Structural reforms adopted in Slovakia – best practices

Peter Goliaš
INEKO Director, Slovakia
October 24, 2014
Workshop on enhancing Ukraine`s integration chances
Kyiv

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Influential pro-reform group

- Many reforms are unpopular, in conflict with vested interests or technically difficult
- How to overcome these barriers? In Slovakia we were lucky to have:
  - Strong NGO sector, think-tanks
  - Free media
  - Experts (e.g. bank analysts) willing and able to comment in media
  - Well educated politicians and policy makers implementing reforms

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Transparent privatization

- Before 1999: Mostly non-transparent methods of privatization preferring local investors linked to politicians
- After 1999: International tenders, direct selling to strategic investors, price as a single winning criteria
- Key assumptions:
  - Investors from democratic and developed countries would bring the advanced knowledge and the culture that would increase the speed of transformation and foster competitiveness
  - The competition for the best price would ensure the highest possible revenues for the state budget

Brown-field investors

- Banking and insurance (fully privatized)
  - Erste, Raiffeizen, Intesa, UniCredit, Allianz, Generali, etc.
- Telecommunications (majority or fully)
  - Fixed line operator: Deutsche Telekom (51% majority)
  - GSM: Orange, O2 (100%)
- Energy (majority or 49% with managerial control)
  - Electricity distributors (49%): E.ON, EDF, RWE
  - Gas industry (49%): Gaz de France & Ruhrgas (in 2014 replaced by Czech energy holding EPH)
  - Power producer (66%): Enel
  - Oil pipeline (49%): Yukos (in 2006 bought back by government)

Important notes

- The privatization of state monopolies required:
  - Establishing new independent regulators
  - Deregulation of prices with negative short-term impact on population particularly in energy sector

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Tax reform (2004) - assumptions

- The investors welcome simple system and lower taxation on corporate profits.
- Lower direct taxes have positive impact on work incentives and reduce tax evasion.
- Lowering direct taxes requires higher indirect taxes, which is unpopular.
- Therefore, referring to political economy, compensation for low income people is one of key preconditions for successful reform.

Key measures

- Radical simplification of the Tax Code:
  - The old system included 90 exceptions, 19 sources of un-taxed income, 66 tax-exempt items, and 37 items with specific tax rates. The reform abolished most of them.
  - Abolishing three minor taxes – gift tax, inheritance tax and real estate transfer tax

