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From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
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National Reform Programme of Slovakia and delivering a Council opinion
on the 2019 Stability Programme of Slovakia

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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of Slovakia and delivering a Council opinion
on the 2019 Stability Programme of Slovakia**

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THE COUNCIL OF THE EUROPEAN UNION,

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

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

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify Slovakia as one of the Member States for which an in-depth review would be carried

¹ OJ L 209, 2.8.1997, p. 1.

out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which was endorsed by the European Council on 21 March 2019. On 9 April 2019, the Council adopted the recommendation on the economic policy of the euro area ('Recommendation for the euro area').

- (2) As a Member State whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovakia should ensure the full and timely implementation of the Recommendation for the euro area, as reflected in recommendations (2) to (4) below. In particular, measures to tackle corruption and improving the justice system will help address the first euro area recommendation as regards quality of institutions, focusing economic policy related to investment in the specified areas will help address the second euro area recommendation as regards supporting investment, and measures to improve skills will help address the third euro area recommendation as regards functioning of the labour market.
- (3) The 2019 country report for Slovakia² was published on 27 February 2019. It assessed Slovakia's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Slovakia's progress towards its national Europe 2020 targets.
- (4) On 25 April 2019, Slovakia submitted its 2019 National Reform Programme and its 2019 Stability Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance⁴.
- (6) Slovakia is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Stability Programme, the government expects the headline balance to improve from a deficit of 0.7% of GDP in 2018 to a balanced budget in 2019 and to remain unchanged out to 2022. Based on the recalculated structural balance⁵, the medium-term budgetary objective – which has been changed from a structural deficit of 0.5% of GDP in 2019 to 1% of GDP as of 2020 – is planned to be achieved in 2020.

² SWD(2019) 1024 final.

³ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

⁴ COM(2014) 494 final.

⁵ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

According to the 2019 Stability Programme, the general government debt-to-GDP ratio is expected to gradually decline from 47.5% in 2019 to 44.4% by 2022. The macroeconomic scenario underpinning those budgetary projections is plausible. At the same time, the measures needed to support the planned deficit targets from 2019 onwards have not been fully specified. The budget includes a non-specified category of expenditure called budgetary reserves (totalling 0.7% of GDP), which reduces predictability in budget implementation.

- (7) On 13 July 2018, the Council recommended Slovakia to ensure that the nominal growth rate of net primary government expenditure⁶ does not exceed 4.1% in 2019, corresponding to an annual structural adjustment of 0.5% of GDP. In view of the Commission autumn 2018 forecast, which projected a closer position to the medium term objective in 2019, and consistent with the rules for unfreezing the required adjustment, the nominal growth rate of net primary government expenditure should not exceed 4.6%, corresponding to an annual structural adjustment of 0.3% in 2019. Based on the Commission 2019 spring forecast, there is a risk of significant deviation from the recommended fiscal adjustment over 2018 and 2019 taken together.
- (8) In 2020, Slovakia should achieve its medium-term budgetary objective. Based on the Commission 2019 spring forecast under unchanged policies, this is consistent with a maximum nominal growth rate of net primary government expenditure of 4.6%, corresponding to a structural adjustment of 0.3% of GDP. Based on the Commission 2019 spring forecast under unchanged policies, there is a risk of a significant deviation from that requirement over 2019 and 2020 taken together. Slovakia is forecast to comply with the debt rule in 2019 and 2020. Overall, the Council is of the opinion that the necessary measures should be taken as of 2019 to comply with the provisions of the Stability and Growth Pact.
- (9) Slovakia's public finances face medium fiscal sustainability risks in the long term. According to the Commission's 2018 Fiscal Sustainability Report, a cumulated improvement of 2.5 pps of GDP in the structural primary balance would be required to stabilise the debt-to-GDP ratio over the long term, relative to the no-policy-change scenario. This is due to the projected increase in pension and healthcare expenditure that is driving up ageing costs (joint contribution of 1.8 pps of GDP). As birth rates are low while life expectancy in Slovakia is expected to increase further, the old-age dependency ratio (comparing elderly people with the active population – the share of the population in work or training) is projected to almost triple by 2060. And, while in 2016 there were only about three inactive people above 65 for every ten employed persons, this is projected to rise to more than seven for every ten employed by 2060 (economic old-age dependency ratio). Introducing automatic adjustments of the retirement age to life expectancy had gradually improved the long-term sustainability of the pension system. This was seen as an important tool to ensure intergenerational fairness and long-term sustainability. Concerns over the long-term fiscal sustainability of the pension systems have heightened following the adoption by Parliament on 28

⁶ Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

March 2019 of a constitutional amendment instituting retirement age caps (64 for men and women without children, with half a year reductions for women for each of the first three children) and scrapping the automatic adjustments linked to life expectancy. According to Slovakia's Fiscal Council, the cap will bring an additional expenditure increase of 1.6% of GDP, from 8.6% in 2016 to 11.4% in 2070 compared to the increase to 9.8% projected in the 2018 Ageing Report. This will significantly increase sustainability risks. No counterbalancing measures have been put forward at this moment and the impact on old age income and poverty has not been calculated.

