

INEKO  
Institute for Economic and Social Reforms

Dušan Zachar (Ed.)

# REFORMS IN SLOVAKIA 2005

*Evaluation of Economic and Social Measures  
(The HESO Project)*

*The HESO Project in 2006 is supported by:*



*THE HESO PROJECT*

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*EVALUATION OF*

*ECONOMIC AND*

*SOCIAL*

*MEASURES*

*January 2005 – December 2005*

*The "REFORMS IN SLOVAKIA 2005" publication has been supported by the British Embassy in Bratislava and by the Open Society Institute.*



REFORMS IN SLOVAKIA 2005  
*Evaluation of Economic and Social Measures (The HESO Project)*

ISBN 80-89026-22-2

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Editor: Dušan Zachar

Translation: SKRIVANEK SLOVENSKO, s.r.o.

[www.skrivanek.sk](http://www.skrivanek.sk)

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**SKRIVANEK**  
jazykové riešenia

Layout and Cover Design:

Milan Kisztner  
J. Poničana 15  
841 07 Bratislava  
Slovak Republic

Printing: ŠOPA PRINT, f.o.

INEKO  
Institute for Economic and Social Reforms

# **REFORMS IN SLOVAKIA 2005**

*THE HESO PROJECT*

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*EVALUATION OF ECONOMIC AND SOCIAL MEASURES*

**Bratislava  
July 2006**

*The Slovak Republic faces the task to secure conditions for a long-term economic growth. A crucial precondition for an efficient implementation of economic and social measures is the knowledge of the status quo and of the impacts on the economy and the society as a whole, to be expected from the relevant measures and it is important to focus on short-term as well as on long-term goals. For a successful implementation of many economic and social measures citizens' acceptance is needed. Therefore, the non-governmental, non-profit organisation Institute for Economic and Social Reforms INEKO aims to make the public more familiar with the nature of economic and social processes in the country and abroad, and to eliminate, through economic research and educational activities, hindrances to a long-term positive development of the Slovak economy and society.*

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## Acknowledgements

The HESO (Evaluation of Economic and Social Measures) Project brings experts' opinions on economic and social measures to the public. This publication has been created thanks to many outstanding personalities who were taking part in quarterly evaluations of economic and social measures. All members of the Experts' Committee were participating without any financial reward. We are very grateful for their contributions and kindness.

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**Robert Žitňanský**, weekly magazine Týždeň

Our thanks also go to fellow workers - **Gabriel Machlica** and **Marián Matusák** who participated in the realisation of the HESO Project in 2005.

Last but not least we would like to express special acknowledgements to the HESO 2006 Project partners - **AJG - Amrop Jenewein Group**, s.r.o., **Allen & Overy Bratislava**, s.r.o., **Investkredit Bank AG**, Representative Office in Bratislava, **Slovnaft**, a.s., **Soitron**, a.s., as well as to **the British Embassy in Bratislava** and **the Open Society Institute** due to their generous support to this publication.

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Project Manager

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## Introduction

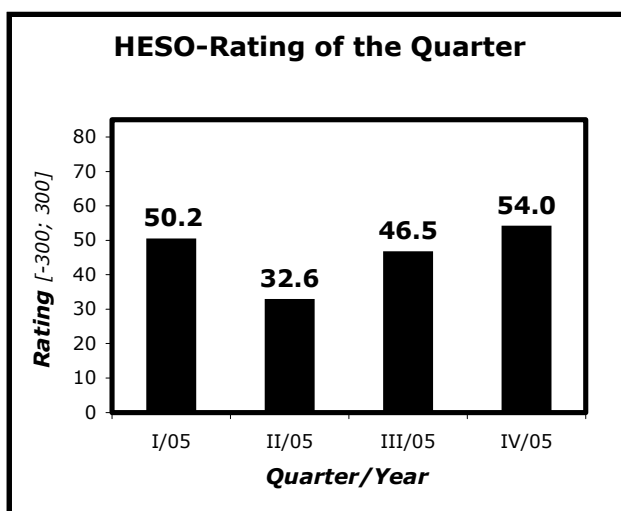
The Evaluation of Economic and Social Measures (HESO) Project of the Institute for Economic and Social Reforms INEKO creates a platform, where reputable economists, analysts, lawyers, sociologists, politologists, journalists, academics, people from business community, representatives of local and regional self-government, trade unions, employers' associations and NGOs express their opinions on quality and importance of different proposed and passed economic and social measures of legislature, executive power as well as on decisions of public institutions in the Slovak Republic and in the European Union. Without the necessity of studying a number of details, Slovak citizens have thus an opportunity to acquire a reliable overview of what economic and social measures and reforms are being prepared and put into practise and what opinion in their respect has been adopted by renowned experts. From the beginning of the HESO Project in April 2000 to the end of 2005, many specialists expressed their views upon 546 measures. In the period of 1Q 2005 – 4Q 2005, which is subject of this publication, 73 experts (see pages 6 and 7) evaluated 68 various economic and social measures.

From their standpoints, we can read out, which measures significantly contributed and still contribute to the social and economic development of Slovakia, and which just hindered and hinder this process. Hence, a citizen can make better decisions in a more convenient way, on which reform activities he/she wants or does not want to support. For example, in 2005, according to the HESO experts, the best evaluated measures were: the extension of supervision authorities of the Supreme Audit Office of the Slovak Republic also to resources used within original competences of local and regional self-governments, to legal entities established by local and regional self-governments, to companies with state shares, to public service institutions, to companies executing activities in the public interest, then the entry of the Slovak currency to the Exchange Rate Mechanism II, the Amendment to the Free Access to Information Act, the State Budget for 2006, and the recodification of the Slovak criminal law. On the contrary, the worst/most damaging measures in 2005 were: an aggressive procedure of state bodies and public institutions in the case of non-purchased land under the KIA plant infrastructure near Žilina, the European Commission's Proposal to harmonise the corporate tax base across the EU, relieving the EU's Stability and Growth Pact rules, and an increase in court charges as well as in regulated gas and heat prices for households unexpectedly during the year.

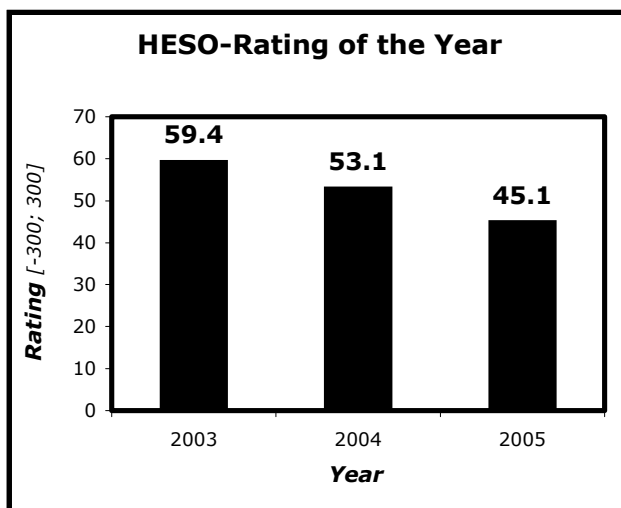
The ambition and the major objective of the HESO Project is not to provide a comprehensive and detailed monitoring of the development in individual areas of the society, nor is it the provision of starting points for the action of competent authorities. The HESO Project aims at regularly providing the citizens with an opinion of the professional community on often discussed, important, innovative, or unprecedented measures of an economic or social character that affect the quality of life of citizens. Thus, the HESO Project wants to create better preconditions for political acceptance of structural measures - reforms - bringing forth systemic changes in the Slovak economy and society.

The publication you are holding in your hands maps the HESO Project results during the period of January 2005 to December 2005. It follows four previous HESO publications, which covered results from the beginning of the Project in April 2000. In the *REFORMS IN SLOVAKIA 2005* publication you can find description and evaluation of selected important and/or interesting economic and social measures/reforms of the monitored period. Due to the Slovakia's membership in the European Union, a separate chapter is included, where most important measures of EU bodies of the previous year are evaluated (see pages 87-100). In some Evaluation of the Experts' Committee text parts, there are quoted exact citations of those experts, who agreed to be cited.

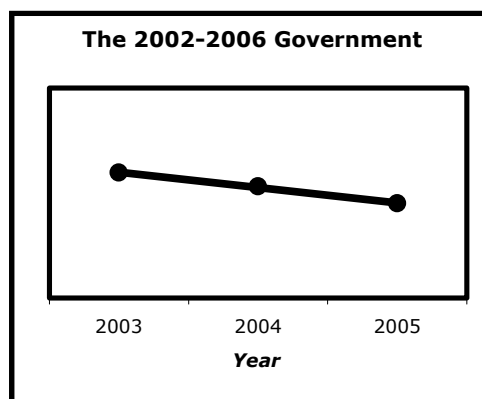
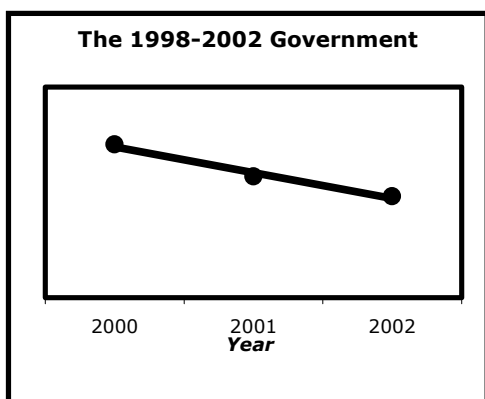
Additional information about the HESO Project and all quarterly results can be found on the Project's web site: <http://www.ineko.sk/static/heso/> (in Slovak). All HESO publications are free available at: [www.ineko.sk](http://www.ineko.sk) (in Slovak and in English).



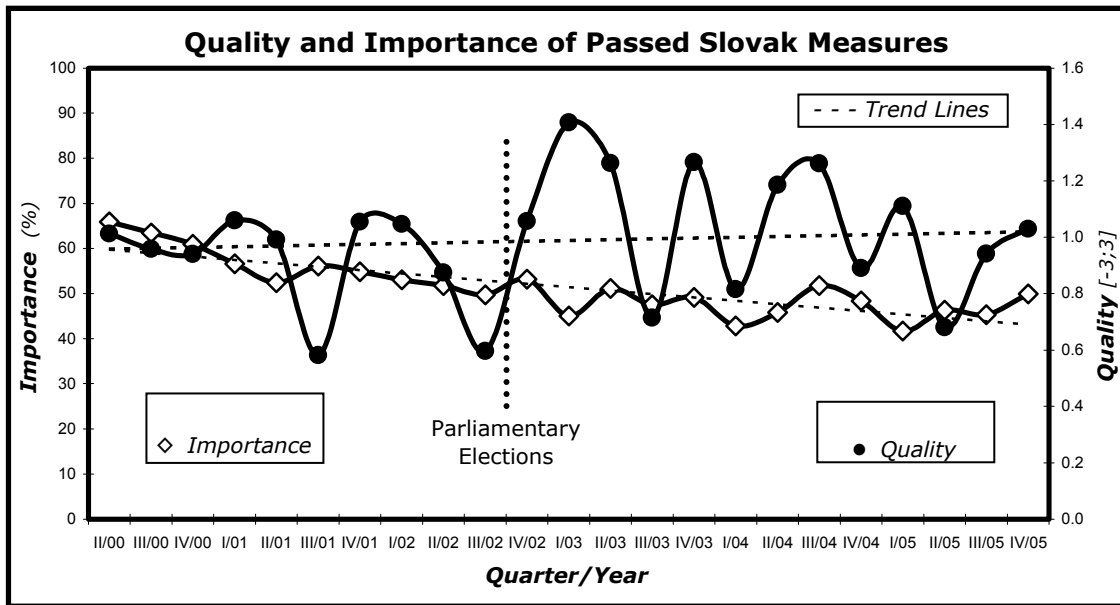
*The HESO-Rating of the Quarter / the HESO-Rating of the Year is an average of all ratings of evaluated measures passed/adopted in relevant quarter / year in the Slovak Republic. It reflects Experts' Committee's opinion on quality and importance of all evaluated measures passed in relevant quarter / year and indicates the reform atmosphere of the given period in Slovakia.*



The HESO-Rating of the Year shows a gradually decreasing trend, which accords with the Political Business Cycle Theory. With approaching parliamentary elections, a decreasing quality and importance of passed measures could be observed. That is to say, politicians often promote expansive measures in the period before elections, which are from the short-term view (right before elections) politically popular, but in a long-term perspective bring negative effects. This can also be demonstrated by trend lines of the HESO-Rating of both previous Slovak Governments. A steeper slope of the left line indicates a more significant change towards passing negative populist measures before elections during the first Government of Mikuláš Dzurinda in comparison with his second Government:



In measures being adopted by the Slovak Government, Parliament and other public institutions in the Slovak Republic, a long-time trend of their rising quality (acceptance by the HESO Experts' Committee) and decreasing importance may be tracked:



Source: The HESO Project, INEKO

## **Methodology**

### **Selecting Measures to Evaluate**

Four times a year a list of approx. 20 measures, which took place during last three months, is prepared. Everyone can suggest through our web page (<http://www.ineko.sk/projekty/formular-heso-navrh-opatreni>), which measure he/she wishes to be evaluated. INEKO makes final selection. Emphasis is laid on measures widely discussed in the public as well as on measures, which are, according to INEKO, rare, innovative and/or important for the economic and social development of the country. Evaluated measures include, among others: acts proposed or passed by the Slovak Parliament, measures adopted by the Slovak Government (acts, regulations, privatisation decisions, strategy documents, policies etc.), decisions of public institutions (e.g. of the National Bank of Slovakia, Antimonopoly Office, Telecommunications Office, Financial Market Authority or other market regulators) and directives, regulations and decisions of EU bodies. Characteristics (description) of the selected measures are prepared by INEKO. For this purpose INEKO uses information from original materials, documents as well as from media sources.

### **Evaluation Experts' Committee**

The evaluation Experts' Committee consists of about 40-50 members for one quarter. The experts come from reputable economic newspapers, banks, consulting companies, business community as well as from academic institutions, trade unions, employers' associations and think tanks (*see the list of all members of the HESO Experts' Committee on pages 6 and 7*). They represent leading or senior management positions in their organisations. The experts do not work in civil service and do not represent any political party. All of the experts attend the project for no reward. The opinions presented in the HESO-project represent solely those of the experts and do not necessarily reflect the views of their employers.

### **Evaluation Criteria**

Experts evaluate all the selected measures in two categories: Quality and Importance for the society and economy. These do not affect each other.

#### ***Quality [-3; +3]***

Experts evaluate the effect of a selected measure and give it a grade (*see the range below*). Often, there is a crucial difference between the real effects of a measure and the effects proclaimed by its author or administrator. Therefore, no matter what the measure presents to solve or improve, experts evaluate the impact and the effects they think the measure will bring to life.

#### **Range:**

-3	absolute disapproval
-2	moderate disapproval
-1	minor disapproval
0	no effect, status quo
+1	minor approval
+2	moderate approval
+3	absolute approval

#### ***Importance for the Society and Economy (%)***

Experts express opinion how essential and necessary the selected measure is for the society and economy, for the economic and social development. This category highlights the importance of reforming a given feature of a system in the country. The higher the score, the more important the measure is.

#### ***Experts' Comments on Evaluated Measures - Evaluation of the Experts' Committee***

Experts are invited to mention the pros and cons of the measures they evaluate. A summary of comments on each evaluated measure sums up the Evaluation of the Experts' Committee.

### **Ratings**

#### ***Rating of the Measure***

To get the rating of the measure, the average quality grade of the measure is multiplied by a coefficient expressing the average value of the measure importance for the society and economy. Thus, the rating values of the evaluated measures come in range [-300; +300]. According to

these rating values all measures are ranked in a chart. Rating of the measure indicates the contribution of the evaluated measure to the economic and social development of the country.

**Rating of the Quarter [-300; +300]**

Only the ratings of measures, which have been implemented or passed by legislative body, executive power or public institutions, are used to complete the rating of the quarter. The rating of the quarter is calculated as an average of all ratings of evaluated measures, which have been passed or adopted in relevant quarter. Often, there might be a time lag between a proposal and a passed measure. If an evaluated measure was drafted or proposed but not yet passed, it will not influence the final rating of the evaluated quarter. It will count only in the quarter in which it is put into effect. The rating of the quarter reflects Experts' Committee's opinion on quality and importance of all evaluated measures passed in relevant quarter and indicates the reform atmosphere of the relevant period.

**Selected Average Foreign Exchange Rates of the Slovak Koruna (SKK)**

<b>Currency</b>	<b>Amount</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>1<sup>st</sup> Half of 2006</b>
<b>EUR</b>	1	41.49	40.05	38.59	37.57
<b>USD</b>	1	36.77	32.26	31.02	30.60
<b>CZK</b>	1	1.30	1.26	1.30	1.32

Source: National Bank of Slovakia



## EVALUATION OF SELECTED MEASURES

(Division of measures according to subject related topics. Most of measures influence directly or indirectly more than one field at the same time, they have intersectoral character. Evaluated measures are arranged into several groups according to the field, which they influence mostly and rather directly.)

### Economic Policy Strategy

#### Competitiveness Strategy for the Slovak Republic until 2010 (National Lisbon Strategy)

The Competitiveness Strategy for Slovakia until 2010 (the so-called Lisbon Strategy for Slovakia, or National Lisbon Strategy) was approved by Cabinet members on 16 February 2005. The document was placed on the agenda by the Deputy Prime Minister and Minister of Finance of the Slovak Republic, Mr. Ivan Mikloš, with the intention of further progress in the issue of application of the objectives and strategy, as set out at the Lisbon Summits by EU Member States representatives in 2000. The aim of the Lisbon Strategy is to transform the EU, by 2010, into "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth". Several European economists and politicians admit today that the Lisbon Strategy has not been very successful so far and suggested its revision (see page 87).

The approved document represents the economic strategy for Slovakia until 2010, which should be a base for Slovak Government policy. The primary goal of the Strategy is to catch up with the living standard of the most prosperous EU countries as soon as possible, which may be achieved through rapid and long-term economic growth. According to authors of the Strategy, in a market economy the state can support growth by creating appropriate conditions that enhance the competitiveness of the economy.

The governmental document deals with two principal "pillars", on which the Competitiveness Strategy is built. In its **first pillar** it puts emphasis on the necessity of successful accomplishment and implementation of structural reforms and maintenance of the principles on which the economic policy is implemented in recent years. The first pillar – successful completion of reforms and their sustainment - constitutes foundations on which the development should be further based.

In the **macroeconomic and fiscal field**, the following principles and goals have been set out as substantial:

- development of market economics and minimisation of interventions to free market functioning, interventions only to an extent, as necessary,
- reduction of public finance deficit to the level below 1 per cent of GDP with an objective of reaching an approximately balanced budget,
- refrain from increasing the redistribution level in the economy,
- maintaining a transparent and neutral tax policy, whereas the Government of the Slovak Republic shall not pursue any public objectives using tax incentives, but only by means of targeted public expenditures.

In the **social field**, the Slovak Government fully subscribed to traditional European values – such as individual responsibility, equal opportunities, the role of family and community for those in need, maximisation of opportunities to assert oneself and the social responsibility to fight poverty. In accordance with those values, the primary responsibility for establishing sufficient social and economic background for oneself and one's family must be borne by each individual. The role of society is to create the prerequisites and equal opportunities to enable the individual to succeed in this effort. One of the next principles that have been set out by the Government in this field is not to discourage an individual from activity and creative endeavour by its social policy, or to create dependence on social benefits. Government policy should focus on elimination of absolute poverty and provide instruments that will make it easier for people to escape severe social difficulties. Last, but not least, one of the objectives is maintenance of a more efficient social network and a flexible labour market, which is a prerequisite for the creation of new job opportunities.

The ongoing reforms in the **health care system and pension scheme** area establish preconditions for quality health care and deserved pensions, reflecting actual activity in the course of the recipient's active life period, according to authors of the conception. In terms of the Strategy in question, the new pension system shall concurrently motivate individuals to stay on the labour market for longer, which fully complies with the objectives of the Lisbon Strategy.

**The second pillar** emphasises priorities of **building up** the so-called **knowledge-based economy**, an economy based on knowledge, and is systematically devoted to fulfilment of the development section of the Lisbon Strategy. Long-term competitiveness of Slovakia can only be

guaranteed by creating favourable conditions for the development of a knowledge economy. In other words, the economic growth must be based on the ability of people to continually absorb new knowledge, produce new know-how and use it in practice. The Strategy defines **four key** areas, which constitute a compact entirety and are equally important:

- information society,
- science, research, innovations,
- business environment,
- education and employment.

**1. Information society.** The introduction of information technologies is one of the best means of transforming Slovakia into a dynamic, knowledge-based economy, according to the document. The authors claim that it is therefore necessary to ensure that each citizen is IT literate, has access to the Internet and is able to enjoy the benefits of the information society, within the next few years, for the purposes of a dynamic introduction of information technologies. Absence of centralised command in this area is deemed to be one of the preceding disincentives its growth. Therefore, the authors suggested strengthening its institutional capacity in this area, in the short-run by increasing the competencies of the representative of the Government of the Slovak Republic for the introduction of information technologies and in the medium-run, for example, by transforming the Ministry of Transport, Post and Telecommunications, shifting emphasis to introduction of information technologies. The results will be an increase in the overall level of education, productivity and employment, improvement in the quality of services, growth of innovations and more efficient use of public funds. In development of the information society, the main three priorities should comprise as follows:

- to ensure IT literacy among all social and age groups, to transform the traditional school into a modern school with regard to IT. One of the principal steps shall comprise increase of IT literacy among all teachers and among employees in public administration as well as improvement of general awareness of the benefits of an information society.
- for an effective interconnection of public administration, making the electronic services provided by private companies available, introduction of a wide range of modern and secure electronic public services. This section includes making public information systems more effective, total accessibility of public registers and databases in the Internet. Last, but not least, introduction of electronic identification cards, which are necessary for transactions within an e-government, is presented in the governmental document.
- wide accessibility of Internet is a crucial prerequisite for the creation of an information society, according to the Strategy. The authors point out outcomes of studies, based on which the price of a computer and of the connection itself is the main barrier to development in this area. It is therefore essential to take appropriate measures in order to promote a more competitive environment and boost the investments in the telecommunications sector, to continue the liberalisation of the telecommunications market, promote the development of public internet connections, including making all school multimedia classrooms open to the public and last, but not least, to promote schemes based on partnership with the private sector (PPP - Public Private Partnership), aiming to provide computers with broadband internet access for the wider public.

**2. Science, research and innovations.** The National Lisbon Strategy claims that innovation policy must become one of the principal long-term priorities of the Slovak Government. Slovakia needs a wide base of scientists able to carry out high quality scientific research at the highest international level. Consequently, it is essential that the scientists be interconnected with the business sector in order to transform the scientific knowledge into material outputs in the economy, in the form of innovations. Public support for basic science and research should be clearly distinguished from the support for applied research, development and innovations, since these are of a different economic nature. The principal objectives in this area are as follows, according to the authors of the Slovak Strategy:

- Raising and supporting of highly qualified scientists by providing motivation to gifted people towards a career as a professional scientist, which should be achieved by creating an environment for quality scientific work and securing their adequate valuation. It is not institutions themselves that should be funded, but high-quality research projects chosen on a competitive basis. In order to achieve defined objectives, the interconnection between scientific research and university education should be strengthened, namely by the application of research university institutions, which should become the foundations of scientific research.
- Research of international quality, adequately interconnected with the business sector, must reflect current scientific development in the world. In addition, it will be necessary, on the basis of broad expert discussion, to choose a small number of priority areas, since Slovakia, as a small country, will not be able to perform high-quality research in all the fields. Further important steps include introduction of mechanisms of an independent quality assessment of programmes and projects and an obligation to publish the results of all publicly funded research projects.

- Effective public support of business activities focused on development and innovations should avoid market failures. Successful establishment of an innovative company carries a considerable risk and high expenditures and the private sector funds less companies than would be economically optimal. The authors of the Strategy therefore suggest strengthening the motivation to increase private sector funding of research, development and innovations, mainly by introducing co-funding. Creation of a public instrument for the provision of venture capital for innovative companies in the early stages of their operation.

**3. Business environment.** A sound business environment, which motivates people to be entrepreneurial, is one of the key instruments of the government in providing for the long-term competitiveness of the economy. Effective competition among businesses is in general the basic motor of the economy and public institutions serve to strengthen and simplify this competition. The document states that the Government shall foster reduction of tax and payroll tax burden for all enterprises. According to the document, individual support to companies by means of public expenditures will only be provided in exceptional cases. The main priorities with respect to the business environment have been set out as follows:

- high degree of law enforcement,
- public institutions as a partner and not as a burden,
- effective access to capital market for all companies,
- high-quality physical infrastructure and services in network industries.

An especially low degree of law enforcement is deemed as the key obstacle to the business sector in Slovakia. It is essential to create conditions for fast enforcement of contracts not only in the stage of the issuing of an effective judicial decision, but also in the stage of its execution and guarantee of protection of ownership rights. According to the authors, this may be achieved by taking steps leading to reduction of the capacity for corruption, improvement of management in the judiciary, improvement of conditions for out-of-court dispute resolution, and reinforcement of active creditors' rights. The whole public administration must make its operation and relationship to entrepreneurs more effective as well. The objectives in this field should be fulfilled by measures including a fully electronic exchange of information between public institutions and entrepreneurs, simplification of requirements of public institutions towards companies upon market entry and enhancement of the transparency and effectiveness of public procurement by means of a fully electronic system. The Ministry of Finance of the Slovak Republic deems creation of a functioning system of venture capital support and formation of a regional stock market (by a merger or close interconnection), as in Scandinavian countries, for example, to be priorities.

**4. Education and employment.** In the human relations field, public policy must create, for all citizens, opportunities to study continually and to smoothly change from one position of employment to another. The document particularly emphasises the use of education policy as a tool for fighting intergenerational reproduction of poverty, i.e. that each child must have an opportunity to obtain quality education corresponding to his/her potential. The main priorities in the area of human resources have been set:

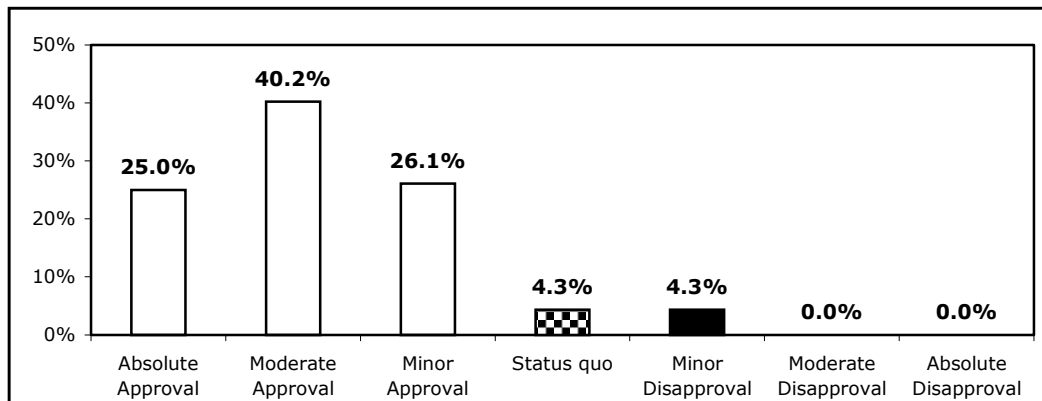
- modern education policy,
- achieving a high employment rate,
- coping with an ageing population.

