
# Large-Scale Transformation of Socio-Economic Institutions - Comparative Case Studies on CEECs

## Background Paper 1: Comparative Country Study - Slovakia

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## Ivana Sikulová (IER SAVBA), Karol Frank (IER SAVBA)



### Abstract

The general idea is to follow the Varieties-of-Capitalism literature on generating indicators on the economic systems actually implemented. However, this literature mostly concentrates on the enterprise (or micro) level in traditional OECD countries, categorizing countries between the extremes: liberal market economies and controlled market economies. It largely neglects the role of the government spending, the transition of former socialist countries and developing countries, and the political process behind the choice of an economic system.

We broaden the perspective by combining the Varieties-of-Capitalism with the Worlds-of-Welfare-States literature in order to provide a comprehensive view on government activities in transition. With the perspective of our contribution to WWWforEurope, we concentrate especially on social welfare, innovation systems, macro stability, and, of course, how these aspects work together (or not) and are explained by the political background.

We will a cluster analysis for OECD and European transition countries and comparative country studies on Slovakia and Hungary. These countries are of special relevance because they represent extreme cases (Slovakia: significant switch in transition path towards star performer, Hungary: muddling towards problem case). One part of the comparative work concentrates on the comparison of Slovakia with other new EU members that also face to challenge of state building after dissolution of one or the other sort (Czech Rep. and the Baltics). The other part of the comparative work concentrates on Hungary in comparison with the other EU-CEECs. A broad based comparison will most likely be possible on available data only. The possibility for deeper qualitative comparisons will have to be determined during the project. The comparative components will focus on the macroeconomic background (Slovakia) and the welfare state (Hungary) respectively.

Cluster analysis (initially forseen for MS25) and comparative country studies allows us to draw conclusions for the EU by providing a first comparison of the position of CEECs with respect to the “old” EU members, most interestingly the southern crisis countries that are often categorized into a form called mixed market economies with sometimes contradicting institutional set ups. Do CEECs converge towards prototype models or do they (still) constitute own models?

## Contribution to the Project

Lessons from CEECs seem to be highly relevant for the transition of the EU towards 2020 goals because of the most profound and ambitious transfer of institutions in recent history which took place in these countries at different speed. Concerning the economic and especially the welfare system, the literature on varieties of capitalism has established two prototypes of capitalism – (LME) and Coordinated Market Economies (CME), a categorization that already divides EU-15 in two groups (anglo-saxon vs. continental). MS23 provides a first set of lessons based on comparative country studies by asking if CEECs are converging towards prototypes of capitalistic systems or rather establish new types of capitalism.

**Keywords:** EU integration, innovation, innovation policy, institutional reforms, macroeconomic disequilibria, market economy with adjectives, social development, welfare reform, welfare state

**Jel codes:** P10, P51

**Introduction**

Contrary to Western Europe, where market oriented economic systems developed over several centuries, transition in CEECs from centrally planned economies to market economies took place in considerably shorter time. Historical, political, social and economic diversity in the CEECs at the beginning of their transition has markedly influenced the way and the extent of their transition process. This diversity has been the reason why, despite roughly the same challenges for all the post-communist countries, the concrete results of the transition process have been specific for each country.

Some CEECs (Poland, Hungary, Yugoslavia) started to introduce economic reforms towards a market economy, building some of its elements, already from the early 1980s. However, in other countries, no reforms were undertaken at this stage. After the fall of the Iron Curtain, some of the nations integrated into federations (Slovakia, Slovenia, Estonia, Latvia and Lithuania) used the opportunity for regaining their independent statehood (1991-1993). All these countries faced a double challenge: 1. to introduce economic reforms leading to a market economy, 2. to build the basic economic institutions needed for managing an independent state economy (e.g. central bank, own currency).

There was a belief that it is possible to project and implement capitalist institutions in CEECs from above and in a relatively short period of time, based on adopted legislative acts and implemented economic policies. However, reality proves to be much more complicated – transition took a longer time and it was much more difficult and complex. Given the legacy of central planning, economic transition of CEECs was path-dependent. The centrally planned economy left no institutional vacuum, so the old institutional framework could not be simply replaced by a new one, already successfully implemented in the Western countries. Hence, during transition the old institutions were combined with the new ones. At the same time, transition of formal institutions was accompanied by transition of non-formal institutions. However, as the neoclassical approach (Washington consensus) minimized to role of institutions in the economy, it underestimated the importance of a balanced building of the institutional framework (in particular formal institutions) at the beginning of transition process.

From the beginning of their transition, all the CEECs had a common strategic goal of joining the European Union (EU) as soon as possible. This became the key external factor of accelerating their transition. Although, the long-term objectives of CEECs were similar, discrepancies arose in each country as regards the priorities, order and pace of the reforms to be undertaken. In some of the CEECs (e.g. Slovakia, Czech Republic, Poland, Estonia) the supporters of more radical reforms (the so-called "shock therapy") enforced this approach, especially in the early years of transition, despite its big negative impact in the short-term (output fall, unemployment and recession). Other countries (e.g. Hungary, Slovenia, Romania) took a more "gradualist" approach, in which reformers decided to implement step-by-step macroeconomic, structural and institutional reforms at the same time, with the aim to avoid drastic changes in output, employment and welfare and to provide time for the national enterprises to adapt to the new conditions.

Similar to OECD countries, instead of one variety of capitalism several varieties developed in CEECs. According to Balaz (2006) institutional and evolutionary economics imply following conclusions for development of capitalism:

- Market economy is an economic space with a dense network of institutions. The system of institutions is path-dependent in each country. Institutions determine functioning of the market and, at the same time, market forces affect evolution of institutions. Therefore there are at least so many varieties of capitalism how many countries exist. However, it is possible to group together respective varieties of capitalism according to the common features of components of the institutional framework.

  - Development is path-dependent, however, institutions are inertial and adjustment to changing conditions is slow. Hence, development of capitalist economies is rather divergent than convergent, and significant diversity of organisational forms of these economies persists.
  - Each variety of capitalism functions in its own institutional environment, which may become a source of competitive advantages as well as disadvantages. Optimality of respective variety of capitalism is not a necessary condition for endurance of this variety. There is no perfect and universally effective model of capitalism to which all the other varieties had to converge.

Historical legacies played an important role in transition of the CEECs. The heritage of the communist pasts, lower levels of development and various informal institutions mean that there is no close fit with the ideal types used for analysing and comparing mature market economies (Lane-Myant 2006). Hence, the VoC approach can only be restrictively, flexibly and sensitively applied to post-communist countries, the mechanical application of the VoC can be misleading. Although some features may already be clear, these countries are still undergoing changes leading to a variety of capitalism with the shape difficult to predict. In addition, institutions can be changed more easily in transition economies because of weaker enforcement compared to developed economies. Hence, more alternatives for capitalist trajectories exist in transition countries, which can develop towards LME, CME or a mixed form of both (Mendelski 2008). It also needs to be pointed out that classification of countries depends on the level of analysis (macro/micro), the length of the period analysed, the sectors and indicators chosen and the methodology. Hence, one and the same country can be sometimes put in different clusters of countries.

At the beginning of the transition process, Slovakia was labelled *late comer*; however, it seemed to become a kind of *star performer* in the first decade of the 21st century. Although the pace of reforms has slowed down few years ago, the Slovak economy provides a good example of a relatively successful transition. The study includes detail information on the economic transition in Slovakia (chapter 1 and 3), comparison of its performance with other CEECs countries (chapter 2) as well as lessons from the transition process of the Slovak economy (chapter 4).

## 1. Slovakia from the View of Varieties of Capitalism and Worlds of Welfare State

The local variety of capitalism in Slovakia has formed differently from the initial conception of the liberal economy at the beginning of transition. In Slovakia a local variety of capitalism with specific features of capital control and with lower productivity level developed (Balaz 2006). Dual economy and reliance on bank finance are other specific features of capitalism in Slovakia. Dual economy includes 1) on one side economy represented by highly effective, export oriented and technologically advanced branches of multinational companies and by international banks, and 2) on the other side several large companies and many small and medium enterprises (SME) in domestic ownership, with SME having lower efficiency and limited personal, technological and financial sources. R&D system is underfinanced in Slovakia (as in other CEECs with the slight exceptions of Slovenia, Estonia and the Czech Republic) and the role of the business sector is relatively weak. From this point of view, Slovakia would fit the Mediterranean model.

During the socialist era, the specific type of social policy conducted in CEECs used to be entitled as the Leninist type of social policy (De Deken 1992). It was universally oriented at a wide group of working people and their families. The state was a sole provider of social safety and one of the conditions for social safety was loyalty and physical presence at work, not a person's effort. No rules for increase of family and social benefits did exist and only thanks to low real wages, benefits seemed to be high.

Legacy of central planning constituted different starting points and different challenges for CEECs compared to countries in the Western Europe. According to Esping-Andersen's (1990) typology, development in CEECs is often described as a gradual change towards the liberal welfare state, characterized by the minimal state, i.e. minimum government interventions in social area and in labour market, and by the shift of responsibility for social welfare from the state to individuals and their families. There are also attempts to identify elements of the corporatist welfare state, emphasizing merit principle, and social-democratic welfare state, promoting universalism and a high degree of redistribution, in respective CEECs countries. According to Farkas (2011), CEECs cannot be put into one single welfare system. Social protection in Poland, Hungary and Slovenia fits the Continental model; the others have the characteristics of the Anglo-Saxon model.

Deacon (1997) supposes that there can be a tendency to return to the corporatist welfare state model in Slovakia, the Czech Republic and in Hungary, as this model (Bismarck's welfare state) worked in these countries between the two world wars and many of its elements survived socialism. According to other authors, welfare state in CEECs is rather a combination of more types of welfare states, depending on the sector examined. However, legacy of central planning and the so called path-dependency should be also taken into account when explaining formation of welfare states in CEECs.

Development of social policy in Slovakia has been turbulent. It is still not sufficiently investigated area as complex analyses of social policy during transition period are missing. One of the reasons is low availability of data, in particular in initial stages of transition.

As a basis for their typology, Korpi and Palme (1997) take the institutional structures of old age pensions and sickness insurance programs with focus on bases of entitlement, benefit principle and forms of governing a social program. According to their classification and based on analyses of institutional development, labour market policy in Slovakia could be placed between the encompassing model and the targeted model, since the principle of definition of unemployment benefits is uniform for all people; active searching for a job (or participation in labour market programs) is condition for registration and help from the state; and help is targeted and temporary (Gerbery and Kvapilová 2006).

From the view of understanding activation, which is a typical feature of welfare state reforms in most EU countries, and based on typology of van Berkel and Moller (2002), approach of paternalist optimists and approach of welfare independence optimists dominate in the measures of labour market policy in Slovakia (Gerbery and Kvapilová 2006). According to paternalist optimists, as people do not want to participate, they have to be forced to do so. According to welfare independence optimists, state interventions and providing allowances restrain people from activity, therefore passive policy should be eliminated. Those who respect rules should be supported and those who do not want to should be forced to do it.

The current pension system in Slovakia shifts a big part of responsibility from state (Social Insurance Company) to the market (private pension funds management companies) and individuals. At the same time, the pension system maintains some responsibility for guaranteeing minimum income for pensioners. Hence, it is rather difficult to class such a system with the typology of welfare states. Taking into account the new structure of the pension system, it is supposed to develop towards the combination of the encompassing model, conditioned by participation in the labour market and by compulsory membership in the system; and the basic security model. The market will define the level of benefits and the state will probably provide guarantee of the minimum income, i.e. the market will be the primary mechanism of inclusion and prevention of poverty. From the view of understanding activation, the pension system is close to autonomy optimists, who suppose active approach of people, and paternalist optimists (Gerbery and Kvapilová 2006).

The system of social aid is very close to the targeted model, with some features of the basic security model. The current system of social assistance to families is a combination of the encompassing model and the basic security model, since child benefits, childbirth benefits and parenthood benefits are universal, however, relatively low; and participation in labour market is important for receiving stronger assistance. From the view of understanding activation, paternalist optimism dominates in case of social assistance and welfare independence optimism in case of social aid (Gerbery and Kvapilová 2006).

Although it is very difficult to identify which out of the welfare state models Slovakia belongs to, in general, we can conclude that during transition the Slovak welfare state moved from universalism towards minimum social security and targeted measures. According to van Berkel's and Moller's (2002) classification of approaches to activation, opinions of paternalist optimists dominated in the

reform processes in Slovakia, in particular after 2002. Belief that the labour market is the primary mechanism of social inclusion, emancipation and participation became a framework for building social policy. The role of state is to reward those who are willing to work and to penalize those who don't work. Significance of passive policy has decreased relatively - benefits were minimized, criteria for receiving benefits were tightened, their real value decreased and the period of receiving them was shortened.

The political pressures for neo-liberal restructuring could be observed all around Eastern Europe, however, election of a right-wing party representing these groups was one of the pre-conditions for neo-liberal restructuring to take place. These conditions were fulfilled in Slovakia after 2002, which became an emblematic case of neo-liberal restructuring and corresponds to the 'minimal welfare state'. However, the neo-liberal restructuring took place only after the imbalances of the old systems had been reduced and stabilized in 1998 - 2002. Further development could be either towards the 'European' social model or could continue in the neo-liberal direction (Myant-Drahokoupil 2010).

As it is not possible to say which variety of capitalism is better than the others, it is also not possible to say whether the current variety of capitalism in Slovakia has good long term perspectives or not (Balaz 2006). Before we discuss the transition in a more detail in chapter 3, we put the performance of Slovakia into the CEEC perspective in chapter 2.

## 2. Analysis of selected indicators

To provide a broader picture, two analyses have been conducted comparing ten CEECs (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia) with three benchmark countries (Germany as the case of CME, UK as LME and Italy as MME):

1. Analysis of selected policy variables (transfers and subsidies, size of government, regulation) and performance variables (Gini coefficient, innovation, fiscal debt), on which the cluster study has been based. Using a different method, this analysis allows for an alternative view on the cluster data.

2. Analysis of selected indicators representing the trinity of welfare/equality, innovation/growth/competitiveness and macroeconomic stability, based on available time series and data from the Eurostat database (see Annex 1). This analysis is based on a broader set of indicators in order to provide a more detailed picture of performance (the trinity) in the CEECs.

Overall, these variations in method and data allows for a kind of robustness check for the results of the cluster analysis and, at the same time, deeper insights into the transition. For both analyses, a scoring model has been developed, based on the average values of the respective indicators for all 13 countries. The model has the following specifications: The average values of individual indicators have been statistically distributed into 10 percentiles, which provided the necessary intervals for assigning points to countries. The points have been assigned to countries in descending order from 10 to 1 (i.e. the country with best performance in the respective indicator receiving 10 points and the worst receiving 1 point).[1] The total score for each country for the sets of policy and performance variables (first analysis) or for individual dimensions of the trinity (second analysis) has been calculated as the sum of the points assigned to the country for indicators in the respective set of variables or in the respective dimension of the trinity.

### a) Analysis of selected policy variables and performance variables

The analysis of the three policy variables and the three performance variables (see Annex 1, table 1) has revealed the following:

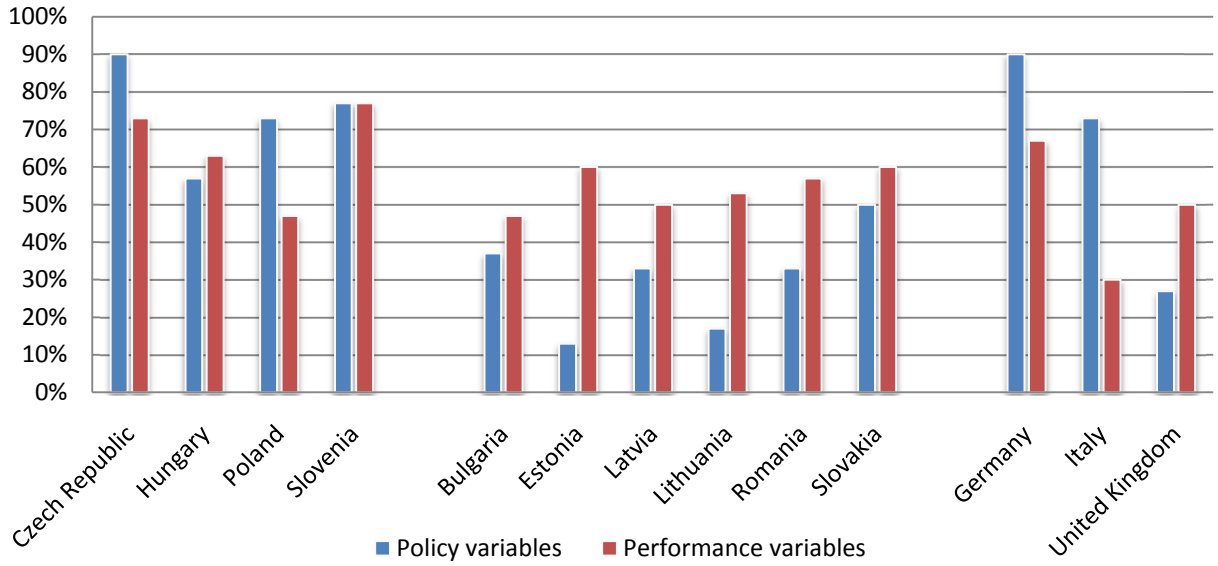
- while the countries in the CEEC CME group reached higher/the same scores in the three policy variables than in the performance variables, with Hungary being a slight exception; in the CEEC LME group, the score in the performance variables is higher than that in the policy variables in all countries included (Estonia and Lithuania represent the extreme cases) (figure 1 and 2),
- basically, the results of the CEEC CME countries are closer to those of Germany and Italy and the CEEC LME are comparable with the UK,
- interestingly, the scores of Slovakia and Hungary are very similar, due to almost the same scores in the respective policy variables and, at the same time, a better score of Slovakia in fiscal debt,

[1] In case of the policy variables, assigning 10 points means the most transfers and subsidies, the biggest government, the most regulation.

its worse score in innovation and a similar score in Gini coefficient when compared with Hungary.

