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Recommendation for a

COUNCIL RECOMMENDATION

on the 2018 National Reform Programme of Slovakia

and delivering a Council opinion on the 2018 Stability Programme of Slovakia

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THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission²,

Having regard to the resolutions of the European Parliament³,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Slovakia as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 22 March 2018. On 14 May 2018, the Council adopted the recommendation on the economic policy of the euro area ('recommendation for the euro area').

¹ OJ L 209, 2.8.1997, p. 1.

² COM(2018) 424 final.

³ P8_TA(2018)0077 and P8_TA(2018)0078.

- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovakia should ensure the full and timely implementation of the recommendation on the economic policy for the euro area, as reflected in the recommendations below, in particular (1).
- (3) The 2018 country report for Slovakia⁴ was published on 7 March 2018. It assessed Slovakia's progress in addressing the country-specific recommendations adopted by the Council on 11 July 2017, the follow-up given to the recommendations adopted in previous years and Slovakia's progress towards its national Europe 2020 targets.
- (4) On 25 April 2018, Slovakia submitted its 2018 National Reform Programme and its 2018 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council⁵, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance⁶.
- (6) Slovakia is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Stability Programme, the government plans to improve the headline deficit to 0.8 % of GDP in 2018, and gradually further to 0.0 % of GDP in 2021. The medium-term budgetary objective — a structural deficit of 0.5 % of GDP — is expected to be reached in 2020. According to the 2018 Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 49.3 % in 2018 to 43.3 % by 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been fully specified. The budget includes a non-specified category of expenditure called budgetary reserves which represents a non-negligible share (0.7 % of GDP) and can be used for ad hoc operations, thus reducing predictability in budget implementation.
- (7) On 11 July 2017, the Council recommended Slovakia to ensure that the nominal growth rate of net primary government expenditure⁷ does not exceed 2.9 % in 2018, corresponding to an annual structural adjustment of 0.5 % of GDP. At the same time, it was stated that the assessment of the 2018 Draft Budgetary Plan and subsequent

⁴ SWD(2018) 223 final.

⁵ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).
COM(2014) 494 final.

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⁷ Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission's assessment of the strength of the recovery in Slovakia while giving due consideration to its sustainability challenges no additional elements in that regard need to be taken into account. Based on the Commission spring 2018 forecast, there is a risk of a significant deviation from that recommendation in 2018.

- (8) In 2019, in view of Slovakia's projected output gap of 1.2 %, the nominal growth rate of net primary government expenditure should not exceed 4.1 %, in line with the structural adjustment of 0.5 % of GDP stemming from the matrix of requirements under the Stability and Growth Pact. Under unchanged policies, Slovakia would be at risk of significant deviation from the requirement in 2019, due to the deviation over 2018 and 2019 taken together. Overall, the Council is of the opinion that the necessary measures should be taken as of 2018 to ensure compliance with the provisions of the Stability and Growth Pact.
- (9) Slovakia's public finances still face risks in the long term. Healthcare expenditure continues to pose a risk to the long-term sustainability of public finances as increasing the cost effectiveness of healthcare in Slovakia remains a challenge. In the long term, public expenditure on healthcare is projected to increase by 1.2 pps. of GDP, above the average estimated increase of 0.9 pps. for the EU. The pension system has seen a gradual improvement in its long-term sustainability due to the automatic increase in the retirement age, which has reduced the projected age-related spending increases in the long term.
- (10) Although some steps have been taken to improve the cost effectiveness of the healthcare system, notably through the implementation of the Value for Money spending review, the potential to rationalise the use of resources remains significant. Plans for a far-reaching healthcare reform allowing the streamlining of services, better hospital resource management and more efficient care system are showing no signs of progress. The consumption of hospital services continues to be high, with high rates of hospitalisation for chronic diseases and discharge rates above the EU average, coupled with relatively low bed occupancy rates. While strengthening the primary care sector can ease the high burden put on hospitals, the system suffers from a shortage of general practitioners, which is exacerbated by their uneven geographical distribution. The age composition of general practitioners also raises concerns for their future supply. Lastly, several provisions aimed at enhancing the cost effectiveness of the health system such as the full introduction of a diagnosis-related group payment system and the effective operationalisation of the e-health system are still in their development phase. They are likely to face further delays and implementation challenges in the future.
- (11) Fiscal revenues are increasing on the back of swift economic growth and efforts are ongoing to improve tax compliance and close Slovakia's high value added tax gap. While fiscal incentives promoting research and development were increased, property taxation remains a weak revenue source. A rolling programme of spending reviews for all key areas of public spending is proving to be an effective and rigorous tool for improving cost effectiveness in government spending.
- (12) Positive developments in the labour market continue, marked by increasing employment and historically low levels of unemployment. Nevertheless, the long-term unemployment rate continues to be one of the highest in the EU, affecting particularly