- (10) Despite some progress in fighting tax evasion, tax compliance remains a challenge and the VAT compliance gap was more than twice the EU average in 2016. While measures planned under the Third Action Plan are expected to bring positive results, some of them are still pending implementation. For instance, the introduction of electronic tax returns is likely to reduce the administrative burden on taxpayers, but a failure to implement all planned measures risks diminishing the overall effect. At the same time, a structured framework of policy measures can help to reduce frequent changes in the tax code and encourage its simplification. Finally, the revenue potential of environmental and property taxation is underused relative to other EU countries.
- (11) Positive developments in the labour market continue, marked by increasing employment and historically low levels of unemployment. There has been good progress in implementing the Action plan for the long-term unemployed, which has helped reduce the number of long-term unemployed by one third over two years. Nevertheless, the long-term unemployment rate remains above the EU average, affecting in particular low-skilled people, young people and Roma. In contrast to falling unemployment rates, reports of skilled labour shortages have become a major issue. Severe regional disparities in the labour market continue to be observed, with higher unemployment concentrated in three regions of eastern Slovakia and labour shortages concentrated in the western part of the country. Continued capacity building for employers and trade unions is needed to promote their more active involvement.
- (12) The range and effectiveness of policies to improve employability is limited. Training and requalification programmes have been strengthened, but are still insufficient and do not target fully the long-term unemployed and disadvantaged groups. The education system does not sufficiently contribute to socio-economic development and is under-funded at all levels. The low quality of educational results, the participation of Roma in inclusive mainstream education as of early childhood and the effective integration of pupils from socio-economically disadvantaged backgrounds in education and training (given the increasing early school leaving rate) are pressing challenges. Educational results and the level of basic skills remain weak by international standards, strongly affected by the pupils' socioeconomic background. Ensuring the Slovak population is equipped with better sets of skills for a changing economy and society is a challenge. Despite progressive salary increases until 2020, the teaching profession remains unattractive and faces increasing shortages. In addition, the quality and relevance of initial training and opportunities for professional development of teachers are limited. Current measures to foster equity and inclusive education have so far fallen short of expectations, and no real progress on desegregation of Roma students was observed. The government has adopted the "National reform plan for education and upbringing" (2018–27) and the first Action Plan (2018-19) (together with an estimated budget), as well as new legislation on

quality assurance in higher education. It will be crucial that these measures are effectively implemented and monitored to see if they bring the expected results.

- (13) The low employment rate for women reflects the fact that long parental leave is rarely taken up by men and is further accentuated by limited access to and low availability of affordable childcare and long-term care facilities. For children under the age of three in particular, the overall enrolment rates in childcare are extremely low. The government adopted a new decision on mandatory participation in early childhood education and care as of 5 years old, with the effect as of 2020. However, further investment and encouraging attendance in childcare and pre-school facilities is needed.
- (14) Even though the share of people at risk of poverty or social exclusion is below the EU average, levels are considerably higher in a number of districts in Southern and Eastern Slovakia. A considerable bottleneck exists in access to high-quality and inclusive education, where the regional disparities translate into particularly pronounced early school leaving rates. Other bottlenecks concern access for disadvantaged groups, in particular for Roma, as well as people with disabilities and people that suffer from homelessness and housing exclusion, to healthcare, long-term care, social housing and other essential services. An integrated approach is essential in order to foster social inclusion for these groups.
- (15) Reforms aimed at improving the cost-effectiveness of the healthcare system are gaining momentum, although the degree of implementation has varied across different care areas. Policy measures carried out in the context of the health spending review achieved some positive results, mainly following a series of cost containment measures in the areas for pharmaceuticals and medical devices. However, there is still room for increasing efficiency and delivering better-value care by strategically reallocating resources between areas of care. Health service delivery remains excessively reliant on hospitals, which, despite regular debt relief, continue to accumulate debt and struggle to fund the investments required to improve efficiency and quality of care. While strengthening primary care is key to reducing avoidable use of hospital services, the low number of general practitioners and the limited scope of services offered in primary care act as a bottleneck to improving the efficiency of the health system. As the government has initiated measures to tackle health workforce shortages, it will be important to fit these efforts into a longer-term strategy aimed at gradually decentralising services from acute care, strengthening primary care and reinforcing preventive services.
- (16) A fragmented research system undermines the effectiveness of public research and development investment in raising scientific research quality and does not attract private funding. Research and innovation policy suffers from ineffective coordination among ministries and other actors, leading to delays and failures of major reforms. The suboptimal transformation process of the Slovak Academy of Sciences raised concerns about the continuity of its operations, which led to the collapse of the whole process. A lack or failure of targeted measures, together with limited engagement by research institutions and limited research capacity, all contribute to low private research and development expenditure. Overall, business research and development remains one of the lowest in the EU and is centred on medium/high-tech manufacturing, areas dominated by multinational firms. Measures to stimulate knowledge transfer, strengthen innovative capacities in industry and improve cooperation between businesses and academia are advancing slowly.