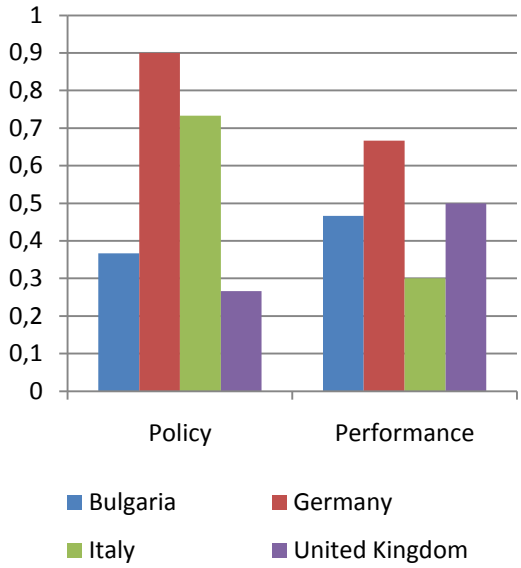
It can be concluded that the analysis provides support for the results achieved in the cluster study. In order to compare the performance of Slovakia and Hungary in a more depth, the analysis of a broader set of indicators of the trinity (welfare/equality, innovation/growth/competitiveness and macroeconomic stability) has been accomplished (see the next subchapter).

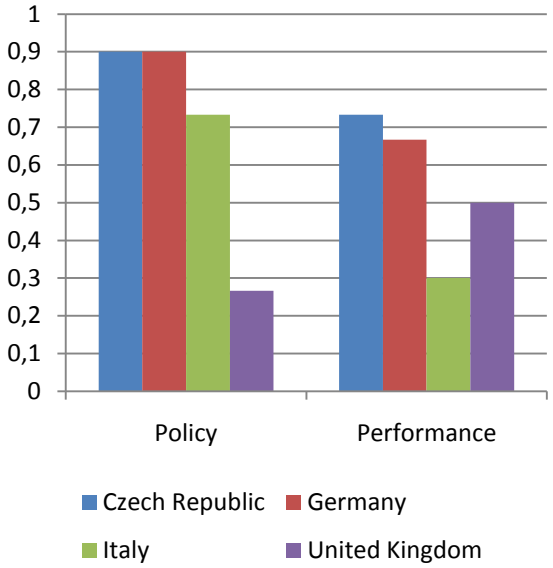
**Figure 1 – The policy variables and the performance variables in the CEEC CME group, CEEC LME group** (according to the results of the cluster study) **and benchmark countries (relative values calculated as shares of respective countries in the maximum values for the individual groups of variables)**

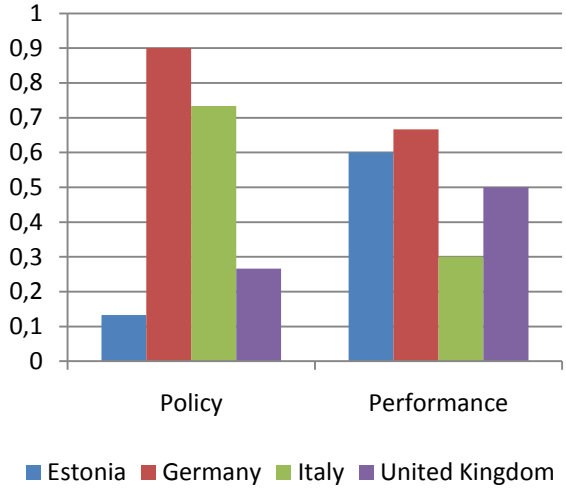


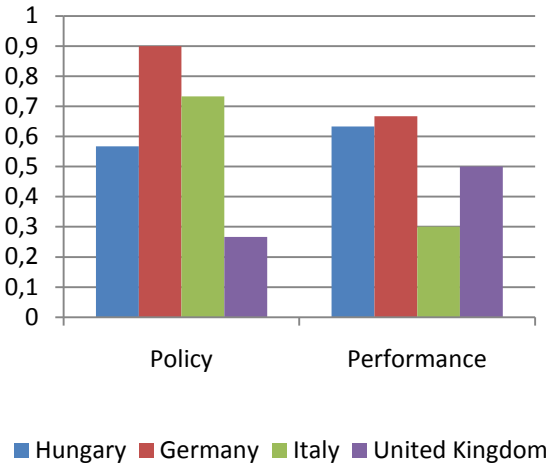

Source: EFW, World Bank, IMF, own calculations

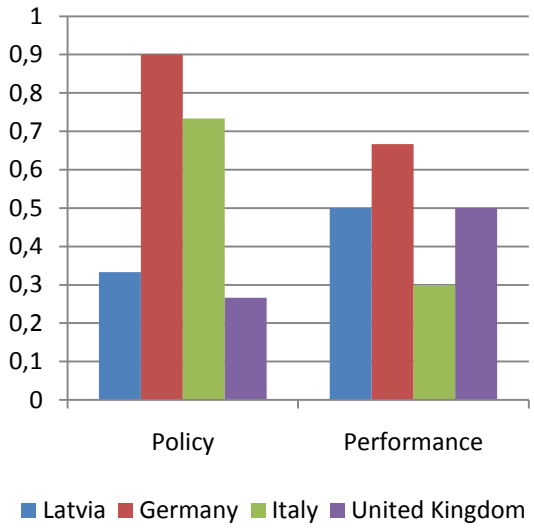
**Figure 2 - The policy variables and the performance variables in individual CEEC countries compared with the benchmark countries (relative values calculated as shares in the maximum values for the individual groups of variables)**

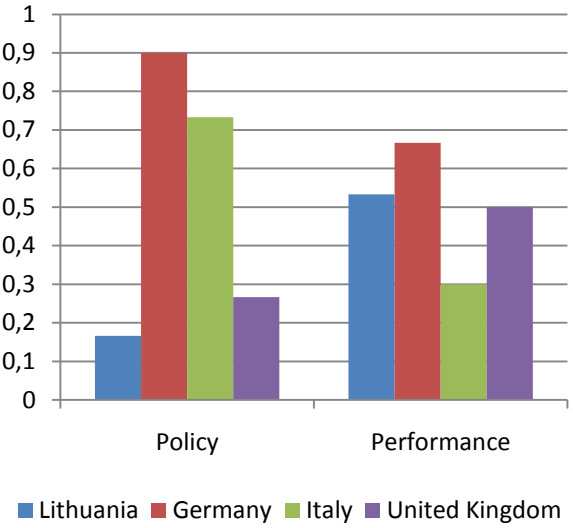


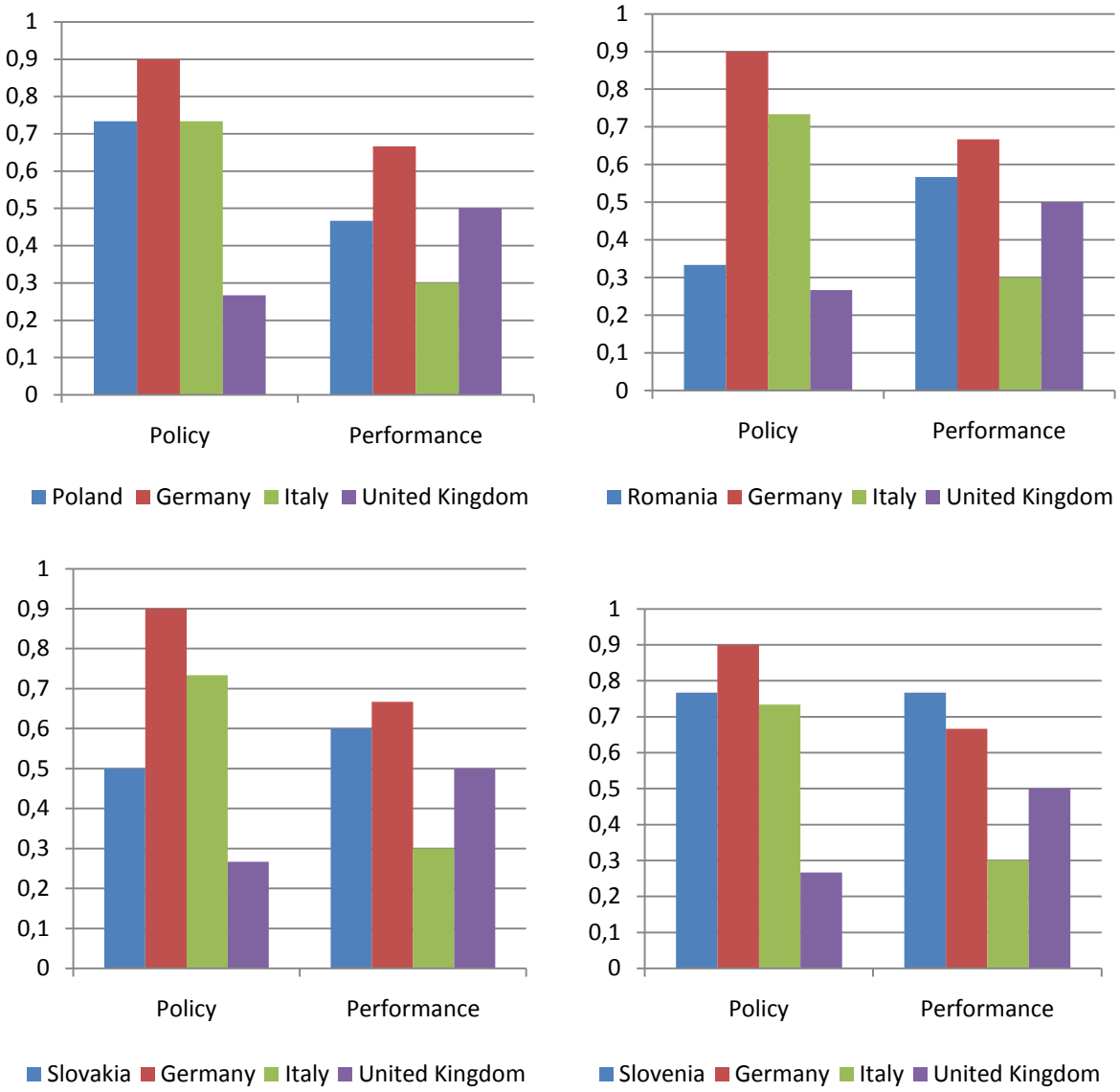






Source: EFW, World Bank, IMF, own calculations

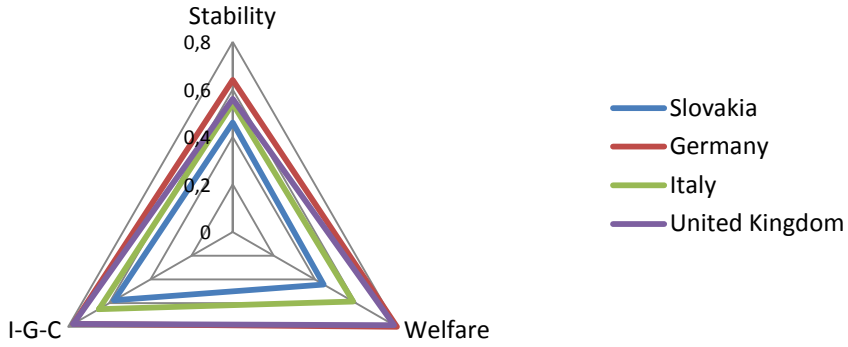
**b) Assessment of the trinity of welfare/equality – innovation/ growth/competitiveness – macroeconomic stability in the Slovak economy**

Based on the data and methodology used in the second analysis, the following figures demonstrate the results of the three dimensions of the trinity in the analysed period in Slovakia, compared with the benchmark countries (figure 3) and Hungary (figure 4). As will be shown later, the results of the Slovak economy in the respective dimensions of the trinity are mixed, which implies that the overall results for the dimensions rank Slovakia neither among the best performing, nor the worst performing CEECs.

When compared to the benchmark countries, results for Slovakia are worse in all dimensions of the trinity and are close to those of Italy. Hungary has performed better than Slovakia only in wel-

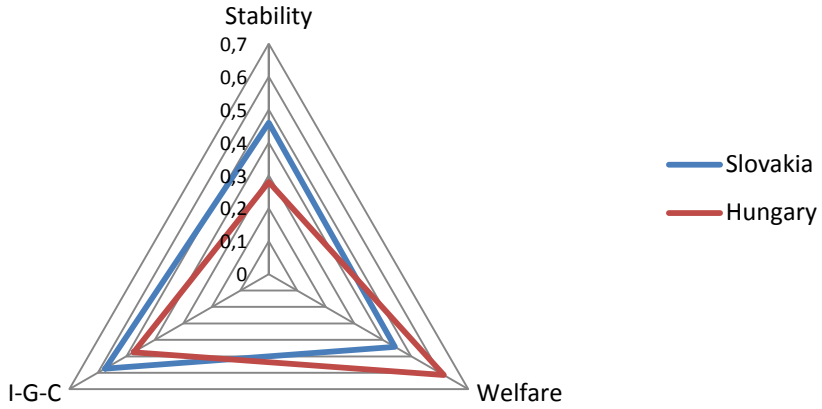
fare/equality dimension, mainly due to lower unemployment and higher expenditure on social protection as % of GDP. On the other hand, Hungary lags behind Slovakia in terms of macroeconomic stability, in particular in public and private indebtedness and price stability, as well as in innovation/growth/competitiveness, with the highest deficit in GDP growth.

**Figure 3 – The trinity of macroeconomic stability - welfare/equality – innovation/ growth/competitiveness in Slovakia, Germany, UK and Italy (relative values calculated as shares in the maximum values for each dimension of the trinity)**




Source: Eurostat (2013), own calculations.

**Figure 4 - The trinity of macroeconomic stability - welfare/equality – innovation/ growth/competitiveness in Slovakia and Hungary (relative values calculated as shares in the maximum values for each dimension of the trinity)**




Source: Eurostat (2013), own calculations.

### c) Comparison with CEECs – special case or common ground?

The summary table with the performance indicators used in the second analysis and average values for all countries analysed is in the Annex 1 (table 2). The scores for each indicator and each country can be seen in the same annex (table 3) and the results are also shown in figure 5 and 6. In addition, the Annex 2 contains a brief analysis of the selected gender issues.

As regards the trinity, the following conditions and trends could be identified in CEECs:

- when we look at respective dimensions of the trinity in CEECs, the worst results in macro-economic stability were registered in Hungary, slightly better results in Bulgaria, Romania and Slovakia; the worst results in innovation/growth/competitiveness were clearly reached in Bulgaria and Romania; and in welfare/equality in Latvia and Bulgaria, followed by Lithuania and Poland (figure 5 and 6),
- on the other hand, the three Baltic states, Slovenia and the Czech Republic performed best among the CEECs in macroeconomic stability; Slovenia followed by Estonia and the Czech Republic in innovation/growth/competitiveness; and again Slovenia followed by the Czech Republic in welfare/equality.
- among the benchmark countries, Germany and the UK represent more developed economies (compared with Italy) with similar results,[2]
- the results for Slovenia mostly fit those of Germany and the UK; in less extent, the same is the case of the Czech Republic (with the most evident difference in dimension of innovation and competiveness) and Estonia (with worse performance in welfare dimension),
- at the same time, Estonia seems to have caught up with Italy and Slovakia is also very close to Italy with deficit in the welfare dimension.

Slovenia and the Czech Republic, followed by Estonia are the most successful countries among the CEECs in terms of performance with respect to all three dimensions of the trinity, with Estonia lagging in terms of welfare. In general, the Baltic States are rather unequal and socially exclusive, Slovenia represents the opposite extreme (with better overall results in welfare/equality indicators than Germany) and the Visegrad countries are between these two extremes.[3] As regards R&D, Slovenia, Estonia and the Czech Republic represents slight exceptions from underfinanced systems in the CEECs.

By many authors, Slovenia (CME) and Estonia (LME) are considered the most successful transition countries with two diverse but coherent institutional systems. Slovenia achieved balance between macroeconomic stability, competitiveness and welfare. One of the factors of the success of Slovenia is its exceptional legacy, as the country inherited from the former Yugoslavia a unique enterprise ownership structure based on self-management and a unique institutional setting.