disadvantaged groups such as low-skilled workers, young people and marginalised Roma. As a result of the improving labour market conditions, reports of skilled labour shortages in some sectors of the economy have started to appear. Regional disparities in the labour market are pronounced, with higher unemployment concentrated in eastern Slovakia and labour shortages concentrated in the western part of the country. Slovakia has started to implement its action plan on the integration of the long-term unemployed, supported by the European Social Fund. The plan introduces personalised services, social counselling, and a new basic profiling system. However, implementation has not yet yielded any structural changes. Gaps persist in cooperation with private partners and non-governmental organisations to alleviate caseloads in public employment services, while individualised counselling is at an early stage. In addition, the rough segmentation of the long-term unemployed does not fully serve as a tool for subsequent referral to activation measures. Training and requalification programmes have been strengthened but are still insufficient and their targeting of the long-term unemployed and disadvantaged groups remains limited. In addition, adult participation in learning is still very low and second-chance education for disadvantaged groups is underdeveloped. The eligibility criteria for unemployment benefits are strict and the duration of benefits is short. This results in low coverage of the short-term unemployed receiving unemployment benefits.

- (13) The gender employment gap and gender pay gap are well above the EU average. The low employment rate of women of childbearing age reflects the long parental leave rarely taken up by men, accompanied by low take up of flexible working arrangements and limited affordability and access to childcare facilities. Particularly for children under the age of three, the enrolment rates in childcare are extremely low.
- (14) The education system does not sufficiently contribute to the socioeconomic development of Slovakia, and is underfunded at all levels. The quality of educational outcomes, the participation of Roma in inclusive mainstream education and the effective integration of students from socioeconomically disadvantaged backgrounds in education and training are pressing challenges. Educational outcomes and the level of basic skills remain weak by international standards and are profoundly impacted by students' socioeconomic background. Early school leaving is low but increasing and regional disparities in dropout rates are pronounced. Despite plans to annually increase teacher salaries by 6% until 2020, the teaching profession is still unattractive, in part due to limited initial training and professional development opportunities. The implementation of measures to increase the participation of Roma pupils in inclusive mainstream education is extremely weak due to inadequate financial support and monitoring as well as insufficient training of teachers on intercultural issues.
- (15) Public administration is still burdened by inefficiency and bottlenecks caused by poor inter-ministerial cooperation and weak political neutrality of the civil service. Implementation of the Civil Service Act has been slowly taking off, but its impact on improving human resource management remains to be seen. On the management of EU funds, administration capacity and efficiency is still limited and staff turnover remains high, in part linked to the political cycle. This is nevertheless being addressed by strengthening the coordinating role of the Office of the Deputy Prime Minister which acts as a stabilising factor on continuity and institutional expertise in implementing organisations.
- (16) European Structural and Investment Funds are pivotal in addressing key challenges to improve competitiveness, growth and jobs in Slovakia. Slovakia suffered from a loss of EUR 26 million of funding for research and innovation in 2017 mostly due to

problems in applying selection criteria and selecting evaluators, as confirmed by the verifications carried out. If appropriate measures are not taken to accelerate implementation, there is a high risk that another part of the funding allocation will be lost. While the project selection rate has now exceeded half of the total allocation for the current programming period, implementation on the ground resulted in payments to beneficiaries amounting only to 11 % of the allocation.

