fell noticeably between 2001 and 2007, having moved even further away from the EU-15 average. This development is, however, more than compensated for by their growing participation in tertiary education, which will have a positive effect on labour productivity in the future. The second important component is *the employment rate of older people,* which has increased due to an increase in the retirement age, but still remains significantly below the EU-15 average. The third component is *the unemployment rate,* which still remains relatively high, even though it has dropped considerably in recent years.
* the demography component is important from a long-term aspect, i.e., in the moment when the share of population in the productive age starts decreasing, thus negatively influencing overall economic growth. Therefore, it is absolutely necessary to focus on problems related to, for example, the fiscal sustainability of the pension system. Currently, the share of the productive-age population in Slovakia is above the EU-15 average, which means that the demography component does not adversely contribute to a relatively lower GDP per capita in Slovakia.

 **Aproach to improving the quality of life in Slovakia**

 QUALITY OF LIFE

The GDP decomposition has expressly indicated the need to increase overall productivity in the economy, increase employment of older people, and cut the unemployment rate. In a small, under-capitalised economy, it is extremely difficult to increase total factor productivity without the involvement of foreign capital and know-how. From a medium-term perspective, Slovakia needs to create conditions for enhanced innovation development. Innovation potential is driven by quality higher education on the one hand, and by a suitable business environment on theother. The GDP decomposition thus indirectly, through low labour productivity, draws attention in particular to such areas as education, business conditions, innovation, and information technologies.

Environmental sustainability

Fiscal sustainability

Health

Transparency &

enforceability

of right

Business environment

* Emloyment
* Social inclusion
* Education
* R&D
* Innovation

Social sustainability

The priorities were identified using an approach introduced in a study prepared by the National Bank of Slovakia2. The study also takes into account additional areas which have only an indirect effect on GDP growth but contribute to a better quality of life. Such areas are identified on the basis of research in welfare economics and the subjective perception of welfare. Welfare economics has the largest number of practical applications in the area of education and health. The priority of ensuring high-quality education thus stems not only from material indicators, but also from the need to ensure equal opportunities. As far as the subjective perception of welfare is concerned, attention should primarily be paid to the need to enhance confidence in the economy and ensure the enforceability of judicial protection of rights and reduction of corruption; these goals may better be accomplished through effective and transparent public administration. The subjective perception of welfare is closely related to health, employment and social relations. While the role of economic policy is clearly evident in the first two areas, it has only a limited application in the case of family relations.

Recommendations made by the European Commission also focus on these areas3. According to the Commission, Slovakia should improve its public finances and reallocate public spending towards education, research and development, and infrastructure. It should also increase the effectiveness of education and R&D systems, as well as improve the business environment and reduce unemployment. All Commission recommendations are included in a separate box.

Structural policies often miss out on the limits of public policy. Therefore, it is necessary to underscore that efforts towards a better quality of life must also take into account long-term fiscal, environmental and social sustainability. Sound public finances are the cornerstone of prosperity in any society. On the one hand, they ensure macroeconomic stability, thus contributing to more robust economic growth; on the other hand, they promote inter-generational justice in that they do not overburden subsequent generations. The need to have long-term sustainable public finances is now underscored by population ageing.

Environmental sustainability is most frequently associated with global warming and reducing the energy intensity of the economy. It is increasingly important to ensure the good quality of the environment; therefore, economic policy should pay more attention to environmental costs, especially in the case of major projects.

Social sustainability is generally linked with income gaps, where Slovakia, along with the Czech Republic and Slovenia, ranks among the most egalitarian Member States. It is therefore necessary to instead concentrate on the effectiveness and efficiency of redistribution policies, mainly with respect to addressing the problems of marginalised social groups. The most effective instrument to ensure the growth of income of the population is to increase employment; therefore, social inclusion and poverty reduction are discussed in a sub-chapter on employment and social inclusion.

In addition to the three essential prerequisites briefly discussed above, the following areas were also identified by the Slovak Government as important for long-term strong economic growth and improvement in the quality of life in Slovakia:

* education, R&D, and innovation;
* employment and social inclusion;
* business environment;
* transparent conditions and enforceability of rights;
* health.