[2] However, similar results of Germany and the UK in welfare/equality dimension result from the fact that while Germany reached a higher score in expenditure on social protection, in-work at-risk-of-poverty rate and in Gini coefficient in the analysed period, the UK was more successful in employment and unemployment rates.

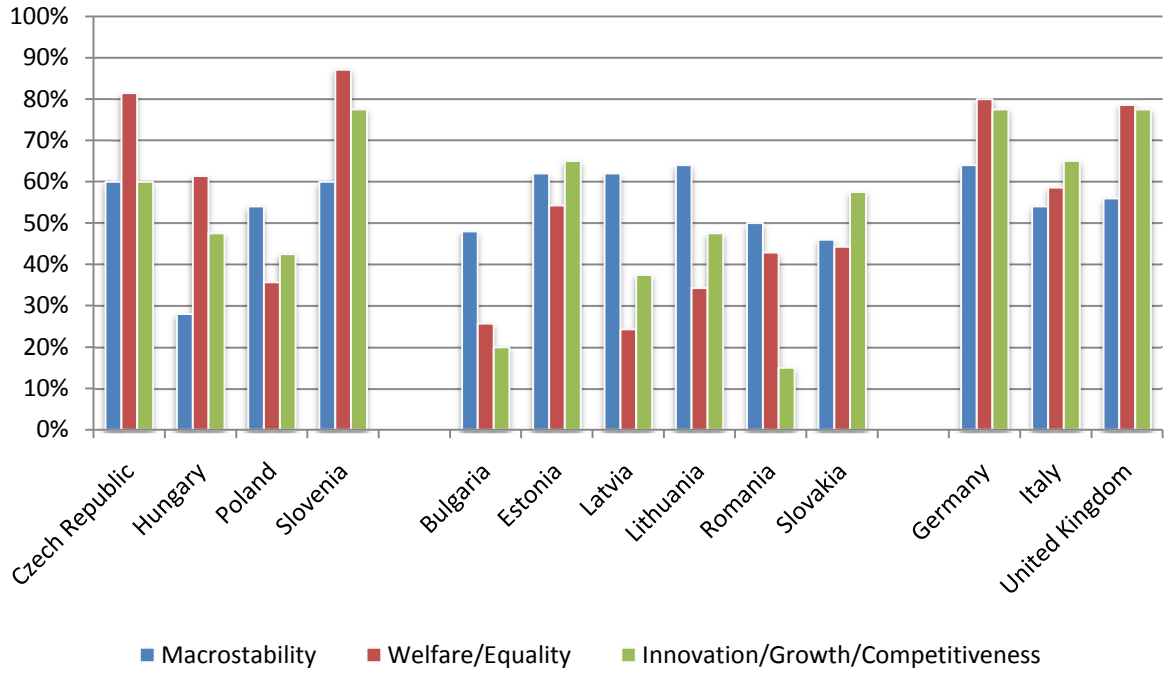
[3] Electoral concerns were an important factor explaining the nature of welfare-state adjustments in transition countries in the 1990s and 2000s.

Estonia and other two Baltic States reveal the best results in terms of macroeconomic stability among the CEECs (figure 5), Latvia and Lithuania only before the crisis. The goal of national independence can explain why macroeconomic stability became a priority for these states. They have enjoyed strong political support for reforms towards the market economy in contrast with many other countries, as radical economic reforms were crucial for the defence of national independence. However, in these countries the domestic demand as a growth driver was so dominant that it led to very large deficits on current accounts before the crisis.

The Czech Republic is also often considered one of the most successful socialist countries to have transited to capitalism, which was confirmed by the results of our analysis. A very important factor for the relative success of the transformation process in the Czech Republic was the early rejection of a "third way" between socialism and market economy. However, the Czech experience with economic transition also shows that liberalisation and stabilisation alone are not sufficient for successful transformation. Adequate legislation and market institutions must be introduced.

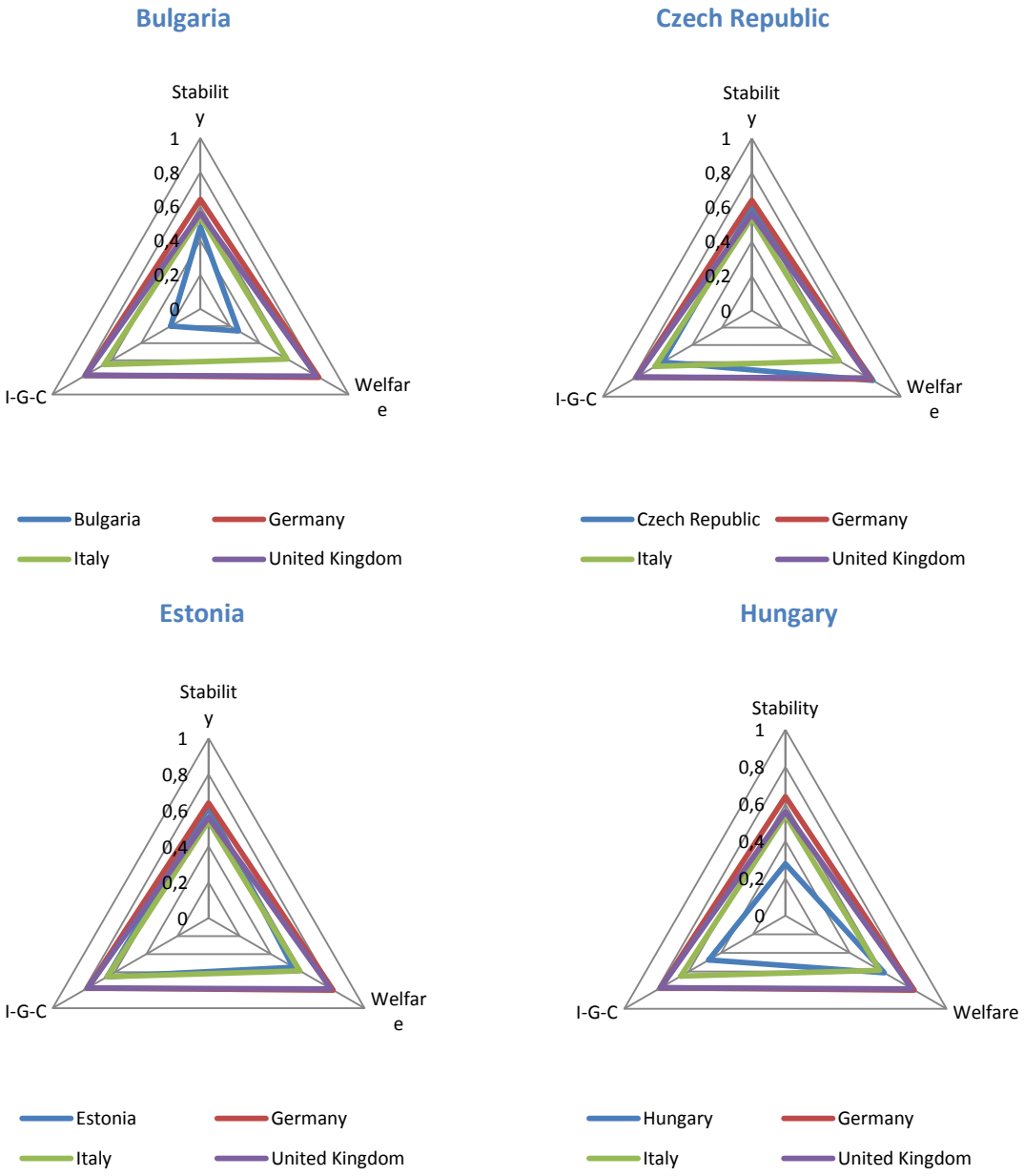
The most problematic case among the CEECs is represented by Bulgaria. It has faced similar problems with current account deficit as the Baltic countries and has performed very bad in innovation/competitiveness, together with Romania.

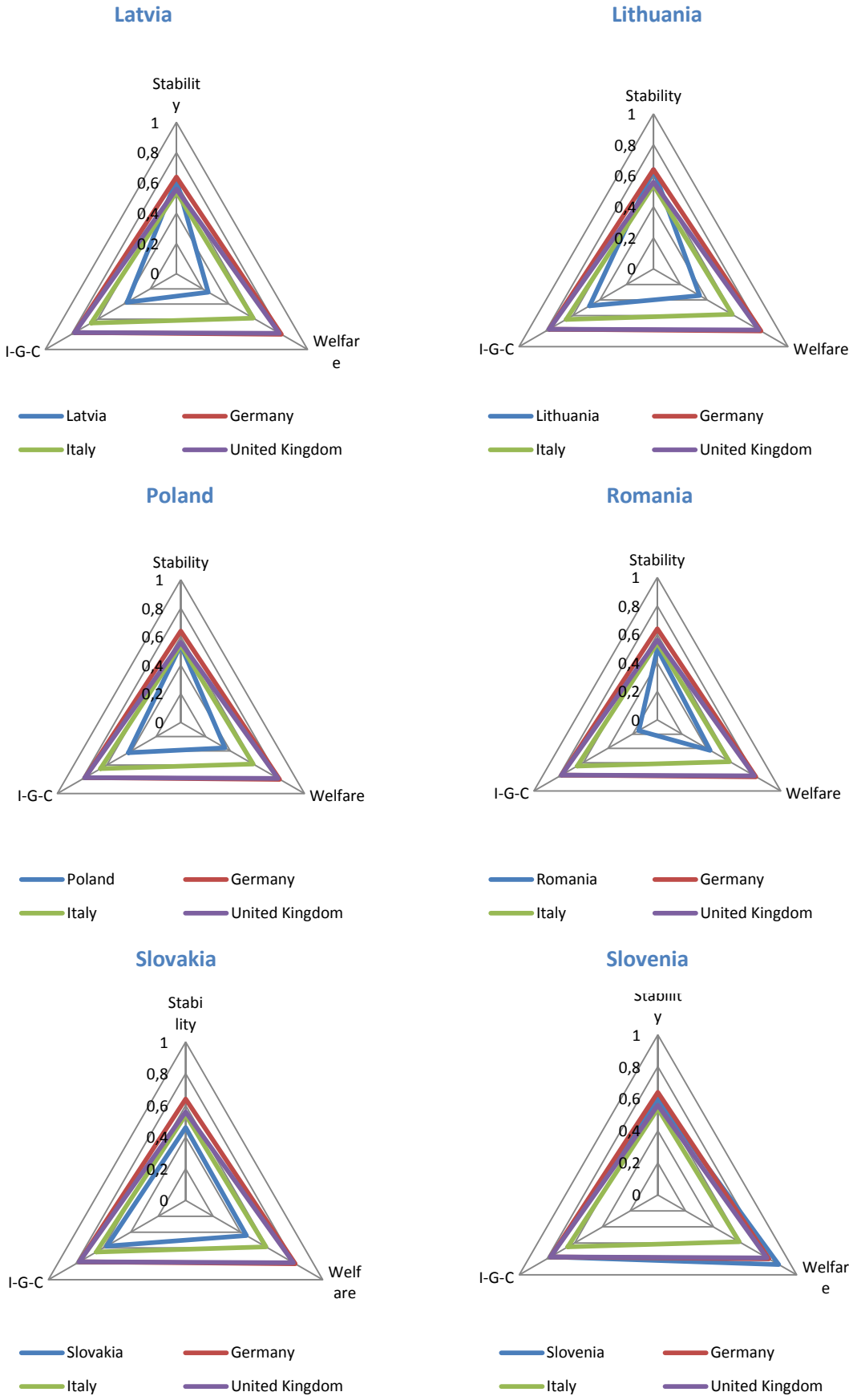
**Figure 5 – The trinity in the CEEC CME group, CEEC LME group** (specified according to the results of the cluster study) **and benchmark countries (relative values calculated as shares in the maximum values for each dimension of the trinity)**




Source: Eurostat (2013), own calculations.

**Figure 6 - The trinity of macroeconomic stability - welfare/equality – innovation/growth/ competitiveness in individual CEEC countries compared with the benchmark countries (relative values calculated as shares in the maximum values for each dimension of the trinity)**






Source: Eurostat (2013), own calculations.

Slovakia performs about average within the CEEC countries, with the following strengths: private debt and general government gross debt (dimension of macroeconomic stability), GDP growth and labour productivity (innovation/growth/competitiveness), Gini coefficient and in-work at-risk-of-poverty rate (welfare/equity). A still high unemployment rate and gross domestic expenditure on R&D represent serious weaknesses. A high long-term unemployment accompanied by significant regional differences, which are not reduced by the mobility of the work force, as well as unemployment of young people and low-skilled workers are big problems of the Slovak economy.

As can be seen from figure 4, the results of the trinity in Slovakia are closer to those of Estonia (LME) than those of Slovenia (CME), which represent two extreme cases in literature. This is in line with the results of the cluster analysis, where Slovakia and Estonia belong to the group of CEEC LME. According to the analysis of the trinity, both countries have focused less on welfare/equity than on other two dimensions of the trinity. On the contrary, the results of Hungary fit more those of Slovenia, with a stronger emphasis on welfare dimension. These economies belong to the group of CEEC CME according to results of the cluster analysis. However, as regards the trinity, the overall results of Hungary are significantly worse than those of Slovenia, which is not the case of Slovakia, when compared with Estonia.

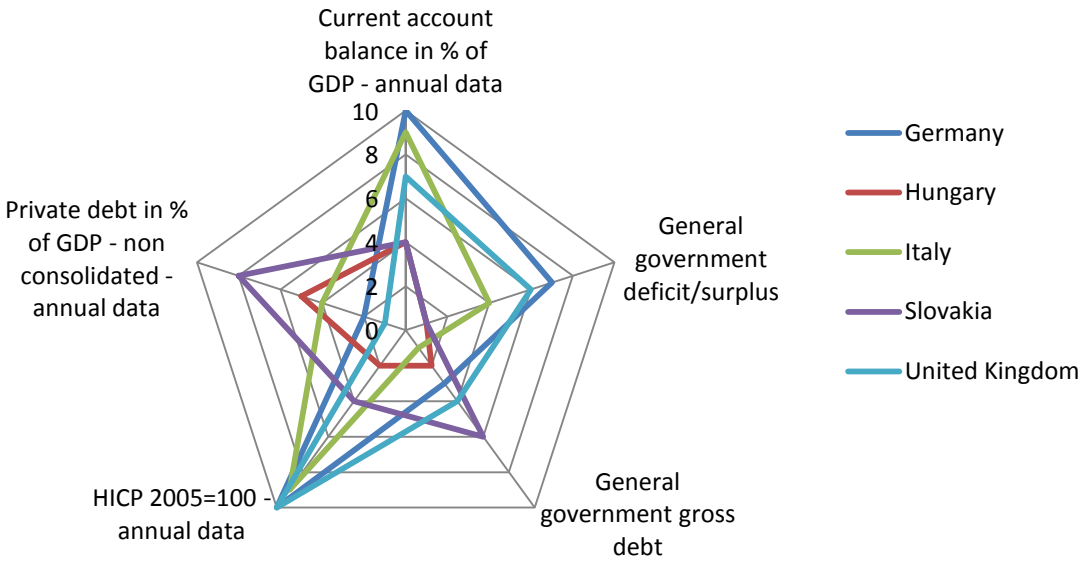
Based on the analysis of the selected indicators, Slovakia does not seem to be a special case. However, comparisons between countries using quantitative indicators reveal only part of the story. From the view of the institutional developments and in particular the pace of the liberal reforms implemented in the beginning of this millennium, special features could be identified in case of Slovakia, leading to the label of *star performer* (see chapter 3).

In the following subchapters, we analyse the dimensions of the trinity in Slovakia in a more detail:

### d) Analysis of macroeconomic stability indicators in Slovakia

From the view of macroeconomic stability, private debt in % of GDP and general government gross debt represent the strengths of the Slovak economy (figure 7), with private debt being one of the lowest among the CEECs and considerably lower than in the three benchmark countries. In contrast to relatively low private and public indebtedness, high general government deficit can be considered a weakness of the Slovak economy in the analysed period, mainly due to developments in 1996-2002 and in the crisis years 2009-2010. As we can see from figure 7, the Hungarian economy has been considerably less successful in macroeconomic stability than the Slovak economy.