Changes within the system of secondary and primary education will require performance of transformation of content and process of a traditional school into that of modern school, and change from memorising of information to an ability to acquire and assess information. Strengthening education in the area of foreign languages, information technology and basic business knowledge, enhancement of quality of teachers, or a gradual increase of average length of education shall be further important steps. At the university level, capacity expansion and a significant improvement in quality are deemed to be necessary. Universities should, by their activities, become one of the engines of economic growth of the region where they are located. Improvement of access to education by increasing available funds (also through financial participation in the tuition fees), enhancement of the quality of teaching, by improving conditions for scientific growth, stimulation of differentiation of universities and their activities, support of acquisition of general skills by university graduates and support of the mobility of students and teachers. Last, but not least, creation of an accessible and market-based system of life-long education is a substantial objective.

As the authors say within the wording of the Strategy, **funding** necessary for fulfilment of its objectives shall in no case threaten either the public finance stability, or convergence fiscal objectives. Reallocation of resources from areas that do not correspond to the basic philosophy and goals of the Strategy to priority development areas is one of the three resources. Funding from EU structural funds and from other instruments supporting competitiveness and innovations is stated as the second source. Sufficient funding of the objectives of the Strategy shall be supplied by the third, no less important, resource, namely funding from a much higher volume of private resources.

The Lisbon Strategy for Slovakia has been a subject of discussion by annotation proceedings, but also by the means of a national conference. The Strategy was appreciated by several opposition deputies, who particularly agree that not a cheap, but on the contrary, a quality and educated labour force should be the future vision of Slovakia. They also agree with the need for a long-term vision of Slovakia, as well as with the necessity to adhere to agreements achieved and to ensure continuity of the Strategy. The creators of the Strategy considered accession of a new Government to be the principal risk, understanding that the economic principles on which current reforms are based is a conflict area. Should a proposal of any current opposition party to abolish tax reform arise, such fact would have a negative impact on the economic growth influx of investment and that would diminish the funds for the support of a knowledge-based economy. Therefore, the authors pointed out the essentiality of political consensus and also the acceptance of the Strategy by the largest possible proportion of the public.

#### Evaluation of the Experts' Committee:



Qualified members of the public deemed the National Lisbon Strategy as a positive document and a quality cornerstone for detailed development of economic and social policy in the mid- to long-term horizon. The measure was perceived as a necessary step for the future direction of Slovakia, as an appropriate answer to criticism that the Government acts without a long-term concept and makes reforms without any vision and also as a vigorous gesture of the Slovak Government, showing that the Government stands behind its reforms and intends to continue with their performance. Interconnection of the document with supranational strategies and reforms under development at the EU level is assessed positively. The Strategy was of higher quality in comparison to previous attempts to formulate the development vision of the Slovak economy and there is a chance that the implementation shall help Slovakia to move ahead. One of the positive attributes of the adopted Strategy is the absence of any "corporative" elements, such as for example specification of particular industries that should be subject to priority support. As a new EU member country, the Slovak Republic is in its framework defined as a pro-reform country. The progress of Slovakia is in the interest of the whole Union, including original member countries, whereas many of those do not have the sufficient political courage to follow the thesis of the European Lisbon Strategy.

Even though experts have expressed a clear affirmative opinion on the adopted National Lisbon Strategy, they commented on several its imperfections. First of all, measurable successfulness criteria for individual objectives should be set out, in order not to feature processes, but outcomes, which are necessary for the society. The quantification of objectives itself could be published directly within the strategy document, not only in consequential action plans.

Some of the persons evaluating deemed identification with the approach of the master concept – EU Lisbon Strategy adopted in 2002 – to be a further problem. The Slovak Strategy is more disposed to market and personal responsibility and less to state interventions in the economy than its European model; however, Slovakia identifies with it in respect to the socio-engineering approach of supporting "development" expenditures. Contradictory theses are common – on one hand not to interfere, on the other hand to support. It is a contribution that the Slovak Strategy focuses on structural reforms and education system reform as well, unlike the European Strategy. One can also agree with the fact that the Ministry of Finance of the Slovak Republic has not specified a scheduled term of "catching up" with the EU. On the other hand, the main objective "to ensure that Slovakia reaches the living standard of the most developed EU countries", was considered by respondents to be likely unrealistic as the EU objective to become the most competitive economy in the world by 2010. For some experts, the document seemed to be too cliché-ridden and idealistic in numerous development sections.

According to the responses of other respondents, a lack of consensus was obvious across the political spectrum, which rates the Strategy as a politically influenced report that is successfully

feasible only in the case of continuity of the current Government composition. Outwardly, the Strategy looked like a conception of a small group of authors, void of a long-term and broader public discussion. Respondents thought that it was essential that other political and opinion groups, as well as other departments, absorbed it and that its objectives become Government objectives, which could be performed, including, but not limited to, unstinting agricultural subsidies and investment incentives. It will be substantial to know to what extent the Strategy is taken as binding in taking measures in other departments. Basically, its prospective contribution is significant.

The evaluating persons have drawn attention to the fact that other strategic documents, which have been approved by the Government in the past (for instance the National Plan of Regional Development, or National Development Plan), or which were developed at that time (System Structure of National Economy Strategy of the Slovak Republic for the 2005 - 2013 period elaborated by the Ministry of Economy of the Slovak Republic) are in some cases inconsistent with the presented National Lisbon Strategy and are frequently subordinated exclusively to pre-election rhetoric and presentation of political entities.

Orientation of the Strategy on so-called knowledge-based economy is important, according to numerous respondents. The intention to focus on development of human capital and technological process is reasonable from the economic point of view. The methods of its performance are crucial, whereas if this is not efficient, economic costs will be higher than benefits.

Emphasis being put on education reform is substantial. However, the approved Strategy lacked the information that would distinguish the present resolution to reform education from similar resolutions that failed to succeed within the period of the past 30 to 40 years. Therefore, it is important to come up with it as soon as possible. The critics claimed that the expression "competition" was missing in the section related to education. It followed from the wording of the document that universities need more resources. However, it would be more effective if they were thrown into the deep water of a competitive environment. One of the respondents felt the expression of the real need for education in individual specialisations in the Strategy was missing.

Some of the valuating experts drew attention to overexposed accentuation of the contributions of information technologies in the economy and an excessive orientation of the Strategy on information society. In Slovakia, there is more of a problem of building the technical infrastructure for affordable prices (on the side of technologies) and the education system (on the side of human capital). The experts sensed the interference of Brussels in the section devoted to information society, in the Strategy, whereas institutionalisation is one of the first issues dealt with. In the area of funding science, proposed funding on a competitive principle – in the form of funding quality research projects selected in a competitive environment and not in the form of funding institutions, was perceived positively. However, proposed raising of public expenditures and significant state influence in this field is the principal imperfection of the Strategy, according to many experts.

Another respondent marked the absence of a broader reference of long-term sustainable development and rural development intentions and its integration to the overall development strategy of Slovakia as a flaw. Amending the document with the objective of building up an appropriate infrastructure in underdeveloped regions should be considered, as well, since it will be difficult to achieve the remaining aims of the Lisbon Strategy for Slovakia. An opinion that the Strategy did not admit the idea of necessity to ensure not only economic, but also social growth and to create conditions for sustainable development through their optimisation, was expressed as well.

Critics declare that the document represented only an obligatory essay. The state should in no case strengthen the competitiveness of the economy by strategies, but by creation of favourable conditions for entrepreneurship, lifting barriers, reduction of taxes and payroll taxes, elimination of bureaucracy etc. On one hand, the Lisbon Strategy for Slovakia set out a horizon to future, but on the other hand it confused the vision with socialist planning. Nevertheless, the Government did not show the ability to resolve some of the objectives (e.g. improvement of law enforcement) and willingness to secure the objectives by adequate financial resources (e.g. for science and research).

### **Entry of the Slovak Koruna to the Exchange Rate Mechanism II (fixing the SKK/EUR exchange rate for 2 years for the duration of which the Koruna rate can oscillate within the fluctuation band of $\pm 15\%$ )**

On 25 November 2005, the Slovak Koruna (Crown) (SKK) joined the Exchange Rate Mechanism II (ERM II). At the time of accession to the EU, the Slovak Republic (SR) and other 9 countries covenanted to accede to the Economic and Monetary Union (EMU), and thus to adopt the common

European currency. Accession to the EMU requires meeting the Maastricht convergence criteria. The Maastricht criteria imply 4 dimensions: exchange rate stability, inflation convergence, convergence of interest rates and fiscal stability.

The exchange rate stability criterion requires that the Slovak currency remains in the ERM II for minimum 2 years prior to its accession to the EMU. This criterion fundamentally requires that the central parity of the Slovak Koruna in relation to the Euro shall be prior to the ERM II entry fixed for the succeeding 2 years. For the duration of this period, it can oscillate within the standard fluctuation band by maximum  $\pm 15\%$  around the central parity without the central parity devaluation. This condition is to ensure that only countries with stable currencies access the EMU. The central parity of the Koruna in relation to the Euro has been set to the level of **EUR 1 = SKK 38.4550**. The lower limit for required interventions is thus **32.69 SKK/EUR** and the upper limit is **44.22 SKK/EUR**.

According to the Ministry of Finance (MF) of the SR, all the Maastricht criteria should be met for the duration of Slovakia's participation in the ERM II. At the beginning of 2008, Slovakia should be ready for convergence evaluation and to introduce the common European currency – Euro, after the last technical preparations, on 1 January 2009.

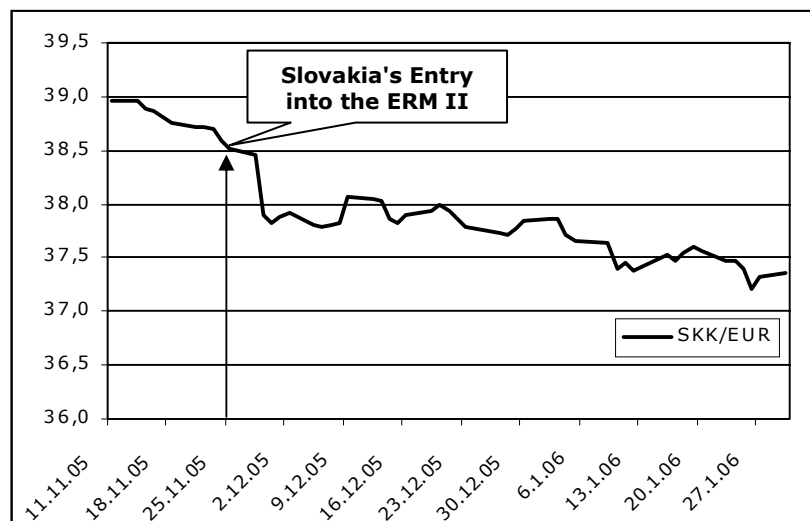
The decision on accession to the ERM II has surprised bank analysts as the previous statements indicated the ERM II entry was planned for 2Q 2006. The National Bank of Slovakia (NBS) and the Ministry of Finance of the SR have justified the earlier entry date by claiming thus there will be more time in 2008 for preparations prior to Euro adoption. The planned date for transition to the European currency as on 1 January 2009 has remained unchanged.

The NBS representatives have viewed the Slovakia's entry into to the Exchange Rate Mechanism II as an additional assurance of exchange rate stability. Given their statements, the membership in the ERM II and the set central parity shall contribute to the Slovak Koruna rate development stabilisation and nominal convergence. Concurrently, they shall also support stable development of the Slovak economy. The representatives of the Ministry of Finance of the SR hold the view that the Slovak Koruna shall by way of rate regime change from the floating to ERM II avoid the regional impacts it has been so far often subject to. By its entry into the ERM II, the Slovak Koruna has got to a different position than that of the currencies of other Visegrad 4 (Czech Republic, Poland, Hungary) countries that still apply floating rates.

Nevertheless, some analysts have reminded us that Slovakia has by its entry into the ERM II given up exchange rate flexibility and the manoeuvring space of exchange rate policy has contracted. In their opinions, the early entry has set up the central parity of the SKK/EUR rate at a more unfavourable level than the later one. In the critics' opinions, Slovakia's early accession to the EMU can partially start the process of price level approximation to the European one by higher inflation instead of nominal rate appreciation. At the same time, they hold the view that speculative attacks cannot be completely excluded either with a broadly set fluctuation band as the Koruna shall be more vulnerable in the set band. Some financial analysts suppose that fluctuations within  $\pm 15\%$  were rare even with a freely floating Koruna rate in the recent years, and thus the asset of the ERM II to Koruna rate stabilisation is questionable.

The Slovak Koruna has responded to its entry into the ERM II by strengthening and as soon as on 29 November 2005 arrived at the level of 37.89 SKK/EUR, i.e. strengthening by 1.48%. The Slovak Koruna was traded on 26 January 2006 against Euro at the lowest levels in history, i.e. at the level of **37.216 SKK/EUR**. According to financial analysts, the Koruna has not extricated itself from the regional impact even after its entry into the ERM II. The weakening of the Koruna as of 9 December 2005 can be for the most part ascribed to the uncertainty related to the viability of the Polish minority Government. The regional factors have thus for the first time since the entry into the ERM II regime weakened the Koruna above 38 SKK/EUR. According to analysts, the regional impact should grow weaker with the oncoming Euro adoption date, although it shall probably not cease.

## Slovak Koruna/Euro Exchange Rate Changes at the Turn of 2005/06



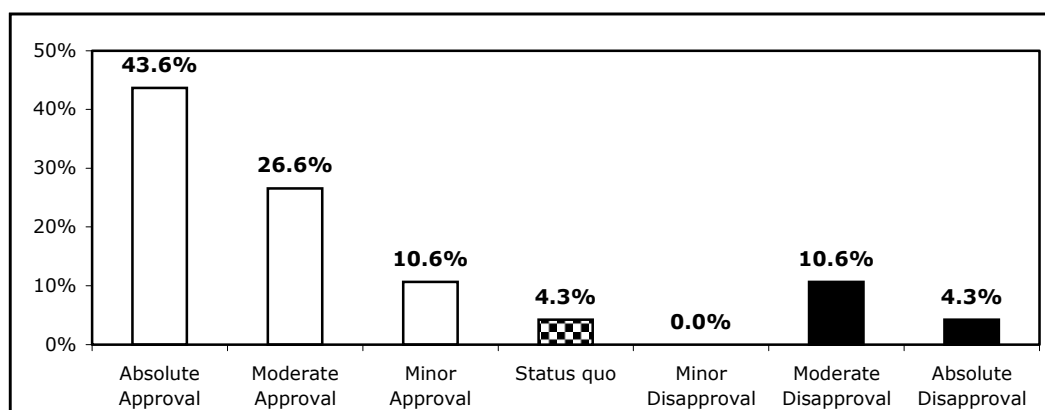
Source: National Bank of Slovakia

Slovakia has joined the ERM II as the seventh country among the new EU member countries, after Lithuania, Latvia, Estonia, Slovenia, Malta, and Cyprus. Slovakia is thus currently the biggest economy in ERM II. The three biggest economies among the new EU members - Poland, Hungary, and the Czech Republic shall probably not join the Eurozone before 2010. Among the old Union member countries, only Denmark is in the ERM II mechanism, however, unlike the new EU members, it is not formally bound to adopt the Euro.

Fulfilment of Maastricht Convergence Criteria						
Criterion	Fiscal Deficit (as % of GDP)	Public Debt (as % of GDP)	Inflation (in %) (EC's* Estimate)	Long-term Interest Rates (in % p.a.)	Presence in the ERM II	Target Date for Adopting the Euro (year)
	<b>-3.0</b>	<b>60</b>	<b>2.5</b>	<b>5.2</b>	<b>min 2 years</b>	
Cyprus	-2.5	70	2.3	4.2	since April 2005	2008
Czech Republic	-3.0	38	1.8	3.8	-	2010
Estonia	1.5	5	4.1	3.5	since July 2004	2007
Lithuania	-2.4	21	2.7	3.7	since July 2004	2007
Latvia	-1.0	13	6.7	3.6	since May 2005	2008
Hungary	-6.0	58	3.7	6.8	-	2011
Malta	-3.5	77	3.1	4.4	since May 2005	2008
Poland	-4.0	47	2.5	5.4	-	2010
<b>Slovakia</b>	<b>-3.8</b>	<b>39</b>	<b>3.3</b>	<b>3.7</b>	<b>since November 2005</b>	<b>2009</b>
Slovenia	-2.0	30	2.5	3.7	since July 2004	2007

\* EC = European Commission

Source: weekly TREND

**Evaluation of the Experts' Committee:**

The expert public has considered the entry of the Slovak Koruna into the ERM II, and thus the Koruna/Euro rate fixing a positive step that implies, apart from the economic pluses related to the Koruna rate stability (e.g. positive stimulus for foreign investors), also a big political asset. Several respondents have viewed the decision of the Ministry of Finance of the SR and the National Bank of Slovakia (NBS) as a clever political manoeuvre that can still play an important role in the attempt to maintain the favourable direction of the SR macroeconomic development, for the reason that future governments cannot simply ignore the obligations and time schedule ensuing from the accession to the ERM II. The binding rules shall restrain the adventurers and amateur economists from manoeuvring in economic policy. The participation of the SR in the ERM II has thus brought along an increase in costs of the incorrect macroeconomic policy that should stand as a sufficiently deterring factor. Naturally, it does not mean it will automatically prevent wrong policy, especially, should unaware wrong policy be the case.

**Ján Pokrivčák:** "Entry into the ERM II is a necessary prerequisite for Euro adoption in the SR. The ERM II entry signifies a good fiscal policy. Earlier Euro adoption shall after all reduce the transaction costs and risk of international business for Slovak enterprises. Nevertheless, the most significant asset of the ERM II entry and the expected early adoption of the Euro is the pressure upon budget discipline increase and macroeconomic stability maintenance. The vision of an early adoption of the Euro impedes the current government and shall impede the future government with politically motivated redistribution policy decreasing the efficiency of the economy."

**Karol Sudor:** "I consider the commitment on the part of government to conform to the game rules, and thus avoid dissipated waste of money as in 1994–1998, the principal positive point."

**Jozef Orgonáš:** "An excellent tactical move by the Ministry of Finance. The process of accession to the Eurozone has become irreversible. Fico's accession can maximally impede this process. In addition, it instantly brings Slovakia a higher credibility."

**Robert Žitňanský:** "Although many doubts may arise in terms of the common currency project, with regard to the commitment under the EU Accession Treaty, Slovakia would not avoid this step. From this perspective, this step is positive because it increases the probability of rational economy policy and exerts pressure upon deficit decrease."

**Juraj Lazový:** "I deem the Koruna's entry into the ERM II a logical step towards the adoption of the Euro within the planned deadline. Although I am in principle for the Euro introduction in Slovakia, I find the whole process more an issue of political decision-making (competition of the new EU members for prestige) than a conclusion of objective economic analyses defining pros and cons."

**Juraj Nemeč:** "Necessary step towards Euro adoption. The economy should be ready for this system by now."

**Ladislav Balko:** "Entry into the ERM II is a matter of criteria (in terms of Maastricht, it is a *conditio sine qua non* Euro) in relation to the planned accession to the Eurozone. The entry has been a surprise for the economic environment; it has not been expected to come at that time. The surprising moment deserves appreciation for the Ministry of Finance of the SR and the National Bank of Slovakia as financial speculators have been provided with absolutely no space. The half-a-year period since November 2005 until the evaluation, confirms that the Koruna has become more stable in the course of this period. It has not weakened since then and strengthened by no more than 4%. That is to say, we can deem our currency rate until now highly stable. Although in the first period, the Koruna has responded to the development in the zone, it seems to have detached itself therefrom. Of course, the market, and thus also the impact on currency, lives slightly in the pre-election expectation that in fact does not exert a significant impact on the Koruna. Certainly, the central parity level (38.45 SKK/EUR) could be discussed but the development has until now confirmed the correct level. The inflation development seems to



create problems that the central bank must correct by interest rates that start to arrive at decent levels for investors and can be attractive for investors and for their profits on investments in the Koruna and partially strengthen the Koruna. However, I think the fluctuation space, unless something from the macroeconomic perspective changes, shall not be made use of."

**Radoslav Štefančík:** "Although I view this step positively, my attitude towards the minimum attempt on the part of government to initiate public discussion on the pros and cons of the common Euro currency introduction is critical. The accession of the Slovak currency to the exchange rate mechanism has been one of the next steps towards Euro adoption, therefore it is high time that the public should be gradually prepared for its adoption."

**Peter Schutz:** "I doubt very much whether the Euro adoption in 2009 is reasonable. Slovakia should wait for the results of the situation development in France and Germany whose incapacities to make reforms can fatally affect the Euro. Increase of standard of living in Slovakia is most closely related to the strengthening of the Koruna, i.e. a process we should not give up."

**Peter Gonda:** "I find the decision of the Ministry of Finance of the SR and the NBS on Slovakia's entry into the ERM II early and risky, and that in the long-term horizon, since this decision means a specific step towards the hasty accession of Slovakia to the Eurozone (as of January 1, 2009) that is currently instable and not qualified for long-term operation without serious negative impacts on households and business entities. According to the Cato Institute CEO, William Niskanen, the pressures on financing social benefits due to the demographic development in Europe can be a factor for EMU dissolution within 10 years. (Niskanen, W.: *Alternative Political and Economic Futures for Europe*). Currently, accession to the ERM II is risky also on its own at the time Slovakia remains within it. Inter alia, it implies higher costs and other negative impacts after possible speculative attacks upon the Slovak Koruna or after other external adverse effects. Management of the conflict between the price stability objective and the stable Koruna exchange rate objective is also questionable at this time (for more information, see Gonda, P.: *Slovensko a Eurozóna: prínosy a náklady*)."

**Igor Daniš:** "The currency vulnerability in the case of the existence of fluctuation bands or limits, as well as the limitation of manoeuvring possibilities of the central bank, must be stressed again. On this occasion, I would like to say I do not agree with the early integration of the Slovak Koruna into the Eurozone. Although, Slovakia records a high share of foreign trade, approximately 70% of GDP, that with the high share therein on the part of EU countries leads to a big inflow of Euro and realisation of payments in Euro. On the other hand, the functioning, as well as the present success and internal contradictions of the Slovak economy are the typical demonstrations of the theory of asymmetric information. The high share of export on foreign markets does not inform the purchasers of the costs of one single Slovak seller – beyond the pressure of competition as in the home economy, in home countries where favourable prices are created due to very low wage costs. In terms of import, Slovak consumers are not familiar with the purchase prices of imported goods and the exporters' margins. In the case of a natural import oligopoly in some, many, industries, price destruction may occur. The whole process results in an unjust redistribution: excess allocation of funds to a small group of people and low wages, deeply below the average wage level. On the contrary, a "purely internal" economy functions together with many negative aspects, far from the market mechanisms and efficiency. Sometimes, efficiency and productivity are not even required for performance and profit increase, as required by the market. Euro introduction can thus even more intensify the above specified internal destructions, especially the lack of money with some groups of citizens and "internal" economy entities. For this reason, I do not agree with the hasty integration of not sufficiently developed economies into the Eurozone. After all, this could be introduced in "some" criteria for Euro adoption (e.g. min. 75-% performance of average of zone economies, etc.)."

In the opinion of one respondent, the Slovakia's entry into the ERM II limits in a certain way the independence of decision of the SR on selected economic issues, however, with regard to the size and nature of the Slovak economy, the respondent finds it understandable and acceptable. In the opinion of other evaluating expert, the accession of the SR to the ERM II shall exert only a minimum practical effect on the current state currency policy performance, regarding the fluctuation band scope and the possibility of revaluing the central parity of the currency rate.

**Eugen Jurzyca:** "The new country of Montenegro counts about half a million citizens. Should it implement a sovereign, high-quality and modern management of currency policy, public funds, pension and social security changes, health care system, school system, defence, justice, etc., I am afraid nobody would be left for work in the private sector. The Slovak Republic is a bigger country than Montenegro but must take into consideration as well whether it is not useful to delegate some powers either "down" or "up". By delegating the currency policy "up", Slovakia shall receive more than it loses. Should the argument that the single currency can be applied only in a consistent region (for example, with an almost perfectly flexible work force) be applied, then we should create a separate currency for example for some regions in Slovakia (e.g. Spiš)."

One respondent expressed the opinion that the measure creates a precondition for full-value membership of the SR in the EU.

## Public Finance

### State Budget for 2006 (state budget deficit – SKK 69bn, fiscal deficit – 2.9% of GDP)

On 13 December 2005, the Members of the Slovak Parliament (National Council of the Slovak Republic) approved the Act on State Budget for 2006. **The multi-annual public administration budget** comprises the state budget and budgets of other public administration entities for a period of 3 years, i.e. for 2006, 2007, and 2008. However, the binding budget is only the state budget for 2006, the budgets for 2007 and 2008 are approved only indicatively, nevertheless, only minimum changes should occur therein.

As in 2004 and 2005, **programme budgeting** that should be also in the oncoming years the key instrument for making public expenditures and transparency thereof more efficient has been applied considerably in draft budget preparation. Programme budgeting joins priorities of the Government and budget expenditures, shows the data that help to increase efficiency and emphasise the purpose the funds shall be used for. The definite interrelation between the provided funds and achieved results must be always present in use of public funds in a way the expenditures of public funds are used for the areas that will bring the biggest asset to the society.

The budget aimed to get the public finances to a level that shall be sustainable in the long term. The budget meets the conditions of the reformed Stability and Growth Pact whereupon structural deficit must be decreased at least by 0.5% per annum until the public funds arrive at an almost balanced position. Initiation of the pension reform, along with the proposed deficit decrease, is to play a significant role in preparation of public funds for the citizens' ageing. Realisation of the approved budget should be a fundamental prerequisite for Slovakia to discharge the crucial Maastricht criterion – public finance deficit at the level of maximum 3% of GDP in a sustainable way. Without the costs on the fully-funded pension scheme creation, this objective would be discharged in compliance with the Programme Declaration of the Slovak Government as soon as in 2006 (*note: the Minister of Finance, Mr. Ivan Mikloš, announced at the beginning of April 2006 that the actual fiscal deficit in 2005 totalled 2.9% of GDP, contrary to the planned 3.4% of GDP*); however, inclusion of the pension reform costs increases the deficit, a fact that should result in discharge of this Maastricht criterion in 2007 (discharge of the objective with inclusion of the pension reform costs).

