Slovakia's economic development: Past successes, future challenges

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Ladies and gentlemen, dear guests and colleagues,

Following these warm words of introduction by Dušan [Head of EC Representation, Bratislava] I would also like to welcome you to today's economic workshop on "Slovakia's growth model". I look forward to the stimulating discussions that no doubt lie ahead, and I look forward to meeting many of you in person throughout the day.

Let me start with some remarks on today's topic. In many ways Slovakia's growth model can only be described as highly successful. Since joining the EU in 2004, Slovakia's real GDP has grown faster than in <u>any</u> other EU member state, at an average rate of 3.8% per year. Throughout its convergence process, Slovakia has avoided major macroeconomic imbalances. Unlike some other regional neighbours, Slovakia adopted the euro in 2009, at a time when trouble was starting to brew in some parts of the single currency area. The country then recovered quickly from a short, sharp recession in 2009 in the wake of the global financial crisis. In the post-crisis period it has been one of the fastest-growing euro area member states, with GDP rising by almost 3% per year on average. Its excessive government deficit was corrected in 2013, and today the unemployment rate is at its lowest in seven years [at 10.3% in Jan 2016].

With a track record this positive, why would we worry about Slovakia's growth model?

It is certainly not worry that motivated us to bring you – leading policymakers, business representatives, academics and analysts – together today. Instead, we are interested in exploring with you the following two questions:

First, **is Slovakia's growth model sustainable, and under what conditions?**

Second, **is this growth model delivering its full benefits, and is it doing so in a balanced way?**

Even if I had full answers to these questions, I would not give them to you now. Instead, I would like to turn my attention to the current state of Slovakia's economy, both in its strengths and weaknesses.

Let's start with a look at the **current economic outlook**. Having grown in 2015 by 3.5%, our latest projections from the Winter 2016 Economic Forecast point to continued robust economic growth in this year and the next. To be sure, strong public investment growth probably won't play as big a role as it did in 2015, when it was boosted by the drawdown of EU funds at the end of the outgoing programming period. But we expect household spending and private investment to partly make up for slower public investment growth. More importantly still, employment growth is expected to grow by a further 1½% this year, which should help bring the unemployment rate below 10% in the coming months.

This reassuring macroeconomic outlook can be best understood in the context of Slovakia's many economic strong points. Foreign direct investment, particularly in the automotive industry, has undoubtedly been a major driver of Slovakia's success. But strong FDI inflows are also a testimony to the attractiveness of the country as a cost-competitive, well-situated and flexible production location. And with Land Rover Jaguar looking set to open a new production site in Slovakia this year, it would become the fourth large car manufacturer in the country. Who would have thought that Volkswagen's acquisition in 1991 of a production facility for Skoda cars in Bratislava would help turn the country – and the Bratislava region in particular – over the past two-and-a-half decades into one of Europe's largest car manufacturing hubs?

On the other hand, we should bear in mind the successes of the past may not necessarily be a good guide to the future. It is quite possible that new investment and growth in the automotive sector will slow, or even stall. Maybe other industries make up for, maybe they won't. The practically relevant question in this is respect is what policymakers and companies can do to minimise the risk of a slowdown, and maximise the chances of both current and new economic activities flourishing.

Competitiveness and innovation will inevitably hold the key to economic success in our increasingly knowledge-based economies. And the response to future growth challenges will, to some extent, come from within the private sector, from companies and employees themselves. But as far as government policy is concerned, Slovakia faces a challenge in need of addressing: **to improve its business environment and public administration.** Whether you ask citizens, domestic or foreign businesses, or organisations such as the World Bank or the World Economic Forum, each survey on this topic points to a number of challenges complicating daily life, but also the setting up and running of a business. Corruption is perceived to be a significant problem in many areas of life.

Another problem confronting Slovakia is the stark regional divide. There can be no doubt that Bratislava has been both the source and a major beneficiary of Slovakia's economic success. In fact, the region of Bratislava is the sixth-richest region in the entire EU when adjusting for purchasing power differences between countries – ahead of Paris, Stockholm and Vienna. Unemployment is running at 6%, verging on full employment. Bratislava's GDP per capita [in PPS] is nearly twice as high as the EU average, at 186%, the Východné Slovensko region is only one third as rich, at only 53% of the EU average. Other, more central regions of Slovakia are not performing much better, neither in GDP nor in unemployment terms. Even life expectancy in Bratislava is 2 years higher than in the rest of the country.

The Commission has studied these and a number of other topics in its Country Report 2016 that was published in February; for a deeper look into these and other economic and social issues facing Slovakia – such as long-term unemployment and the underperforming education sector - I invite you to pick up a copy of the Report on display.

You may wonder how these two challenges – the public administration challenge and the regional divide – relate to today's topic on future growth.

In my view, they provide us with a starting point to the two questions I outlined earlier on the benefits and sustainability of the current growth model:

The current business environment may stand in the way of entrepreneurship and investment – also from abroad. And the regional divide suggests that the benefits of Slovakia's growth have been are shared in an unequal way across the country. Finally, given shortcomings in the labour market and education system, there is scope for putting Slovakia's human resources to better use. **So I believe these observations are a good starting point for looking into the future of Slovakia's growth model.**

Let us think five, maybe ten years ahead. In the European Union and beyond, globalisation will continue, tying economies and citizens closer together. Physical distances will shrink further due to transport and information technology. Effective competition will increase. This is also true at the regional level, as Slovakia's neighbours, the Czech Republic, Hungary, Poland all show a favourable cost-competitiveness, particularly when compared to the western and northern Member States.

Converging economies such as Slovakia and its neighbours will face different growth challenges compared to more advanced economies, where capital stock and productivity levels are high, but growth may be low. By contrast, Slovakia still has some room for catch-up growth before its growth curve risks to flatten. **The question is, how can Slovakia's resources be put to best use in order to deliver this convergence?**This is what we should now turn to discussing. We have arranged today's workshop around three central themes. Let me say a few words on each of them.

Our first session is titled "*Diversifying the Slovak economy.*" We would like to explore how Slovakia's large manufacturing base can grow further, but also whether it can - and perhaps should - diversify away from the automotive sector. We should also ask ourselves if the FDI-fuelled success story be repeated in other industries? Finally, should diversification be supported by government policy, and how?

Our second session will be directly related to the first session, though from a different viewpoint: ***How can Slovakia move up the value chain?*** Can it move away from being an assembly location to one of high-skill and high-tech production? Perhaps the answer comes from within the automotive sector itself, as companies may expand their scope of activities via vertical integration. What are the structural prerequisites in terms of the business environment, innovation and human capital? And what do previous success stories teach us?

Our final session is titled "Bridging the regional divide". In it, we plan to discuss strategies to support convergence of the East with the West, and how to seize opportunities in weaker regions. We will be keen to hear about real-life examples of successful regional development, both from within Slovakia and its neighbours. But we will also confront the question of how the country can best adapt in the short-term to regional disparities.

I'm sure you'll agree that this is an ambitious-sounding agenda. And although we can't expect definitive answers by the end of today, debating these questions in such a distinguished forum will mark the first step towards a shared vision and strategy.

So I think the time is right to now start talking about Slovakia's future growth model.

Thank you, and much success to all of us.