- (17) The low effectivity of public administration also translates to other sectors, including energy and the environment. Recycling rates are very low and air quality remains relatively poor. Sustainable forest management is an increasing challenge. The energy sector suffers from overregulation and energy policies are not fully in line with the climate and energy objectives of the EU.
- (18) Slovakia has taken important steps towards achieving a well-functioning system of public procurement. Efforts have been made to introduce quality award criteria. Mandatory electronic tools for conducting public procurement procedures should be in place in October 2018. While not optimally efficient, comprehensive prior verifications have been carried out on all projects funded through the European Social and Investment Funds. Nevertheless, a satisfactory performance has not yet been achieved in the areas of internal controls, transparency, digitisation, professionalisation and strategic public procurement. This is reflected in Slovakia's scores related to anti-competitive practices, which remain somewhat above the EU average, despite some improvement. Moreover, there are still only limited signs of commitment to fighting corruption. More than half of businesses perceive corruption as widespread in public procurement managed by national authorities.
- (19) Corruption, complex administrative procedures, excessive and fast-changing business regulations and the poor quality of regulatory bodies heavily affect the quality of Slovakia's business environment. While Slovakia lost some ground in some international comparisons, it has identified a number of measures to improve the quality of the business environment and boost investment. Slovakia has also strengthened its framework for regulatory impact assessment, extending its use in recent years. Finally, a new strategy for better regulation has been recently adopted. High regulatory barriers remain in the business services sector with levels of restrictiveness higher than the EU average for architects, engineers, tax advisers, lawyers, patent agents, real estate agents and tourist guides. Recommendations to address the regulatory barriers were made in the Communication from the Commission of January 2017⁸. However, Slovakia has reported no progress in tackling those restrictions.
- (20) Overall, no progress has been achieved in stepping up the fight against corruption. Corruption perceptions remain high and prosecutions for such offences have fallen further. The perception of corruption has further deteriorated in the wake of the murder of an investigative journalist and his findings on a wide range of high-level corruption cases. The proportion of high-level cases prosecuted is extremely low. The lack of accountability for police and public prosecutors has not been resolved and hinder the fight against corruption and investigations of sensitive corruption cases.
- (21) Improving the effectiveness of the justice system, including the independence, remains a challenge for Slovakia, despite some improvements in efficiency. Concerns about the independence of the judiciary persist, including the appointment processes for judges at all levels of the judiciary.

⁸ COM(2016) 820 final

- (22) Although boosting innovation can trigger competitiveness and facilitate the transition to a knowledge-based economy, Slovakia's capacity to innovate remains moderate, with a business research and development intensity which is very low (0.40 % of GDP in 2016). While the country has a large medium/high-tech manufacturing sector, the dominant multinational companies have so far shown only limited interest in carrying out research and development activities and the percentage of small and medium-sized enterprises innovating in-house was much lower in Slovakia (13.9 %) than in the EU as a whole (28.8 %) in 2016.
- (23) Public investments in research and innovation increased strongly between 2009 and 2015 due to the use of the European Structural and Investment Funds. The full potential of these investments has not been realised due to inefficiencies in Slovakia's research environment. Despite the strengthened role of the Office of Deputy Prime Minister for coordination of research, development and innovation, the overall governance of policy in this area is weak. The fragmented nature of the system and the weak governance framework, with responsibilities split among several ministries and implementing agencies, which are often poorly coordinated, leads to a regular postponement of reforms. Measures to stimulate knowledge transfer, strengthen research capacities in industry and improve the cooperation between businesses and academia are advancing only slowly.
- (24) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Slovakia's economic policy and published it in the 2018 country report. It has also assessed the 2018 Stability Programme and the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Slovakia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovakia but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (25) In the light of this assessment, the Council has examined the 2018 Stability Programme and its opinion⁹ is reflected in particular in recommendation 1 below.

HEREBY RECOMMENDS that Slovakia take action in 2018 and 2019 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1 % in 2019, corresponding to an annual structural adjustment of 0.5 % of GDP. Implement measures to increase the cost effectiveness of the healthcare system and develop a more effective healthcare workforce strategy.
2. Reinforce activation and upskilling measures, including quality targeted training and individualised services for disadvantaged groups, in particular by delivering on the action plan for the long-term unemployed. Foster women's employment, especially by extending affordable, quality childcare. Improve the quality and inclusiveness of education, including by increasing the participation of Roma children in mainstream education from early childhood onwards.
3. Increase the use of quality-related and lifecycle cost criteria in public procurement operations. Tackle corruption, including by ensuring enforcement of existing legislation and by increasing accountability at the level of police and prosecution. Improve the effectiveness of the justice system, in particular by safeguarding independence in judicial appointment procedures. Reduce the fragmentation of the

⁹ Under Article 5(2) of Council Regulation (EC) No 1466/97.

public research system and stimulate business innovation, including for small and medium-sized enterprises.

Done at Brussels,

*For the Council
The President*