#### Macroeconomic Framework of the 2006 State Budget

The Government presumed for the oncoming 3 years dynamic economy growth at the level of average 5.7% per annum, inflation below 2.2%, and employment growth by 0.8 to 0.9% per annum. In the budget creation, the Ministry of Finance (MF) of the SR took for the starting points the following macroeconomic prerequisites:

Macroeconomic Predictions of the Ministry of Finance of the SR					
	Reality	Forecast			
	2004	2005	2006	2007	2008
GDP ( <i>in current prices; in SKK bn</i> )	1,325.5	1,429.8	1,531.4	1,648.2	1,767.7
GDP Growth ( <i>in constant prices; in %</i> )	5.5	5.1	5.4	6.1	5.6
Average Annual Inflation Rate ( <i>in %</i> )	7.5	2.8	2.5	2.0	2.0
Real Labour Productivity Growth ( <i>in %</i> )	5.2	3.3	4.4	5.3	4.7
Average Registered Unemployment Rate ( <i>in %</i> ) ( <i>calculated from the number of disposable job applicants;</i> <i>data from the Central Office of Labour, Social Affairs and Family</i> )	14.3	11.9	11.6	11.4	11.1

Source: Draft Public Administration Budget for 2006-2008

The biggest uncertainty in budget creation for 2006-2008 that concerns above all 2007 and 2008 referred to non-approval of the basic European budget limit – Financial Perspective for 2007 until 2013. Regarding the fact the amount of resources Slovakia would be able to receive in those years, neither the areas the funds are to be used for, were known at the budget creation time, they could not be integrated under the presented budget.

Another significant uncertainty in the public funds development referred to the estimate of interest on the part of citizens in participation in the fully-funded pension scheme (2<sup>nd</sup> Pillar). The answer to the question of the number of citizens who would decide to enter the new system was known as late as on 30 June 2006 when the time limit set for deciding whether to enter the 2<sup>nd</sup> Pillar on the part of majority of citizens expired. According to the MF of the SR, higher participation

of citizens than estimated in the budget for 2005-2007 was obvious. In 2006, pension system reform impact upon the fiscal deficit is estimated to amount to 1.3% of GDP.

#### State Budget Quantification for 2006

The main objective of fiscal policy, ensuing from the Programme Declaration of the Slovak Government, is to support economy growth, to head towards a sustainable position of public funds in the long term, to decrease the degree of redistribution via public funds, and to discharge the Maastricht criteria. Taking these intentions and economic terms for starting points, the limits for public administration budget formation for 2006-2008 have been formed in a way that the public administration budget deficit, expressed in the ESA 95 methodology, would not be affected by the introduction of the 2<sup>nd</sup> (fully-funded) pension scheme pillar in 2006 at the level of 2.9% of GDP. However, upon the Eurostat decision as of September 2004, the fiscal deficit will be reported in the oncoming years also with the pension reform impact, i.e. the fiscal deficit in 2007 and 2008 should arrive at the level of 3.0% or 2.7% of GDP. The public administration deficit for 2006 has been budgeted in the amount of SKK 44.4bn and the state budget deficit in the amount of SKK 69bn. According to the ESA 95 methodology, especially the Social Insurance Agency and the National Property Fund of the SR exert significant impact upon the fiscal deficit in budgets of other public administration entities.

<b>Public Administration Budget</b> (in SKK bn)	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<i>- Budget on an accrual basis (the ESA 95 methodology)</i>				
Public Administration Revenues	520.5	563.9	588.5	617.3
Public Administration Expenditures	568.3	608.3	638	665
Fiscal Deficit	-47.8	-44.4	-49.5	-47.7
<b>Fiscal Deficit (as % of GDP)</b>	<b>3.4*</b>	<b>2.9</b>	<b>3.0</b>	<b>2.7</b>
Balance of other Public Administration Subjects	+9.5	+24.6	+5.8	+6.1
<b>State Budget Deficit</b>	<b>-57.3</b>	<b>-69.0</b>	<b>-55.3</b>	<b>-53.9</b>
Adjustment Factors**	4.2	-7	-15.1	-17.2
<i>- Budget on a cash basis (the International Monetary Fund methodology)</i>				
State Budget Deficit	-61.5	-62.0	-40.2	-36.6
State Budget Revenues	257.2	268.2	312.9	323.7
State Budget Expenditures	318.8	330.2	353.1	360.3
* In reality, fiscal deficit in 2005 was 2.9% of GDP (data published in April 2006).				
** Adjustment factors stand for a difference between cash-based and accrual-based public finance accounting.				

Sources: Draft Public Administration Budget for 2006-2008; Ministry of Finance of the SR

According to the presenters, the continuing fiscal consolidation and healthy economic growth associated with low interest rates and stable exchange rate should be the principal economic factors for public debt stabilisation during the whole budget period. State budget deficit will be the main source of nominal public debt increase.

<b>Public Debt</b> (in the ESA 95 methodology)	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Public Debt (in SKK m)	525,184	588,165	623,837	662,283
Public Debt (as % of GDP)	36.73	38.41	37.85	37.47

Source: Draft Public Administration Budget for 2006-2008

In comparison with the 2005 State Budget, **state budget revenues for 2006** should increase by 4.3 %, after taking into account the inflation, they refer to growth by 1.7%. The share of tax revenues in total state budget revenues in the budget framework for 2006-2008 is dropping from the level of 78.7% in 2006 to the level of 75.9% in 2008. Tax incomes should increase in 2006 by 4.5%. Transfers referring mostly to the incomes from the EU budget funds are the second most significant income of the state budget.

<b>State Budget Revenues</b> (in SKK m)	<b>2005</b>	<b>2006</b>	<b>Real Change*</b> (2006/2005) (in %)	<b>2007</b>	<b>2008</b>
Tax Revenues	201,993	211,157	<b>2.0%</b>	230,072	245,729
Non-Tax Revenues	15,614	14,921	<b>-6.8%</b>	13,464	14,383
Grants and Transfers	39,619	42,094	<b>3.7%</b>	69,394	63,544
<b>Total</b>	<b>257,226</b>	<b>268,171</b>	<b>1.7%</b>	<b>312,930</b>	<b>323,656</b>

\* based on the Ministry of Finance inflation estimate for 2006 – 2.5%

Source: Draft Public Administration Budget for 2006-2008; own calculations

According to the budget presenters, total tax revenues in the ESA 95 methodology should increase at a healthy rate in compliance with the economy growth. Nevertheless, the below indicated table shows the tax revenues of the state budget calculated on a cash basis in 2006 shall drop on a year-to-year basis by SKK 3.1bn for the reason of short-term cash drop-out of **value-added tax** (VAT) incomes on account of institutional change in tax payment with import of goods from other than the EU countries that shall exert no impact on the accrual basis. The second factor is the fact the National Highway Company (NDS) has become since 1 March 2005 a VAT payer, and thus the newly built motorways shall bring VAT to the budget. On the contrary, the VAT yield on vignettes, beforehand not subject to taxation, shall to a certain degree act as a compensating factor. The development of business **income tax** of natural persons should be affected by the improving conditions for small-sized enterprises and the expected economy growth. Income taxes of legal entities should profit from the expected inflow of direct foreign investments and the ongoing process of enterprise sector restructurisation. Increase in **excise taxes** should correspond to the household consumption growth rate in the constant prices. In 2006, the excise tax yield shall be affected by an increase in tax rates for cigarettes and alcohol.

<b>Tax Revenues</b> (on a cash basis) (in SKK m)	<b>2004</b> (Reality)	<b>2005</b> (Budget)	<b>2006</b> (Estimate)	<b>Real Change*</b> (2006/2005) (in %)	<b>2007</b> (Forecast)	<b>2008</b> (Forecast)
<b>Tax Revenues</b>	<b>229,197</b>	<b>243,121</b>	<b>260,498</b>	<b>4.5%</b>	<b>283,310</b>	<b>303,634</b>
of which: to the State Budget	209,459	201,993	211,157	<b>2.0%</b>	230,072	245,729
to Local Budgets	19,738	30,829	37,441	<b>18.5%</b>	40,361	43,859
to Regional Budgets	0	10,298	11,870	<b>12.5%</b>	12,849	14,018
<b>Direct Taxes</b>	<b>71,196</b>	<b>69,651</b>	<b>79,953</b>	<b>12.0%</b>	<b>88,017</b>	<b>97,070</b>
Personal Income Tax	34,224	33,185	39,302	<b>15.5%</b>	43,421	48,224
Corporate Income Tax	31,297	30,066	36,181	<b>17.4%</b>	39,950	44,040
Withholding Income Tax	5,675	6,400	4,470	<b>-31.9%</b>	4,646	4,806
<b>Indirect Taxes</b>	<b>142,977</b>	<b>162,710</b>	<b>167,411</b>	<b>0.4%</b>	<b>181,949</b>	<b>193,007</b>
Value Added Tax	99,576	117,339	115,497	<b>-4.0%</b>	127,994	136,907
Excise Taxes	43,401	45,371	51,914	<b>11.6%</b>	53,955	56,100
<b>Other Taxes</b>	<b>4,611</b>	<b>760</b>	<b>634</b>	<b>-18.6%</b>	<b>644</b>	<b>657</b>
<b>Local Taxes</b>	<b>10,413</b>	<b>10,000</b>	<b>12,500</b>	<b>22.0%</b>	<b>12,700</b>	<b>12,900</b>
Specific Local Taxes and Fees	3,703	2,600	3,850	<b>44.5%</b>	3,900	3,950
Tax on Motor Vehicles (Road Tax)	2,464	2,500	2,650	<b>3.4%</b>	2,700	2,750
Real Estate Taxes	4,246	4,900	6,000	<b>19.5%</b>	6,100	6,200

\* based on the Ministry of Finance inflation estimate for 2006 – 2.5%

Source: Draft Public Administration Budget for 2006-2008; own calculations

Under the draft public administration budget for 2006-2008, **state budget expenditures** have been budgeted at the level indicating slightly faster growth in comparison with the expected inflation rate. The state budget expenditures without state debt for 2006 total SKK 306.1bn. In comparison with the volume of SKK 288.5bn in 2005, this is a 6.1%-nominal and 3.5%-actual increase of expenditures with the estimated inflation of 2.5%.

<b>State Budget Expenditures</b> (in SKK bn)	<b>2005</b>	<b>2006</b>	<b>Real Change*</b> (2006/2005) (in %)	<b>2007</b>	<b>2008</b>
State Budget Expenditures	318.8	330.1	<b>1.02%</b>	353.1	360.3
of which: State Debt Expenditures	30.3	24.0	<b>-22.70%</b>	32.0	31.3
State Budget Expenditures excl. State Debt Expenditures	288.5	306.1	<b>3.50%</b>	321.1	329.0

\* based on the Ministry of Finance inflation estimate for 2006 – 2.5%

Source: Draft Public Administration Budget for 2006-2008; own calculations

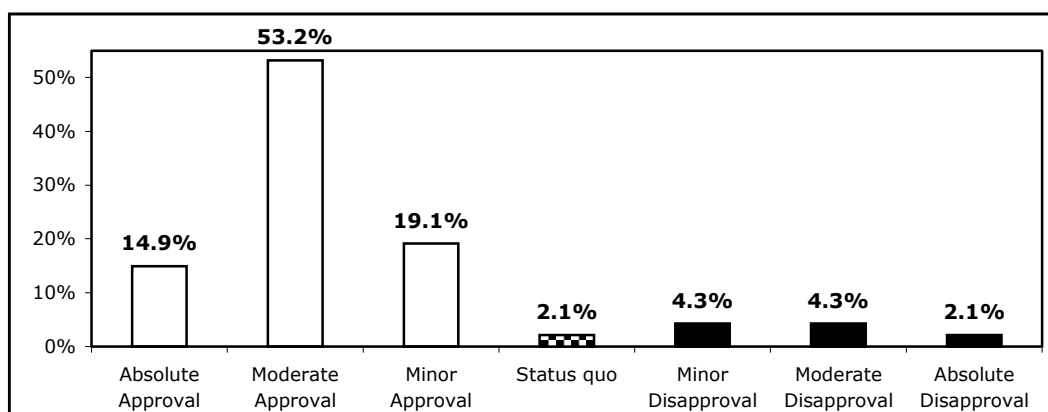
The highest actual increase in expenditures has been recorded in environment wherein more than SKK 12bn will be available, whether by means of the own chapter of the Ministry of Environment, or from other resources, i.e. a year-to-year increase by more than one third. The resources for social assistance programmes and health care system have increased as well. More money should flow into the education segment as one of the basic pillars of the so-called knowledge-based economy formation. One of the state budget objectives for 2006-2008 is to increase the share of newly admitted students for daily studies for the 19-year old generation so as it arrives at the level of at least 45% in the academic year 2008/2009. As to science, the 2006 State Budget has allocated thereto in total SKK 7.7bn, i.e. 0.51% of GDP. As for defence, SKK 28.5bn (4% actual increase), i.e. 1.86% of GDP has been allocated thereto for 2006. For agriculture, resources in the volume of SKK 22.3bn, i.e. actual increase by 6.3% compared with 2005 have been budgeted for 2006. The total volume of agrosubsidies for business entities in 2006 under the budget should amount to SKK 18.7bn, i.e. compared with 2002, when subsidies totalled SKK 10.0bn, an actual increase by almost 52%. By use of various means of the Common Agricultural Policy of the EU, subsidies in the amount of SKK 17.6bn shall be provided, whereof for direct payments a volume of SKK 7.6bn has been budgeted, i.e. 54% of the level in the EU-15 countries.

#### **Opinions on the 2006 State Budget**

The Slovak Minister of Finance, Ivan Mikloš, has appreciated the fact nobody has tried to doubt the estimate of total revenues and nobody has tried to increase the fiscal deficit in the discussions. Representatives of all the coalition parties have confirmed constructiveness of the discussions compared with the previous years. At the government level, the discussed issue of the amount of direct payments to farmers, an issue of priority importance for the Party of the Hungarian Coalition (SMK), has been settled as well. According to the approved parameters, the farmers should receive in direct payments in 2006 by SKK 400m more than in the previous year. In total, the resources for direct payments to farmers have scaled up to 54% of average support level in 15 original EU member countries. During the discourse in Parliament, the opposition members have proposed settlement of direct payments for farmers up to the maximum possible amount of 65% of the European 15 average. Overall, the members have enforced only slight budget adjustments that all in all totalled several tens of millions Slovak Korunas. Each proposal has covered also proposal for the source of the necessary resources.

According to the presenters, the State Budget for 2006 has reflected the programme priorities of the Government and contributed to Slovakia's development as knowledge-based economy. The fact the state budget deficit during the election year is to decrease by 0.5% point in comparison with the approved deficit of the previous year has been deemed the biggest positive of this year budget. According to many analysts, this has been the best pre-election budget in the SR history. The approved budget has conformed to the Government's objective to adopt the Euro in 2009. Nevertheless, the National Bank of Slovakia, alike some bank analysts, has expressed its opinion that with regard to the faster economy growth, this positive development should be used for higher savings in public funds. The critics have found the budget faulty in view of the fact a lot of funds flows into subsidies for agriculture, and results in increased prices and reduced effectiveness therein.

According to the opposition representatives, the State Budget for 2006 has not actually reflected the Slovak economy and met the multinational monopolies halfway. One opposition party has called the budget militant, in view of the fact the state budget has allocated a lot to the defence resort at the expense of for example education or health care. In addition, the opposition parties have reproached the budget for the state expenditures do not drop, on the contrary, in some areas they increase.

**Evaluation of the Experts' Committee:**

The expert public has valued the 2006 State Budget highly positively. Regarding the election year, it has been an agreeable surprise because it has kept the fiscal deficit within relatively reasonable limits and has not been too wasteful. One respondent has appreciated the fact that for the first time in the new history of the SR the new Government needs not to start with a package of consolidation measures but can start upon a solid basis to instantly enforce its programme priorities.

Several experts have provided their opinions to the particular structure of state budget expenditures. According to one expert, the money allocation should reflect more the Government's priorities, although the expert has been aware of the fact the structure may have fallen a sacrifice to the aggregate number in the process of political negotiation. Another evaluator has found the following aspect positive: the increase in expenditures in the education resort for the reason of need of investing in the education and knowledge-based economy growth. The evaluating experts have criticised a lot the increasing expenditures in the agriculture resort that keep on prolonging the agony of this sector by making it a profit "business" also for inefficient producers, i.e. precisely in contravention of the development should the market dictate it. Increase of the resources in agriculture has not got yet reflected in increase of the sector efficiency. Agricultural subsidies after all exert negative impact also on the competitiveness of the entire economy. One respondent has criticised the fact the budget "rewards" also such resorts where complex reforms have not been yet initiated (e.g. culture), in contravention of the Government-declared philosophy. In the respondent's opinion, some items in the budget (e.g. social scholarships for university students) reinforce the interest groups preferring the status quo and impede future reforms. One evaluating expert has expressed an opinion the relatively low planned deficit of the public administration has been also a result of the elimination of financing some activities and limiting, or minimising the payments in the social area. Another respondent has claimed that higher pressure could have been exerted upon deficit decrease, and the budget structure could have been changed more significantly.

**Ján Pokrivčák:** "The Slovak State Budget for 2006 is better than the budgets of the neighbouring countries and also better than the previous budgets of the SR. More resources are provided to support to economy efficiency (infrastructure, science, schools) and less to redistribution."

**Juraj Nemeč:** "Another step towards meeting the Maastricht requirements, I find the high rate of budget discipline (deficit amount) in effect positive. The high increase of resources for the business sector is open to dispute. The increase of resources for education is still insufficient. Unless the university financing reform is successfully realised, the current level of resources leads to constant drop of quality."

**Juraj Lazový:** "I view the approved budget positively with regard to the pre-election period and the current political structure in the Parliament."

**Karol Sudor:** "Regarding the state's revenue aspect development, I find it a wasted chance for balanced budget formation. A good government does not spend more than it collects. Notwithstanding, I find it a success with regard to the fact it was formed in a pre-election period. The best budget in the history of the SR."

**Igor Daniš:** "Standard. Debt could be reduced more, or more invested into motorways, on the other hand, the real deficit, including the political decision on pension reform, is notably high."

**Martin Krekáč:** "I cannot see any particular reason for arriving at the state budget deficit and fiscal deficit. State budget management should be balanced, especially in a period of abrupt economy growth."

**Peter Schutz:** "Deficit decrease is surely good but very slow to my taste. Therefore, minus one. Notable reduction of expenditures is missing."

**Peter Gonda:** "The state budget, or public administration budget for 2006, is in comparison with the previous ones more economical and less wasteful. In view of the political possibilities (relatively pro-market oriented government) and economic prerequisites (for example, fast economic growth), I find it not much ambitious, almost a wasted chance. It can be illustrated in the slight decrease in fiscal deficit in proportion to GDP in comparison with the previous year; however, not by total savings in public expenditures. In my opinion, it is a disappointment in relation to the desired status (in view of the rate of approaching the budget in line with the liberal economy principles) because:

- it preserves and expands deformations in public expenditures, whereas it significantly increases the public expenditures (even above the inflation level), thus leaving a high degree of redistribution;
- it is not based on decrease of social security contributions and taxes, whereas it relies on non-tax incomes that need not to recur (for more information, see Gonda, P.: Rozpočet verejnej správy na volebný rok 2006 nie je reformný /pravicový/).

**Ladislav Balko:** "In terms of budget as annual plan of revenues and expenditures, such a projection can be agreed with. I find positive also the fact the Government has not followed the path of enormous election populism before the election, whereas it indicates an effort to observe the commitments ensuing from the membership in the EU in the field of public funds. The amount of such budget composition is open to dispute, in particular, the absolute increase in deficit when in comparison with the previous year deficit to GDP (GDP totalled SKK 1.430bn in 2005) and GDP growth by 6.5%, i.e. about SKK 93bn (this year, GDP is planned to total the amount of SKK 1.531bn.), the absolute deficit amount should be higher than the last year's planned deficit budgeted to SKK 61.5bn, whereas the deficit has not been arrived at only due to the absence of national participation in use of Euro funds. Personally, I incline to the opinion the faster GDP growth needs not to be viewed in perspective of faster budget decrease but in view of financing those public sector segments that establish the future pro-growth trajectory – family and young generation, science and education, quality of health lives of citizens."

One evaluating expert has viewed also the issue of the budgeting process. In the expert's opinion, the programme budgeting is in principle a very sensible instrument; however, the expert finds disagreeable that the application thereof is often not in compliance with the original idea. For the most part, in case of the not reformed sectors, it is only a matter of disguising the "top-down" approach towards budget formation. A systematic analysis of efficiency of use of funds for individual programmes must be intensified in the future.

## **Tax Policy**

### **Amendment to the Act on Local Taxes (delimitation of upper limits for local taxes on lands and buildings as 20- and 40-multiple of the lowest rate thereof in the community/town)**

On 25 October 2005, the Members of the Slovak Parliament approved the Amendment to the Act on Local Taxes.

The Act as of 2004 has introduced facultative local taxes a community or a town can levy without any upper limits (real estate tax, tax on dog ownership, tax on public place use, tax on accommodation, tax on vending machines, tax on no-lottery-bonus gambling machines, tax on motor vehicle entrance and stay in a historical part of a city, tax on nuclear device, and tax on motor vehicles that can be imposed by a higher territorial unit). The local tax on municipal wastes and minor building wastes is obligatory, and therefore a community must introduce it. This Act was for the first time applied in 2005.

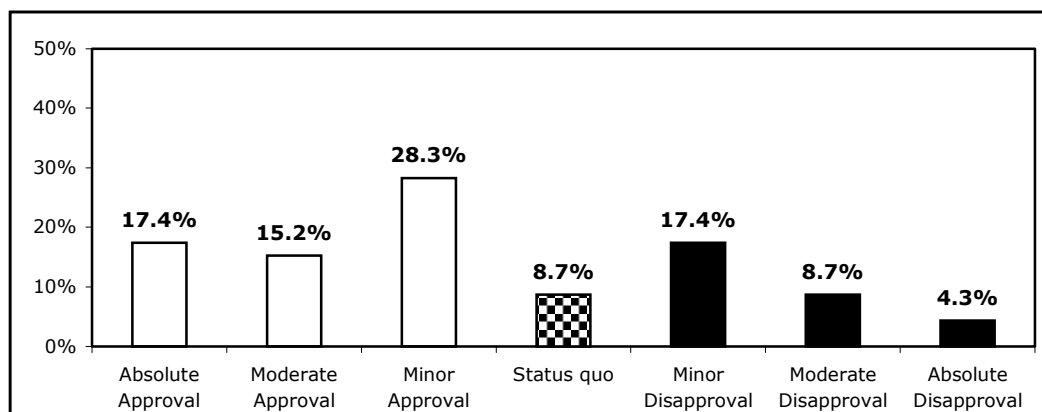
The current amendment has introduced a significant change, and that the upper limit delimitation for taxes on lands and buildings. It has been stimulated by a wave of criticism and dissatisfaction on the part of citizens and entrepreneurs upon whom some municipalities imposed for 2005 several-times higher real estate taxes if compared with the previous year as the towns and communities had been under the fiscal decentralisation given autonomy to decide on local tax rates.

The Ministry of Finance of the SR has proposed the tax rate that is to be delimited by a community for individual kinds of lands and buildings must not exceed as from the next year 20-multiple of the lowest rate that the community delimitates also autonomously. In the end, the Members of the Parliament approved the limit of 20-multiple of the lowest rate for taxes on lands and 40-multiple for taxes on buildings. Not a year ago, the MF of the SR resisted determination of transient periods or any local tax amount limits and was enforcing tax competition between towns and communities as the best self-regulation instrument. According to the Minister of Finance, Ivan Mikloš, the MF has partially changed its approach with regard to the fact communities had been in some cases misusing their competencies and increasing the local tax rates inappropriately for some social groups, especially for entrepreneurs.

The representatives of towns and communities did not agree with the upper limit for local taxes. They considered the adopted restriction an intervention into the self-governing function of communities. In their opinions, the fiscal decentralisation aimed to enable the communities to provide for financing their tasks also by means of their autonomous fiscal policy, whereas the adopted amendment limited their powers to render decisions. According to several representatives of communities, there is a risk the measure shall in some cases paradoxically lead to real estate tax burden increase as the relevant towns will not decrease the highest rate but on the contrary increase the lowest one, and thus shall arrive at the statutory 20/40-multiple difference between the lowest and the highest tax rate. Thus, according to the critics, the change will affect those who have benefited from the relatively lowest taxes. For example, the City of Nitra has imposed taxes on buildings reserved for agricultural production by a sum of SKK 2.50 per square metre and administrative premises by 140 Korunas per square metre, i.e. 56-multiple difference in order to arrive at higher tax revenues. According to the mayor of Nitra, the city shall be now forced to decrease the highest tax rates, and thus to accept a lower tax selection, or to approximate the tax rates and give up the possibility of affecting the allocation of a certain type of business activities in the city.

Several business associations protested against adoption of the Act on Local Taxes in 2004. With regard to the non-existence of limits and regulation mechanisms with determination of real estate tax rate at the self-government level, the entrepreneurs were afraid of real threat of this Act misuse in a form of groundless tax increase. According to the analysis of the Business Alliance of Slovakia (PAS), taxes in case of buildings reserved for business activities have increased since the beginning of 2005 in approximately half of the monitored towns of the SR by more than 100%. The biggest increase, by as much as 465%, has been recorded in Bratislava – the metropolitan district of Staré mesto, with the rate of SKK 250 per square metre. Nitra and Košice with SKK 140 per square metre, or SKK 120 per square metre, have ranked the 2<sup>nd</sup> place after Bratislava, under the category of the highest tax on buildings for other business activities. In case of tax on built-up areas, according to the Business Alliance of Slovakia, the toughest situation for entrepreneurs among the monitored towns has been recorded in Trnava, the lowest taxes have been in Považská Bystrica. Currently, the definitely highest taxes on building plots are in Bratislava. Towns hungry for new work places, such as Lučenec, Svidník, or Komárno stand on the other end of the chart list.



**Evaluation of the Experts' Committee:**

The evaluating experts have slightly approved and notably objected the introduction of limit restrictions with delimitation of upper limit for rates of local taxes on lands and buildings. The approving opinions could be characterised by a conviction that communities have been misusing the amendment to the original Act on Local Taxes for inadequate increase of especially real estate taxes for business entities. Some respondents have found the asset of the amended act and restrictions to unrestrained autonomy on the part of towns and communities with delimitation of rates of local taxes on lands and buildings mostly in relation to good business environment development.