**Figure 7 - Selected indicators of macroeconomic stability in Slovakia, Hungary, Germany, Italy and UK (the higher value, the better performance)**

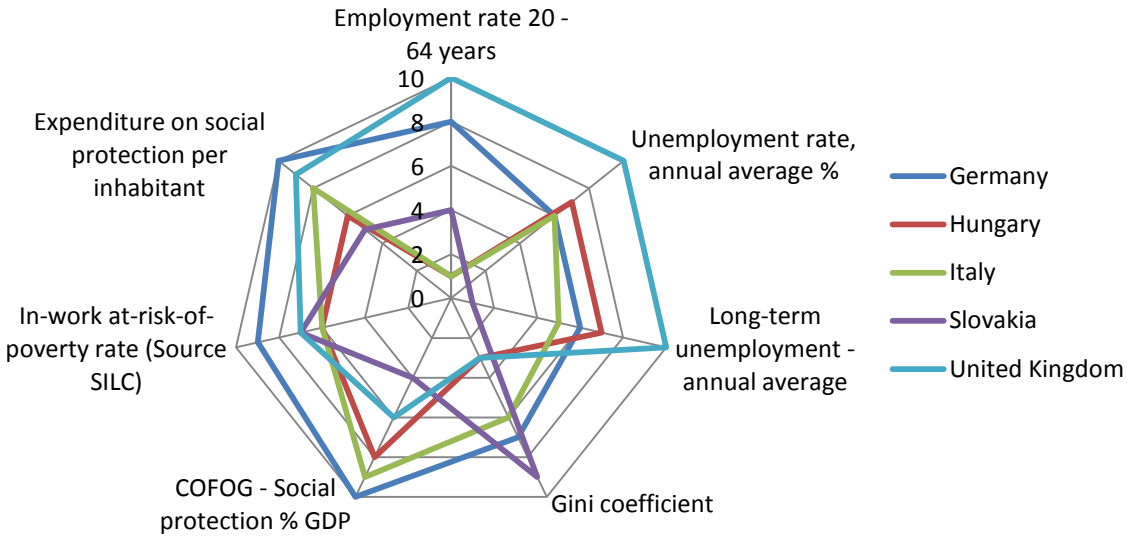



Source: Eurostat (2013), own calculations.

### e) Analysis of welfare system indicators in Slovakia

When we look at selected indicators of welfare/equality, Slovakia has had relatively good results in Gini coefficient (also better than the three benchmark countries) and in-work at-risk-of-poverty rate (figure 8). In contrast, unemployment and long-term unemployment belong to serious long-time problems of the Slovak economy. General government expenditure on social protection as % of GDP is one of the lowest among the CEECs. As can be seen from figure 6, Hungary, compared with Slovakia, reached better results in unemployment as well as in expenditure on social protection. However, inequality and in-work at-risk-of-poverty have been higher in Hungary.

**Figure 8 - Selected indicators of welfare/equality in Slovakia, Hungary, Germany, Italy and UK (the higher value, the better performance)**

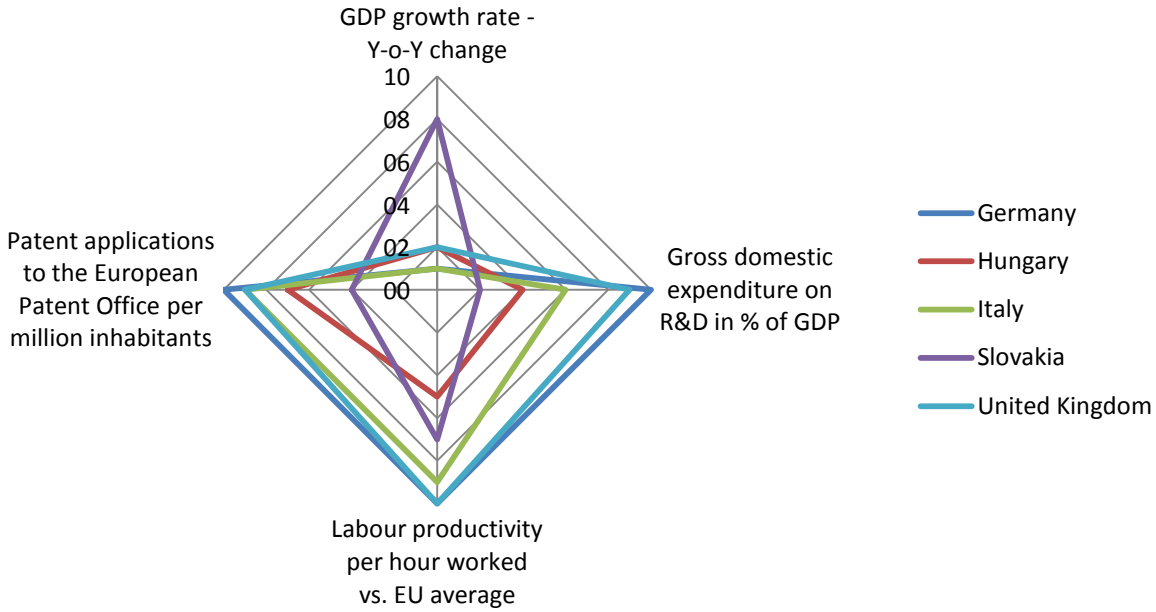



Source: Eurostat (2013), own calculations.

### f) Analysis of innovation/growth/competitiveness indicators in Slovakia

From the view of this dimension of the trinity, Slovakia has been definitely one of the fastest growing economies among the CEECs (figure 9), with only Estonia and Lithuania growing faster in average in the analysed period. However, for years of the strongest economic growth, increased deficit in the current account has been characteristic. Strong and persistent rise in labour productivity led to economic growth without increasing employment in Slovakia. Labour productivity per hour worked in relation to the EU average has been higher only in Slovenia and the benchmark countries. On the other hand, Slovakia lags behind the benchmark countries and behind the most developed CEECs in R&D expenditure as well as in patent applications. In these two indicators, Hungary performed better than Slovakia.

**Figure 9 - Selected indicators of innovation/growth/competitiveness in Slovakia, Hungary, Germany, Italy and UK (the higher value, the better performance)**




Source: Eurostat (2013), own calculations.

## 3. Stages of transition of the Slovak economy and the role of the political background

Until 1989 the Czechoslovak economy can be characterised as highly monopolised, with low energy efficiency, low competitiveness due to the abstention of any structural reforms in the 70's or 80's, low innovation potential and capacity, relatively skilled labour force and highly centralised and state owned economy without any private sector. The state was the only employer and open unemployment was not a problem that would require special attention. Having a paid work was considered to be responsibility of every citizen who was able to work. Hence, the socialist system did not deal with labour market policy in that way as market economies did. Given income equalization and weak social differentiation, anti-poverty tools did not seem to be necessary.

Basically, it is possible to distinguish the following stages of the Slovak transition to the market economy: [4]

1. Initial stage of transition of Czechoslovakia (1990-1992)
2. Stage of unsustainable economic development and implementation of "own way of transition" (1993-1998)
3. Stage of macroeconomic stabilisation and implementation of standard macroeconomic policies (1998-2002)
4. Stage of more advanced reforms and accelerating economic growth (2002-2006)
5. Post-transitional stage (since 2007 - onwards)

While the first and partially the second stage of transition were managed by the IMF and the World Bank, the European Commission played the key role in the following stages, given integration efforts of the Slovak Republic. After EU accession, the Slovak government had relatively free hands when deciding on further progress of economic transition.

Transition from centrally planned towards market economy is an unprecedented process with a relatively clearly defined starting point[5] but a more difficult definable end. According to Morvay (2005) transition of the economy ends when:

1. a functioning market mechanism has been build,

2. the economy is able to generate a strong and sustainable growth and

3. distortions have been eliminated, which enables an equal interaction of the economy with more advanced market economies without any stronger protection.

At the present time, not all of the markets work sufficiently well in the Slovak economy, e.g. the capital market. Prior to the global financial and economic crisis, economic growth had been relatively strong, however, the next years will fully examine in what extent it is also sustainable. As regards the third condition, one of the weaknesses of the Slovak economy consists in the fact that it is competi-

[4] The Annex 3 provides an overview of transition stages in Slovakia.

[5] We used the term „relatively clearly defined" as it is not so easy to define the start of transition in Slovenia or in Hungary.

tive only in a relatively few types of goods. Low labour costs are still the main competitive advantage of the Slovak economy, while technology gap remains large.

### Initial stage of transition of Czechoslovakia (1990-1992)

In Czechoslovakia different scenarios of transition that originated after November 1989 had a common goal to get back to the market economy. They differed in conception on how to achieve this goal and also what this goal really means. Hence, the authors of alternative conceptions of transition added different adjectives to the term *market economy,* e.g. *social, ecological, social-ecological* a. o.. Two basic strategies of transition were formulated in Czechoslovakia in 1990 – the Czech scenario and the federal scenario. Neither of them represented purely gradualist or purely shock therapy approach. They were certain combinations of both these approaches with different weights of gradualism and shock therapy in each scenario. After elections in June 1990, the new Czechoslovak parliament approved the basic strategy of socio-economic transition - *The Scenario of Economic Reform,* which integrated both scenarios mentioned above. This scenario of shock therapy, based on adoption of the model of liberal capitalism, included stabilisation, market liberalisation, privatisation, currency convertibility, liberalisation of foreign trade and, in later stages, building of market institutions.

The following year was extremely difficult for Czechoslovakia. The starting point of the economic transition was represented by one-shot price liberalisation, which was followed by further rapid liberalisation steps including abandoning of wage regulation, introduction of internal convertibility of the currency (Czechoslovak Koruna) and opening of the domestic market to international competition, which gave an impulse to beginning of production restructuring. In addition to the liberalisation package, stabilisation measures were adopted in order to contain inflation and a negative development in the balance of payments. The key elements of stabilisation policy included restrictive monetary and fiscal policy.

Devaluation of the currency resulted in significantly undervalued exchange rate, however, in a long term a sustainable one. The undervalued exchange rate helped to maintain competitiveness of majority of production in the Western markets and partially replace exports to the COMECON countries by exports to the West. On the other side, the undervalued currency decreased motivation of enterprises for product innovation. Re-institutionalisation of foreign trade was enabled when Visegrad countries signed the Central European Free Trade Agreement (CEFTA). Especially in Slovakia, the process of industrialisation during the socialist era made the economy more vulnerable after the collapse of the COMECON and resulted in rising unemployment rate and the necessity to implement structural changes in these sectors.

In contrast to Hungary and Poland, which had partial experience with functioning of the market and private sector already before 1989, in Czechoslovakia private sector was absent. This provided reasoning for as fast transition as possible. However, already since the beginning of transition, proposals of respective approaches to this process were not realized in their pure form. Gradually, more and more elements of institutionalism became a part of the transition strategy. Although in the first stage of transition the neoclassical conception dominated, later it was enriched by knowledge of evolu-

tionary-institutional approach. While the pace of transition remained a controversial issue also after the first stage of transition, in case of building the institutional framework, different approaches to transition converged. There had been a significant progress regarding the importance of institutions for successful development of the market economy. Economists supporting radical reforms enriched their approach by institutional issues of transition, which were underestimated before (Morvay, 2005).

In the beginning of transition process in Czechoslovakia, the Slovak nationalist groupings declared that the economic reform prepared by the federal government is not appropriate for Slovakia, which (according to them) needed its own reform conception, tailored to conditions and needs of the country. However, the economic problems of Slovakia after November 1989 were not caused by the federal conception of transition in the first place, but rather by disadvantageous structure of the economy and its low technological level. Hence, structural adaptation became even more difficult in Slovakia than in the Czech Republic. In Slovakia as well as in the Czech Republic, it was inevitable to accomplish conversion of armament production, reduction or closing of inefficient mining and overequipped metallurgical production, restructuring and modernisation of several traditional industries in engineering and consumer industries.

The first and second stage of economic transition (1990-1998) represents a very difficult period of the Slovak history. Economic policy in Czechoslovakia preferred macroeconomic stabilisation to economic growth. Although macroeconomic stabilization programmes in the first stage of transition were temporary successful, they did not lead to a sustainable growth of the economy. In Slovakia a high price had to be paid for reducing inflation and for lower budget deficit. Due to disintegration of COMECON, price liberalisation and restrictive monetary policy, the Slovak GDP fell significantly (the so called transition recession). The cumulative loss of GDP reached more than 22 % of GDP in 1989-1992.

Social consequences of economic transition were underestimated in the beginning of the 90ties. Transition recession was deeper than expected and caused increase in unemployment and poverty[6] as well as awareness of the existing regional disparities. It proved to be much more complicated to cope with unemployment, which was initially considered only temporary. Increase in unemployment resulted from conversion of armament production, elimination of inefficient overemployment, insufficient creation of new workplaces as well as from privatisation, which was a key element of the shock therapy model.

In order to reduce antipathy of the citizens to the shock therapy reforms and to prevent open social unrest, social system needed to be built concurrently with implementation of these reforms. Building a market economy required shifting from the centralized system of social protection, based on a complex state care of citizens, to a decentralized, less paternalist, more selective and merit based system. In Czechoslovakia, implementation of social reforms began in 1990, when federal scenario of social reform was elaborated. Its aim was not to reform the whole system but to facilitate realization

[6] For this period, data are not available.

of the economic reform. Social institutions (employment offices, social insurance companies) and social safety net were established. The social safety net was supposed to be temporary, later replaced by specific acts regulating respective components of social policy. Development of the social system contributed to mitigation of negative impacts (in particular growing unemployment) of the shock therapy on population. However, initial assumption that unemployment will be only a temporary phenomenon that is possible to cope with social safety net proved to be mistaken. It is difficult to estimate what effects on social welfare the gradualist approach to transition would have. However, strongly negative short term impacts would probably occur in any case.

We can conclude that from the perspective of capitalism development, the federal strategy focused on implementation of liberal market oriented measures. However, the above mentioned negative effects, especially on the Slovak economy, resulted in favourable conditions for creation of the so called "own way of transition", which was implemented in the next stage of the transition.

### Stage of unsustainable economic development and implementation of "own way of transition" (1993-1998)

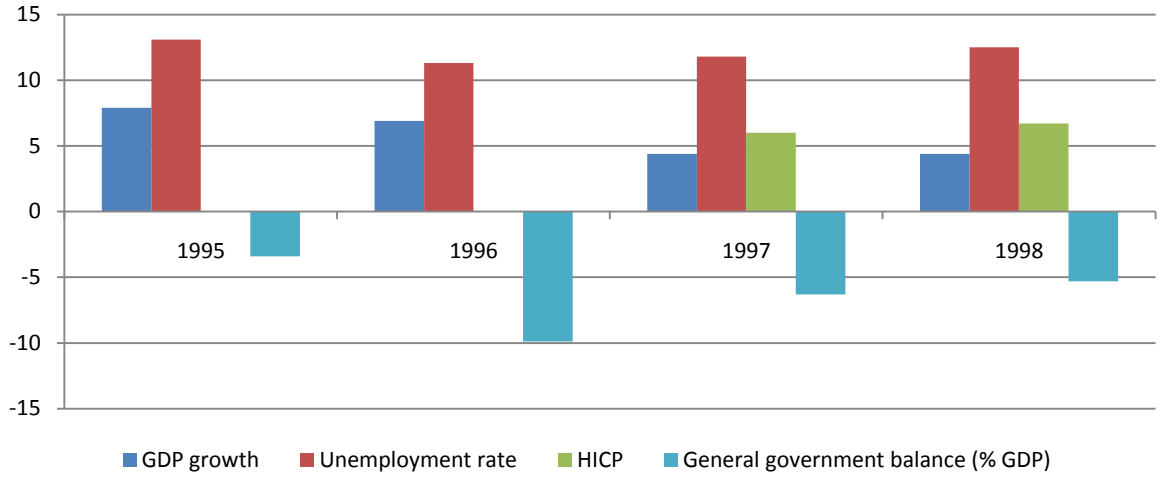
In Slovakia, economic and social transition from centrally planned economy towards "economy based on principles of socially and environmentally oriented market economy" (according to the article 55 of The Constitution of the Slovak Republic) has taken place. Establishment of an independent republic and building of the market economy required primarily new institutions necessary for functioning of the state and economy. In the second stage of transition the government started to implement the so called „own way of transition", which represented a specific type of transition and was in opposition to the federal transition strategy.

The split of Czechoslovakia into two independent states further shaped the conduct of economic policy in Slovakia. The first changes of the federal transition strategy started to be implemented at the end of 1993 and besides economic objectives, the strategy declared the intention for integration into EU and NATO. Although becoming a part of the European integration was one of the most important priorities of the government, the actual outcome was quite the opposite. The existing democratic deficit excluded Slovakia from joining the first wave of post-socialist states, which opened accession negotiation to the EU and NATO. The conclusion of the Luxemburg summit in 1997 stated, that although Slovakia is basically fulfilling the economic criteria for accession, the existing democratic deficit and insufficient application of democratic principles are major obstacles for opening accession negotiations. With the exclusion of Slovakia from the first wave of EU accession talks, Slovakia was in less favourable position to attract FDIs and was perceived as less reliable partner than the rest of the transition countries[7].

[7] The US Secretary of State Madeleine Albright under President Clinton called Slovakia „the black hole in the heart of Europe" in 1997 due to undemocratic and authoritarian behaviour of the government led by prime minister Vladimír Mečiar.

In this period Slovakia experienced rather high GDP growth rates. The average economic growth in 1994 – 1998 reached 5.9 % (in 1995 the annual GDP growth reached even 7.9 %). However, the rapid economic growth was not sustainable due to the dominant role of the government consumption.