Key measures

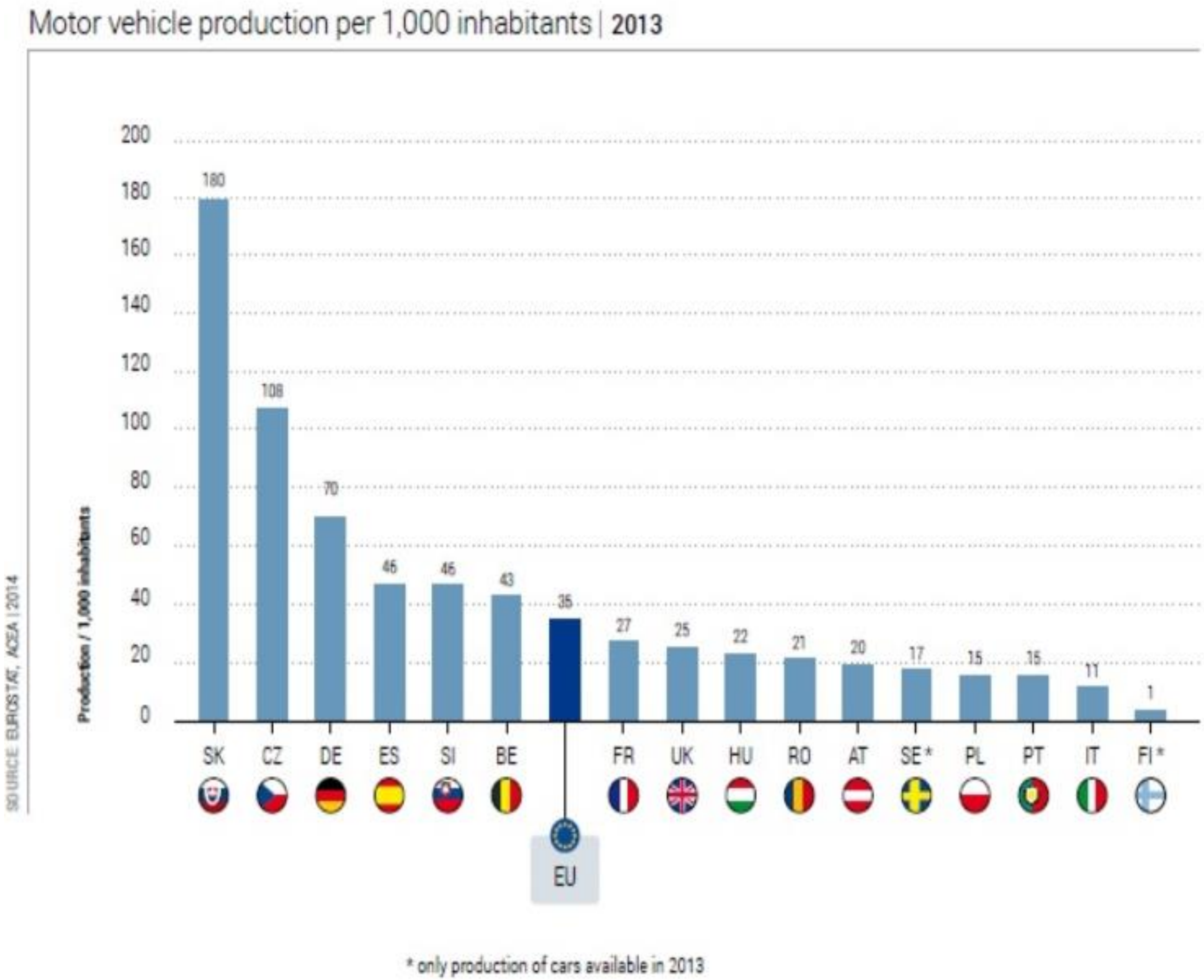
- 19% personal income tax instead of 5 progressive rates
  - In 2013 a higher rate of 25% was reintroduced
- 19% corporate income tax istead of 25%
  - In 2013 incresed to 23%, currently at 22%
- 0% dividend tax instead of 15%
- The combined statutory corporate income tax rate and dividend tax rate dropped from 36.3% in 2003 to 19% in 2004 (lowest in the OECD)

Key measures

- 19% value added tax instead of lower rate of 14% and upper rate of 20%
  - Later, lower 10% rate for books and drugs was introduced
- Increase in the excise tax rates on mineral oils, tobacco, and tobacco products, spirits and beer
- Compensation for low income cohorts:
  - Increasing the basic personal allowance deductible from the tax base from €968 to €2,021 per taxpayer in 2004 (€3,803 in 2014)
  - Everybody with wage below approximately 40% of the average wage in the economy (€317 in 2014) did not pay any income tax at all. Others paid 19% on the difference between their income and the tax-free income.

Green-field investors

- Automobile and electronic industry (2005: Peugeot-Citroen, Kia; expanding production at Volkswagen; Sony, Samsung), later also IT sector (IBM, Dell)
- Strong GDP growth mainly in 2006-08
- Since 2012, Slovakia has been the biggest automobile producer per capita in the world



Source: http://www.acea.be/statistics/tag/category/per-capita-production

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Firing costs

- Before the reform: 3 months notice period plus 2 months severance pay
- Reform (2003): 3 or 3 (2 or 2 for contracts lasting shorter than 5 years)
- 2007: 2 plus 2 or 3 plus 3
- 2011: 1 or 1 (for contracts lasting less than 1 year); 2 or 2 (for contracts lasting over 1 year and under 5 years); 3 or 3 (for contracts lasting 5 years and over)

Firing costs

- 2013: Re-introduction of concurrence and gradual increase of protection:
  - 1 plus 0 (for contracts lasting shorter than 1 year);
  - 2 plus 0 (over 1 year and under 2 years);
  - 2 plus 1 (over 2 years and under 5 years);
  - 3 plus 2 (over 5 years and under 10 years);
  - 3 plus 3 (over 10 years and under 20 years);
  - 3 plus 4 (for contracts lasting 20 years and over)

Other measures

- Increasing overtime limit from 150 hours to 400 hours yearly (40-hour working week, plus 8 hours overtime)
- Practically indefinite extension of the fixed-term contracts; currently limited to 2 years (with exception of seasonal works) with possibility to sign a new temporary contract not sooner than 6 months after elapsing of this 2-year period.
- Weaker Labor Unions
- 2009: Flexible working time account (Flexi-conto)