Several evaluating experts have expressed opinions this should be just a temporary measure. They have pointed out to "extortion" of entrepreneurs by communities. Particularly, in case of large industrial enterprises, a plant cannot be simply closed right away and left for other place in response to changes of tax rates. One respondent has proposed the communities could have delimited the taxes only for categories of tax payers, and not individually since thus it is a potential source of extortion and corruption.

In the opinion of one member of the Experts' Committee, the amendment has not been adopted for the reason of "whim" on the part of communities but rather for the reason of lack of financial coverage of tasks ensuing from the delegation of competencies from the state to self-governments. Many tasks in various areas have been delegated to self-governments and the communities are to take care for financial resources under their competencies. On the other hand, the measure should bring a higher degree of responsibility on the part of communities towards citizens since these will be able to control better the way the communities dispose of funds.

**Jozef Orgonáš:** "At last, the extortion of the business sector by communities will end up."

**Igor Hornák:** "At least a partial obstruction to the arrogance of local governments."

**Ludvík Posolda:** "The amended Act will impede the possibilities of misuse."

**Igor Daniš:** "It is not clear to me, and nobody, nor any report, proposal, commentary, or analysis have elucidated to me why just the 20- and 40-multiple. Have not there been any other criteria for solving this problem? Of course, the former situation wherein taxes were delimited freely was not admissible, ready for misuse in Slovakia, in poor democracy, in particular at the local level, not held back by responsibility and control."

**Juraj Nemeč:** "As long as we respect the specific Slovak problem of low mobility, then the amendment can be accepted. Nevertheless, in general, it is an area that the market/political market can, at least theoretically, solve also without limits."

**Eugen Jurzyca:** "In my opinion, time regulation would be better. Let a community have even 100-times higher rate than other communities, but let it not increase the rate the next year it has attracted an investor. This is the biggest risk and the new regulation does not remove it."

**Radoslav Štefančík:** "In this case, I am for competition and maintenance of the principle of subsidiarity. The state should not intervene in the powers of communities and towns."

**Radoslav Procházka:** "It is denial of one of the support constituents of fiscal decentralisation – tax competition in the sector of municipalities. On one hand, it restricts the space for tax chicanery of entrepreneurs by local self-government bodies, on the other hand, it effectuates it in a way based on non-confidence in free market and competition actuation. Again one of the examples the system core is intervened in so as to correct the partial manifestations."

**Milan Velecký:** "A purpose-built amendment whereby the state tries to protect a few companies. Point no. 1 – these companies will probably not all the same save a lot on taxes because the community will increase the lower limit in order to fall within the new range. They will not

*decrease the upper one so as not to decrease their incomes. On top, the amendment comprises also other follies: for example, with tax on land, the value is determined directly under the Enclosure thereto (so far, the value determination has fallen under the local self-government competencies). Thanks we have got the wise Bratislava that will tell us what is the value of for example a pasture land in Ploštín. The people of that place would not manage to tell the value... They would either ascribe a too high value and the poor farmer would bleed out on taxes, or a too low value and the community would be in lack of money. Point no. 2 – in Bratislava, they have put down in the Enclosure almost the same values of lands as having been determined so far by self-governments. That is, the self-governments have not been probably silly until now, it only has had to be shown it has not been so serious with the decentralisation and reinforcement of competencies.”*

Although some critics of the amendment have admitted that the existing risk of excessive taxation at the local level had spoken for the adoption of this standard; however, also for the reason of "learning process" on the part of mayors and people, it would be important that they determine the local tax rates themselves and then see the consequences of the high or low taxation. Communities must learn themselves what tax they can determine. In the opinions of opponents, the amendment has held back competition between communities that the fiscal decentralisation has originally intended. It is a paternalistic approach. The measure has significantly restricted also the possibilities on the part of communities of exerting by means of fiscal policy active impact upon the community and town appearance and orientation towards certain types of business activities, population, etc. Under the new order, there shall be the risk of manipulating rather the lower than the upper tax rate, whereas the possibilities of the prospect party to pay a premium for a specific or interesting location are underrated.

One respondent has viewed the issue from different angles depending on (no)business activity performance of the part of citizens: *"If excessive taxation affects the citizens– natural persons, non-entrepreneurs – in social terms, I would approve the limits, although, the way they have been defined is very unhappy, i.e. where the local bodies keep to determine the constant the limit derives from. In this case, I would be for, in view of the fact the demand for lodging is in case of individuals very unyielding, the towns could misuse this fact and by imposing high taxes (along with absence of compensations) cause notable social problems in a short-term horizon. However, in terms of companies, I do not consider the negative impact thereupon a sufficient reason for central regulation. It is up to the decision of local bodies what local fiscal policy they will enforce. Entrepreneurs can always relocate their registered seats to another area with better tax terms and conditions, or after all to withdraw from business activities. If local bodies assume this risk when rendering decisions on resources and distribution of local budgets, it is their autonomous decision. They shall account for their decisions before the electorate and the non-governmental sector, or some local independent institution, should they decide to establish some that shall supervise over the local representatives' activities and decrease the risk of short-sighted measures, can show them what they are really like. It is high time that the local institutions mature as well. The state's paternalistic hand only hinders this process.”*

**Amendment to the Income Tax Act (increase in tax-deductible flat expenses for tradesmen from 25% to 40%; child tax bonus increase from SKK 450 to SKK 540 per month; cancellation of old age insurance premium rate decrease by 0.5% per each child; non-approval of lower limit increase and upper limit introduction for the assigned sum of 2% of income taxes for public beneficial services)**

The Amendment to the Income Tax Act as of 28 October 2005 has increased **tax-deductible flat expenses for self-employed persons** from the hitherto 25% to 40%. Flat tax expenses for craftsmen have remained unchanged at the level of 60%. Self-employed persons will be able to assert the new amount of flat tax expenses for the first time in 2007 with presentation of tax returns per 2006; however, the amounts of tax advance payments shall be affected thereby as soon as in 2006. The original Government proposal reckoned with unification of flat tax expenses for all the tradesmen, including craftsmen, at the level of 35%. Tradesmen can deduct flat expenses from their incomes since 2004 when the new Income Tax Act, that has replaced the until then valid flat tax, has come into effect. Assertion of flat expenses simplifies administration as tax payer is not obligated to maintain single-entry or double-entry accountings but maintains only the statutory register of incomes that replaces accounting maintenance in a simplified form.

According to the representatives of the Slovak Tradesmen Union, the adopted increase in flat tax expenses has not been satisfactory. Instead of the approved 40%, they would adopt increase to the level of 55%. The representatives of the Slovak Chamber of Tradesmen and Slovak

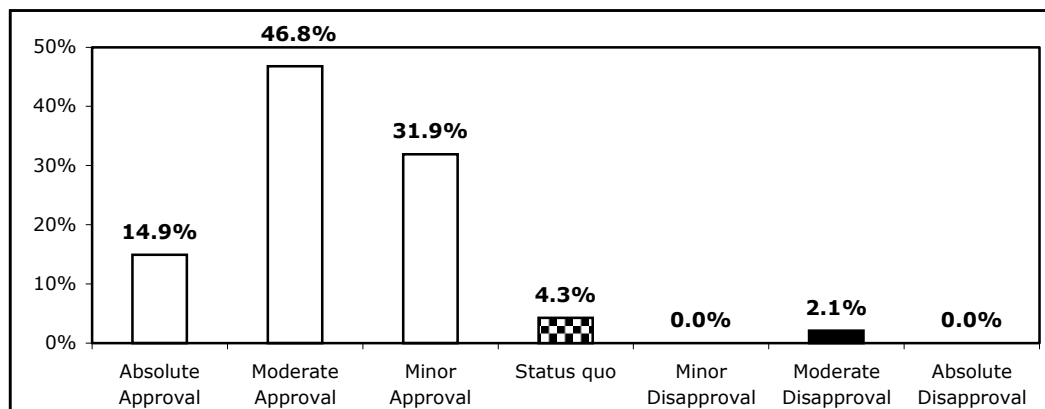
Association of Small-Sized Enterprises have considered the increase unsatisfactory as well and required increase of the deductible flat expenditures rate also for craftsmen. The opposition members have proposed to introduce 80% of deductible flat expenditures for farmers. Some observers have supposed the Ministry of Finance of the SR could proceed further and even out the flat expenses for all the small-sized entrepreneurs to the level of 60%.

The Members of the National Council of the SR have approved also a new tax bonus amount for children. The **child tax bonus** sum has increased from SKK 5,400 per annum (SKK 450 per month) to SKK 6,480 per annum (SKK 540 per month). This sum shall be subsequently annually increased to the same degree as the subsistence minimum amount. Tax bonus is a sum by which the taxpayer's tax is reduced for each dependent child sharing the taxpayer's household.

Concurrently, the amendment has **cancelled decrease of the old-age insurance premium rate by 0.5% per each dependent child** (the so-called payroll tax bonus), i.e. under the new rules, all the employees shall pay the same amount of 4%. According to the presenters, this system has been demanding in terms of administration and more favourable for the more solvent people since 0.5% meant for them a notably higher allowance than for the less solvent ones.

The Members of the Parliament have approved the finance resort proposal whereupon **tax assignation** – assignment of 2% of paid taxes of natural persons and legal entities for public beneficial service purposes should be restricted. To explain, the assigned tax sum should be according to the Ministry of Finance of the SR at least SKK 250 (currently minimum SKK 20 with natural persons and SKK 250 with legal entities) and should not exceed SKK 5m with legal entities. The Ministry has defended its proposal by claiming the assigned small sums pointlessly load the administration (as the administrative costs of tax offices for documenting and sending the small sums often exceed the very assigned contributions), and by the proposal to restrict the assigned contribution amount, the Ministry aimed to prevent reallocation of capital within large companies that establish own foundations or unincorporated associations. According to the Committee of the National Council of the SR for Finances, Budget and Currency, such a measure would result in a big drop-out of resources for public beneficial activities of the non-profit sector and with natural persons would deprive more than 335,000 citizens of the possibility of assigning 2% of tax. As at the end of July 2005, 417,000 natural persons and 14,000 legal entities assigned 2% of tax per 2004, whereas the revenue totalled SKK 878m. Recently, approximately 40% of gainfully employed natural persons have been making use of the possibility of assigning 2% of tax, whereas the average assigned sum totals about SKK 650. Natural persons make approximately one third of the total tax assignation revenue. Ondrej Dostál from the Conservative Institute of M.R. Štefánik has calculated that in case of approving the minimum sum in the amount of SKK 250 for natural persons, these persons would have to earn per month from almost SKK 13,000 up to above 17,000 (depending on the number of maintained children) in order to be able to assign 2% of the paid tax to the non-profit organisations. In his opinion, tax assignation would become a matter of luxury for the better earning citizens.

#### Evaluation of the Experts' Committee:



The amendment to the Income Tax Act brought various unrelated changes which were assessed differently by the experts. According to the majority of assessors, the amendment had more positive elements than negative. They welcomed the increase in tax-deductible flat expenses for small traders from 25% to 40%, which would have a positive impact on small enterprise area, but at the same time they pointed out that it would be of benefit if it could be unified with craftsmen, who are entrepreneurs as well, while they can subtract at large as many as 60%. Some of them agreed with the increase in the child tax bonus, which, according to one of the interviewees, should be valorised every year by the amount of inflation. Some experts perceived positively the abolition of a so-called payroll tax bonus, which was unambiguously a regressive measure,

advantageous for the richer, because 0.5% meant a significantly higher concession for them than for those earning less.

According to some opinions, the amendment brought positive steps which are, however, non-systematic. They represent further adjustments and changes in legislation which is still not transparent enough. The tax and payroll tax system should be perceived as a whole and so the problems in the given area should be solved. According to one interviewee, the measures dealt with the social aspect, but whose realisation is essentially made possible mainly through resources saved in other social issues, and according to him, it is disputable whether it was such a positive measure as it could seem at the first moment. According to him, it is disputable how their realisation will be provided for in further periods as far as the financial resources needed are concerned.

Different attitudes were recorded in the issues of tax assignments and non-approval of limits for remitted sums of 2% of taxes. The major part of interviewees agreed with a complete abolition of this institution which is, according to them, administratively very demanding, inefficient and can be abused. Some of them shared the opinion that this is still not the right time to limit the institute of tax assignment since real benefactors are few and far between in Slovakia.

**Juraj Nemeč:** *"The amendment contains various measures, some of them will have a more crucial impact (small traders – I take it as a positive step), others only a very marginal one."*

**Martin Krekáč:** *"The package of measures in the Income Tax Act can be assessed as one of many small steps for reducing the administrative complexity of the tax burden of specific population groups (small traders) and the opportunity to remit 2% tax-part for a purpose which the tax payer himself considers to be important."*

**Eugen Jurzyca:** *"The increase in flat tax expenses for small traders means further destruction of knowledge-based economy barriers. Without a "flat rate", the situation would be as follows: If a small trader uses a lathe, he can include his depreciations into costs and so reduce the tax. If a small trader uses only his brain, he is not allowed to include his depreciations into costs. So the tax system discriminates the use of knowledge and prefers the use of machines."*

**Milan Velecký:** *"For self-employed persons, the chance for insurance rate reduction did not function in practice; the Social Insurance Agency claimed that it had no software premises for it. Otherwise, it is a subject for discussion. Europe faces the ageing of its population and growing problems to maintain the current pension scheme. There is (in SR was?) a totally legitimate requirement also to link pension insurance to the number of children, because the continuous system may include not only payment of insurance payrolls, but also children who will contribute to it in future. For flat expenses – it is a pity that some craft activities still remained preferential (60%). It surely is not good to put the tax payers against yourself. If flat expenses have to exist, then they should be equal for all self-employed persons. I do not mind the non-approval of the upper border in tax assignment. If a company dedicates 2% of its tax to an allied subject, nothing bad will happen. Because even then they can only be used for public benefit aims."*

**Ladislav Balko:** *"Every measure directed at supporting economic development, employment etc. should be a contribution. However, as a financial lawyer, also working with tax law, I must express a critical opinion on the fact that the current Income Tax Act has been amended more than ten times since its acceptance at the end of 2003. This does not speak for a systematic approach in the area of tax acts, which again will lead to an unclear and complicated legal adjustment. It is disputable whether this measure will be favourable for self-employed persons and effective for reducing the tax and payroll tax burden of some groups. The non-determination of an upper limit for remitted sums from 2% of income taxes of legal entities will be decisively against tax ethics – the risk that a large volume of money could flow between a mother company and an allied foundation or civil association. Couldn't a strict legal determination of the objective for the use of assigned resources be taken into account?"*

**Igor Rintel:** *"I do not agree with the introduction of an upper border, if the equal tax rate is valid, the other conditions should also be equal."*

**Robert Žitňanský:** *"A reasonable measure, except for the part related to the assignment of 2% of tax. The most reasonable solution would be the abolition of this part – if the state feels like it does not need 2% of the income tax, it should reduce the tax rate by this amount. Anyone who wants to can find a public benefit recipient of his money. This will also hinder the effect of company foundations which then use the 2% for their PR activities."*

**Peter Schutz:** *"This is a good amendment, the tax assignment should, however, be abolished as a whole."*

## Transparency

### **Act on the Property Origin Documentation (if the court admits that the property value exceeds the documentable incomes by at least thousand times the minimum wage (SKK 6.5m), this property goes to the state; the division of the burden of proof in civil-legal proceedings between the financial police, the prosecution and the citizen)**

On 23 June 2005, the Slovak Parliament approved the proposal of opposition deputies from the SMER-SD (SMER-Social Democracy) party for the issue of the Act on the Property Origin Documentation. Its aim consisted in legalising a particular way of depriving the property of people who were not able to document the legal origin and the way of acquisition of their property accumulations in a plausible way. The act assumes that anyone can document the origin of their property accumulations.

Despite the fact that this act should be applicable to any person who cannot document the origin of his property, the proponents explicitly emphasised the application of this act on constitutional agents, higher state functionaries and other persons who took important economic or financial decisions in the period since 1 January 1990. According to the justification report, this domain of persons was especially highlighted because it dealt with the period when serious decisions were taken during privatisation or in public competitions, etc., and when there existed the biggest chances for illegal enrichment.

The procedure according to this act is a common civil-legal proceeding. On the basis of a written announcement (an non-anonymous incentive from public power bodies or from natural persons and legal entities) or on its own incentive, the financial police will examine incomes, property value and the way of property acquisition by the person against whom the submitted announcement is directed. The financial police acts in concurrence with other persons and bodies, which, according to law, are obliged to provide them with the necessary information. They encourage the competent public prosecutor to submit a proposal for initiating the proceeding, if after the examination, they find out that the person's property value exceeds the documentable incomes by at least one thousand times the minimum wage (currently SKK 6.5m). The public prosecutor will afterwards examine the incentive and ask the person marked by this incentive for an explanation or a submission of proofs about how s/he obtained the property stated in this incentive. If the person does not provide an explanation, does not submit proofs within 30 days, or the public prosecutor does not consider his/her explanation to be sufficient and estimates well-founded that the property value exceeds the documentable incomes by at least one thousand times the minimum wages, the public prosecutor submits a proposal for initiating the civil-legal proceeding in the court.

If during the proceeding in front of the court, the public prosecutor documents the existence of a difference to the amount of at least one thousand times the minimum wage between the defendant's documentable incomes, which s/he may have earned, and his/her real property, the court will express by its adjudication that this property difference was obtained by the defendant from illegal incomes and it falls into the state's hands. As the approved act is not included in the criminal law, this will not automatically mean a criminal-legal recovery. If during the proceeding in front of the court, the defendant documents the opposite, the motion will be voted down. According to the submitters of this act, no prohibition of return application relates to it.

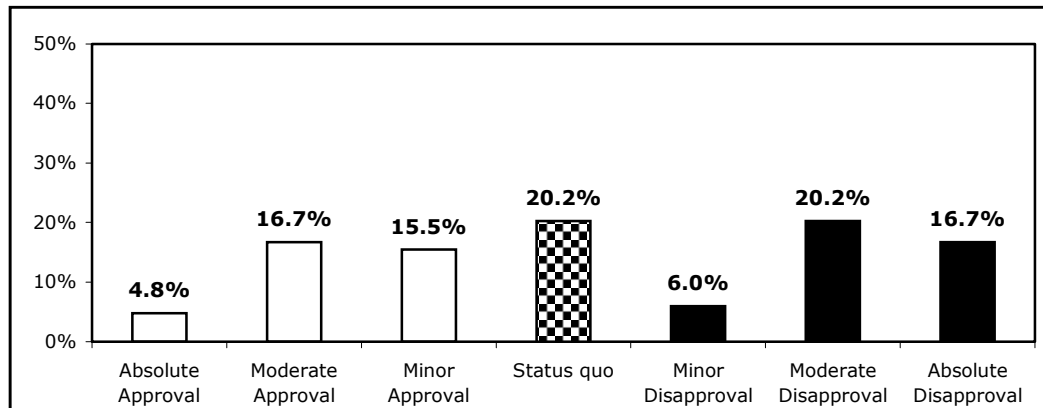
The biggest dispute in the Act on the Property Origin Documentation consisted in who would endure the burden of proof in the court. The opponents of the act insisted that the burden should be endured only by the public prosecutor, i.e. by the state. The submitter of the act, Robert Fico, said that in such a case, the act is of no importance. The approved act assumes the division of the burden of proof in front of the court between the public prosecutor and the defendant. The Minister of Justice, Daniel Lipšic, emphasised that documentation of the property origin would be included in a civil proceeding, not in a criminal one, and therefore the burden of proof cannot be endured only by the public prosecutor.

The critics of this act agreed on two main reasons for the non-acceptance of this standard. According to them, the act will not meet its goal to prosecute illegally enriched persons, as there is an assumption that they will have no problem to "prove" the origin of their property (donation or loan from a private (e.g. also dead) person, etc.), on the other hand, there is a certain risk of abuse. According to the critics, the risk of abuse arises from the fact that the financial police are obliged to examine any announcement and only if this turns to be unjustified can they postpone it. The announcer is not obliged to state the reasons of his/her doubt and endures no responsibility for a possible groundless announcement.

The Attorney General, Dobroslav Trnka, pointed out possible problems with the enforceability of the legal standard. Although the financial police is entitled to enter into enterprise subjects, the private person can reject the entrance of the police into his/her home. The investigator will so be significantly restricted in the property value determination. According to the attorney general, problems may also occur within the provision of a foreign bank's information about Slovak clients, as according to him, the Slovak legal regulations cannot force the foreign bank to provide these data.

The Act on the Property Origin Documentation was also submitted in the Parliament by the Minister of Justice in the recently ended election period. But the Minister Lipšic drew it back after several altering proposals in 2004. The Deputy Fico had been trying to pass an Act on the Property Origin Documentation already since 2001.

#### **Evaluation of the Experts' Committee:**



Although the aim of this act was correct according to several assessing experts, the means for its achievement was chosen badly. By this measure, the state chose the path of smaller resistance, when instead of a more effective use of available control and repressive devices, it reduced significantly one of the key parts of the legal state – the burden of proof of the apparatus of power being after the incrimination of an individual, and on the contrary, it transferred this burden of proof to citizens. The draft of this act is incorrect in the fact that the principles of criminal action, such as indisputably the action of an individual leading to the acquisition of property without documentation of its legal origin, were replaced through a deliberate squiggle by procedures characteristic for a civil-legal proceeding, which allow the state to charge the defendant with the burden of proof, and so to avoid the accusation from violation of the defendant's innocence presumption principle. It is alibistic to want from a citizen to present and submit announcements. The system of state power should have sufficient instruments for to discover illegal enrichment. According to several respondents, more money should have rather been given for quality investigators, tax officers, judges, etc. Even without the Act on Property Origin Documentation, the state would be entitled to examine those people, whose tax returns do not apparently correspond with his/her property. The act can be perceived as the admission of the low effectiveness of the state power execution – execution of tax offices which are not equipped for possibility of a continuous monitoring of the tax payer's property acquisitions. One of the interviewees considered the new act to be a very ineffective demonstration of the effort to enthrone a sort of doubtful justice in property relations.

According to several experts, the disadvantage of this act (as well as many other acts) consists in the fact that it indicates neither the problem nor its solution properly, but it conceals them alibistically (according to several interviewees, the act was accepted especially for political reasons – with the aim "to close the eyes and mouth " of the reviewers, and not for an honest solution to a problem). Some submitters of this act support the existence of large state companies which are a real problem, a source of black money in the economy. The Act on Property Origin Documentation looks like a solution for tunnelling state companies, and so with its help, the society lets probably persuade itself for further years that their problem-free existence is possible, which is to certain detriment.

The majority of assessors assumed that the implementation of this act would be difficult and its effect in practice would be minimal, and so it would bring nothing essential into the illegal property issue. Further, it will be even difficult to document the illegal origin of the property, because the punishable profiteers will surely think hard of steps and ways of concealing doubtful transactions. On the contrary, there is a risk that honest people will be "bullied" only because they have been informed on by their envious neighbour. Several respondents were afraid of the Slovak impeachment folklore. According to them, the standard abuse will not be prevented by the condition that the incentives cannot be anonymous. Exactly as we knew so-called white horses –

abused cats'-paws in business-legal relations, we will probably very soon hear also about white horses – abused cats'-paws providing incentives according to the Act on Property Origin Documentation upon the instruction and for reimbursement of someone else who will stay anonymous. They were also afraid of actions for a political order and a presentation of politicians who will prove their success rate so that they will draw out some small cases and so they will present their interest to solve this problem, while the big cases will herewith be covered and non-punished. Also the low quality of the legal standard, allowing several interpretations, was pointed out. One of the interviewees criticised enthroneing the retroactivity principle.

The proponents considered this act as a needed standard which is a big challenge for the Slovak public – discussion, democracy, mentality. Time will show the truth and whether the act was drawn properly. The necessity to document resources used for property acquisition is a common element of several world tax systems and according to the proponents, it represents a relatively effective device of the fight against corruption, tax avoidances and money laundering. They hoped that not only the "small fish" would be caught and the period of an arrogant presenting of multi-million properties of several top politicians, public officers, judges, liquidators of state companies and administrators of assets in bankruptcy, selling the property under its price often also to themselves, etc., who have not been punished so far even despite the possibility of unambiguous proof of their incomes, would come to an end.

### **Extension of supervision authorities of the Supreme Audit Office of the Slovak Republic also to resources used within original competences of local and regional self-governments, to legal entities established by local and regional self-governments, to companies with state shares, to public service institutions, to companies executing activities in the public interest (Amendment to the Constitution of the Slovak Republic)**

The Amendment to the Constitution of the Slovak Republic from 27 September 2005 strengthened supervision authorities of the Supreme Audit Office (NKÚ) of the SR. NKÚ competences were limited only to supervision of the management with that property and financial resources of communities, towns and Higher Regional Units which they obtained for the reimbursement of costs for the transferred execution of the state administration (nearly 50% of all incomes of local and regional self-governments). According to Constitution Amendment presenters from the Ministry of Justice, there arose a situation that after decentralisation of competences from the state administration to local and regional self-governments, including transfer of a significant volume of financial resources, financial supervision, executed by an independent state body, was provided for insufficiently. According to the Ministry of Justice, the public administration reform required to introduce a more effective mechanism for supervising total public finances, since the state cannot get rid of its responsibility for the efficient functioning of the whole public administration and for the efficient public finance management.

According to this Amendment, communities and Higher Regional Units should be supervised by the NKÚ in a full range. With its supervisory activity in self-governments, the NKÚ takes no decisions on the use of resources in self-governmental units, but it examines whether these resources were used efficiently in accordance with the law, so in concern of the whole community of citizens within a self-governmental unit. According to the Ministry of Justice, citizens must become sure that along with the internal supervisory mechanism on a local and regional level (main supervisors of communities), there also exists an independent supervisory authority (external supervision - NKÚ) which watches their interests, and, if needed, it is able to interfere, or signalise an objectively existing threat of their interests and needs. The presenters were sure that extending the NKÚ supervisory competences did not disturb the right of citizens to participate in management of public matters, it did not interfere with the autonomous decision-making of self-governmental bodies, limit application of their competences, or reduce the establishment of resources needed for the execution of self-governmental functions.