**Figure 10 – Development of main macroeconomic indicators in 1995 – 1998**




Source: Eurostat, Statistical Office of Slovakia

The expansive fiscal policy (e.g. financing of large infrastructure projects by short term loans with high interest rates) was accompanied by the restrictive monetary policy of the National Bank of Slovakia, which resulted in rapid increase of interest rates and significant crowding-out effect in the economy. In 1996 the annual real growth rate of government consumption went up by 17.4 %. Furthermore the volume of general government debt grew by 111.6 %, which represented and increase by 12.4 percentage points relative to GDP. The structure of debt was not sustainable. Since 1995 the volume of short-term debt increased by 401.2 % from 494 million EUR to 1.98 billion EUR. The share of short-term debt on total debt reached 28 %. The main reason for the changes in the structure of the debt was the focus of fiscal policy on large scale infrastructure projects financed especially by short term loans with high interest rates.

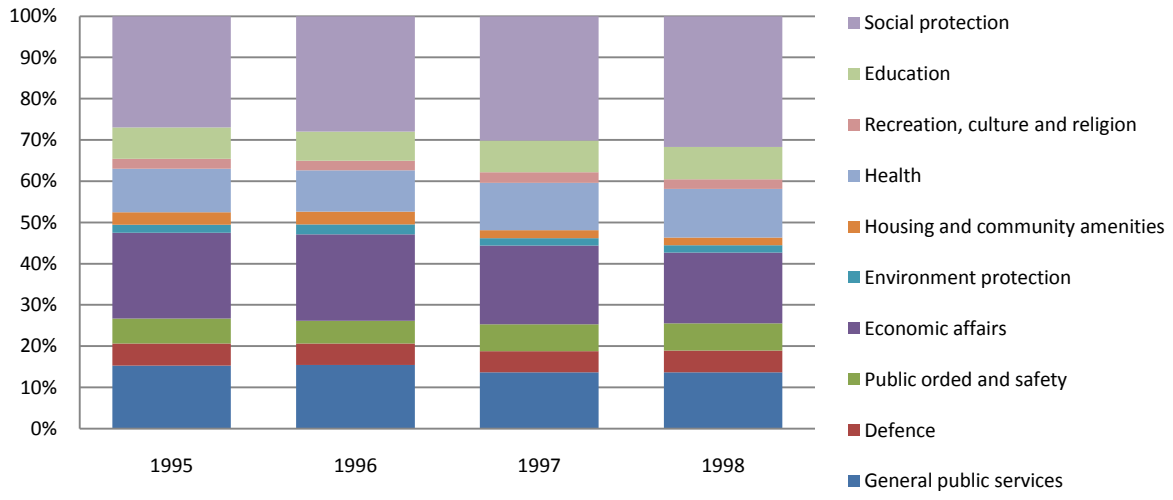
**Table 1 – Development of selected indicators in 1995 – 1998**

| | 1995 | 1996 | 1997 | 1998 | Average | 1998-1995 |
|---|---|---|---|---|---|---|
| **GDP growth** | 7,9 | 6,9 | 4,4 | 4,4 | 5,9 | |
| **Unemployment rate** | 13,1 | 11,3 | 11,8 | 12,5 | 12,2 | -0,6 |
| **Employment rate** | 52,0 | 53,3 | 52,4 | 51,7 | 52,4 | -0,3 |
| **Index of real wages (Y-o-Y)** | 104,0 | 107,1 | 106,6 | 102,7 | 105,1 | |
| **HICP** | | | 6,0 | 6,7 | 6,4 | |
| **General government balance (% GDP)** | -3,4 | -9,9 | -6,3 | -5,3 | -6,2 | |
| **General government gross debt (% GDP)** | 22,1 | 31,1 | 33,7 | 34,5 | 30,4 | 12,4 |
| **Private debt (% GDP)** | 68,4 | 62,6 | 61 | 64,3 | 64,1 | -4,1 |
| **Current account balance (% GDP)** | 2,0 | -9,9 | -9,1 | -9,5 | -6,6 | |
| **Labour productivity per hour worked (EU27=100)** | 47,0 | 49,3 | 51,5 | 53,4 | 50,3 | 6,4 |
| **Total R&D expenditure (GERD/GDP)** | 0,92 | 0,91 | 1,08 | 0,78 | 0,90 | -0,14 |

Source: Eurostat, Statistical Office of Slovakia

The decline of GDP growth rate which started in 1996 signalled that the existing policy mix is not sustainable. An optimal policy mix can be defined as a combination of fiscal and monetary policy which maintains price stability and allows the economy to perform near or at the production possibility frontier (Frank, 2004). The unsustainable fiscal policy, stagnating restructuring of the economy, the lack of momentum to implement further structural reforms and growing external and internal imbalances resulted in the need to implement significant macroeconomic and microeconomic reforms in the following years.

**Figure 11 - Structure of general government expenditure in 1995 – 1998 (share of individual expenditure on total expenditure – COFOG classification)**




Source: Eurostat, own calculations

In the observed period, the share of total general government expenditure reached from 48.7 % of GDP in 1995 to 45.8 % in 1998. The highest decline has been recorded in economic affairs by 2.3 percentage points, general public services by 1.1 percentage points and housing and community amenities by 0.7 percentage points. On the other hand, the highest increase has been recorded in social

protection by 1.4 percentage points. These changes are also reflected in the share of individual expenditure on total expenditure (figure 11). The highest decrease has been recorded in economic affairs by 3.7 percentage points, followed by general public services by 1.6 percentage points. The highest increase can be observed in social protection, where during this period, the share of expenditure went up by 4.7 percentage points from 27 % in 1995 to 31.7 % in 1998. Similarly the expenditure on health grew by 1.3 percentage points in 1998 relative to 1994. The development of expenditure in this period shows significant focus of the economic policy on health and social security, especially in the last two years.

Reform of the social system was not a key priority at that time. Only amendments that were necessary for coping with the most urgent problems were adopted and more significant changes were postponed into future. Until beginning of the new millennium, agreement on the way of reforming the social system had not been found and only halfway solutions were adopted. Strengthening the social safety net and long discussions on several issues (e.g. pensions) led to increasingly inefficient use of sources and growing passivity of people. Social system was insufficiently efficient, costly and it was not able to keep up with demographic and economic changes.

Transformation of social system in Slovakia had to add social dimension to the market economy. The principles of the transformation included: de-etatization, pluralisation, democratisation and privatization of the social system, as well as state guarantees. The social security system had to be disconnected from the state budget - the state system should be transformed to the public insurance system. The first crucial change regarding transformation of the Slovak social system was establishment of a new institution responsible for social insurance, the National Insurance Agency (1993) as a statutory institution. It had to administrate three separate funds - the funds for health, sickness and pension insurance. Since 1994, financing has really separated from the state budget. Subjects, for which the state had to pay the health, sickness and pension insurance, were defined in law. In 1995, the National Insurance Agency was divided into two statutory institutions - the Social Insurance Agency (administration of compulsory sickness and pension insurance) and the General Health Insurance Agency; and several other health insurance companies were established (plural health insurance system).

In 1996, *Scenario of transformation of the social system in the Slovak Republic* was adopted. It was based on the previous federal scenario, initially refused by Slovakia. The one pillar system of social security changed to the three pillar system consisting of social insurance, state social assistance and social aid. The basic system of social insurance was compulsory, guaranteed by state, regularly valorized and linked to the economic activity of citizens and to their work incomes. Replacing the term *social care* by the term *social aid* reflected that individual responsibility of citizens and their active approach to their own social situation became necessary. The changes focused on activation and tightening criteria in case of receivers of benefits. Gradually, family policy had reduced to financial benefits, which decreased in relation to living costs, and less attention was paid to flexible working time, development of services and linkages with gender policy. The living minimum, defined in 1991,

became the basis for calculation of several types of social benefits, not only a kind of definition of poverty limit, in 1998.

With respect to the prototype model of the capitalism, this period is difficult to classify. It can be concluded that the experiment with the own way of transition failed and led only to significant macroeconomic imbalances in the next period. The privatisation process was highly influenced by political decisions, with the objective to create the so called "Slovak capital stratum", composed of enterprises owned solely by the Slovak entrepreneurs. However, the majority of enterprises under control of these entrepreneurs were knowingly led into bankruptcy (so called "tunnelling"). The lack of relevant legal procedures and laws, the existing links between politicians and entrepreneurs made this behaviour possible, without any significant legal sanctions. As a result, the low inflow of FDI, international isolation of the Slovak Republic, expansive fiscal policy and restrictive monetary policy created significant macroeconomic imbalances. The relatively favourable development of unemployment rates was the result of the economic policy to maintain employment at all cost before the parliamentary election in 1998. Due to the limited restructuring of existing sectors and introduction of necessary stabilisation measures, the unemployment skyrocketed after 1998. The crucial turning point, which led to implementation of standard macroeconomic policies in the next stage of transition, was the result of the parliamentary elections in 1998.

### Stage of macroeconomic stabilisation and implementation of standard macroeconomic policies (1998-2002)

After the 1998 parliamentary elections, a new left-centre-right government had been appointed. The new government adopted a series of measures and in fact abandoned the concept of the so called "own way of transition". The main changes, which had been implemented, are following:

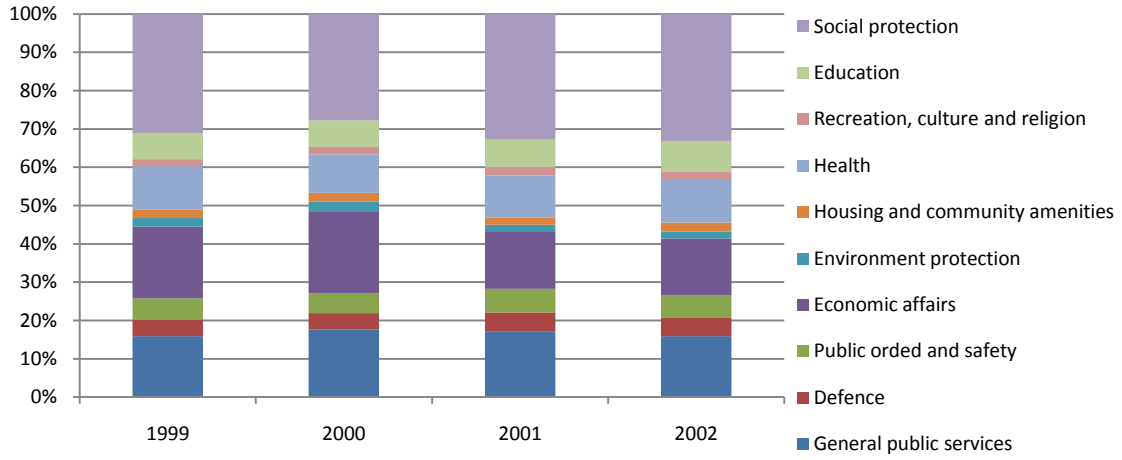
- Introduction of hard budgetary constraints on so called "strategic" state owned enterprises.
- Changes in fiscal policy towards a more transparent accounting of revenue and expenditure
- Focus on macroeconomic stability.
- Implementation of necessary institutional reforms: bankruptcy laws, changes in the position of natural monopolies (mainly network industries), increase of transparency of company ownership etc.
- Partial elimination of price distortions (price liberalisation).
- Consolidation and privatisation of state owned financial institutions.
- Changes in the regulation of financial markets.

However, the implementation of these reforms was not smooth from the beginning. The lengthy discussions about the depth and intensity of these reforms resulted in depreciation of the Slovak koruna against the US dollar. The National Bank of Slovakia abandoned the fixed exchange regime in favour of managed floating exchange regime. This depreciation forced the government to step in and implement a series of measures, which helped to stabilise the development. These measures included:

- Increase of the reduced VAT rate from 6 to 10 %.
- Introduction of import fees at 7 %.
- Gradual abolishment of state guarantees to enterprises.
- Abolishment of Specific State Funds and their integration into the general government budget.
- Decrease of capital expenditure.
- Wage freeze in public sector etc.

However, these measures were not accompanied by deeper structural reforms (public finance reform, social security reform, healthcare reform etc.) due to the opposing views in the government on the need of further structural reforms.

**Figure 12 - Structure of general government expenditure in 1999 - 2002 (share of individual expenditure on total expenditure – COFOG classification)**




Source: Eurostat, own calculations

Figure 12 shows the development of expenditure in 1999 – 2002. The total general government expenditure declined by 2.8 percentage points from 47.9 % in 1999 to 45.1 % in 2002, mainly due to the implementation of restrictive fiscal policies aimed at reduction of domestic demand. The only increase of expenditure relative to GDP has been recorded in education by minor 0.3 percentage points. The highest decline of expenditure relative to GDP has been recorded in economic affairs by 2.3 percentage points.

**Table 2 – Development of selected indicators in 1999 – 2002**

| | 1999 | 2000 | 2001 | 2002 | Average | 2002-1999 |
|---|---|---|---|---|---|---|
| **GDP growth** | 0,0 | 1,4 | 3,5 | 4,6 | 2,4 | |
| **Unemployment rate** | 16,2 | 18,6 | 19,2 | 18,5 | 18,1 | 2,3 |
| **Employment rate** | 49,7 | 48,6 | 48,6 | 48,7 | 48,9 | -1,0 |
| **Index of real wages (Y-o-Y)** | 96,9 | 95,1 | 101,0 | 105,8 | 99,7 | |
| **HICP** | 10,4 | 12,2 | 7,2 | 3,5 | 8,3 | -6,9 |
| **General government balance (% GDP)** | -7,4 | -12,3 | -6,5 | -8,2 | -8,6 | -0,8 |
| **General government gross debt (% GDP)** | 47,8 | 50,3 | 48,9 | 43,4 | 47,6 | -4,4 |
| **Private debt (% GDP)** | 60,3 | 48,6 | 49,0 | 53,1 | 52,8 | -7,2 |
| **Current account balance (% GDP)** | -5,7 | -3,5 | -8,3 | -7,9 | -6,4 | -2,2 |
| **Labour productivity per hour worked (EU27=100)** | 53,9 | 54,9 | 57,3 | 60,4 | 56,6 | 6,5 |
| **Total R&D expenditure (GERD/GDP)** | 0,66 | 0,65 | 0,63 | 0,57 | 0,63 | -0,09 |

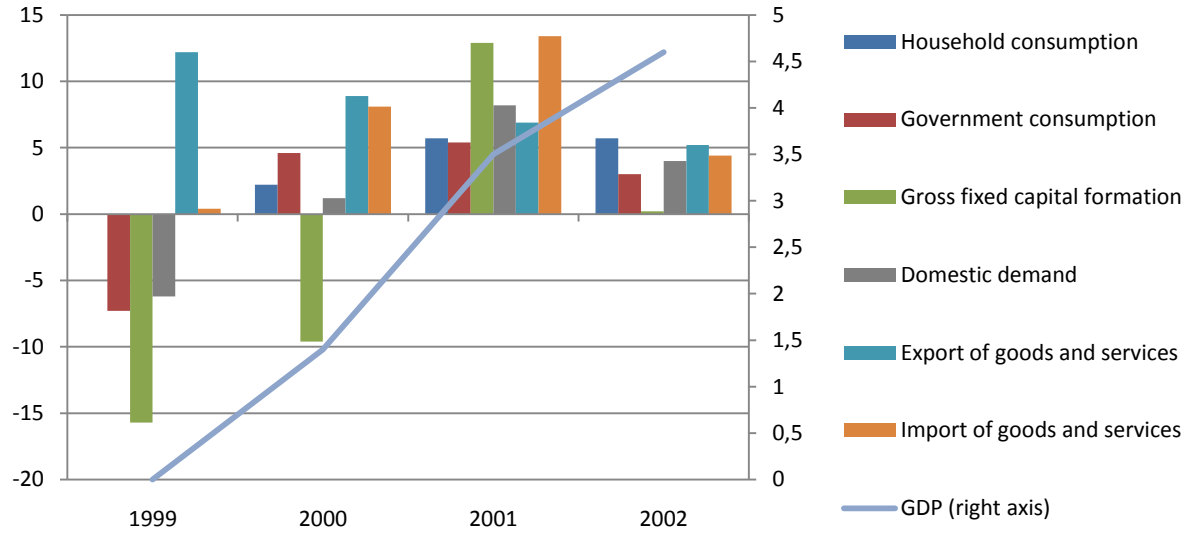
Source: Eurostat, Statistical Office of Slovakia, own calculations

As a result of the economic policy and the restructuring of enterprises, the average unemployment rate reached 18.1 % in this period. The highest unemployment rate of 19.2 % was recorded in 2001. The employment rate oscillated close to 48.5 %. The labour productivity per worker employed increased from 53.9 % in 1999 to 60.4 % of EU27 in 2002. The implementation of macroeconomic policies helped to reduce the general government debt from 47.8 % of GDP to 43.4 % in 2002. A more detailed look at table 2 shows that in 2000 the share of general government debt reached even 50.3 % of GDP. This rapid increase was caused by the need to undertake the restructuring of financial sector, which was highly undercapitalised and suffered from significant volume of non-performing loans. The total cost for restructuring of banking sector reached approximately 5 % of GDP in 2000.