- (17) To increase Slovakia's productivity and maintain the convergence process, sustained investment efforts are also needed in digital and transport infrastructure, and energy efficiency. There is a need to improve basic fixed broadband and 4G coverage and take-up of ultrafast broadband. Investing into energy efficiency, in particular in the buildings sector, and environmental technology can be a source of green growth and will help preserve scarce environmental resources. In addition, to allow less developed regions to catch up and become more knowledge-based, competitive and productive, more strategic investment is needed to fill in the infrastructure gaps and to improve transport networks. Slovakia is lagging behind with regards to completing both the core road and railway network under the Trans-European Transport Network, such as in the Rhine-Danube corridor. Weaknesses in the transport network could be tackled by enhancing the interconnectivity, multimodality and interoperability of the existing public and urban transport network, and by promoting sustainable modes of transport.
- (18) A heavy administrative and regulatory burden may negatively affect investment and innovation, especially for small and medium-sized enterprises. Despite government efforts, administrative burden is not being reduced enough and the Slovak business environment is losing ground in international comparisons. Quality of legislation and lack of predictability are a concern for businesses. These challenges should be addressed by the full deployment of Slovakia's Better Regulation Strategy (RIA2020) and the strengthening of its Better Regulation Centre. The Slovak professional services sector remains highly regulated. The restrictiveness of regulation is above the weighted EU average for lawyers, patent agents, civil engineers, architects, accountants, tourist guides and estate agents.
- (19) The government is substantially reforming public procurement practices by overhauling the legal framework to simplify procedures and reduce transaction costs. A new focus on professionalisation is welcome; however, general benefits are only emerging slowly. In the context of distrust towards public institutions, public buyers need to make more effort to regain confidence from businesses, media and the public at large. This hinders the introduction of much needed novel practices. Efforts to increase the use of quality criteria need to be stepped-up to achieve better value for money and improve strategic use of public procurement.
- (20) Slovak public administration still faces inefficiencies and bottlenecks caused in particular by ineffective cooperation between government departments. The lack of capacity and strategic planning as well as administrative inefficiencies hamper a smooth delivery of ESI Funds. As a result, Slovakia lost EUR 120 million of funding from the 2014-2020 period, while distribution of funds to final beneficiaries remains low. In addition, sub-optimal preparation of projects funded by ESI funds led to delayed investment and resulted in tight deadlines for public procurement procedures, increasing the risk of irregularities.
- (21) Corruption continues to pose a challenge and there has been only limited determination to prosecute high-level corruption cases. Efforts to combat corruption are hindered by organisational and procedural weaknesses at the police and prosecutor's level, and weak protection for whistle-blowers. Also, improving the effectiveness of the justice system, including its independence, remains a challenge. Despite some improvements in terms of efficiency and quality, concerns about the independence of the judiciary persist and the delay in the process for appointing judges to the constitutional court could affect the functioning of the justice system.

- (22) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report⁷. This would allow Slovakia to make the best use of those funds in respect of the identified sectors, taking into account regional disparities. Strengthening the country's administrative capacity for the management of these funds is an important factor for the success of this investment.
- (23) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Slovakia's economic policy and published it in the 2019 country report. It has also assessed the 2019 Stability Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Slovakia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovakia, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (24) In the light of this assessment, the Council has examined the 2019 Stability Programme and its opinion⁸ is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that Slovakia take action in 2019 and 2020 to:

1. Achieve the medium-term budgetary objective in 2020. Safeguard the long-term sustainability of public finances, notably that of the healthcare and pension systems.
2. Improve the quality and inclusiveness of education at all levels and foster skills. Enhance access to affordable and quality childcare and long-term care. Promote integration of disadvantaged groups, in particular Roma.
3. Focus investment-related economic policy on healthcare, research and innovation, transport, notably on its sustainability, digital infrastructure, energy efficiency, competitiveness of small and medium-sized enterprises, and social housing, taking into account regional disparities. Increase the use of quality-related and lifecycle cost criteria in public procurement operations.
4. Continue to improve the effectiveness of the justice system, focussing on strengthening its independence, including on judicial appointments. Increase efforts to detect and prosecute corruption, in particular in large-scale corruption cases.

Done at Brussels,

*For the Council
The President*

⁷ SWD(2019) 1024 final.

⁸ Under Article 5(2) of Council Regulation (EC) No 1466/97.