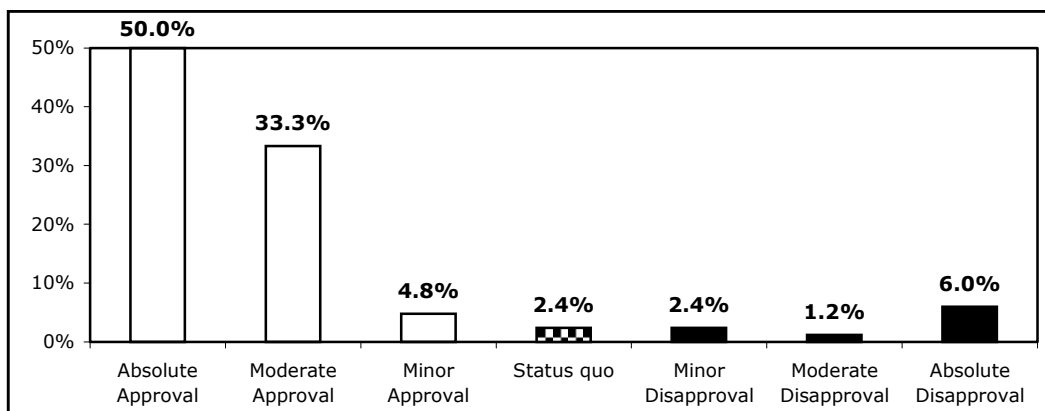
The Amendment contained an addition of NKÚ's factual activity in areas which had been covered with supervision insufficiently. According to the Amendment, the NKÚ is an independent body, which supervises the management of:

- budget resources, which are passed by the Slovak Parliament or Government according to law,
- property, property rights, financial resources, liabilities and receivables of the,
  - State
  - public service institutions,
  - National Property Fund of the SR,
  - communities,
  - Higher Regional Units,

- legal entities with property participation of the State, public institutions, National Property Fund of the SR, communities, Higher Regional Units,
- legal entities founded by communities or Higher Regional Units,
- property, property rights, financial resources and receivables, which have been provided to the SR, to legal entities or natural persons within development programmes or for other similar reasons from abroad,
- property, property rights, financial resources, liabilities and receivables, for which the Slovak Republic took over a guarantee,
- property, property rights, financial resources, liabilities and receivables of legal entities executing activities in public interest.

The fulfilment of new tasks should have been provided for by the NKÚ with supervisory capacities available at that time. The increase in expenditures in 2006 was estimated to the amount of nearly SKK 23m. The Amendment assumed that disputable issues would be solved by the Constitutional Court of the SR in well-founded cases. Some oppositional political parties (SMER-Social Democracy, Free Forum (SF)) wanted to amend the Constitution in order for NKÚ to obtain a chance of also supervising the financing of political parties.

**Evaluation of the Experts' Committee:**



Regarding the essential transfer of state administration competencies to the local and regional self-government, to a continuously bigger domain of institutions executing achievements in the public interest, administrating and re-distributing public property and resources and regarding a relatively high corruption rate in public administration, the aim of extending Supreme Audit Office's (NKÚ) supervisory competences was assessed by the professional public highly positively. The corruption decentralisation, as well as a relatively smaller amount of experience (possibly also a relatively lower professional qualification rate) with manipulation with public finances on a local and regional level represent a considerable risk regarding an efficient public finance management. Strengthening supervision could increase the transparent and efficient use of public resources, which is an important argument for the introduction of an independent qualified supervision.

Another reason for as wide a state supervision as possible over manipulation with financial resources, which the self-governmental bodies obtained from citizens, is a legal framework which determines self-government's functioning and authorities, including the execution of sanctions (police, courts, remand homes) for rejection or violation of obligatory regulations of self-governments in the area of public order and especially taxes on a local level, which is provided for by the State.

European supervision standards require to establish an internal and external supervision system for any public subject. After the state administration decentralisation, the self-governments administer a high rate of public resources and no external supervision system was created on their level, which was no optimum status according to majority of assessing experts. Furthermore, internal supervision quality is more than disputable. Community supervisors are often just puppets in the hands of the mayors who pay them. Regarding the fact that the local and regional self-government itself takes a lax attitude to the application of its own supervisory mechanism, which causes suspicions about effectiveness, the extension of the NKÚ authorities appears to be a beneficiary measure.

On the other hand, according to an respondent, the quality of supervision executed by the NKÚ and the emphasis on accordance supervision, and not on result supervision, is a limiting factor for the positive impact of NKÚ competences extension. According to an another opinion, it is disputable whether 20 further NKÚ employees will be enough for the extended competencies. A solution could be that community supervisors would be in a contractual relation with NKÚ which would pay and supervise them.



Arguments that the Amendment to the Constitution would threaten the independence of local and regional self-governments and statements of Association of Towns and Communities of Slovakia that it is about the introduction of communist "national committees" into the self-government, does not have a rational basis. NKÚ will not interfere with the decision processes of communities, it will only supervise the management of public money and those should not be left to an often intentionally non-transparent and inefficient decision making of self-governmental bodies. There was expressed an opinion that some protagonists of self-governments might, due to a more strict supervision, lose their "grey zones", where they wasted money without any limits, and therefore they fought against the acceptance of the Constitution Amendment. It was important to subordinate supervision of money, coming from national resources, also to national supervision. The local and regional self-government has to feel pressure of supervision because it is naive to rely only on media or the citizens that they would watch the local level. Even the NKÚ supervision does not need to discover any mistakes, but many assessors assumed that the supervision on a central level may be more effective than own self-governmental supervisory mechanisms. This is true especially in smaller communities, where people know each other, and therefore there exists a higher risk of impact on internal supervision and tendency of deflection from democratic procedures directed to a clan-based, persons-accepting or "group-mafia" way of decision making.

For some interviewees, it was disputable as to what extent the self-government should be supervised directly by the State. If self-governmental subjects manage with their own resources, according to this opinion, they should not be supervised by the NKÚ. But currently, it is necessary to defend the interests of tax payers also through the NKÚ. But according to an evaluator, the best solution would be an achievement of status, in which the mentioned subjects would provide for supervision funding for themselves from their own incomes.

According to an expert, it is of no benefit to "feed a useless dinosaur" - NKÚ - with new competencies, s/he says there should be an opposite trend. Some suggested that the institute of town or community supervisor should be reformed instead, i.e. own internal supervisory mechanisms, or competences of state prosecution, financial police, tax offices, etc. should be strengthened.

## **Privatisation**

### **Concept of Additional Privatisation of 51% Shares of the Západoslovenská energetika Company (direct sale of 41% shares to the current owner - E.ON, sale of 10% shares through public offer on the Bratislava Stock Exchange)**

By its resolution from 5 October 2005, the Slovak Government passed an Additional Privatisation Concept Update – Západoslovenská energetika (ZSE), a.s. Company Additional Privatisation Procedure Proposal. The governmental measure concerned the part which so far determined 51% of ZSE company shares as a permanent property participation of the National Property Fund of the SR. The Slovak Government decided on the additional privatisation of remaining ZSE state shares. So the state should have sold 41% shares by direct sale to the current owner of 49% shares – to the company E.ON Energie AG München and it should have offered the remaining 10% for sale on the basis of public offer through the Slovak securities market– on the Bratislava Stock Exchange.

In May 2002, the SR Government passed the privatisation of 49% shares of three power distribution companies – Západoslovenská energetika, a.s., Stredoslovenská energetika (SSE), a.s., and Východoslovenská energetika (VSE), a.s. The share in ZSE was obtained by the German power and gas company E.ON, which paid EUR 330m for the 49% share it bought. National Property Fund of the SR kept the remaining 51% shares.

In October 2005, the passed Additional Privatisation Concept Update consisted in confirming the way of privatisation of 51% shares of the ZSE company as it was received by the SR Government upon previous resolutions from 2004. The decision of the Government guaranteed the company E.ON a 81% share in ZSE, as the German investor currently controls 40% and has a manager control in it. European Bank for Reconstruction and Development (EBRD) owns 9% of shares which it obtained from the Germans. The price, for which E.ON should have bought ZSE shares additionally, was not determined. Regarding the company award in an international competition from 2002, the real value of 40% share should have exceeded SKK 10bn. The Slovak Ministry of Finance asserted that privatisation incomes were used for state debt reduction. According to protagonists of the SR Ministry of Economy, the result sum for sale should have been generated through privatisation advisor. This Ministry expected sale of 49% shares by the end of 2006. It was assumed that in the 1<sup>st</sup> quarter of 2007, also concrete resources would be available.

It should have been dealt with another one of series of privatisation of natural monopolies in the energy industry. The additional sale of ZSE shares should have been the first case when the state lost its influence in a company completely. The additional privatisation of ZSE should not have had a direct impact on prices for electricity in households. The price determination is governed by law and price movements have to be approved by the Regulatory Office for Network Industries according to the development of entitled costs of power distribution companies themselves.

The main activity of ZSE is electricity sale and distribution and the provision of complex services related to this. On 1 January 2005, the amount of ZSE property was SKK 13.35bn and net profit for 2004 was SKK 2.627bn, half of which accrued to the state through pay-out of dividends.

According to daily Financial Times Deutschland, the energy market in Central European countries is attractive for Western European distributors, as opposed to domestic markets, rates of growth move from a long-time point of view around 4% annually. According to a study by Deutsche Bank, western distributors have spent EUR 18.3bn (SKK 687bn) in area of gas and electricity distributors in the Central and Eastern European (CEE) region. E.ON itself currently supplies together more than 6 million clients in CEE countries.

According to the proponents, the decision of the Government to place 10% of ZSE shares on the stock exchange should have had a positive impact on the capital market in Slovakia. Ten percent of ZSE shares had a value of SKK 600m in a nominal expression, but according to analysts, their price could be increased to SKK 2.5bn. According to representatives of the Bratislava Stock Exchange, it would be an enormous contribution for investors. Chances for pension administration companies to invest would expand. According to law, they have to place 30% of their investments on the domestic market, i.e. in Slovakia.

After cutting the election period and after determining the early parliamentary elections for 17 June 2006, the SR Government on its negotiation on 25 January 2006 passed that it would accept no decisions about privatisation after 31 March 2006. But the Cabinet did not decide which companies will be concerned. Finally, the Government coalition agreed that it would stop carrying out any privatisation projects or sales of property. The decision to stop privatisation activities from 31 March to the end of the election period had an impact on the privatisation of 6 largest heating plants, 6 companies within the Slovak Bus Company (SAD), as well as on the additional

privatisation of the SSE and VSE power distribution companies. The discontinuance of privatisation concerned also additional privatisation of ZSE and Železničná spoločnosť (The Railway Company) Cargo Slovakia, the privatisation process of which had already advanced. The sale of Slovenské elektrárne (Slovak Electricity Company) and airport companies in Bratislava and Košice was ended with the condition that the Government had already signed contracts with competition winners and in case of their violation, it might have to reckon with the prosecutions of investors.

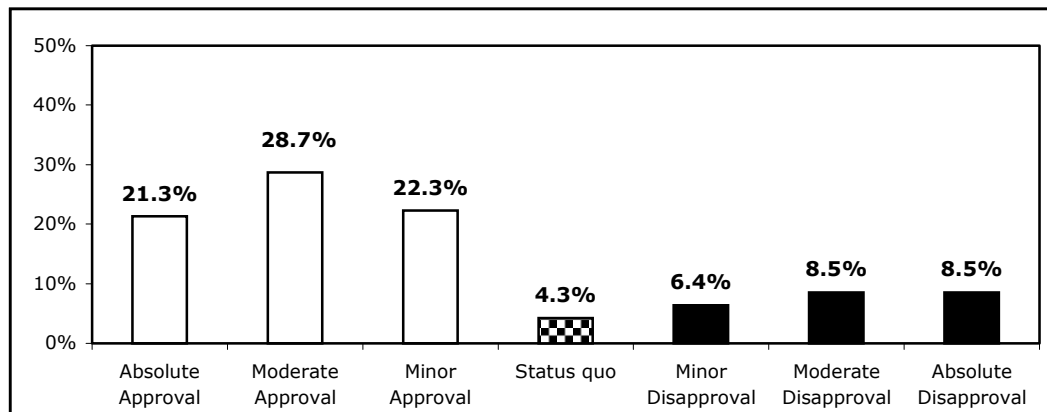
#### Stopped privatisation projects:

- Západoslovenská energetika (ZSE)
- Železničná spoločnosť (The Railway Company) Cargo Slovakia
- Stredoslovenská energetika (SSE)
- Východoslovenská energetika (VSE)
- SAD companies in Trenčín, Zvolen, Lučenec and Poprad, Banská Bystrica and Bratislava
- heating plants in Bratislava, Zvolen, Trnava, Žilina, Martin and Košice
- arms holding DMD Group.

#### Sales to be completed:

- Slovenské elektrárne (Slovak Electricity Company)
- Airports in Bratislava and Košice.

#### Evaluation of the Experts' Committee:



Many economists consider any sale of state property as a good step, as the state is usually a bad manager.

**Ján Pokrivčák:** "The private sector can use property rights more efficiently than the state, so additional privatisation is appropriate."

Several interviewees marked the submitted concept and additional privatisation carried out according to it essentially as correct, as it would have a positive impact on the Slovak capital market. According to an assessor, the sale of shares through public offer on the Bratislava Stock Exchange would be of much benefit especially for the reason that no standard privatisation using standard capital market devices had so far taken place in Slovakia. This expert would welcome a larger share determined for sale on capital market. On the contrary, another expert presented his opinion that no such artificial support, but only connection with other stock exchange would help the capital market in Slovakia.

Many respondents criticised the direct sale to the current dominant shareholder - E.ON company without public competition and questioned scheduled revenue amount, which they considered to be low also for the reason of the frequent increase in prices for electricity, which it helps to maintain stable profits for Západoslovenská energetika (ZSE).

**Karol Sudor:** "Additional privatisation as such is the right step, but an absence of competition is nonsense, and so a lack of competition for a higher offer, bad communication with the public on the privatisation of profitable companies as such. A positive thing is to reduce the impact of state as an acquitted „incapable" in the management of any state company."

**Ladislav Balko:** "Even if E.ON acquitted itself, privatisation without competition evokes a lack of transparency in the sale and it also means getting rid of a chance of obtaining a higher revenue. In relation to the fact that another natural monopoly would be sold, the issue of this company's price policy will be important in future, but there may be certain worries by consumers about further monopoly growth of prices. As the task of an independent regulator does not still function in my opinion, the consumers' worries may be justified."

**Igor Daniš:** *"As usual, a question arises (I presented it in the press already in 1993), why privatise – change the owner - from the economical point of view, within a working, prosperous company. By carrying out the sale, did the Government probably want to revitalise the small regional capital market (insufficient competition)? Otherwise it really concerns only meeting the schedule for pension companies regarding the localisation of certain resources."*

**Igor Hornák:** *"The sale of the remainder to a majority shareholder is of no advantage. A progressive sale to the public on the capital market would be more appropriate also regarding result price and the secondary effects of interest in stock investment (see the Czech ČEZ Company or Polish example)."*

But as the additional privatisation of ZSE was stopped by the SR Government after determining the early parliamentary election, it will depend a lot on the post-election structure of the Government, which procedure (if any) will be chosen.

## **State Aid • Support of Investments**

### **The Procedure of State Bodies and Public Institutions in the Case of Land under the KIA Plant Infrastructure (entrance of construction companies and mechanisms on private land without the consent of owners; start of preparatory terrain arrangements without construction permission; alleged archaeological research)**

The construction related to the Hyundai/KIA car plant investment in Northern Slovakia in the surroundings of Žilina moved on to the next stage – the construction of related infrastructure by communities Teplička nad Váhom, Mojš, Gbeľany and Nededza, which started around 23 May 2005.

The Žilina Invest Company needed for the construction of infrastructure nearly 420 acres of land, on which arrival roads, canalisations and other engineering networks should have been built. The amount of estimated costs for this construction stage was SKK 780m.

As the arrival of machines was scheduled on August 2005, according to schedules, the main arrival road should have been ready by this time. Similarly to the acquisition of land and construction of KIA plant itself, also in this case the situation related to the acquisition of land from hands of various private owners became complicated above all because of the dissatisfaction of land owners with the purchase prices. Also this time, petition committees of citizens started to assert themselves in the concerned communities. The land owners, who sold land under KIA plant itself right at the start (for 136 SKK/m<sup>2</sup>), were the least satisfied, because later, the Government decided to pay out more than two and a half times as much (350 SKK/m<sup>2</sup>) to those land owners who did not agree with the first price (see page 49). Subsequently those owners, who got significantly less money for their land, required an additional compensation of the difference from the Slovak Government. The owners of land under the infrastructure expressed their concern to sell off their parts of land, but they conditioned it with an appropriate price and also an additional payment of the higher amount for square metre (no more than 350 SKK/m<sup>2</sup>) to people who sold their land under plant to the state earlier and for a lower price (136 SKK/m<sup>2</sup>).

The Managing Director of Žilina Invest, which bought the land, estimated that the price for land under the infrastructure of Hyundai/KIA car plant in the mentioned locality near Žilina should have moved lower than advanced by members of petition committee of concerned owners. The Minister of Economy Mr. Pavol Rusko said that the purchase of land under the car plant infrastructure should have caused no problems because new expertises should have regarded the fact that land were sold for 350 SKK/m<sup>2</sup> in this locality. The Minister of Economy neither excluded that if owners (who sold their land earlier and cheaper) were not compensated, some of them would be not willing to sell land within infrastructure for the new prices either. On basis of new expertises, owners of non-purchased land should have been negotiated with. A new, faster way of deprivation for important investments could have been used theoretically, but the SR Ministry of Economy did not count with its use.

The Minister of Economy mentioned in one of his statements that KIA investment construction is in a certain time slip and the situation continues to be complicated. In an effort to catch up determined deadlines, the construction companies started with the first infrastructure construction stage, which was – according to statements of several persons responsible for construction – "archaeological research", which would include generation of topsoil and low bed fixation for making the dig site more available.

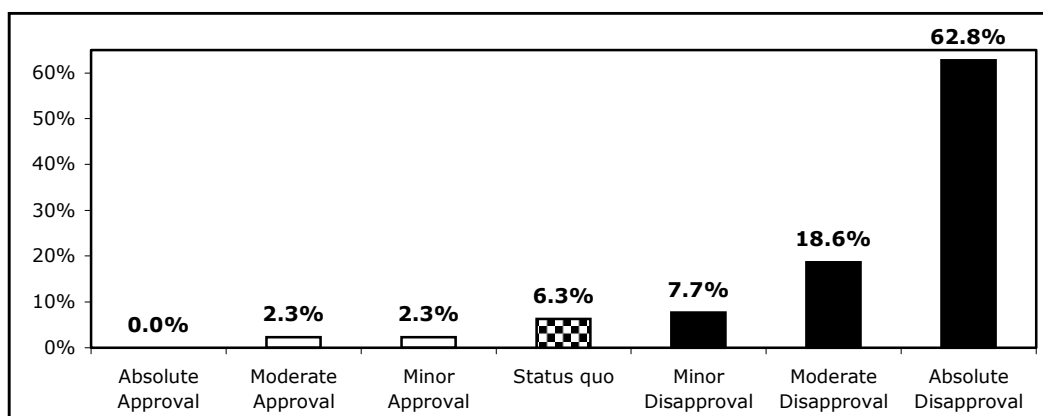
According to the information of concerned people – land owners and their legal attorneys, construction companies entered their land and started works without any permission and consent from the owners. According to law, any construction needs a construction permission, which, however, could not have been issued because the construction permission could have been issued only for land that is settled regarding the ownership and transferred to investment companies. The attorney of affected citizens stated that there was no legal base for infrastructure construction start in this case, but works on the above-mentioned land still continued. Upon statements of concerned owners, despite statements about archaeological research, all reflected that a road is constructed gradually on their land. The Žilina Invest Company, which managed the infrastructure construction, claimed that it concerned only the archaeological research and that fixed areas, which resembled road basement, were needed for this research. The representatives of Žilina Invest stated that they informed land users (agricultural co-operatives), who agreed with the archaeological research, about that research. But according to lawyers, the start of archaeological research on non-purchased land without consent of owners is law avoidance. Because according to law, a person who will do research, has to conclude at first an agreement with a real estate owner,

not with a real estate user. Only if they do not agree, will the National Institute for Monuments Protection of the SR decide on carrying out the research, even if the owner does not agree.

In relation to the construction of the infrastructure for KIA car company on private land, the land owners delivered a crime announcement to the district public prosecutor in Žilina at the beginning of July 2005. They expressed a doubt that a crime related to detriment of foreign matter was committed. According to information in the media, an incentive related to KIA car company was also received by the SR General Attorney, who forwarded it to the police, while the incentive was further assigned to the investigator concerned. The Žilina Invest Company was prohibited through a preliminary measure from 16 August 2005, issued by the District Court in Žilina, from entering the above-mentioned land and continue in the construction of the road for KIA car company. The District Court decided so to the benefit of the owners who brought action because bulldozers worked on their private land and a road then appeared there. The Žilina Invest Company did not respect the preliminary measure of the court and continued in the construction and entrances on land, so after 4 days, abidance of prohibition to enter on land started to be watched by the police continuously.

The roads and other communications for Hyundai/KIA should have been constructed by 15 August 2005 and the total length of the new roads should have been a little over 20km.

#### **Evaluation of the Experts' Committee:**



The HESO Experts' Committee expressed a significantly disagreeing attitude to the procedure of state bodies and public institutions in the case of land under the KIA plant infrastructure. Activities on private land without consent of their owners were an unjustifiable interference in the proprietary rights of citizens and a serious problem with regard to constitutional rights, which cannot occur. According to experts, the entrance of construction companies and heavy mechanisms on private land without consent of owners and start of terrain arrangements without construction permission meant the highest ignorance of basic rules, on which current society and market economy should stand. Such a procedure creates dangerous leading case with potential far-reaching consequences by abidance of legal procedures in similar and other disputable cases in future. This results in an extraordinarily negative impact on the culture of relations between temporary holders of state power and citizens as their originators.

Private ownership non-violation is a basic pillar of decent free society and market economy and the state is obliged to protect, not to violate, this principle. Some interviewees said that it was an absolutely unjustifiable step caused by the arrogance of the state, and especially political power, the effort of which is to succeed in investment attraction politically. Incompetence and an evident effort to achieve political points stuck in "humorous" improvisations, such as carrying out of archaeological research using a large amount of heavy construction technology. Such behaviour of the state power made an impression of existence of a corporate dictatorship, not a legal state. State promises concerning the KIA investment were in a significant advance against reality and these were only consequences of this. There was also a dispute why bodies active in crime prosecution did not proceed since the beginning of 2004, when the political euphoria about arrival of KIA car company was ruling, and did not hinder abidance of ownership rights before the Government decided to remove the Minister of Economy Pavol Rusko who proclaimed the investment vehemently.

According to further echoes, such behaviour by public power demonstrated an insufficient expropriation management. The KIA plant construction preparation was underestimated by the SR Ministry of Economy, which could be observed in everyday media information. Some experts (including the ex-Director of the Slovak Investment and Trade Development Agency SARIO) were calling attention to potential problems with owners of land within future KIA plant even before the final decision of the KIA representatives to invest in Slovakia. A sensitive issue, such as land

expropriation, should be approached more carefully and transparently in the future. The entrance on foreign land can be protected even in an armed way in some countries. Based on this fact, it is already obvious that private ownership should stay untouched and entrance on foreign land should be allowed exclusively only in the most special cases regarding the seriousness of circumstances, which surely was not true in case of KIA. A strict determination of exceptions and circumstances regarding expropriation in case of so-called global social interest could help to avoid a similar status. An agreement would, however, be the best solution. According to this, a business is good if both participants are satisfied and if neither of them feels cheated, or even aggrieved. But as one of the interviewees said, the responsible state representatives have still not woken up to the fact that people do not usually put social objectives above their personal interests.

The behaviour of state bodies might be explained by a certain concern in playing a waiting game, while the land were settled, in no way it could be spoken about as a correct procedure. The cause was in this way an exemplary case, when the rate of excitement for the matter was much higher than the professional and organisational abilities to realise the matter itself.

According to a presented opinion, neither the land owners themselves, who abused failure of state along with preparation of total investment of KIA car company, were completely without fault. This preparation was not created thoroughly by the SR Ministry of Economy.

### **Non-passing of Investment State Aid of the Total Amount of nearly SKK 7bn (direct state aid from the State Budget - 21% of the total amount of the investment) to the South Korean Tyre Producer – the Hankook Company**

On 6 July 2005, the SR Government did not pass a proposal for an investment contract between the company Hankook Tire CO.LTD. and the Slovak Republic and the town of Levice. The main reason for rejection of this proposal was the inadequate amount of state aid.

The South Korean company Hankook decided to place its production plant in Levice in the middle of May 2005. Poland (it offered state aid in amount of EUR 46m, which is nearly SKK 2bn), Hungary and later the Czech Republic also endeavoured to obtain the production plant of the largest South Korean tyre producer Hankook Tire. The investment is said to exceed EUR 0.5bn (over SKK 19bn). Hankook Company spokesman declared that the winner would be the country which would offer the best conditions, even in the form of tax concessions.

Within its direct support, Slovakia offered more than SKK 4bn to the Korean producer and within tax concessions, it would achieve more than SKK 1.2bn. In addition to the promised financial aid, the offer included also the promise of an improved road connection between Levice and the motorway, or speed communication. This communication should have led from Nitra to Hronský Beňadik by 2009. The promise also included a significant improvement to the road between Hronský Beňadik and Levice by the end of 2010. Announcing the investment, the Minister of Economy Mr. Pavol Rusko mentioned that there is also a chance of extending the current road to a four-lane one. The costs for investment aid would then total SKK 6.988bn altogether.

<b>Proposed State Aid to the Hankook Company</b>	
Direct Impact on the State Budget	SKK 4.281bn
Tax Relief	SKK 1.217bn
Road Construction Costs	SKK 1.5bn
<b>Total</b>	<b>SKK 6.988bn</b>
Planned Amount of the Investment	EUR 498m (SKK 19.9bn)
Planned Amount of New Direct Jobs Created	1,500
Share of Investment Stimuli (incl. Tax Relief and Road Construction Costs) in the Total Amount of the Investment	35 %
Costs per Job Created (excl. Road Construction Costs)	SKK 3.67m

Source: daily SME

The tyre company Hankook chose out of three Central European localities for its production plant Levice in the middle of March 2005. The company planned to start construction at the beginning of 2006 and production in 2008. The investment should have directly created 1,500 new jobs. A further 500 to 700 jobs should have arisen indirectly through subcontractors. The factory should have supplied regional car companies, including the Slovak plant of KIA Motors near Žilina.