Figure 13 shows that especially in the first two years of this period, the sharp decline of gross capital formation was recorded. In 1999, the negative development of all individual GDP components was offset by the export, thus avoiding an annual decline of GDP growth rate in Slovakia. In the following years Slovakia started to increase its annual growth rates from 0 % in 1999 to 4.6 % in 2002. Compared with the previous period, the economic growth was sustainable and did not create significant macroeconomic imbalances.

It can be concluded that this period laid the foundations for balanced economic growth in the following years. The large scale privatisation of state owned enterprises increased the inflow and stock of FDI, helped to recapitalise the economy and provided the necessary financial resources for the stabilisation of general government budget. However, the social consequences of these reforms resulted in steep increase in unemployment rates, especially in some regions due to restructuring of traditional industrial sectors. The process of privatisation has been accompanied by doubts about the transparency of the whole process. Although significant results in macroeconomic stabilisation have been achieved, the composition of the parliamentary majority did not provide enough momentum to implement more systemic reforms in pension system, healthcare and the structure of revenue and expenditure of public finance.

**Figure 13 – Changes in the individual GDP components (real Y-o-Y changes) in 1999 – 2002**




Source: Eurostat, Statistical Office of Slovakia

With regard to the prototypes of capitalism, economic policy in this period implemented large number of market oriented reforms, which created the foundation for even more market oriented reforms in the following period. Despite the composition of the government parties (left – centre – right coalition), the main principles of the reforms pushed the Slovak economy closer to liberal market economies.

### Stage of accelerating economic growth and more advanced reforms (2002-2006)

After the 2002 parliamentary elections, a more coherent government has been formed (however, with very narrow parliamentary majority), with the dominant position of centre-right parties. Moreover, the majority of parties, which formed the new government, had already experience from the previous election period. This provided unique opportunity for continuation of previous economic policy and implementation of more thorough economic reforms. The structural changes had been adopted in social security system (including changes in the pension system), labour code, collective bargaining, healthcare system, judiciary system and public finance. Significant efforts have been made in this period to catch-up with the neighbouring countries and start negotiations for EU accession. Table 3 shows a brief chronology of Slovakia's integration efforts.

**Table 3 – Chronology of Slovakia's EU accession efforts**

| | |
|---|---|
| 4. October 1995, Luxembourg | Signing of Association Treaty between Slovakia and the European Communities |
| 27. June 1995, Cannes | Official request of the Slovak government to join the EU |
| November 1996, Strasbourg | Resolution of the European Parliament calling to respect human rights and democracy in Slovakia |
| 12.-13. December 1997, Luxembourg | The EU Council recommend to start accession negotiations only with the six countries in the first group |
| 31. March 1998, London | Decision to start accession negotiations with six countries - Czech republic, Estonia, Hungary, Poland, Slovenia and Cyprus |
| 10. December 1999, Helsinki | Decision to open accession negotiations with Slovakia |
| 9. October 2002 | The European Commission approves the accession of Slovakia to the EU in 2004 |
| 1. May 2004 | Accession of Slovakia to the EU |

Significant reforms have been implemented in the field of public finance, especially in the tax system, which later became a “symbol” of economic reforms of Slovakia. Slovakia introduced a flat tax rate with 19 % on personal income as well as corporate income taxes. The uniform VAT tax rate at 19 % was introduced and most of the excise duties had been increased. The main idea was to shift from income taxation to consumption taxation. Further measures included the implementation of fiscal decentralisation, creation of the State Treasury and the Debt and Liquidity Management Agency. The main role of the Debt and Liquidity Management Agency within the system of the State Treasury is security of activities relating to operative state debt management, state liquidity management and management of the whole system of the State Treasury, management of financial risks and pursuance of financial operations in the financial market. These institutions have improved the public finance management with following effects:

- Increase of the state budget revenue.
- Cost reduction of state debt management.
- Increased transparency and quality of information on the development of public finance management.
- More efficient financing of the state budget deficit during the fiscal year.
- Reduction of transaction costs among the individual public sector organisations etc.

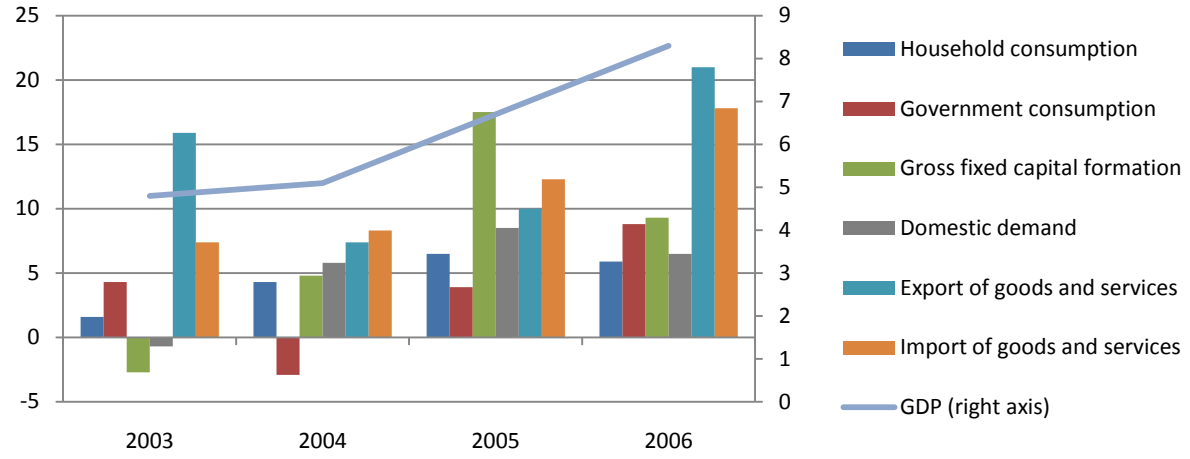
**Table 4 – Development of selected indicators in 2003 – 2006**

| | 2003 | 2004 | 2005 | 2006 | Average | 2006-2003 |
|---|---|---|---|---|---|---|
| **GDP growth** | 4,8 | 5,1 | 6,7 | 8,3 | 6,2 | |
| **Unemployment rate** | 17,4 | 18,1 | 16,2 | 13,3 | 16,3 | -4,1 |
| **Employment rate** | 49,6 | 49,1 | 49,8 | 51,2 | 49,9 | 1,6 |
| **Index of real wages (Y-o-Y)** | 98,0 | 102,5 | 106,3 | 103,3 | 102,5 | |
| **HICP** | 8,4 | 7,5 | 2,8 | 4,3 | 5,8 | -4,1 |
| **General government balance (% GDP)** | -2,8 | -2,4 | -2,8 | -3,2 | -2,8 | -0,4 |
| **General government gross debt (% GDP)** | 42,4 | 41,5 | 34,2 | 30,5 | 37,2 | -11,9 |
| **Private debt (% GDP)** | 48,8 | 48,8 | 51,4 | 55,1 | 51,0 | 6,3 |
| **Current account balance (% GDP)** | -5,9 | -7,8 | -8,5 | -7,8 | -7,5 | -1,9 |
| **Labour productivity per hour worked (EU27=100)** | 62,9 | 63,5 | 65,3 | 67,5 | 64,8 | 4,6 |
| **Total R&D expenditure (GERD/GDP)** | 0,57 | 0,51 | 0,51 | 0,49 | 0,50 | -0,08 |

Source: Eurostat, Statistical Office of Slovakia

The average annual GDP growth in this period reached 6.2 %, which contributed to reduction of unemployment rate from 17.4 % in 2003 to 13.3 % in 2006. The employment rate grew by 1.6 percentage points since the beginning of the period and reached 51.2 % in 2006. The rapid economic growth combined with relatively sound budgetary policies (the average general government deficit reached 2.8 %) resulted in decrease of public debt from 42.4 % to 30.5 % of GDP. Positive tendencies have been also recorded in labour productivity, which increased by 4.6 percentage points. Despite the implementation of large scale reforms in various sectors of the economy and public sector, some sectors have been omitted. The reform of education system as well as R&D and innovation support has not been implemented. The share of total R&D expenditure on GDP went down from 0.57 % in 2003 to 0.49 % in 2006.

**Figure 14 – Changes in the individual GDP components (real Y-o-Y changes) in 2003 – 2006**




Source: Eurostat, Statistical Office of Slovakia

The share of social protection reached 34.8 % in 2005 (figure 15), which was the highest value observed in all periods. The rest of the individual expenditure remained relatively stable, minor changes have been observed in general public services (from 16 % to 12.8 %) and health (from 12.4 % to 16.1%). The increase of expenditure on health has been caused by implementation of the health reform.

**Figure 15 - Structure of general government expenditure in 2003 - 2006 (share of individual expenditure on total expenditure – COFOG classification)**


Source: Eurostat, own calculations

It can be concluded that in this period, more coherent reforms, although not without mistakes, have been implemented. These reforms, together with the inflow of FDI, joining the EU and the operation of new industries, created preconditions for fast economic growth in the next stage.

Furthermore, a complex reform of the social system has been implemented, based on three principles: motivation of citizen, activity of citizen and benefit for citizen. Changes realized in social, tax and pension system as well as in public administration were mutually interconnected. *Strategy of promoting employment growth by means of social system and labour market reforms* set as a long-term goal a sustainable reduction of poverty achieved by employment growth and creating possibility to find a job for everyone who wants to work. The strategy underlined motivation aspects of social policy and criticized the previous social system claiming that clients misused it. Changes in coping with poverty were characterised by the need to activate beneficiaries by reducing the amount of benefits and tightening conditions for receiving them. However, it is doubtful whether reduction of benefits can motivate those who want to work but have a problem to find a job, given high unemployment and insufficient labour supply, especially in regions with traditional and long-term unemployment rate.

Since 2004, the Social Insurance Agency has had a nationwide competency in the area of the sickness insurance, the pension insurance, the accident insurance, the unemployment insurance and the guarantee insurance (the insurance in case of employer's insolvency). Hence, the Social Insurance

Agency has been designated to be the competent institution for the following branches of social security: sickness benefits, maternity and equivalent paternity benefits, invalidity benefits, old age benefits, survivors´ benefits, benefits in respect of accidents at work and occupational diseases, unemployment benefits.

Due to demographic and economic development, the pension system is becoming unsustainable[8]. The framework of the pension reform conducted in the 2003-2005 period included three pillars (two compulsory and one voluntary) of future pension income. The first compulsory pillar, performed by the Social Insurance Company, is based on the pay-as-you-go system and has a strong solidarity aspect. The second pillar represents an old-age pension saving performed by the pension funds management companies. It is based on compulsory savings and is strongly income-oriented. The third pillar, based on voluntary savings, is supplementary pension insurance performed by the supplementary pension companies. The first and the second pillars represent the basic system of the pension insurance. Those who are connected to the first pillar only pay an insurance premium for old-age insurance to the Social Insurance Company in the amount of 18% of an assessment basis. Those who are connected also to the second pillar paid 9% for the old-age insurance to the Social Insurance Company and 9% to the pension funds management company chosen (before changes adopted in 2013). The pension age was increased to 62 years for both men and women.

The authors of the reform considered the second pillar to be the tool for elimination of pension system unsustainability. However, this is not as sure as the expected age of living is increasing, hence old age benefits will be paid for a longer period. The strength of the pension reform consists in the fact that it constituted more sources of income and so distributed the risk of generating sources. However, it should be underlined that communication among supporters of different opinions on the pension reform and communication with citizens were insufficient (and rather ideological) prior to realization of the reform. This, together with the influence of the political cycle, resulted in several amendments of the pension reform, which weakened stability and reliability of the second pillar. [9]

Furthermore, many of the reforms especially in the healthcare and education were not finished or even not started. Especially the education sector is still lacking a coherent and clear strategy how to modify the existing system. The prerequisite of a successful entry of school leavers to the labour market is a new quality of vocational education and training. It requires adaptation of the existing branches of education and vocational training to the requirements of the labour market to avoid further qualification mismatch. In tertiary schools, it is necessary to focus on expanding the capacities (by diversifying higher education institutions), a significant quality and flexibility rising of higher education, human resource development and involvement of higher education and R&D institutions in innovation networks. Higher education institutions should lay more stress on providing higher education in a global language and on the support of student and researcher mobility. Slovakia's

[8] According to the European Commission, by 2060, Slovakia will have had the steepest increase in the old-age dependency ratio of all EU member states and will rank second after Poland (European Commission, 2012).

[9] At the end of 2012 more than 25 amendments and changes have been adopted.

significant priority in respect to access to education is the integration of children from risky and marginalised groups into standard school environment.

This transition period clearly pushed Slovakia to liberal market economies. The reform and principles of the social system, the tax reform, privatisation of state owned enterprises and the generally negative attitude toward state interventions and state ownership (although based on negative experience with political nominations and managements of state owned enterprises in the previous transition periods) were the most prominent features of economic policy. Despite the liberal market orientation, the importance of attracting foreign direct investment and competition among the CEEC countries in this area forced the government to provide substantial investment subsidies.

### Post-transitional stage (2007 – onwards)

In 2006 a new centre-left government was appointed, which basically accepted and only slightly amended the social-economic reforms implemented by the previous government. This period has been significantly affected by the economic crisis. Despite the effects of the crisis, the real GDP growth reached an average 3.8 % during these five years, mainly due to unprecedented growth in 2007 and 2008. The main factors, which contributed to the first recession experienced since the start of the transition, were rapid decline in external demand and gross fixed capital formation.

The effects of the crisis started to influence the Slovak economy at the end of 2008. In 2009, the impact of the crisis resulted in:

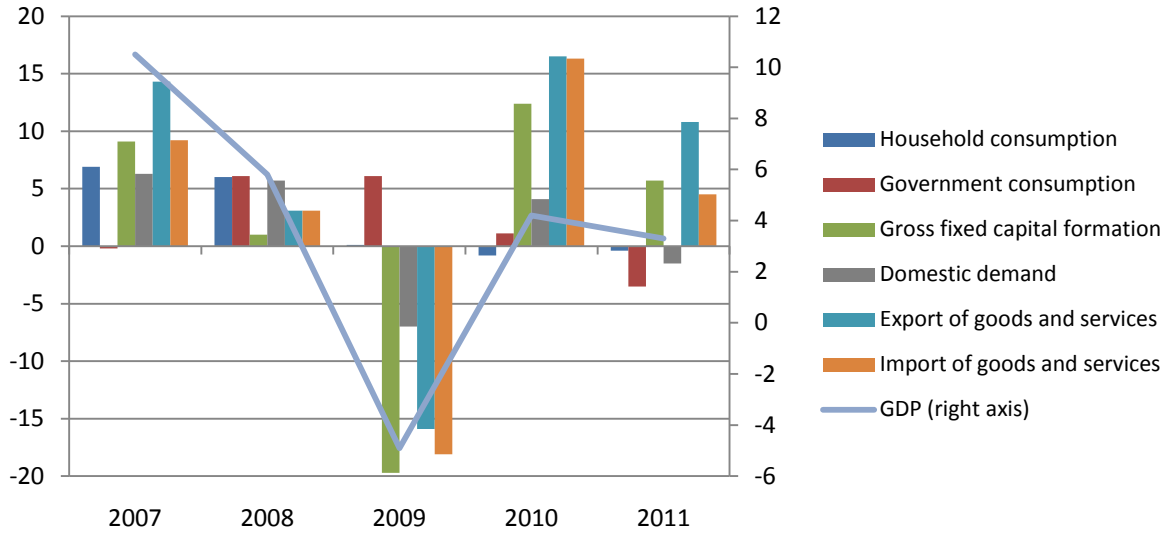
- Annual decrease of real GDP by 4.9 %.
- Annual growth of unemployment rate by 2.5 percentage points to 12.1 % and even to 14.4 % in 2010.
- Deterioration of general government balance. The general government deficit went up to 8 % of GDP in 2009 and 7.7 % in 2010. Consolidation efforts supported by the recovery of economic growth reduced the general government balance deficit to 4.9 % in 2011.
- High growth of general government gross debt. In the pre-crisis period, the gross general government debt was steadily declining to 27.9 % of GDP, the lowest level since the beginning of the transition. Since 2009 to 2011 the general government debt went up by 15.4 percentage points to 43.3 % of GDP.