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Pension reform

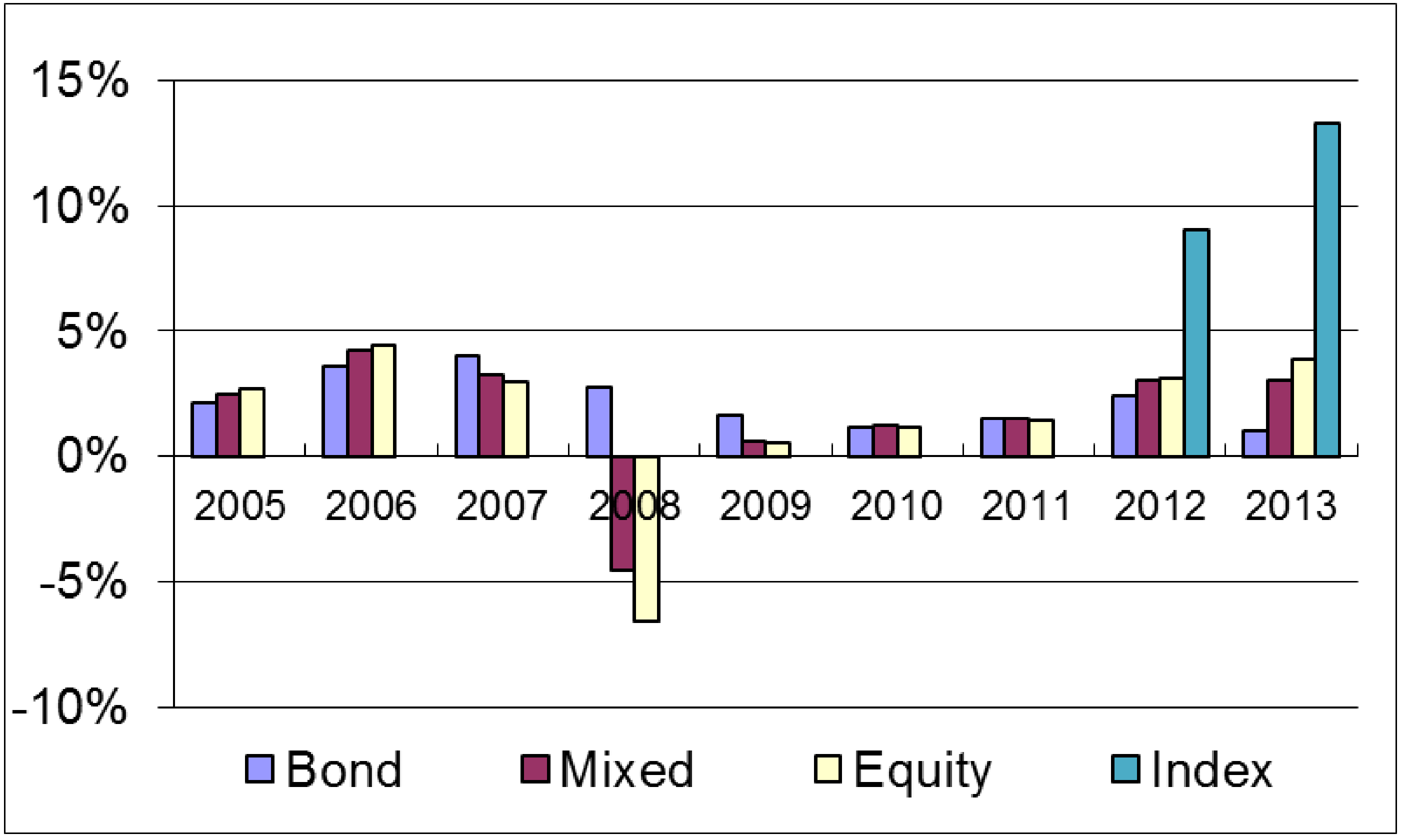
- Trade-off between Merits & Solidarity:
  - Gradual linking of contributions to benefits
- Long/term financial stability:
  - Prolonging retirement age
    - 2004: Gradually up to 62 years for both genders
    - 2017: Retirement age will be linked to life-expectancy
  - Indexing pensions:
    - 2004: Automatic (average of wage growth and inflation)
    - 2012-16: Transitional period: Increase by a fixed sum and/or inflation
    - 2017: Indexed purely by inflation for pensioners basket of goods

Pension reform

- Introducing second fully-funded pension pillar
  - 2005: 9% contribution rate (of gross wage)
  - Transformation cost of around 1.1% of GDP yearly was covered by privatization revenues (2005-2009), later directly from the state budget
  - 2012: The contribution rate was decreased to 4%, it is expected to grow up gradually to 6% by 2024
  - Funds: Pension management companies (currently six) are obliged to administer two types of funds, a guaranteed bond fund and an unguaranteed equity fund. Voluntarily they also operate mixed and index funds.