State Aid to:	Amount of Direct State Aid (in SKK bn)	Planned Amount of New Jobs Created	State Aid per Job Created (in SKK m)
<b>Hankook</b>	<b>4.281</b>	<b>1,500-1,600</b>	<b>2.9-2.7</b>
KIA Motors Slovakia	5.4	2,800	1.9
Peugeot Citroën Slovakia	5.0	3,500	1.4
Mobis Slovakia	1.4	1,000	1.4

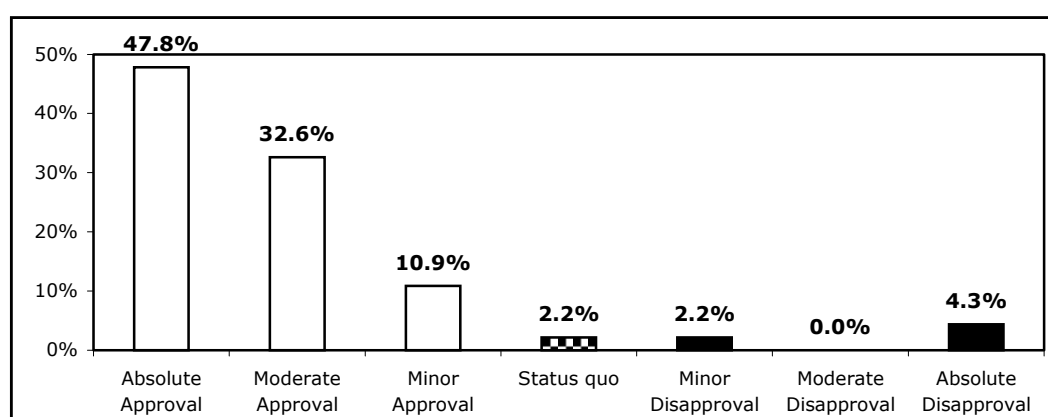
Source: daily SME

Finally, the Slovak Government did not pass the proposal for the investment contract on 6 July 2005. The main reason for rejecting this proposal was the inadequate amount of state aid. The Minister of Finance Mr. Ivan Mikloš said that the total volume of state aid in the SR was limited and there could be a lack of money for the support of new investors. One of the next arguments of the Government was that it would be a simple production that would not attract as many suppliers as a more sophisticated production. The SR Prime Minister Mr. Mikuláš Dzurinda said that conditions for acquisition of investment were unacceptable. The Minister of Economy Mr. Pavol Rusko said that the Government's attitude of rejection to the investment aid provision was a faulty and unfortunate step, due to which the establishment of 1,500 jobs failed. The Mayor of Levice argued for the acceptance of the proposal because of the high unemployment rate in the Levice Region.

After the Government's attitude of rejection, the Korean company Hankook decided that it would not prolong the exclusiveness of negotiations with Slovakia and would begin negotiations again with the other countries, including Slovakia. The South Koreans were willing to concede to demands for state aid from 21% of the total investment to 19%. But the Prime Slovak Minister Dzurinda said that the amount of state aid for Hankook would have to decrease to 6%, while the costs for one established job could not exceed SKK 1m.

Finally on 30 October 2005, Hankook Tire Company signed an agreement on the establishment of plant for tyre production in Dunaújváros with the Hungarian Government. After the Slovak Government's decision, Levice - Géňa industrial park started to negotiate with other smaller companies. The Mayor of the town said that all potential investors could establish around 1,600 new jobs.

#### Evaluation of the Experts' Committee:



Evaluation experts have expressed their support for the Government's decision not to provide investment stimuli for the investment of the South Korean tyre producer – Hankook Company. The proposed amount of the stimuli was inadequate in comparison with the contribution of the investment. Had the Government approved this amount of stimuli, this would have been a dangerous precedent also for other investments, although there are projects with much higher added value (science, research, innovation and non-production sphere) and with a higher social contribution also in the field of tackling unemployment, where the money in question could be utilised.

**Radoslav Procházka** stated that "disapproving of this proposal has prevented the wasteful use of public resources, when the proposed use of the public resources would be wasteful, because the amount of investment aid: (i) is excessively high, (ii) it would limit the use of resources available for other investment projects, (iii) did not demonstrate any potential to contribute towards the development of a so-called educational economy. Apart from this, any state aid in the form of direct investment stimuli represents the distortion of free economical competition and denying of its basis."



**Radoslav Štefančík:** *"In the case of the Hankook Company investment, it would literally have been a bought investment. The decision of the Company to invest in Slovakia was not the result of fair-play. Time has proved that despite the Hankook company departure, other smaller companies expressed an interest in investing in the Levice location. The state has profited from the decision and the region did not lose out either."*

**Igor Hornák:** *"The correct decision. The support would have been a breach of competition on the local market; moreover the aid was exaggerated in comparison to the aid provided in Hungary and absolutely inadequate to the effects which the placement of this investment would have brought – low-qualified professions. But it is a shame to make promises, which are not kept."*

**Milan Velecký:** *"The price, for which we should have bought the Hankook investment, was too high. The Government's position was badly pre-negotiated, because the price could have been changed for billions at Government level!"*

**Juraj Nemec** has also said, *"that the amount of the support required by Hankook was too high"* and he pointed out the need for clear rules of contribution to investments, into which industries, how much etc.

**Jozef Orgonáš** considers the Government's decision as correct, saying, *"if the amount of investment stimuli had been used for domestic entrepreneurs, it could have had a higher effect."*

**Eugen Jurzyca** mentioned that *"with progressing economical transformation, the importance of supporting foreign investments decreases and the importance of permanent quality improvement of the business environment as the condition of optimising the investment level becomes more important, not only from abroad, but also from Slovakia."*

Investment stimuli as such are a very uncertain institution. A country should compete with its high quality business environment and the stimuli should be received by sophisticated investors at the best, bringing in production with a high added value. Inadequately high support of large foreign investments only to the production factories deforms the business environment and often puts domestic entrepreneurs at a disadvantage. Moreover according to one respondent, the type of production in question (tyres production) is sufficiently represented in Slovakia, and if someone wishes to compete, the one should try to do it alone, not with a begging hand stretched towards the state.

According to another evaluator, it would have been an abuse of the investment stimuli institute for spoiling the investors. It would be surrendering to an outrageous race for foreign investments without considering the stimuli's efficiency for one job. The public has also noticed the information about the corruption objective of these stimuli and that it has started the coalition crises, because it should have only been a corruption source only in favour of one coalition partner. The question is, would the investment support have been rejected, had there been no coalition crises, or if all partners had been in consent beforehand.

It was interesting, that almost half of the investment support amount (according to media information) was sufficient in Hungary to get the Hankook Company investment. In relation to this, one of the respondents has pointed out the interview, provided to the Slovak media by the Hungarian Minister of Economy and Transport. According to his words, Hungary first economically exactly reviews each project, the Government approves the conditions, and only after that they may they come to an agreement with an investor.

One of the respondents has presented the opinion that state aid is provided, because in our geographical region there is strong international competition in attracting foreign direct investments. In the case of Hankook, he thinks the proposed state aid might have been too high, but this implication was not supported by any trustworthy analyses.

### **Supplementing the Land Price under the KIA Plant in Žilina up to SKK 350 per square metre to the Owners who Initially Sold them for SKK 136 per square metre and the Purchase of Plots of Land under the Plant Infrastructure for SKK 350 per square metre (supplementing the price was subject to a declaration on their honour from owners to stop court proceedings and to sell the land for the infrastructure)**

On 14 September 2005 the Government of the SR approved the Report on the Purchase of Plots of Land for the KIA and Hyundai Mobis Plants and Related Infrastructure, presented by the substituting Minister of Economy and Minister of Finance Mr. Ivan Mikloš. The material was a reaction to problems in obtaining the plots of land for constructing the KIA and Hyundai Mobis

factories and the related infrastructure. The subject of disagreement on the purchase of plots was their differing basic prices.

The acute problem was the purchase of land designed for roads, sewage and other infrastructure, because only 21% of plots were bought at the time, and some the owners, who owned the land under the factories, made the sale of land for infrastructure subject to the payment of a higher price (350 SKK per square metre) for the plots sold under plants which had been already been sold for a cheaper price (136 SKK per square metre). Considering the obligations of the SR arising from investment contracts and terms of handing over individual constructions, the building of the infrastructure continued despite unsettled plots of land (see page 45). Considering the continuation of land works and the suspicion of breaching the constitutional rights of land owners, the District Court in Žilina issued preliminary measures and stopped the works on access communication and other parts of the infrastructure. At the same time the Attorney General Office started investigating the suspicion of damaging another person's property and the criminal act of unauthorised use of another's property. The ongoing works on the factory's infrastructure have been stopped including those with a valid building permit. In accordance with concluded investment contract, the SR is obliged to observe the agreed dates of the construction, as well as other obligations, but the state of the matter made it more complicated.

The Government estimated that the South Korean investors can apply sanctions to the SR to the amount of SKK 4bn for each 100 days of delay. Another effect of the delay in procuring the plots of land could have been the withdrawal of the Korean investors from the investment contract, finishing their business activity related to constructing plants and no obligation towards the SR would arise for them.

According to the governmental Report, on the basis of analyses, it was recommended to purchase the plots of land under the infrastructure for the price set in the expert opinion and also to conclude the contract on settlement with all owners, who sold their plots under the plant for a lower price than SKK 350 per square metre. These landowners were therefore paid the additional amount for the land under the KIA and Hyundai plants. The additional payment was subject to each owner signing a declaration on their honour that they *"support the project implementation and agree with the course of the works so far and with stopping all ongoing court and other proceedings, which prevent the due implementation of infrastructure construction and other related proceedings and that they have suffered no damage in relation to the aforesaid"*. According to Mr. Mikloš, the additional payment would not take place without this agreement with all the owners, the money would have been paid, but the construction could not have continued anyway. The Government of the SR approved the decision in the end, and agreed with the proposal to add finances to the investment in question and ordered the Minister of Finance to provide financial resources from the State Budget to purchase the plots of land for infrastructure and also for the additional payments for plots under the KIA and Hyundai Mobis factories. Additional costs to the amount of SKK 425.7m were estimated for the purchase of plots for infrastructure, the average price being SKK 350 per square metre and the additional payment to owners of land under the plants created the need of extra SKK 380m (SKK 805.7m in total).

The costs for purchasing land under the infrastructure were not calculated in state aid, it was defined as *"other state support for the development of the region"*. Neither the plots, nor the external infrastructure built upon it – roads, sewage, electricity, water, gas, sewage water ducts, external part of railway and telecommunication lines – will be in the ownership of the car producers. Paying the owners of plots of land under the infrastructure was not therefore in conflict with 15% of the approved amount of state aid to investors valid in the EU, but the additional payment for land under the car plants was in conflict. According to the Minister of Finance, the state aid was increased by the amount of SKK 380m due to the rise of the actual investment volume, because KIA Motors plans to invest EUR 130m more in Slovakia than originally expected.

The approved governmental material also considered several alternatives for solving the problem with non-purchased plots of land. As the first option, the Report mentioned the dispossession of plots necessary for building the infrastructure. *"Legally the most clear solution"* was considered as the advantage of dispossession, as well as saving SKK 390m, which was paid for land under the KIA and Hyundai plants. The unclear time schedule (100 – 200 days), delaying of construction and possible sanctions from the investors would be a disadvantage.

The advantage of the accepted solution should have been its rapidity, the elimination of possible sanctions and approximately the same costs as for dispossession, but only if the additional payment of SKK 380m is not taken into consideration. The need for additional resources was the disadvantage.

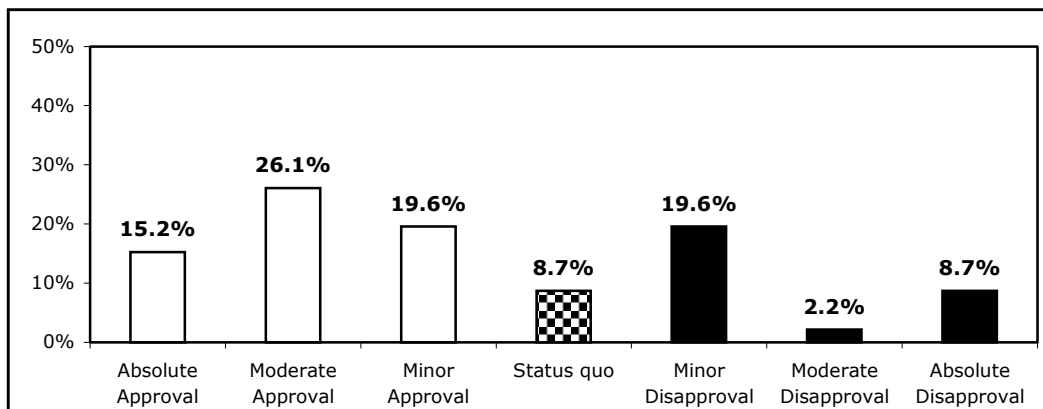
The third proposed way was a so-called temporary solution. The assumption of this solution was the possibility of the fast purchase of land owned by unknown owners via the Slovak Land Fund, which would represent an additional payment of SKK 43.3m. The known landowners, who are connected with plots of land under the factory, would be paid the price according to new expert opinion together with additional payment for plots under the factory. It was planned to build more than 1/3 of new connecting road on the obtained land, which would be connected to newly built

communication, partially implemented on resolved plots of land. The other part of the infrastructure would be resolved by dispossession without additional payment for plots under the plant. The main advantage of this solution would be speeding up the construction of the provisional access communication with the factory and keeping the dates for delivering the press and other technologies, saving part of the resources for additional payments. The disadvantage would be unfinished sewage and possible damages to the buildings and equipment of investors, as well as legal procedures of various petition committees due to the different approach to landowners.

According to the substitute Minister of Economy Mr. Mikloš, the final choice was only made out of bad possible solutions, where the effort was to choose the least painful one. Without taking the approved step, the Slovak side according to the Minister, would not be able to keep the obligations arising from the contract and start of the construction would be seriously endangered, which would cause the need to cover the damage.

The gradual purchase of plots of land under the infrastructure started at the end of September 2005. However, there were again landowners, who felt aggrieved. The problem was in setting different prices for land under the infrastructure, which varied from SKK 216 to SKK 516 per square metre. According to media information from July 2006, the sale of plots of land for infrastructure has not been definitely finished yet.

#### Evaluation of the Experts' Committee:



The experts have assessed the Government's decision to pay additional price for plots of land under the KIA factory in Žilina as a slightly beneficial measure. The majority of evaluators have expressed themselves in favour of the additional payment up to SKK 350 per square metre to those landowners, who initially sold their land for SKK 136 per square metre and also for purchasing the plots for infrastructure for SKK 350 per square metre. But the solution was not systematic and ad-hoc, which served its purpose in this situation, but which satisfied the needs of all parties in question. Good news for the safety of private ownership in Slovakia was the fact, that the Government came to an agreement with landowners and did not choose dispossession as the solution. It was a pragmatic solution, which could be considered as correct under the circumstances. Apart from this, the dispossession procedure would have delayed the investment, and most probably made it more expensive. The measure has increased the legal safety and credibility of the state. This was also a good reason for having the whole problem over as quickly and simply as possible. Multiple failures in process action together with the threat of contractual penalties have created an environment, where the easiest solution could seem to satisfy the requirements of the landowners. From a long term perspective, the measure can affect a decrease in the Government's negotiating position of, but on the other hand the position of private ownership shall be strengthened by it.

Also according to **Radoslav Štefančík**, it was on the one hand about „*solving a long term problem with purchasing lands, on the other side, a negative precedent was established for the future. Considering the importance of the decision for the society, it was not easy to set the correct line, because other decisions could most probably lead to higher financial losses.*” He thinks, that it is necessary to add that “*adding up the price was only the top of the iceberg of the problem, caused by the KIA Company investment. In the case of the investment, the state should have negotiated with landowners before offering the location in Žilina, and if those landowners had not agreed with the sale, they should have offered to South Korean company another locality, or completely given up this investment.*”

According to **Juraj Nemec**: “*it is difficult to evaluate one partial measure from the whole set in relation to this mess. If this helps to finish the whole case, it can be considered a positive*

*procedure. But the problem was right at the beginning, when the scope for speculations was established, the law was breached, etc."*

**Milan Velecký** said that, *"nothing else can be done, but to agree. It was only putting out the fire, some damage was done, but if no action had been taken, it could have ended up much worse. The former management of the economical sector (and also the Government, coalition rule is not an alibi, all are responsible to the same extent) did not manage the preparation of such large investment and most likely the cooperation with local self-government also failed – unlike in Trnava, and now companies have been established in greenfield sites on a smaller scale in Galanta, Námestovo, Poprad, Martin and elsewhere without any major problems."*

**Radoslav Procházka** has expressed slight disapproval with this solution *"only because it was fixing previous mistakes in state bodies actions. The quality of this fixing remains questionable. But above all this measure again confirmed the favouring of momentary purposes before sticking to the rules, it has created a negative precedent, deepened the non-systematic activity of the state in the relevant area and in some sense it has also damaged the personal effort and the reputation costs of the owners, who were not willing to accept the original price from the start."*

**Igor Hornák** said, that it is about *"keeping equality in relation with the state, on the other hand, the citizens who have protected their rights actively, should be rewarded. The overall management of the KIA project is poor."*

Finally the state has only done what it should have done at the beginning, however, the Government did not act then as if it honoured private property. Some evaluation experts have agreed that the Government should take firmer action against the guilty parties. It was a positive step that the new Minister of Economy, Mr. Jirko Malchárek, has drawn consequences in terms of personnel from the investment not being ready, whose burden will have to be borne by taxpayers. According to one of the respondents, there were several guilty parties, and these can make similar mistakes in the future, which was considered a greater problem.

As one of the respondents said, for this case not to become a precedent, it will be necessary in the future (I.) to clearly define the mechanism of awarding state aid, if this aid is to be provided, so it would not result in the state accepting an obligation, which it can not keep in terms of agreed dates and then it acts under pressure or even at the edge of law and Constitution. (II.) As the second step, it is necessary to make the actions around plots more transparent and flexible, so the speed in acting would not require non-systematic or illegal steps.

Other experts have on the contrary expressed sceptical opinions on investment stimuli. Even this measure needn't be the solution to the already established precedent in the case of future investment projects. According to opinion of one of them, it can be expected that the price for which the plots were bought this time, will make the arrival of other investors to Slovakia much more expensive and it will make the preparation of industrial parks more complicated for self-governments. Another respondent has presented a more critical opinion, not approving the additional payment up to SKK 350 per square metre for sellers, who already had valid sales contracts concluded at the lower price. The landowners have used the time pressure of investors and the state, and with the knowledge of possible delay in court proceedings, and state obligations to keep the dates, they forced the state to take this particular action.

Despite many approvals of the Government's action, there were opinions, according to which the present state could have been avoided. The whole problem started when the state represented by ex-Minister of Economy Mr. Pavol Rusko offered the South Korean investor plots, which were in ownership of private owners. According to the Constitution of the SR, the landowners are entitled to remuneration for their land, even if this means making the investment more expensive. The problem was caused on the side of the state due to far too great a euphoria from the arrival of a large investor and mainly as the result of using or abusing the arrival of investors for political purposes by increasing the voter credit of relevant parties by their contribution to attracting investors in favour of increasing employment, etc. The problem could have been avoided, if the Minister of Economy, not only in this one case, had not informed the public about the arrival of an investor. The state did not have the locations prepared with ownership relations sorted out, which therefore caused the increased expense of the whole investment.

According to the reactions of critics of the measure, indecisiveness and incompetence has again been shown in the work of governmental structures. As **Jozef Orgonáš** said, *"the weakness and slowness of the State was shown"*. It is the fault of the Ministry, that the whole process was chaotic, unprofessional and non-transparent. That is why there was not the slightest reason for citizens to pay for the Ministry's mistakes. According to **Ludvík Posolda**, those were *"the mistakes of politicians and state servants financed by the money of taxpayers"*.

## Rules in the Field of Individual State Aid Provision to Investors (providing relatively higher investment stimuli for investors who want to do business in regions with a high unemployment rate and in industries with a high added value)

On 26 October 2006, the Government of the SR approved the new Rules in the Field of Individual State Aid Provision to Investors, proposed by the substituting Minister of Economy and Minister of Finance Mr. Ivan Mikloš. The objective of creating clear rules in the field of providing individual state aid to investors, the preparation of which was the result of cooperation between the Ministry of Finance, the Ministry of Economy and the Slovak Investment and Trade Development Agency SARIO, was to provide a more efficient and transparent system of state aid. The rule of motivating investments in underdeveloped regions and projects with a high added value was set as a key rule. Another objective was to have more jobs in undeveloped regions of Slovakia.

The foundation for the approved rules was the division of Slovakia into 3 types of areas, according to recorded unemployment in districts, as well as dividing enterprising sectors into 3 groups. The amount of state aid for investors shall therefore depend on the location of the investment, where the poorest regions with the highest unemployment rate shall be preferred, and the aid shall depend upon the type of activity carried out by the new investor. The highest aid should then go to investments, which would create the highest added value, such as research and technological centres, and the lowest to the processing industry.

- **Green zone:** districts with an unemployment rate above 15% (in the period 10/2004 – 9/2005: 29 districts)
- **Yellow zone:** districts with an unemployment rate from 10% to 15% (24 districts)
- **Red zone:** districts with an unemployment rate up to 10% (26 districts).

Another rule is that if the "Yellow district" only has the neighbours, which are "green" or "yellow" districts, where at least one of these districts belongs to the green zone, such a district is considered as a green zone for purposes of this rule. Analogically the rule is valid in the case of "Red district", which is in this case considered "only" as yellow zone. According to the aforementioned, the highest aid should therefore be directed to districts of the Self-governing Regions of Košice, Prešov, Banská Bystrica, Nitra; the investors would get relatively lower support in the districts of the Bratislava, Trnava, Trenčín and Žilina Self-governing Regions, and the lowest state aid is in Bratislava City.

In the interest of the economical development of the SR, preferences for state aid provision in individual economical industries were set. In accordance with the National Strategy for Foreign Direct Investments Support, the priority interest is the development of services with high added value – development and IT, software centres, etc. (Type C), on the contrary, the state aid for industries, which are less attractive from the point of view of creating added value and economical development of Slovakia, for example assembling, distribution centres, etc. (Type A) was limited. Investment projects were divided into 3 types:

- **Type A – processing industry:** investment projects introducing new production and assembling of components  
– **distribution and logistic centres:** centralised processing in the field of servicing activities
- **Type B – strategic investments in high-tech industries** with network externalities (information and communication technologies – ICT, biotechnologies, nanotechnologies, etc.) and mainly industries with a high technological potential  
– **strategic services centres:** centres of shared services (centralisation of supporting activities such as human resources, ICT, sale, etc.), customer centres, and technological support centres, call centres
- **Type C – research and development centres,** technological centres, centres of technological development: research and development activity, which is not directly connected, or related to industrial or trade activity.

Investors interested in state aid have to fulfil the **condition of the minimum amount of investment costs**, depending on the project type and zone:

Project Type	Zone	Minimum Amount of Investment Costs (in SKK m)
A	Green + Yellow	SKK 200m
	Red	<i>no State Aid Allowed</i>
B	Green + Yellow	SKK 40m
	Red	SKK 40m
C	Green + Yellow	SKK 30m
	Red	SKK 30m

Source: Rules in the Field of Individual State Aid Provision to Investors

Next, the investor must invest within the project **a minimum of the given percentage of investment costs into "modern technologies"**. In the case of yellow and green zones, at least 35%, in the red zone 45% of these costs. If the investor is interested in tax concessions from the state, he/she will have to, apart from the aforesaid rules also fulfil criteria set out in the relevant norms (Act on Investment Stimuli, Income Tax Act) – investment costs must be at least to the amount of 400 mill. SKK and the investor must use at least 200 mill. SKK from own assets. If the project is implemented in the region with unemployment rate above 10% (yellow or green zone), these amounts are decreased by half.

The rules also contain the **option of individual assessment** of investment project, when the provision of state aid is not subject to part of the rules, setting the amount and form of the state aid. The condition is, that the investment project must be implemented in the yellow or green zones, investment costs must be at least SKK 10bn and also at least 1,000 new jobs must be created.

Another attribute, from which the state aid shall depend is the **minimum share of employees according to defined educational structure**. Type A projects must have minimum of 60% of employees from total number with specialised secondary education and minimum of 10% of employees with higher education. Type B projects must have minimum of 50% of employees with full secondary education with graduation exam and with a minimum share of 35% of employees with higher education. And finally, Type C projects must have at least 40% of employees with full secondary education with graduation exam and the share of employees with higher education must be a minimum of 50% of employees.

**The amount of individual forms of state aid provision** and investment stimuli in the respective zones and projects types cannot, according to the approved Rules, exceed the maximum limits defined as a percentage of the eligible project costs. For investment projects in the sensitive sectors (e.g. 15% limit on automobile industry) the maximum limits for state aid provision resulting from the European Union regulations shall apply, if these are lower than the limits specified in the Rules. The document also established a special maximum limit for large investments exceeding EUR 50m which is calculated on the basis of a formula.

<b>Total State (Regional) Aid Ceilings</b> (as % of eligible investment costs)			
	<b>Type A Project</b>	<b>Type B Project</b>	<b>Type C Project</b>
Green Zone	<b>40 %</b>	<b>45 %</b>	<b>50 %</b>
Yellow Zone	<b>35 %</b>	<b>40 %</b>	<b>50 %</b>
Red Zone	<b>0 %</b>	<b>30 %</b>	<b>45 %</b>
Red Zone - Bratislava	<b>0 %</b>	<b>20 %</b>	<b>20 %</b>

*Source: Rules in the Field of Individual State Aid Provision to Investors*

The maximum amount of state aid in the form of **transfer of a real estate title from the State or municipality** for a price lower than the market value (hereinafter PNM) is defined as a percentage of the eligible costs invested in the implementation of the project. In the case of a Type A project, the state aid amounts to 3% in the yellow and green zones and 0% in the red zone. For Type B and Type C projects, the limit is respectively 6% and 15% in all zones.

Another form of state aid is a financial **grant to cover the eligible costs associated with the initial investments in the tangible assets for Type C projects**. It can be granted if the investor did not obtain PNM state aid in full or not at all. The investor can be provided with the financial aid to acquire tangible assets. The same maximum amount of 15% was agreed for all three zones (less the percentage of state aid provided in the form of PNM).

The maximum amount of **allowance provision for newly created jobs** depends on the location of the project in the Slovak Republic and the project type. In all cases, assistance can be provided to a maximum of 30% of the annual salary costs for every newly created job. The maximum amount of provision per job was specified in each case. The allowance for Type A and B projects in the green and yellow zones can be provided if at least 30% of people hired are previously unemployed workers and it can range from SKK 125,000 to 200,000 per job. Type B projects can only be granted the allowance in the red zone, to a maximum amount of SKK 100,000. For Type C projects, the allowance provision for newly created jobs can be granted for 30% of the salary costs per annum for every created job in the absolute amount of SKK 200,000.

**Tax relief** can be afforded to investors under the conditions that he does not apply for any other of the above-mentioned regional forms of state aid and concurrently does not request an education allowance. The second option applies if the investor is not granted the state aid in some other form of regional state aid in the maximum amount. In that case, the investor can be granted state aid in the form of tax relief calculated as the difference between the maximum percentage limit for the state aid provision in terms of the table below and state aid that is to be provided to the investor by means of other forms of regional aid.