**Table 5 – Development of selected indicators in 2007 – 2011**

| | 2007 | 2008 | 2009 | 2010 | 2011 | Average | 2011-2007 |
|---|---|---|---|---|---|---|---|
| **GDP growth** | 10,5 | 5,8 | -4,9 | 4,2 | 3,3 | 3,8 | |
| **Unemployment rate** | 11,0 | 9,6 | 12,1 | 14,4 | 13,5 | 12,1 | 3,4 |
| **Employment rate** | 52,3 | 53,7 | 51,8 | 50,5 | 51,1 | 51,9 | -1,8 |
| **Index of real wages (Y-o-Y)** | 104,3 | 103,3 | 101,4 | 102,2 | 98,4 | 101,9 | |
| **HICP** | 1,9 | 3,9 | 0,9 | 0,7 | 4,1 | 2,3 | -1,2 |
| **General government balance (% GDP)** | -1,8 | -2,1 | -8,0 | -7,7 | -4,9 | -4,9 | -5,9 |
| **General government gross debt (% GDP)** | 29,6 | 27,9 | 35,6 | 41,0 | 43,3 | 35,5 | 11,4 |
| **Private debt (% GDP)** | 64,3 | 69,4 | 73,9 | 72,8 | 76,3 | 71,3 | 8,5 |
| **Current account balance (% GDP)** | -5,3 | -6,2 | -2,6 | -3,7 | 0,1 | -3,5 | 1,6 |
| **Labour productivity per hour worked (EU27=100)** | 71,3 | 74,2 | 73,8 | 74,6 | 74,0 | 73,6 | 3,3 |
| **Total R&D expenditure (GERD/GDP)** | 0,46 | 0,47 | 0,48 | 0,63 | , | 0,50 | 0,17 |

Source: Eurostat, Statistical Office of Slovakia

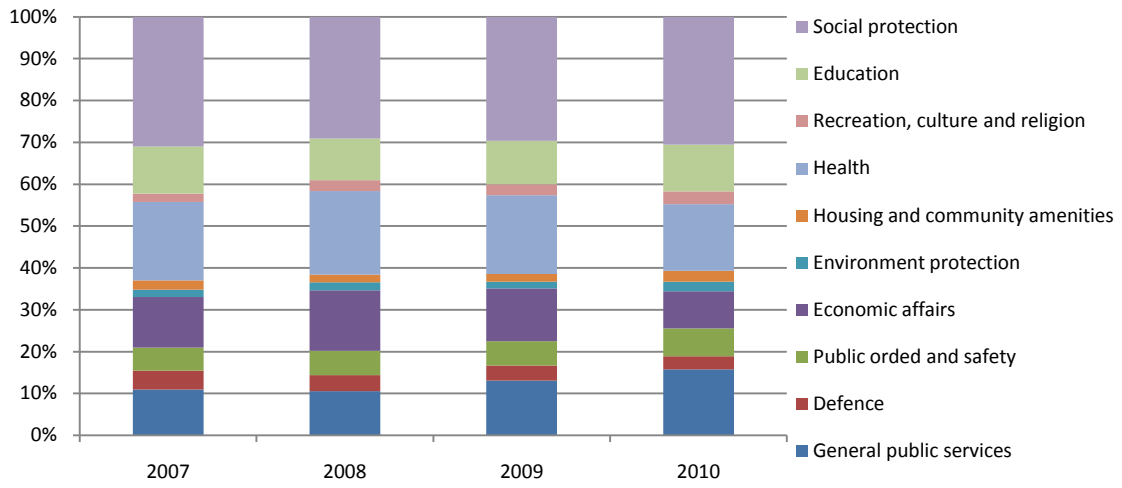
**Figure 16 – Changes in the individual GDP components (real Y-o-Y changes) in 2007 – 2011**




Source: Statistical Office of Slovakia

The structure of expenditure remained in most of the categories unchanged. Since 2007 to 2010 the highest increase can be observed in the general public services by 4.9 percentage points and public order and safety. The share of the rest of the individual expenditure on total expenditure decreased, mainly in economic affairs by 3.2 percentage points, health by 2.8 percentage points and defence by 1.4 percentage points (figure 17). The macroeconomic policy carried out in 2010 focused primarily on the reduction of the general government deficit. Due to the parliamentary elections in June 2010, the fiscal policy had only little manoeuvring space to elaborate a thorough plan for fiscal consolidation. Most of the measures focused only on general cuts in expenditure and increasing general government revenue. Further measures have been directed at institutional changes, electronic public procurement and auctions, sale of excessive immovable property, increase of direct and indirect taxes (VAT by 1 percentage point from 19 % to 20 %).

**Figure 17 – Structure of general government expenditure in 2007 - 2011 (share of individual expenditure on total expenditure – COFOG classification)**




Source: Eurostat, own calculations

In this period Slovakia started to use the available resources from EU Cohesion policy (approximately 11.5 billion EUR). Without EU funding, national regional policy would lack the necessary resources for regional development. Especially in times of fiscal consolidation and impact of the global economic crisis, the Cohesion Policy is providing significant amount of financial resources for regional development in all policy areas. The areas, which are benefiting from the progress in implementation of operational programmes, are transport infrastructure, research and development, environment, support of enterprises, healthcare and regeneration of public infrastructure. The regional disparities in Slovakia are characterised by a significant west – east and north – south divide, with the Bratislava region being the most developed region in terms of GDP per capita. The main factors underlying the existing regional disparities are the following:

- Lack of high quality transport infrastructure, low regional interconnection and accessibility.
- Institutional quality of regional and local administration.
- Low inter-regional as well as intra-regional mobility of labour force.
- Difficult access to affordable housing in areas providing employment opportunities.
- Environmental burdens related to previous heavy industrial activity.
- Low level of economic development in border regions, especially in the east and south of Slovakia – proximity to low developed regions of Ukraine, Poland and Hungary.
- Restructuring of "traditional" industry sectors.
- The quality of human resources (education attainment, entrepreneurial spirit).

The economic recession affected all Slovak regions and resulted in an increase in unemployment rates (above the national average) especially in the eastern and central parts of the country. However, the more developed regions in western part of Slovakia were affected as well. In general, the regions mostly affected by the recession were regions with a high share of export oriented industries localised in the western and northern parts of the country. The economic recovery was driven by external demand and gross capital formation. The recovery of production in export oriented indus-

tries (automotive, electronic) has not been accompanied by rapid employment growth, which resulted in substantial increase of labour productivity.

Due to relatively strong economic growth in Slovakia in the last two years (compared to the rest of EU countries), the decline in regional GDP per capita in PPS in 2009 will be only temporary. The latest available data on unemployment suggest that the economic recovery after the initial decline of GDP is not contributing to reduction of the unemployment rate and the development of unemployment remains highly uncertain. Whether these positive tendencies will continue is dependent on development of external environment and domestic economic policy. The high openness of the Slovak economy makes it vulnerable to business cycle changes in important export industries. It is necessary to point out that due to strong dependence of the Slovak economy on external demand, the future prospects of economic growth remain very fragile.

At present the Cohesion policy is providing significant amount of financial resources for public and private investments, mainly in the area of public infrastructure, R&D, territorial development, healthcare and environment. However, the financial implementation of Cohesion policy programmes is not optimal. Significant efforts are needed to fully utilise the potential of the financial resources allocated in the operational programmes to improve the absorption and more importantly to achieve the objectives set in the operational programmes. The significance of this instrument is even higher in times of fiscal austerity and lack of domestic public funding.

**Table 6 – Stages of transition in Slovakia with respect to the trinity of macroeconomic stability, welfare/equality and innovation/growth/competitiveness**

| | **1990 - 1992** | **1993 - 1998** | **1998 - 2002** | **2002 - 2006** | **2007 - onwards** |
|---|---|---|---|---|---|
| **Transition strategy** | Washington consensus | Own way of transition | Implementation of standard macroeconomic policies (right-centre-left coalition) | Implementation of more advanced reforms (centre-right government) | Influence of the political cycle (centre-left and since 2012 left-wing government) |
| **Macroeconomic stability** | Stabilisation measures | Weak | Improving | Improving | Deterioration due to the crisis |
| **Welfare/Equality** | Weak | Weak | Weak | Weak, unemployment slightly improving | Deterioration due to the crisis |
| **Innovation** | Weak | Weak | Weak | Weak | Weak |
| **Growth** | Transition recession | Unsustainable but high | Stagnation and slow growth | Growth recovery | Rapid economic growth, impact of the crisis |
| **Competitiveness** | Weak | Weak | Improving | Improving | Improving |

The economic reforms, which had been implemented in 1998 – 2006, have been more significantly modified after the appointment of the new left-wing government in 2012.[10] In the following year, the flat tax system has been modified towards more progressive taxation. The personal income tax rate has been set to 19 % and 25 % (for monthly income above EUR 3311) and the corporate income tax rate increased from 19 % to 23 %. The minimal level for social contributions for self-employed has been increased since 2013. The labour code has been also modified and strengthened the position of unions and employees. The pension reform is still one of the most discussed reforms in Slovakia. The most problematic issue is the high deficit in the Social Insurance Company, which is responsible for the pay-as-you-go system. For this reason, the participation rate in the second pillar has been decreased from 9 % to 4 % of gross wages. The government is pursuing its fiscal consolidation plan to reach the general government deficit below 3% of GDP in 2014.

The present development suggests that the effects of the reforms, which had been implemented in 1998 – 2006, are fading. The future development of the Slovak economy will depend also on a new set of reforms aimed at changes in the education system, R&D and innovation support, domestic SME support and implementation of extensive reforms in the public sector (especially the judiciary system and public administration). Despite the recently implemented changes in economic policy, Slovakia still seems to be closer to LME than to CME and the future development will be again strongly dependent on the political cycle.

[10] It is the first single party government in the history of independent Slovakia.

## 4. Initial plans and final outcomes – lessons from CEECs for the political economy of large-scale transformation of institutions

The way of managing transition in Slovakia is characterised by several mistakes which resulted in economic losses as well as decreasing confidence in transition process. The first stages of transition are characterized by following mistakes and shortcomings (Schmoegnerova, 2010):

1. the speed of transition,
2. a late start of building institutional framework of the market economy,
3. misunderstanding of the role of the state in the market economy in general and in transition process in particular.

There have been many discussions regarding the pace of reforms in Slovakia. The shock therapy proved to be appropriate for few reforms (price liberalisation), however, in some areas this approach was not feasible (privatisation, restructuring the enterprise sector) or it was even damaging (liberalisation of foreign trade relations) (Schmoegnerova, 2010). Liberalisation of foreign trade was conducted at once and in an asymmetric way. Privatization process, focusing on speed and range, suffered from several weaknesses; legal environment and institutional framework for business activities was insufficient.

An important question was whether the unexpectedly high costs of transition resulted from a too slow or from a too fast implementation of reforms. What is undisputed is that an inadequate timing, whether too slow or too fast, as well as an inadequate order of reforms can lead to slowdown or even to stoppage of the transition process (Morvay, 2005). However, there is no profound evidence that in case of realization of reforms according to the gradualist approach the results would be significantly better. In addition, the choice of the approach strongly depends on political decisions.

Transition from the centrally planned towards the market economy is coupled with a significant change of the role of state in the economy. As in a socialist economy government played a crucial role in the enterprise sector, the change of the role of the state became a strategic task of transition. However, many functions of the state were underestimated. An almighty state became almost powerless, which resulted in its incapability to respond to several market failures (Schmoegnerova, 2010). It took a rather long time to define the new tasks of the state in the market economy.

Transition process has created foundations of the market economy in Slovakia. However, its design is still not satisfactory. The global financial and economic crisis has revealed even more shortcomings of transition. Continual legislative and institutional changes and political controversies have been typical features of transition. The way of implementation of some welfare reforms makes their long term sustainability doubtful. Frequent changes of reforms, law amendments and sudden changes in the welfare system (in particular in the pension system) may increase fears about the final results of the reforms.

During transition, regional disparities have sharpened significantly, which has reflected in particular in increasing unemployment rate and growing number of receivers of social benefits. Long term un-

employment as well as unemployment of young people has become a serious social problem. Long term unemployment raises the risk of permanent dependence on social benefits, the risk of falling into poverty and transfer of poverty to the next generations.

Nowadays, the Slovak economy, similarly as the whole Europe, faces another two transitions, namely transition towards knowledge based economy and transition towards low carbon economy.

Although the transition of Slovakia and other CEECs countries towards market economies represents a unique process, identification of its successful sides as well as problems and shortcomings may be useful for other transition processes[11]. However, given the differences in initial conditions, in historical, political, economic and social background as well as in the final goals and character of reforms, it should be kept in mind that the story of economic transition of Slovakia from the centrally planned to the market economy, with its positive as well as negative features, cannot serve as a pure guide for conducting any transition in any country.

Anyway, as the Slovak experience with transition shows, it is crucial to build functioning institutions, in particular the formal ones, already in the initial stage of any transition. In addition, both too slow and too fast implementation of reforms can result in a slowdown or even stoppage of the transition process. At the same time, a high pace of reforms should not be achieved at the expense of their quality and long term sustainability, since numerous additional changes of institutions can decrease confidence in the authors of respective reforms.

Moreover, the experience of Slovakia shows how reform strategies and the parameters of adopted reforms are linked to the political cycle. In the periods of right-wing or centre-right governments, liberal policy direction tends to be significant. However, the change of the government to the left-wing one or centre-left one usually results in more or less significant changes in the policy direction, which slow down, stop or even return the economy from the way towards a liberal market economy.

[11] Transition process is understood as changes in structure as well as principles of functioning of an economy.

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# Annex 1

**Table 1 - Average values of policy and performance variables, scores and relative scores in CEECs and the three benchmark countries**

| Variable/Country | Czech Rep. | Hungary | Poland | Slovenia | | Bulgaria | Estonia | Latvia | Lithuania | Romania | Slovakia | | Germany | Italy | United King-dom |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Policy variables** | | | | | | | | | | | | | | | |
| Transfers and subsidies 00-09 | 70,9 | 52,5 | 50,5 | 55,6 | | 42,4 | 35,6 | 36,1 | 35,2 | 34,1 | 53,6 | | 75,6 | 57,4 | 37,6 |
| Size of Government 00-09 | 57,4 | 45,5 | 48,4 | 51,0 | | 37,7 | 34,4 | 43,6 | 36,5 | 38,8 | 42,1 | | 47,7 | 45,7 | 38,6 |
| Regulation 00-09 | 39,6 | 36,8 | 39,9 | 38,5 | | 34,0 | 27,9 | 32,7 | 33,6 | 37,8 | 35,2 | | 43,1 | 39,8 | 26,6 |
| **Performance variables** | | | | | | | | | | | | | | | |
| GINI 95 98 05 | 74,2 | 71,6 | 66,6 | 70,4 | | 68,4 | 65,6 | 65,8 | 66,3 | 70,0 | 74,2 | | 71,7 | 64,0 | 64,0 |
| Innovation 00-09 | 76,0 | 84,8 | 74,4 | 85,0 | | 65,7 | 78,3 | 65,6 | 72,2 | 48,3 | 71,2 | | 90,9 | 80,8 | 92,9 |
| Fiscal Debt 00-09 | 27,7 | 63,7 | 45,1 | 27,5 | | 36,2 | 5,0 | 15,0 | 20,5 | 20,3 | 37,5 | | 65,8 | 106,6 | 45,1 |
| **Scores and relative scores** | | | | | | | | | | | | | | | |
| **Policy variables** | | | | | | | | | | | | | | | |
| Transfers and subsidies 00-09 | 9 | 6 | 5 | 7 | | 5 | 2 | 3 | 1 | 1 | 6 | | 10 | 8 | 4 |
| Size of Government 00-09 | 10 | 6 | 8 | 9 | | 2 | 1 | 5 | 1 | 3 | 4 | | 7 | 6 | 3 |
| Regulation 00-09 | 8 | 5 | 9 | 7 | | 4 | 1 | 2 | 3 | 6 | 5 | | 10 | 8 | 1 |
| Relative score (% of maximum) | 0,90 | 0,57 | 0,73 | 0,77 | | 0,37 | 0,13 | 0,33 | 0,17 | 0,33 | 0,50 | | 0,90 | 0,73 | 0,27 |
| **Performance variables** | | | | | | | | | | | | | | | |
| GINI 95 98 05 | 10 | 9 | 5 | 8 | | 6 | 2 | 3 | 4 | 7 | 10 | | 9 | 1 | 1 |
| Innovation 00-09 | 5 | 8 | 5 | 8 | | 2 | 6 | 2 | 4 | 1 | 3 | | 9 | 7 | 10 |
| Fiscal Debt 00-09 | 7 | 2 | 4 | 7 | | 6 | 10 | 10 | 8 | 9 | 5 | | 2 | 1 | 4 |
| Relative score (% of maximum) | 0,73 | 0,63 | 0,47 | 0,77 | | 0,47 | 0,60 | 0,50 | 0,53 | 0,57 | 0,60 | | 0,67 | 0,30 | 0,50 |