Returns in funds

Gross returns of funds in the fully funded second pension pillar (weighted averages)



Source: INEKO

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Education reform

- 2003: Introduction of “normative” financing based on number of pupils (i.e. normative = fixed amount of money per pupil) with equal financing of primary and secondary public and private schools
- Objectives:
  - To increase transparency in financing schools
  - To increase pressure on their rationalization and efficiency – the quality should be guaranteed by free choice of school (students and their parents should choose the best).
- Problem: Lack of information about quality

Measuring quality

Gymnázium, Poštová 9, Košice - Staré Mesto

513 ŽIAKOV (Z TOHO 0 EXTERNÝCH)

0 ZO SOCIÁLNE ZNEVÝHODNENÉHO PROSTREDIA

- UČITEĽOV

Zobraziť viac

HODNOTENIE ŠKOLY 2009 - 2012 2010 - 2013 2011 - 2014

8,2

ŠKOLA S VYNIKAJÚCIMI VÝSLEDKAMI

- 7,9 MATURITY
- 10 ÚČASTI NA SÚŤAŽIACH
- - INŠPEKCIA
- 7,5 MIMORIADNE VÝSLEDKY
- 2,1 PEDAGOGICKÝ ZBOR
- 9,5 NEZAMESTNANOSŤ ABSOLVENTOV
- 7,7 PRIJÍMANIE NA VŠ
- 6,9 FINANČNÉ ZDROJE

OHODNOŤTE ŠKOLU 3,7 3 HODNOTENIA Pridať komentár

ÚDAJE ZA JEDNOTLIVÉ ROKY 2009 2010 2011 2012 2013 2014

MATURITY	PERCENTIL V RÁMCI GYM	POČET BODOV ZO 100	PRIEMER ZA GYM	POZNÁMKA
Slovenský jazyk	95	82	74	na základe 119 žiakov
Matematika	95	77	59	na základe 52 žiakov
Maďarský jazyk	-	-	60	
Slovenský jazyk a slovenská literatúra	-	-	56	
Anglický jazyk B1	-	-	85	
Anglický jazyk B2	89	72	61	na základe 83 žiakov
Nemecký jazyk B1	-	-	-	
Nemecký jazyk B2	17	38	51	na základe 1 žiaka

Source: INEKO portal on primary and secondary schools, http://skoly.ineko.sk/

Key success factors

1. Influential pro-reform group
2. Transparent privatization, international tenders
3. Tax reform bringing simplicity and lowering direct taxes
4. Labor market reform bringing flexibility
5. Pension reform linking benefits to contributions and introducing fully funded second pillar
6. Education reform (2003) introducing per-pupil financing of schools
7. Increasing transparency and fight against corruption

Key measures

- 1998-2002: Privatization of banks, telecom, and energy industry
- 2000: Free Access to Information Act (no “trade secret” objection)
- Open legislation:
  - The portal http://jaspi.justice.gov.sk offers complete information from collection of laws and official gazettes
  - The portal http://www.rokovania.sk includes complete information on the consultation of legislative proposals with full texting of comments and reactions

Key measures

- 2003: Online business registry (user-friendly, searchable)
- 2004: Specialized Court and Prosecutor’s Office (focus on big corruption cases)
- 2007: Online Land Registry
- 2011: Publishing all property contracts and invoices of public institutions on internet.
  - The contracts are not valid unless they are published
  - Shift from on-demand (i.e. based on information demanded by citizens) to automatic transparency
  - Searchable portals (such as http://tender.sme.sk)

Key measures

- 2011: Wider use of mandatory electronic auctions and other competition methods in public procurement. According to the Transparency International Slovakia this measure led to rise of bids in public tenders and to 6-15% savings.
- 2012: Publishing court rulings on internet, random selection of judges
- Current challenges: Open data initiative, measuring quality and efficiency of public services

Thank you for your attention!

For more details, see the analysis:
http://www.ineko.sk/file_download/817