<b>Tax Relief Ceilings</b> (as % of eligible investment costs)			
	<b>Type A Project</b>	<b>Type B Project</b>	<b>Type C Project</b>
Green Zone	<b>44 %</b>	<b>50 %</b>	<b>50 %</b>
Yellow Zone	<b>38.5 %</b>	<b>44 %</b>	<b>50 %</b>
Red Zone	<b>0 %</b>	<b>33 %</b>	<b>44 %</b>
Red Zone - Bratislava	<b>0 %</b>	<b>20 %</b>	<b>20 %</b>

*Source: Rules in the Field of Individual State Aid Provision to Investors*

An **allowance provision for the education of employees** can be granted to the amount of 60% of the eligible costs of the employer (55% in the Bratislava region) and to the amount of 70% in the case of a disadvantaged job applicant (60% in the Bratislava region). The allowance for the general education of a single employee cannot exceed the specified maximum limits.

<b>Maximum General Education Allowance per Employee</b> (in SKK)			
	<b>Type A Project</b>	<b>Type B Project</b>	<b>Type C Project</b>
Green and Yellow Zones	SKK 30,000	SKK 40,000	SKK 40,000
Red Zone	SKK 0	SKK 30,000	SKK 30,000

*Source: Rules in the Field of Individual State Aid Provision to Investors*

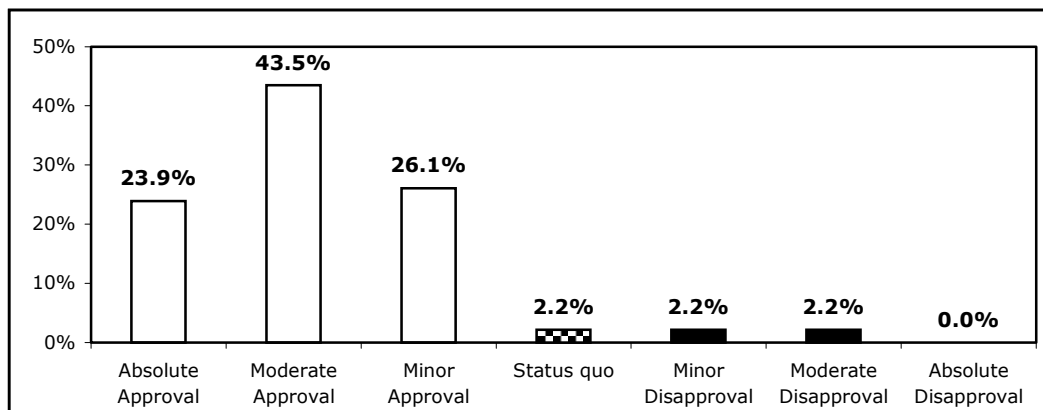
**State assistance for specific training of employees** can reach up to 35% of eligible employer costs (30% in the Bratislava region), and 40% concerning disadvantaged job applicants (35% in the Bratislava region).

<b>Maximum Special Training Allowance per Employee</b> (in SKK)			
	<b>Type A Project</b>	<b>Type B Project</b>	<b>Type C Project</b>
Green and Yellow Zones	SKK 50,000	SKK 80,000	SKK 100,000
Red Zone	SKK 0	SKK 50,000	SKK 100,000

*Source: Rules in the Field of Individual State Aid Provision to Investors*

The document furthermore exactly specified the subjects eligible for the state aid provision. There is no legal claim to the state aid according to the Rules. Nevertheless, the Government attempted to grant the stimuli to every subject that fulfilled the conditions for the state aid provision according to Mr. Mikloš, the Minister of Finance. Among other things, the new Rules also specified that the investor should receive the Government decision on the state aid provision within 110 days of the delivery of the complete questionnaire and should be notified of the amount of the state aid within 20 days.

According to the submitter of the document, Mr. Mikloš, the absence of transparent rules perturbed the investors, slowed down the process of allocation of investment stimuli and resulted in a situation where Slovakia has less jobs and more expensive jobs than it could have had should the rules have existed. According to the submitters, the Rules concerning state aid provision are in accordance with the National Lisbon Strategy aimed at supporting investments in the so-called knowledge-based economy.

**Evaluation of the Experts' Committee:**

The new Rules in the Field of Individual State Aid Provision to Investors were designated by the experts in the HESO Experts' Committee as important and beneficial. Practically all the respondents approved of the provision of investment stimuli on the basis of the unemployment rate in the district (higher stimuli in an area of higher unemployment) and the added value of the investment (higher stimuli for higher added value).

The definition of the Rules, the routing of the investments to underdeveloped regions and greater support of sophisticated investments were positively assessed. Should the state intervene in the economic processes at all, then it needs to take form of the creation of prerequisites for economic development. The adoption of the Rules that limited the virtually absolute freedom of the politicians in pledging state aid to the investors was evaluated very positively. As confirmed by the personal experiences of one of the respondents, there was an absence of any formal rules in the provision of state aid; the existing method was based on individual cases lacking any clearly defined procedural rules. The general information on the extent and structure of the aid was unknown and additionally, the attempts to direct the investments to remote and less developed regions in the country were largely unsuccessful. Contrary to that, the new Rules should be able to provide incentives for investors to invest also in these regions. It was also suggested that decisions on the provision of the stimuli should be taken by a cross-sectional body rather than the Ministry of the Economy alone. The measure was appropriate regarding the asymmetrical development in some areas, primarily in the areas of high unemployment. Apart from that, the rules are expected to introduce a degree of transparency to the entire process of obtaining the aid. The state aid was regarded as a temporary measure employed as a tool of "bribery" of foreign investors in order to compensate for the shortcomings of the institutional framework and tax system, to reduce the risk of the investment, compensate for the potential political risks and possibly to serve as a tool for active labour market policy. Ideally, the elimination of the deficiencies of the market would be preferable but from the real-life perspective of the necessity of the stimuli, the actions of the Government should be welcomed.

According to **Milan Velecký** the Rules are finally conceived and as he stated *"once we have to buy the investors (and that unfortunately we need to do because our neighbours buy them as well), at least we have systematically and clearly stated what exactly and under what conditions we want to buy."*

According to **Ludvík Posolda**, however, such a measure *"should have been at the very beginning of the stimuli provision."*

**Radoslav Štefančík** commented that *"not only the investors, but above all the citizens will have a clear picture of what state aid is being offered to investors. At the same time, the Government has significantly contributed to the solution of the problem of regional disparities and the negative orientation of the Slovak industry on a single sector."*

**Jozef Orgonáš** observed that *"the single most important thing is transparency, for it will increase the credibility of the state and businessmen."*

**Igor Hornák** remarked that Slovakia *"finally has some rules"*, even though he does not assume that *"they will suppress the corruption symptomatic of the public resources management to the advantage of private individuals in dealings between the politicians and the businessmen."*

**Juraj Nemec** also expressed his approval of the measure: *"In the first place I will not judge the content but the principle. The latter is definitely positive. If the conditions for the public expenditure program are not clearly stated in advance (after all the law of the financial control and the rules of the EU require ex-ante audit), then chaos sets in and space is created for inefficiency and even corruption. The rules might not be perfect, but as long as they exist and as long as there is an interest to positively work with them, they can be tuned over time to correspond to the real-*



life experiences. The scenario suggested by the opponents where the Government itself will not abide by these rules is not as much a problem of the directive as it is of our daily reality."

**Radoslav Procházka:** "If the state aid needs to exist at all, securing the rules with a relatively clear content and predictable effects is an obligatory precondition for both its legitimacy and efficiency. The content of the given regulations more or less corresponds with the purpose and the philosophy of the state aid. The only objection is then directed towards the fact that such rules are needed in the first place."

**Igor Daniš:** "I agree with the objective, but I am unable to decode the specific sums. On the basis of what were they being specified? On the basis of Slovak experience? Copied from the Czech Republic or Hungary? Are the specific financial stimuli going to be valid also in the near future? Secondly: why does the Government discriminate in favour of some subjects while championing the existence of the flat tax? Where is the philosophy of the flat tax? Isn't a direct injection the only way to achieve the given goal?"

According to one of the respondents, the fact that the Rules do not envisage a so-called feasibility study (study on the feasibility of the investment) can be regarded as a shortcoming. The study should derive from the goals formulated in advance by the state based on their quantification and the subsequently calculated efficiency of individual investments. Another Member of the Experts' Committee stated that the Rules could have been completed following the Hungarian example in such a way as to make obvious that the state aid provision is always efficient, that there exists a flexible procedure for the approval of the conditions and that there are clear-cut powers of the Ministry of Economy, alternatively those of the Government so that the approved conditions are not open to political abuse and the public resources management is transparent (for example the possibility of an independent expert evaluation of the proposed conditions, publication of the contracts etc.) Yet another expert questioned the content of the Rules. He approved of the Rules, but considered some of the terms as a potential stumbling block. If a sector is considered as higher added value, the same does not need to apply to a specific enterprise. Take an example of a company in the electro-technical industry: if all the company does on the territory of the Slovak Republic is to assemble and re-pack then the added value is very low. The other question concerns the structure of this added value. Therefore, it would be useful to specify the criterion of the actually achieved added value in the Slovak Republic.

According to another expert, the defined criteria of the Rules create an impression that both the industrial policy and the labour market policy should be carried out via the means of state aid provision. Yet specifically these two goals can prove to be contradictory. On the one hand, in the area of labour market policy subsidies of the unqualified workforce as a tool for preserving their contact with the labour market and preventing their final exclusion would be of the highest social contribution. As is clearly showed by the recent study by the World Bank, the education level of the population in the regions and the unemployment rate are highly correlated. The same study also indicated that even though of minor influence, there also exists a regional influence above the individual framework of the influence of knowledge and skills, i.e. person with the identical education faces different opportunities to find an employment depending on the regional membership. For this reason, regionally focused subsidies can be supported in order to enable the employment of individuals with higher education. On the other hand, the political and industrial part of the criteria is aimed at attracting and maintaining the investments in sophisticated technologies and the minimum number of people with higher education to be employed by the investor is prescribed also in the case of less demanding sectors in terms of knowledge (probably as an indicator of the degree of sophistication of the activity). Accordingly, a company that would employ 10 Roma settlements for manual labour with a very flat organisational structure (i.e. with a small number of educated executive employees) would not be eligible for the state aid as defined by the Rules regardless of the substantial social contribution of the investment.

A negative reaction against the measures has also been voiced because of the structure of production in the Slovak Republic that will be determined by the state rather than the market. This can consequently result in a worse allocation of the resources. Competition between the regions within the state for the investments is beneficial, but the Rules are demotivating, i.e. they motivate the regions to doing-nothing since they support the regions that are "inactive". The regions should be creating conditions for the investments, and if this is not happening and the investments are not forthcoming resulting in a high unemployment rate, the region is rewarded with higher state aid. On the other hand, a region that creates the conditions and attracts investors will have its state aid reduced. The market is the best agent to decide in what commodities the state has a comparative advantage, whereas the Government cannot decide and it only interferes with the efficient allocation of the resources. Regional development is conditioned by the construction of infrastructure (roads, railways), i.e. public goods produced by the central government. The task of the Government, therefore, should be the creation of a favourable business environment that will stimulate the accumulation of domestic and foreign capital and that will in turn stimulate an increase in production with higher added value.

## **Competition Policy**

### **Ruling of the Antimonopoly Office of the Slovak Republic on the Abuse of Slovak Telecom's Dominant Position by Refusing Access to its Local Lines (SKK 885m fine imposed; obligation to release the access to local lines within 60 days of the legal validity of the ruling)**

On 25 May 2005 the Division of Abuse of a Dominant Position of the Antimonopoly Office of the Slovak Republic (PMÚ) issued a ruling that Slovak Telecom (ST), a.s. abused its dominant market position by failing to provide access to its local lines (the so-called "last mile"). ST was penalised for the violation of the law to a total of SKK 885 million and was ordered to rectify the illegal situation within 60 days of the legal validity of the ruling. It was the highest fine ever imposed by PMÚ. ST rejected the fine and appealed against the decision of PMÚ to the second-instance administrative body – Appellate Council of PMÚ that issued a legally valid decision on 21 December 2005 and reaffirmed the fine. ST again rejected the verdict of the appellate body and on 27 January 2006 filed a lawsuit at the regional court requesting the inspection of the legality of the decision. ST declared that after exhausting all the legal tools available in the Slovak Republic, it would pursue its cause on the European level. The Regional Court allowed for a suspension of the execution of the contested second-instance decision of PMÚ until the legally valid ruling of the court was issued.

Local lines to which the access was denied are crucial for companies that wish to compete with ST in the provision of a telephone service or access to Internet. ST is the owner and administrator of the entire telecommunication network in the Slovak Republic and the local lines (also known as the "last mile") connect the end points of the network in the premises of the customer to the main switchboard. The problem rests with the uniqueness of the facility the local lines represent and that is essential for any business activities in this sector, but cannot be further constructed for objective reasons. Investment costs are too high, and there is a slow rate of return on the investment with a high level of risk of incurring "sunk costs" (costs that cannot be influenced by measured decisions, will not change and are irrecoverable). Access to the end points lines is a wholesale service designed for the providers of Internet, telephone services, etc.

PMÚ ruled that ST had used its ownership of the unique facility with the aim of maintaining and reinforcing its position on the related markets. Provision of Internet connection is one example of such a market, one that is fully liberalised and open to wide competition. Pursuing this course of action, ST abused its dominant position on one market in order to strengthen its position on another potentially competitive market. By failing to provide access to its "unique lines", ST limited its competitors' potential to develop, apply modern technologies and enter into new markets and in the end restricted the prospects of offering new attractive services to the end users. Consequently, the competitors had to wait for the introduction of the new technologies by ST, whereas if they had access to local lines they could have launched the new technologies themselves and with virtually no restraints. By blocking the access to the local lines ST secured exclusive access for itself to the new technologies and services.

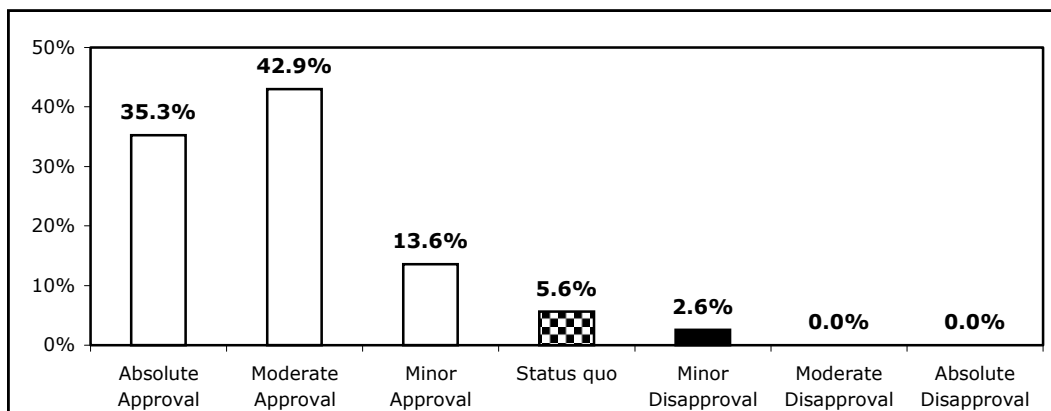
Abuse of its dominant position concerned the entire territory of the Slovak Republic and all the potential competitors of ST. PMÚ assessed the seriousness of ST's conduct with regards to the fact that in a wider context the company's course of action concerned services provided in the entire sector of electronic communications. Electronic communications should be the principal factor on the path of the Slovak Republic towards an information society; in order to create the basic conditions for the access of people, companies and public institutions to modern communications services within a worldwide information infrastructure.

As ST did not rent its users' lines to the households and companies, it received money from the customers (for online minutes and high-speed connection) even if they had bought the connection from a rival company. The first to demand access to local lines were Internet providers because release of access to local lines should reduce the costs of access to clients.

PMÚ based the exact amount of the fine on the considerations of seriousness of the violation of the law, the extent of the illegal conduct and the fact that ST broke the law repeatedly. The Office first concluded the situation to be illegal as early as the end of July 2002 and ordered the end point lines to be released for everyone. The decision was at the time reaffirmed by the Supreme Court of the Slovak Republic. According to PMÚ, ST ignored the ruling. The ST representative commented that the release of local lines was blocked by the missing ruling of the Telecommunications Office of the SR that should have been in accordance with the European regulatory framework.

Competitors claimed that the release of local lines could cost ST some of its profits. That could be the case should the alternative operators or Internet providers succeed; they would rent the lines from ST in the locality where they wish to provide their services for a matter of hundreds of Korunas. The customers would then pay for the services only to their operator (and no longer to ST), while ST would receive only a monthly payment from the operator (competitor) for the rented lines. Representatives of the Association of Telecommunication Operators (ATO) claim since 2001 that one of the major obstacles in the effective regulation is the state share in ST. Shareholders' rights of the state in the company are handled by the Ministry of Transport, Post and Telecommunications of the SR, which simultaneously prepares the telecommunication policy, finances the regulation authority and thus faces a conflict of interests. The Ministry on the other hand rejected any responsibility for the situation or any influence exercised over the Telecommunications Office of the SR and furthermore pointed out that the state is only a minority shareholder in ST.

#### Evaluation of the Experts' Committee:



The ruling of the Antimonopoly Office of the Slovak Republic (PMÚ) on the abuse of Slovak Telecom's (ST) dominant position by refusing access to its local lines was evaluated by practically all members of the Experts' Committee as a beneficial and much needed measure. Through its execution, the state fulfilled its task. An effective antimonopoly mechanism is a precondition for efficient functioning of a market economy, and attainment of so-called allocation efficiency. Steps taken against Slovak Telecom were appropriate even though much delayed. From the viewpoint of the credibility of antimonopoly institutions in the Slovak Republic, the imposition of a fine in a total amount of SKK 885 million and the obligation to release the local lines within 60 days of the legal validity of the ruling were similarly important. The harshness of the measures can be explained as a compensation for its delay. The conduct of ST demonstrated the struggle of a monopoly for its position on the market. Supposing that PMÚ continues imposing punitive measures on ST for the reluctance to change its conduct rather than stop at a single-occasion fine, the necessary change in liberalisation is just a matter of time.

Even in spite of the assurances to the EU, liberalisation of the telecommunications market in Slovakia is considerably inadequate. From the perspective of the worldwide experiences with liberalisation of telecommunications, which give evidence of lower prices, termination of the ST monopoly can be considered positively. The fact that the valid legislation and the regulation of the market in telecommunications services allowed for such a prolonging of the liberalisation process by ST was regarded as a very negative aspect by the experts. As regards the time factor, it is questionable whether this process was in any way accelerated by the PMÚ ruling (*the Appellate Council of the PMÚ decided on the remedial instrument of ST as late as at the end of 2005*).

In the critical opinion, the problem was not one-sided and should not have been considered as such. The attempt to establish a competitive environment created a conflict with the telecommunications operator that had built an expensive network and was forced to supply it to its competitors.

According to one of the respondents the fine imposed was too moderate, in the opinion of another the decision of PMÚ was only a theatrical gesture of a regulatory body.

## **Transport Policy**

### **Pilot Project of Financing and Operating Motorways by Means of Public Private Partnership (PPP) (selection of private concessionaires for sections of motorways for 25 years; state stake in the concessionary company; annual payments to concessionaires first from the State Budget and then from the toll)**

The Government of the Slovak Republic at its session on 29 June 2005 approved a Proposal to Finance Motorway Construction Projects by Means of PPP (Public Private Partnership). The Cabinet approved the initiation of public procurement for a concessionaire for the PPP pilot project on the 28.9 km Lietavská Lúčka – Turany section of the D1 motorway. The year 2007 is the projected start date of implementation of the pilot project.

The Government document Update of the New Project of Motorway and High-speed Road Construction from June 2003 approved the alternative of finishing the D1 motorway connecting Bratislava and Košice with a priority so-called northern connection by 2010, with planned application of public private partnership on the selected sections (in the total length of 94 km). The reason behind the decision to employ a PPP scheme for financing the motorway construction was the inability to achieve the agreed goals if the funds were provided only from the state budget and the EU.

The National Highway Company (NDS) selected a consultant for the selection of methods and conditions for financing motorway construction using private capital – Mott MacDonald. The consultant prepared a study on the feasibility of the PPP financing of motorway projects in December 2004. The study showed that given the adoption of certain measures, application of the PPP scheme for the motorway projects in Slovakia is viable. The consultant in accordance with the plans of the Ministry of Transport, Post and Telecommunications of the SR analysed the schedule of D1 motorway completion by the year 2010 and he also analysed the alternative of completion by 2013 on his own initiative. On the basis of the comparison of alternatives, the consultant recommended for preparation the schedule projected for 2013 given that various adverse effects can interfere with the process of PPP procurement in the schedule projected for 2010, particularly financial and non-financial risks that would exceed the positive effects of earlier completion of the motorway. Meeting this schedule would to a large extent depend on the volume of EU funds available in the new 7-year budgetary period, which was unknown at the time. Despite the recommendation, the Ministry of Transport proposed to follow the construction schedule with the earlier completion date reasoning that the preparations of the pilot project would ascertain the real potential of the schedule in relation to the tunnelling method of the Višňové Tunnel.

Approximate analysis established that given the optimistic estimate of the possibilities of EU funds utilisation in the programming period of 2007 – 2013, the completion of D1 motorway construction is conditioned by the implementation of the PPP project on the minimum section of 43 – 50 km. Investment costs required for the PPP project in the length of 94 km were estimated at SKK 69bn. Nominal annual payments required by the concessionaire at this value of the investment and with the prospect of providing for the maintenance of the motorway for the duration of the concession, i.e. 25 years, were estimated at SKK 13.6 – 15.9bn in the 2010 schedule and SKK 11.5 – 11.9bn in the 2013 schedule. Estimated toll revenues will not be sufficient to finance the annual payments to the concessionaire, and the payments, therefore, will have to be partly covered from the future state budgets. The document and the comparisons of the estimates of net present values of the projects when procured through public tender and when procured by means of a PPP scheme implied that the PPP procurement with the scheduled date of completion by 2013 would be profitable by approximately 3 – 4.5bn.

The criterion chosen for the selection of sections for the PPP pilot project were sections with the highest intensity of traffic and the capacity of the road section, with the daily intensity between 19,300 and 21,700 vehicles. At the same time there is evidence of high frequency of accidents in these road areas. Decisive for the schedule of the selected pilot project construction will be the technically most demanding and complicated Višňové – Dubná Skala section, where the 7,460 km long two-piped tunnel should be located. The tunnel will be cut through a hard, rocky, granite environment. The Ministry of Transport proposed observing the construction of this part of the pilot project in order to establish the real chances of meeting the schedule with the completion date of the D1 motorway by 2010.

#### **Protection of interest in PPP**

A concessionary agreement with the concessionaire should be concluded in the name of the State by the Ministry of Transport after obtaining prior approval of the Ministry of Finance and subsequently also approval of the Government of the Slovak Republic. According to the document,

it is crucial that the prospective concessionaries and financing subjects have their interests adequately safeguarded for the entire duration of the concession, which is 25 years. In principle, granting the concession by the Ministry is understood as procurement of services and according to the Ministry of Transport that does not imply that the project has to be automatically included in the state debt, but this issue has not been decided yet.

The consultant originally proposed that the shareholders of the concessionary company would be exclusively private investors. However, the Ministry of Transport was of the opinion that a state stake in the concessionary company could be beneficial (direct information on the concessionary's activity, fair share of the concessionary's profits, etc.) and therefore proposed that the state demands a minority interest in the concessionary company, preferably through a contribution in kind. This task of the state should be delegated to the National Highway Company (NDS) - joint-stock company.

**Diversification of risks in the implementation of PPP**

In accordance with the consultant's recommendations, the concessionaire will be required to assume the construction risk, the risk of the motorway's serviceability and part of the risk from the demand. This should be sufficient to exclude the transaction from the state debt. The state assumes the risk of the timely acquisition of a land decision, building permit and the grounds. The Ministry of Transport opted for a DBFO type of contract (design-build-finance-operate). According to the Ministry, the applicants involved in the concession planning will be highly motivated to elaborate a final project with the minimal costs throughout its life cycle.

**Estimate of the annual payments requested by the concessionaire**

The consultant in its cash flow model estimated annual payments to the concessionaire totalling 3.466bn (in the pilot PPP project) for the 25 years of the concession duration.

**Estimates of the toll collection revenues**

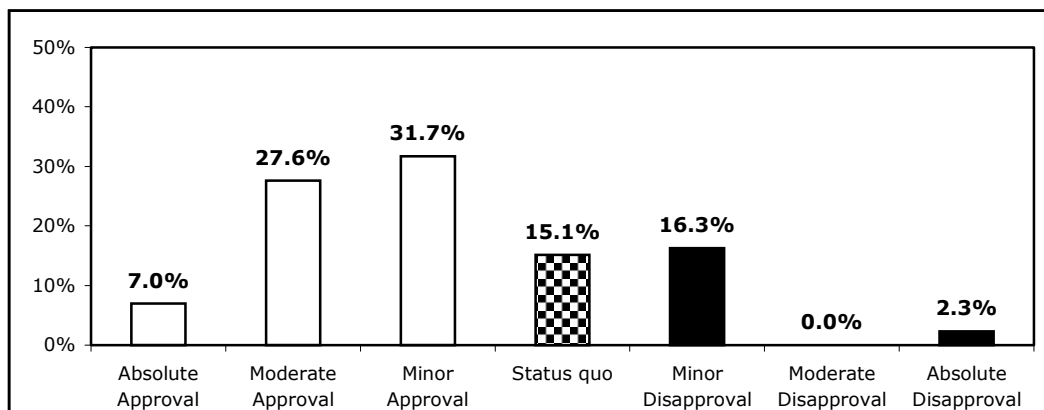
The Slovak Ministry of Transport planned to introduce electronic toll collection on motorways and high-speed roads for vehicles over 3.5 tonnes and later on also for vehicles under 3.5 tonnes. The consultant estimated that the initial tariffs of SKK 0.40 per km for vehicles under 3.5 tonnes and SKK 0.80 per km for vehicles over 3.5 tonnes (the tariffs should more than double by 2036) would generate revenue of SKK 1.86bn in 2010 and SKK 15.58bn in 2036. The consultant did not recommend increasing the tariffs on the grounds of their acceptance by the users. Calculating with alternative toll tariffs recommended by the Ministry, e.g. SKK 0.85 per km for vehicles under 3.5 tonnes and SKK 2.7 per km for vehicles over 3.5 tonnes, the estimate of the revenues would be SKK 4.159bn in 2010 and SKK 11.11bn in 2030.

Based on the decision of the Ministry of Transport and the Ministry of Finance, toll revenues should be preferentially used to pay back the loans of the National Highway Company. The calculations of the toll indicated that if using the higher alternative toll tariffs, it would be possible to cover the fixed annual payments to the concessionaire partly from the toll and the state budget from 2010 and approx. from 2014 entirely from the toll.