**Table 2 - Average values of selected indicators in CEECs and the three benchmark countries**

| Indicator/Country | Bulgaria | Czech Republic | Estonia | Ger-many | Hungary | Italy | Latvia | Lithua-nia | Poland | Romania | Slovakia | Slovenia | United Kingdom |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Innovation/Growth/Competitiveness** | | | | | | | | | | | | | |
| GDP growth rate - Y-o-Y change (95-11) | 2.8 | 3.0 | 5.1 | 1.4 | 2.3 | 1.0 | 4.2 | 4.7 | 4.4 | 2.6 | 4.5 | 3.4 | 2.3 |
| Gross domestic expenditure on R&D in % of GDP (95-11) | 0.5 | 1.3 | 1.1 | 2.5 | 0.9 | 1.1 | 0.5 | 0.7 | 0.6 | 0.5 | 0.6 | 1.5 | 1.8 |
| Labour productivity per hour worked vs. EU average (00-11) | 37.3 | 66.4 | 51.0 | 125.6 | 56.5 | 106.3 | 39.2 | 50.0 | 50.0 | 33.5 | 66.6 | 79.6 | 111.3 |
| Patent applications to the European Patent Office per million inhabitants (95-11) | 1.78 | 11.09 | 11.68 | 255.42 | 12.67 | 70.18 | 4.92 | 2.43 | 2.97 | 0.83 | 4.22 | 40.14 | 87.70 |
| **Macroeconomic Stability** | | | | | | | | | | | | | |
| Current account balance in % of GDP - (95-11) | -6.5 | -3.7 | -7.2 | 2.7 | -5.2 | -0.3 | -7.7 | -7.3 | -4.1 | -6.6 | -6.0 | -1.5 | -1.8 |
| General government deficit/surplus (95-11) | -0.1 | -4.4 | 0.3 | -2.7 | -5.5 | -3.6 | -2.3 | -3.6 | -4.6 | -3.8 | -5.6 | -3.2 | -3.5 |
| General government gross debt (95-11) | 44.2 | 24.8 | 5.8 | 65.4 | 66.8 | 111.3 | 18.1 | 21.4 | 45.4 | 19.2 | 37.5 | 27.3 | 50.2 |
| HICP 2005=100 - annual data (97-11) | 6.8 | 3.2 | 4.8 | 1.5 | 7.5 | 2.2 | 5.1 | 3.5 | 5.1 | 29.0 | 5.4 | 5.1 | 2.1 |
| Private debt in % of GDP - non consolidated - annual data (95 - 11) | 102.7 | 67.8 | 103.5 | 126.7 | 93.8 | 97.1 | 87.6 | 47.4 | 48.3 | 60.0 | 60.5 | 96.3 | 172.7 |
| **Welfare/Equality** | | | | | | | | | | | | | |
| Employment rate 20 -64 years (98-11) | 62.4 | 71.3 | 71.0 | 70.9 | 61.3 | 60.2 | 68.4 | 68.3 | 61.6 | 65.3 | 65.3 | 70.1 | 74.4 |
| Unemployment rate, annual average % (98-11) | 11.7 | 7.2 | 10.3 | 8.7 | 7.6 | 8.4 | 12.6 | 12.0 | 13.8 | 6.8 | 15.3 | 6.4 | 5.8 |
| Long-term unemployment - annual average (98-11) | 6.8 | 3.3 | 4.7 | 4.5 | 3.5 | 4.6 | 5.7 | 5.6 | 6.7 | 3.3 | 9.6 | 3.1 | 1.5 |
| Gini coefficient (05-11) | 32.7 | 25.2 | 32.3 | 28.7 | 26.8 | 31.8 | 36.8 | 34.9 | 32.4 | 34.2 | 25.6 | 23.5 | 33.1 |
| COFOG - Social protection % GDP (02-11) | 12.0 | 13.0 | 11.4 | 20.7 | 17.1 | 18.8 | 11.0 | 11.8 | 17.0 | 12.0 | 12.3 | 17.1 | 16.1 |
| In-work at-risk-of-poverty rate (Source SILC) (05-11) | 49.5 | 16.1 | 22.8 | 19.8 | 30.2 | 25.7 | 38.9 | 32.8 | 33.2 | 43.0 | 23.1 | 18.0 | 23.2 |
| Expenditure on social protection per inhabitant (99-10) | 1557 | 3224 | 1827 | 7607 | 2936 | 6312 | 1468 | 1804 | 2323 | 1195 | 2402 | 4376 | 6833 |

Source: Eurostat (2013), own calculations.

**Table 3 – Scores and relative scores for selected indicators in CEECs and the three benchmark countries**

| | Czech Republic | Hungary | Poland | Slovenia | Bulgaria | Estonia | Latvia | Lithuania | Romania | Slovakia | Germany | Italy | United Kingdom |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Macroeconomic stability** | | | | | | | | | | | | | |
| Current account balance in % of GDP - (95-11) | 6 | 4 | 5 | 8 | 3 | 2 | 1 | 2 | 3 | 4 | 10 | 9 | 7 |
| General government deficit/surplus (95-11) | 2 | 1 | 2 | 6 | 9 | 10 | 8 | 5 | 3 | 1 | 7 | 4 | 6 |
| General government gross debt (95-11) | 7 | 2 | 5 | 6 | 5 | 10 | 10 | 8 | 9 | 6 | 3 | 1 | 4 |
| HICP 2005=100 - annual data (97-2011) | 8 | 2 | 5 | 5 | 3 | 6 | 6 | 7 | 1 | 4 | 10 | 9 | 10 |
| Private debt in % of GDP - non consolidated -(95 - 11) | 7 | 5 | 10 | 5 | 4 | 3 | 6 | 10 | 9 | 8 | 2 | 4 | 1 |
| Relative score (% of maximum 50 points) | 0,60 | 0,28 | 0,54 | 0,60 | 0,48 | 0,62 | 0,62 | 0,64 | 0,50 | 0,46 | 0,64 | 0,54 | 0,56 |
| **Innovation/Growth/Competitiveness** | | | | | | | | | | | | | |
| GDP growth rate - Y-o-Y change (95-11) | 5 | 2 | 8 | 6 | 4 | 10 | 7 | 9 | 3 | 8 | 1 | 1 | 2 |
| Gross domestic expenditure on R&D in % of GDP (95-11) | 8 | 5 | 3 | 9 | 2 | 6 | 1 | 5 | 1 | 4 | 10 | 7 | 10 |
| Labour productivity per hour worked vs. EU average (00-11) | 6 | 5 | 3 | 8 | 1 | 4 | 2 | 3 | 1 | 7 | 10 | 9 | 10 |
| Patent applications to the European Patent Office per million inhabitants (95-11) | 5 | 7 | 3 | 8 | 1 | 6 | 5 | 2 | 1 | 4 | 10 | 9 | 9 |
| Relative score (% of maximum 40 points) | 0,60 | 0,48 | 0,43 | 0,78 | 0,20 | 0,65 | 0,38 | 0,48 | 0,15 | 0,58 | 0,78 | 0,65 | 0,78 |
| **Welfare/Equality** | | | | | | | | | | | | | |
| Employment rate 20 -64 years (98-11) | 10 | 1 | 2 | 7 | 3 | 9 | 6 | 6 | 5 | 4 | 8 | 1 | 10 |
| Unemployment rate, annual average % (98-11) | 8 | 7 | 1 | 10 | 4 | 5 | 2 | 3 | 9 | 1 | 6 | 6 | 10 |
| Long-term unemployment - annual average (98-11) | 8 | 7 | 2 | 9 | 1 | 5 | 3 | 4 | 8 | 1 | 6 | 5 | 10 |
| Gini coefficient (05-11) | 10 | 8 | 5 | 10 | 4 | 6 | 1 | 1 | 2 | 9 | 7 | 6 | 3 |
| COFOG - Social protection % GDP (02-11) | 5 | 8 | 7 | 8 | 3 | 1 | 1 | 2 | 3 | 4 | 10 | 9 | 6 |
| In-work at-risk-of-poverty rate (Source SILC) (05-11) | 10 | 6 | 4 | 10 | 1 | 8 | 3 | 5 | 2 | 7 | 9 | 6 | 7 |
| Expenditure on social protection per inhabitant (99-10) | 6 | 6 | 4 | 7 | 2 | 4 | 1 | 3 | 1 | 5 | 10 | 8 | 9 |
| Relative score (% of maximum 70 points) | 0,81 | 0,61 | 0,36 | 0,87 | 0,26 | 0,54 | 0,24 | 0,34 | 0,43 | 0,44 | 0,80 | 0,59 | 0,79 |

# Annex 2

**Selected gender issues**

When we have a look at selected gender issues (gender employment gap, share of women researcher) in the CEECs and in benchmark countries, there are relatively big differences. Information on the gender employment gap (calculated as the difference between the employment rates of men and women) for the CEECs before transition to market economy is not available, but it is likely that the gender gap in employment was probably smaller (or in any case not much larger) than in the beginning of this millennium. The planned economy required a large workforce, and the state encouraged women's participation through family-related supports and benefits. The transition has weakened job security for both women and men, although women have tended to lose somewhat more than men.

The gap has narrowed in particular in the Baltic States since 2000 (table 1). In 2011, the smallest employment gap was found in Lithuania and Latvia, followed by Bulgaria, Estonia and Slovenia. All these countries reached even lower employment gap than Germany and the UK. At the opposite end of ranking were the Czech Republic and Slovakia, with employment of both men and women being higher in the Czech Republic than in Slovakia. However, these two countries still register smaller gender gap compared to Italy, where employment of women is even below 50 %.

**Table 1 – Gender employment gap in the CEECs and the three benchmark countries**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Bulgaria** | 9,5 | 6,8 | 7,1 | 8,2 | 8,4 | 9,7 | 9,5 | 9,9 | 10,7 | 9,8 | 7,4 | 5,4 |
| **Czech Republic** | 18,3 | 18,1 | 18,6 | 18,7 | 18,1 | 18,8 | 18,6 | 19,1 | 19,5 | 18,8 | 18,7 | 18,2 |
| **Estonia** | 9,5 | 9,3 | 10,0 | 9,5 | 7,9 | 6,4 | 7,0 | 8,9 | 8,9 | 2,2 | 2,0 | 5,9 |
| **Germany** | 15,6 | 15,0 | 13,7 | 12,8 | 12,3 | 12,5 | 12,2 | 12,4 | 12,3 | 10,9 | 10,5 | 10,3 |
| **Hungary** | 15,0 | 14,8 | 14,7 | 14,1 | 13,9 | 13,6 | 14,2 | 14,7 | 13,9 | 12,6 | 11,0 | 11,9 |
| **Italy** | 30,6 | 29,6 | 29,1 | 29,0 | 26,6 | 26,4 | 25,9 | 25,9 | 24,8 | 24,1 | 23,3 | 22,7 |
| **Latvia** | 8,9 | 7,4 | 8,4 | 9,6 | 9,1 | 9,7 | 9,1 | 9,4 | 7,6 | 0,6 | 0,2 | 2,9 |
| **Lithuania** | 3,5 | 3,6 | 6,9 | 6,9 | 8,4 | 8,3 | 6,9 | 7,0 | 6,7 | -0,6 | -1,5 | 1,0 |
| **Poland** | 13,8 | 13,0 | 12,2 | 11,9 | 12,3 | 13,4 | 14,2 | 14,7 | 15,7 | 15,0 | 13,9 | 14,6 |
| **Romania** | 12,4 | 12,3 | 13,3 | 13,5 | 12,3 | 13,5 | 12,7 | 13,1 | 14,3 | 14,4 | 14,9 | 14,2 |
| **Slovakia** | 12,8 | 12,2 | 13,0 | 13,0 | 14,2 | 15,8 | 17,1 | 17,3 | 17,1 | 16,4 | 14,5 | 15,1 |
| **Slovenia** | 9,6 | 10,5 | 10,3 | 10,4 | 10,0 | 9,6 | 9,8 | 10,4 | 8,9 | 7,7 | 7,5 | 7,0 |
| **United Kingdom** | 14,6 | 14,3 | 14,1 | 14,2 | 14,1 | 13,5 | 13,4 | 13,8 | 13,0 | 11,4 | 11,4 | 11,5 |

Source: Eurostat, own calculations.

As regards research and development sector, despite some progress, gender inequalities tend to persist in the whole EU. Among the CEECs, the share of women researchers is the lowest in the Czech Republic and in Hungary, reaching less than one third of total researchers in all sectors; however, still more than in Germany (table 2). On the other hand, in Lithuania and Bulgaria, the proportion of female researchers even exceeds that of male researchers, followed by the other two Baltic States,

Romania and Slovenia. With less than 35 % share of women researchers, Slovakia is at the level of Italy and belongs to the CEECs with higher gender inequality in this respect. In sum, Lithuania is a country with almost no gender inequalities in the two indicators, while in the Czech Republic, inequalities are the largest among the CEECs.

**Table 2 – Share of women researcher in all sectors in the CEECs and the three benchmark countries (full-time equivalent, % of total researchers)**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Bulgaria** | 45,9 | 46,1 | 47,2 | 47,3 | 47,2 | 46,5 | 45,4 | 47,8 | 48,0 | 48,4 | 50,2 |
| **Czech Republic** | 25,6 | 25,7 | 26,2 | 26,1 | 24,9 | 26,3 | 25,3 | 25,4 | 25,4 | 26,0 | 25,4 |
| **Estonia** | 41,6 | 42,0 | 41,3 | 42,2 | 41,3 | 39,5 | 40,4 | 41,5 | 37,9 | 41,6 | 41,4 |
| **Germany** | : | 16,1 | : | 16,3 | : | 17,5 | : | 18,6 | : | 20,6 | : |
| **Hungary** | : | : | : | : | : | : | 31,4 | 31,7 | 30,7 | 30,4 | 30,2 |
| **Italy** | : | : | : | 28,6 | 29,1 | 32,5 | 32,9 | 33,8 | : | 34,2 | 34,6 |
| **Latvia** | 49,3 | 55,1 | 53,2 | 53,3 | 54,3 | 49,8 | 47,5 | 49,6 | 49,7 | 50,3 | 46,8 |
| **Lithuania** | 43,6 | 46,6 | 47,2 | 48,4 | 47,3 | 48,5 | 48,6 | 48,5 | 48,8 | 50,4 | 50,8 |
| **Poland** | 60,8 | : | : | 37,5 | 37,2 | 39,4 | 38,4 | 39,4 | 38,1 | 38,2 | 38,4 |
| **Romania** | 42,9 | 43,3 | 45,3 | 44,6 | 44,6 | 46,2 | 45,2 | 43,8 | 45,6 | 44,8 | 44,5 |
| **Slovakia** | 35,2 | 34,4 | 34,6 | 31,8 | 32,0 | 33,8 | 33,1 | 33,7 | 33,1 | 33,7 | 34,6 |
| **Slovenia** | 38,8 | 39,8 | 40,8 | 41,0 | 41,3 | 41,1 | 42,1 | 41,4 | 42,3 | 42,2 | 42,0 |
| **United Kingdom** | : | : | : | : | : | : | : | : | : | : | : |

Source: Eurostat.

# Annex 3

## Transition stages in a nutshell

**1990-1992: Federal transition strategy within Czechoslovakia**

- Deep transition recession during 1991-1992,
- Swift privatization along three fronts (restitution, small-scale privatization, voucher privatization),
- Price liberalization,
- Break-up of Czechoslovakia and foundation of two independent states

**1992-1998: Independence and the stalled transition**

- On January 1, 1993 foundation of the independent Slovak Republic,
- Foundation of Slovak koruna and National Bank of Slovakia
- Expansionary fiscal policy
- Fixed exchange rate
- Liberalisation of the foreign trade and minor liberalisation of regulated prices
- Crowding – out effect, high interest rates due to suboptimal policy mix

**1998-2002: Macroeconomic stabilisation, implementation of first reforms**

- Managed floating exchange rate (October 1998),
- Restored short-term macroeconomic stability
- Gradual liberalisation of prices in network industries
- Restructuring and privatisation of the banking sector
- Restrictive fiscal policy
- Accession to the OECD (2000)

**2002 – 2006 onwards: Completing the transition – structural reforms and EU and Eurozone accession**

- Significant reforms implemented (tax reform, pension reform, social insurance, labour market)
- Public finance reform, pension system reform, labour market reforms
- High inflow of FDI, expansion of the automotive industry, privatisation.
- Accession to the EU, NATO, ERM II and EMU
- Accelerating growth of GDP

**2007 – onwards: Post-transitional stage**

- Impact of the economic crisis, first recession since the 1993.
- Euro adoption in 2009
- Rising unemployment, structural problems
- Deterioration of budgetary balances. Fiscal expansion in 2009, after 2009 consolidation of general government deficit.
- Gradual deconstruction of flat tax system, changes in the pension systems, labour market policies (especially the labour code)

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# Project Information

## Welfare, Wealth and Work for Europe

## A European research consortium is working on the analytical foundations for a socio-ecological transition


### Abstract

Europe needs a change: The financial crisis has exposed long neglected deficiencies in the present growth path, most visibly in unemployment and public debt. At the same time Europe has to cope with new challenges ranging from globalisation and demographic shifts to new technologies and ecological challenges. Under the title of Welfare, Wealth and Work for Europe – WWWforEurope – a European research consortium is laying the analytical foundations for a new development strategy that enables a socio-ecological transition to high levels of employment, social inclusion, gender equity and environmental sustainability. The four year research project within the 7th Framework Programme funded by the European Commission started in April 2012. The consortium brings together researchers from 33 scientific institutions in 12 European countries and is coordinated by the Austrian Institute of Economic Research (WIFO). Project coordinator is Karl Aiginger, director of WIFO.

For details on WWWforEurope see: www.foreurope.eu


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