**Evaluation of economic efficiency of the PPP pilot project**

Economic efficiency was evaluated by means of the net present value method. Model calculations of the economic efficiency suggested that implementation of the pilot project through the PPP scheme and subsequent provision of the maintenance for the duration of 25 years would be financially more profitable than implementing the project through traditional public procurement.

**Evaluation of the Experts' Committee:**



Public Private Partnership is one of the forms of cooperation between the public and private sectors with a number of potential contributions as well as risks. It is commonly used abroad with mostly positive experiences, but it is questionable to what extent these projects could be

efficiently managed in the SR (at a time when the public procurement system itself does not work properly). PPP projects have the potential to lead the way forward, but considering that the extent of failure in Slovakia is fairly high it is essential to concentrate on the quality of the projects and individual contracts. Any contract between the state administration and state budget on the one hand and the private sector on the other hand has to be simple, comprehensible to the public and transparent.

Advocates of the measure believe that presence of the state will facilitate the process of obtaining loans and that the presence of private capital will secure better supervision of the invested money. Numerous respondents voiced the opinion that financing and operating motorways by means of public private partnership should have already been implemented earlier. They would welcome acceleration of the process of motorway construction following the example of Croatia. Other respondents would focus on the setup of high-quality and transparent rules of the cooperation with the private sector rather than the speed of implementation of the PPP motorway-construction related projects.

In order to prevent future abuse, it is necessary to determine the toll tariff on the sections constructed by means of PPP in advance so that the conditions and tariffs on these sections are the same for the other sections of the motorway. Significant factors according to the experts are whether this form of motorway financing is more cost-efficient, what share of the profit will go to the private investors and finally, all things considered, whether the construction by means of public private partnership will be more advantageous for the public finances than construction by means of the traditional form.

Formation of the National Highway Company (NDS) was criticised in terms of the setback to the transparency of public finance. The pilot project of financing and operating motorways by means of PPP envisages institutional integration that, according to one of the respondents, could yet increase the lack of transparency. NDS is in 100% ownership of the state and confusing situations may arise if NDS is a shareholder in the concessionary company. NDS, that is the state, would be simultaneously represented on both sides of the contract, and other than obscuring the cash flow, the situation may result in some interesting legal situations, for example if the contract is not fulfilled, etc. In any case, the participation of NDS in the concessionary company could increase the state's share of risks. Participation of NDS in the concessionary company was thus considered undesirable by this respondent.

## Social Policy

### Social Security

#### **Differential Increase in Pension Benefits in 2005 Depending on their Amounts (up to 10.2%; 0% in pensions over SKK 15,824; extending of the reference period for calculation of pensions based on earnings from the period starting with 1994 to the period starting with 1984)**

On 18 May 2005 Members of the Slovak Parliament amended the Social Insurance Act and voted for the differential increase in pension benefits with the aim of reducing the high inequalities in the pensions of existing pensioners. In accordance with the adopted measure, the increase in pensions in 2005 was not regulated by the relevant clause in the social insurance act, but the pension benefits paid as of 1 July 2005 and awarded in the period between 1 July 2005 and 31 December 2005 were modified as follows, in relation to their amount:

- pension benefits under SKK 3,906 were increased by 10.2%,
- pension benefits between SKK 3,907 and SKK 3,956 were increased to SKK 4,306,
- pension benefits between SKK 3,957 and SKK 10,937 were increased by 8.85%,
- pension benefits between SKK 10,938 and SKK 11,077 were increased to SKK 11,907,
- pension benefits between SKK 11,078 and SKK 14,719 were increased by 7.5%,
- pension benefits between SKK 14,720 and SKK 15,824 were increased to SKK 15,825,
- pension benefits over SKK 15,824 were not increased in 2005.

In this manner the low pension benefits were increased by a higher percentage, whereas pensions over SKK 15,824 were not adjusted at all.

The measure was intended as a response to the information gradually collected by the Ministry of Labour, Social Affairs and Family of the Slovak Republic over the two years that the new social insurance act had been effective. The provision that established automatic annual valorisation of the pension benefits each year in July by the given average percentage of the year-on-year growth of consumer prices and the year-on-year growth of average wage in the economy of the SR, was effective already for the second year, but actually was never used. The Slovak Government and Parliament decided that the provision would not be implemented in 2004 and instead the pension benefits were increased twice by ad hoc adjustments by 4% in February and by 3.4% in December. The reason behind these measures according to the Ministry of Labour was the attempt to assist pensioners in overcoming the effects of undertaken reforms. A lump-sum contribution of SKK 1,000 was also provided as a form of compensation.

According to the original social insurance act, pension benefits should have been automatically and flatly increased by 8.85% as calculated pursuant to the law on the basis of the year-to-year growth of nominal wages in the Slovak economy (10.2%) and the year-to-year growth of consumer prices (7.5%) in 2004. Such an increase would further accelerate the growing pension differentials between two basic groups of pensioners – the ones that retired before 1 January 2004 (so-called old-pensioners) and the ones that retired after this date – that is after the reform of the pay-as-you-go pension system. The majority of the first group receives significantly lower benefits than people in the other group, because pensions in the old system depended only to a minimum extent on the earnings of the policy holder and the assessment basis was limited – the sum over SKK 10,000 was not considered. If a person's average earnings were SKK 10,000 or more, his/her pension benefits were calculated from the sum of SKK 4,067 ( $2,500 + 1/3 \times 3,500 + 1/10 \times 4,000$ ). Old-age pension benefits under the old system were assessed on the basis of the average monthly gross salary in the best 5 out of the last 10 calendar years. Pensions calculated in this way were then annually valorised.

Starting from 1 January 2004, pension benefits are dependant on the earnings of the policy-holder, length of the pension insurance and current pension value (in 2005 established at 195.31). The maximum assessment basis is defined as 3 times the average wage in the economy, so that the personal wage point can reach number 3. The Average Personal Wage Point (POMB) in the new system can be calculated as a quotient of the gross annual wage and 12 times the average wage in the economy. Earnings of the pensioner in the period starting from 1994 were considered for the calculation of pension benefits. According to the information of the Ministry of Labour, the decision to retire only a couple of days later could earn an additional several thousands of Korunas in comparison to a colleague of the same age who retired earlier. The Ministry also admitted the existence of considerable differences between people who continued working after acquiring the entitlement to an old-age pension and did not claim it. The differences were caused by the change

in the way the pensioners were rewarded for the additional years worked in the old and new system.

<b>Old-Age Pensions before the Pension Reform (i.e. until Dec 31, 2003)</b> (in SKK)					
Year 2003	<b>Working Period (Period of Paying Social Contributions)</b>				
<b>POMB*</b>	<b>25 years</b>	<b>36 years</b>	<b>38 years</b>	<b>40 years</b>	<b>42 years</b>
<b>0.25</b>	4,156**	4,775	4,888	5,000	5,112
<b>0.40</b>	4,725	5,469	5,604	5,739	5,875
<b>0.60</b>	5,469	6,375	6,540	6,706	6,870
<b>1.00</b>	5,918	6,928	7,112	7,296	7,480
<b>1.50</b>	5,918	6,928	7,112	7,296	7,480

\* POMB = Average Personal Wage Point; it represents the average of annual ratios of individual gross wage to average gross wage in the Slovak economy over a specific period (e.g., POMB 1.00 means that the worker has earned the average wage in the economy, with POMB 0.50 he has earned half the average wage, with POMB 2.00 twice the average wage).

\*\* The minimum old-age pension was set at 1.1 times the subsistence minimum (SKK 4,631 Sk in 2003).

<b>Old-Age Pensions shortly after the Pension Reform (i.e. after Jan 1, 2004)</b> (in SKK)					
Year 2004	<b>Working Period (Period of Paying Social Contributions)</b>				
<b>POMB</b>	<b>25 years</b>	<b>36 years</b>	<b>38 years</b>	<b>40 years</b>	<b>42 years</b>
<b>0.25</b>	3,213	4,626	4,883	5,140	5,397
<b>0.40</b>	3,488	5,023	5,302	5,581	5,860
<b>0.60</b>	3,855	5,551	5,860	6,168	6,477
<b>1.00</b>	4,590	6,609	6,976	7,343	7,710
<b>1.50</b>	6,196	8,922	9,418	9,913	10,409
<b>2.00</b>	7,114	10,244	10,813	11,382	11,951
<b>2.50</b>	8,032	11,566	12,208	12,851	13,493
<b>3.00</b>	8,950	12,887	13,603	14,319	15,035

Source: INEKO, www.dochocky.sk

The original mechanism of valorisation by 8.85% would cost the Social Insurance Agency SKK 4.17bn by the end of 2005. The new system of increasing the pension benefits increased the costs by approx. SKK 60bn.

<b>Old-Age Pensions Granted as of December 31, 2003</b>		
<b>Amount of the Pension</b>	<b>Number of:</b>	
	<b>Old-Age Pensioners</b>	<b>Early Old-Age Pensioners</b>
under SKK 2,099	2,283	50
SKK 2,100 - SKK 3,099	1,944	3,648
SKK 3,100 - SKK 4,099	8,857	1,983
SKK 4,100 - SKK 5,599	99,365	1,610
SKK 5,600 - SKK 7,199	300,676	81
SKK 7,200 - SKK 8,999	139,498	25
over SKK 9,000	18,686	1

Source: daily SME, Social Insurance Company

<b>Old-Age Pensions Granted as of March 31, 2005</b>		
<b>Amount of the Pension</b>	<b>Number of:</b>	
	<b>Old-Age Pensioners</b>	<b>Early Old-Age Pensioners</b>
under SKK 2,099	2,659	0
SKK 2,100 - SKK 3,099	5,179	0
SKK 3,100 - SKK 4,099	7,679	1
SKK 4,100 - SKK 5,599	76,208	1,156
SKK 5,600 - SKK 7,199	548,371	6,580
SKK 7,200 - SKK 10,999	493,222	7,239
SKK11,000 - SKK 15,999	4,848	562
SKK16,000 - SKK 20,999	1,265	4
SKK21,000 - SKK 29,999	430	0
over SKK 30,000	57	0

Source: daily SME, Social Insurance Company

Submitters of the proposal acted in response, according to them, to the significant differences between the new pension benefits and the old-pensioners. Intervention was inevitable so that the valorisation did not add to the growing gap and people did not suffer from the consequences of the improper set-up of the new system or the injustices of the old pay-as-you-go system that denied the merit principle and limited the maximum pension benefits. The proposal on the



differential increase in pension benefits was endorsed by many Members of the Parliament, including many opposition MPs. The Minister of Labour, Social Affairs and Family Mr. Ľudovít Kaník declared that the measure was not a systemic solution and pointed out the Amendment to the Social Insurance Act being prepared in his department (see below). He commented on the issue of pension differentials that the cases of high benefit payments, approx. over SKK 10,000, often concerned people who continued working beyond the statutory retirement age, that is they worked for more years. The opponents considered the measure to be a failure of the pension reform, and its pay-as-you-go pillar in particular. They argued that pension differences were created primarily by the change of the system rather than introduction of the merit principle.

Amendment to the Social Insurance Act also modified the period that is considered for the calculation of old-age pension benefits. Up to now the decisive criterion for determination of Personal Wage Point was retrogressive earnings back to 1994; and only if this period did not include 10 years that could be used for the calculations, the Social Insurance Agency could also take into consideration the period before 1994. Effectual from 1 July 2005, the calculations consider the period starting with 1984 and if this period does not include 22 years required for the calculation of pension benefits then the period prior to 1984 will be considered. It was expected that the modification would cut down the new pensions because people generally earned less in the period before 1984.

The Amendment to the Social Insurance Act became effectual as of 1 July 2005.

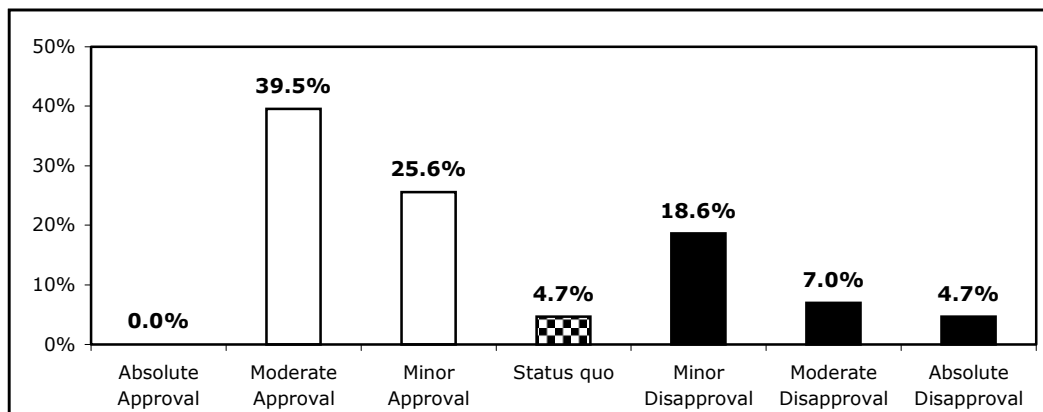
In response to the unsatisfactory status of the valorisation of pension benefits, the Ministry of Labour drafted another Amendment to the Social Insurance Act. Apart from some other changes, the Amendment proposed yet another change in the method of valorisation of pension benefits in 2006. The proposal split the pensions into two groups: lower pension sums (up to 0.7 times the average wage) to be valorised using an index established by an arithmetic average of the average year-to-year inflation and year-to-year growth of the average wage in the economy. Higher pensions (over 0.7 times the average wage) were to be increased only by the inflation. The authors of the proposal planned to prolong the use of the so-called Reduced Average Personal Wage Point (Value of POMB between 1.25 and 3.0 is not considered in its full amount. Reduction of the percentage is gradually decreased over the years.) that should help to prevent too fast an increase in the pension benefits in the years following the implementation of the pension reform (2004-2005), and moved the deadline from 2006 to 2012. According to the authors of the project, the principle of the pension reform based on regular valorisation that is determined by economic development, and the merit-principle of the calculations of pension benefits should not be compromised.

Mrs. Iveta Radičová who replaced Mr. Ľudovít Kaník in the office of Minister of Labour, Social Affairs and Family in October 2005, withdrew this governmental proposal from the Parliament with the objective of drafting a comprehensive systemic solution of the 1<sup>st</sup> (Pay-As-You-Go) Pillar. However, due to the timing of premature elections she didn't have enough time to fulfil her aim. Nevertheless, she still managed to revise the social insurance act by partial amendments.

Through the Amendment from 7 December 2005 Iveta Radičová attempted, in her own words, to moderate the negative consequences that arose from the transfer to a new system and that manifested in the growing differences between the highest and lowest possible pension payments, by means of prolonging the use of so-called reduced POMB until 2014 (without approval of the amendment the full POMB would be implemented in 2007). The measure therefore postponed the full implementation of the merit principle in the first-pillar pensions and prolonged the period characterised by the solidarity of the better earning with the low-earning pensioners. According to the calculations of the Ministry of Labour, the highest-earning pensioners will be deprived of approx. SKK 1,600, while the lowest pension will grow by more than SKK 800 compared to the status without the Amendment.

The Amendment from 21 April 2006, which presented modified and supplemented provisions of the original proposal of Ľudovít Kaník, was widely supported throughout the entire political spectrum. Other than the provisions increasing the number of recipients and the amounts of widow's, widower's, orphan's and disability pensions, the Amendment was passed, increasing by approx. SKK 1,000 the old-age pensions of the old-pensioners who were adversely affected by the maximum assessment base effective at the time when their pension entitlements were calculated (in the years 1988 – 2003). The Social Insurance Agency will need to re-calculate the old-age pensions of about 80,000 people by the end of 2007. It will cost SKK 880m in 2006 and more than SKK 2bn per annum in the following 3 years. The moderation of differences between high and low pension benefits was to be further advanced by the approved amending proposal of the Member of the Parliament Mr. Július Brocka (Christian Democratic Movement (KDH)) that restricted valorisations of pensions over SKK 17,200. The Ministry of Labour opposed and welcomed the submission of a proposal by the President of the SR Mr. Ivan Gašparovič for examination of this discriminating provision by the Supreme Court of the Slovak Republic.

Pension benefits were automatically valorised for the first time by 5.95% in 2006.

**Evaluation of the Experts' Committee:**

The greatest risk of the pay-as-you-go pillar – its vulnerability to political pressure and the absence of Governments' ability to commit themselves and pay in the future the cash flows promised in the past, has been fully demonstrated. The unreformed system was unreliable because of the perpetual changes and because of the inadequate provision for people in old-age, even if it claimed to function. Pensioners were paid pension benefits that were largely unrelated to their previous earnings. The reformed pay-as-you-go system was intended to be merit-based and in its structure immune to political interventions. Yet we constantly watch "emergency measures" that gradually diminish the credibility of the system and obstruct formation of the much-needed confidence. However rational and justified the reasons might be for the revisions, the fact is that the state does not deliver what was promised in the past and thus creates a precedent for similar conduct in the future. This time the system was sacrificed (even though the Government denied it) to the sense of injustice (even though possibly justified) of a narrow circle of people. The question is what would the Government reaction be in the face of greater challenges, for example the increasing effects of the ageing population on the expenses of the state over time.

According to a number of experts, the measure diminished the merit principle of the system and in this way actually increased the tax burden of the citizens. The question was raised again as to what extent the system should be solidarity or merit-based. One of the respondents observed that once the Minister of Labour introduced the merit principle to the first, pay-as-you-go pillar he should not have shrunk back when people expressed their dissatisfaction. Pensioners' hurt and offended feelings could have been expected after introduction of the merit principle.

Arguments in favour of the merit-based pay-as-you-go pillar, such as faster growth in real wages (1<sup>st</sup> Pillar) than the rate of return on capital (2<sup>nd</sup> Pillar) in the process of convergence were until recently understood and supported. Judging from the recent events, some of the respondents started to incline toward the minimalist 1<sup>st</sup> Pillar and reduction of the contributions to this pillar from purely politically-economic reasons – at least for those who are new to entering the pension system or still have about 15-20 years to go before retirement.

Aforementioned provisions aroused suspicion in some of the respondents as to the systematic work of the Ministry of Labour, Social Affairs and Family of the SR and the ill-considered concept of the 1<sup>st</sup> Pillar reform – the pay-as-you-go system of pension provision. As stated by another respondent, the pension reform was approached primarily from the perspective of getting it pushed through politically and earning success with its theoretical version, including having passed the legislation. This definitely was a crucial part of the extensive changes, but it was necessary to consider technical problems from the very beginning of the pension reform in order to avoid distressing people. For a common pensioner, the most important thing at the end of the day is how much money he gets. According to one of the experts, there are numerous options available, including various mathematical modelling methods, which could be used to model in advance the real-life effects of the system. The question to be asked is whether these steps were carried out consistently. Once the intervention is made in the way the pensions are being calculated and then the rules of the game are changing, a great deal of mistrust in the system is aroused.

Some of the experts found the measures acceptable since in principle they represent corrective actions in the pension reform. The measures, however, were generally unsystematic and only partially amended already lacking parameters. It was exactly the wrong set-up of the parameters that caused disproportionate differences between the new- and the old-pensioners. The relevant measure of the Ministry of Labour compensated for the differential provision of pension benefits in the last years. Today's economic situation doesn't allow for the provision of pension benefits in the amount of SKK 4,000 as it did 5 years ago when the purchasing power of such a pension was higher (living costs lower). According to these opinions, it was necessary to minimise differences in the pensions of comparable employment groups. New high pensions that often exceed net

average wage should be frozen for the time being and attention should be focused on the lowest ones.

Extension of the reference period for calculation of the pensions based on earnings from the period starting with 1994 to the period starting with 1984 was evaluated positively, particularly from the economic viewpoint. Ideally, the people's earnings in their entire productive age would be considered in the calculations, and this should already be applicable for young people.

## **Employment Policy**

### **Act on Illicit Work and Illicit Employment (definition of illicit work and illicit employment; straitening the scope for illicit employment; widening the obligations of evidence and registration towards the Social Insurance Agency; extension of inspections; stricter sanctions)**

On 9 February 2005, the Members of the Slovak Parliament approved the governmental Act on Illicit Work and Illicit Employment. Slovakia has not had any legal regulation, which would **define illicit work and illicit employment**. The approved Act set out illicit employment as the exploitation of work without a duly concluded employment contract in writing, or an agreement on the temporary work of students and consequential neglect of the notification duty of an employer towards the Social Insurance Agency. Illicit work was defined as work performed by a natural person for a legal entity, which is an entrepreneur and does not have a legal relationship established in terms of a separate regulation.

The following inspection bodies perform the **inspection of illicit work** and illicit employment:

- Labour Inspectorate,
- Central Office of Labour, Social Affairs and Family and
- Offices of Labour, Social Affairs and Family (Labour Offices).

Thus Offices of Labour, Social Affairs and Family were added to the existing inspection bodies. The authority to perform labour inspection of an employer was enhanced to be legitimate outside the territorial scope of the respective Labour Inspectorate. Further authorisation with respect to free admission to the premises of an employer, as well as proving the identity of a natural person present at workplace were added.

The Act established the **obligation for the employer to register employee policyholders** and savers within an old-age pension saving scheme to health insurance, pension insurance and unemployment insurance prior to the commencement of said insurance, no later than **prior to the commencement of the performance of activities**, delete them from said register not later than on the day following the expiration date of insurance. An employer must notify the Social Insurance Agency of the hiring of a new employee even before the employee actually starts to work. In terms of the existing legislation, providing notification of a new employment relationship within 8 days of the commencement of the employment relationship was sufficient.

In addition, the Act placed a new duty on the employer to keep a file of work performed during the employment relationship, as well as the performance of work on the basis of an agreement on the temporary work of students, for the purposes of monitoring the hours worked. Furthermore, the registration of this group of workers in the Social Insurance Agency was introduced. Inspection bodies may, in the course of their inspection activity, verify whether or not a law has violated by an employee or employer, using data provided from this register.

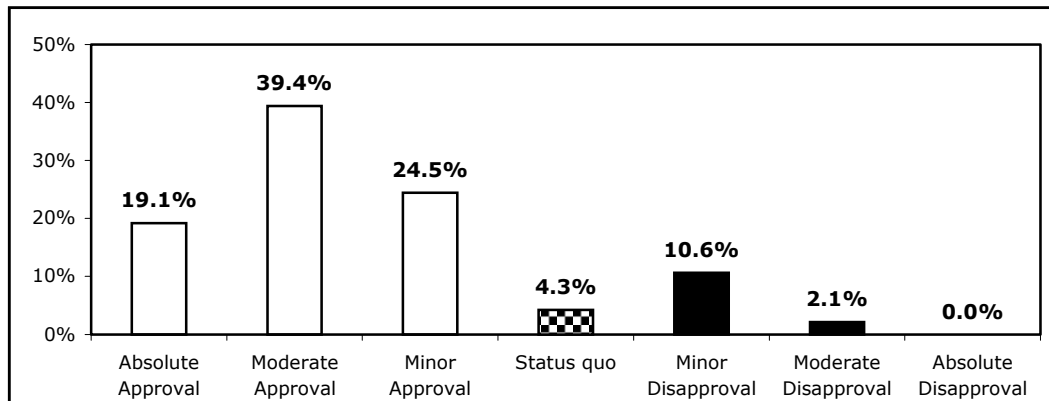
The new regulation entitled authorised bodies to impose fines on an employer for neglecting the provisions of the Act on illicit work and illicit employment up to the amount of SKK 1m and to impose a disciplinary fine, in the event of obstruction of the inspection of illicit employment, up to the amount of SKK 20,000. This entity will be excluded from the public procurement and state aid process for 5 years. The Act assigns the responsibility for illicit work to the employee himself/herself, in addition to the employer.

According to the proposers, illicit work has substantial macroeconomic consequences on the state and public budgets. During the second half of 2004, Labour Inspectorates, Trade Licensing Offices, Police and Tax Offices revealed 661 cases of illicit work, which was twice as high as the previous six months. This concerned mainly employment without an employment contract, or an otherwise substantiated employment relationship. The commencement of effectiveness was accompanied by a Slovak operation, "**Wind**", focusing on discoveries of illicit work. From April 4<sup>th</sup> to April 12<sup>th</sup>, 2005, Labour Offices and Labour Inspectorate representatives performed 7,077 inspections. Inspectors discovered more than 990 cases of employment without a labour contract, or agreement, in 12 days. According to the data of the Social Insurance Agency, employers filed

38,600 new job positions, thanks to the "Wind" operation, which was expected to increase the accrual income increment of the Social Insurance Agency from premiums by at least SKK 40m per month, according to the Ministry of Labour, Social Affairs and Family. Consequently, the Ministry of Labour, Social Affairs and Family launched an operation titled "Wind 2", which took place from June 6<sup>th</sup> to June 10<sup>th</sup>, 2005. During this operation, 338 illicitly employed individuals were discovered and penalties amounted to SKK 2.5m were imposed.

Some of the entrepreneurs blamed the Ministry for focusing on suppression rather than on motivation and did not save on similar administrative measures, in order to be able to reduce high payroll taxes consequently, which are one of the reasons for undeclared work and illicit employment. According to them, the administrative burden was increased for entrepreneurs and a motivation for the corruption and bribery of inspectors and labour inspectors, instead of increasing employment as a result of a low tax and payroll tax burden and thus labour costs.

#### Evaluation of the Experts' Committee:



The evaluating experts perceived the effort to combat illicit work in a positive manner. According to several of them, it was appreciated that the Government has started to be devoted to this issue after having proceeded to cardinal system measures, which made the labour market significantly more flexible. The measure was marked as the establishment of the governing law and equal conditions for everyone on the market. It was accomplished that dutiful employers, who have higher labour costs since they pay payroll taxes for their employees, are not in a comparative disadvantage anymore, in comparison with companies practicing illicit employment. Illicit work should most definitely not continue to be fostered. Although this measure in itself has not created a system solution for the unemployment problem, the repressive nature of the measure and the introduction of transparency to the labour market registration system will probably be of substantial importance predominantly for the Social Insurance Agency and the balance shall return to legitimate employment and will contribute thereby to the elimination of undeclared work. One of the respondents deemed the measure as an effort to protect employees, e.g. so that they may participate fully in the new pension scheme.

However, according to many experts, the Act on Illicit Work and Illicit Employment resolves "only" effects, but not causes. The payroll tax, still very high, is the main incentive to work illicitly. The professional public believed that the options of radical reduction of the payroll tax burden have not been completely exhausted, since there was only a small chance for this measure to pass at that time, due to a lack of political will. It would require namely a more radical redefinition of all the items that public insurance should cover. One of the respondents saw a significantly larger space in the field of minimum wage, where several forms of recognition could be considered. He was also missing "creative" (motivational) measures in the form of tax advantageous vouchers in cases of non-declared work of e.g. tradesmen in the service sector. Even though some of the evaluating persons were missing incentive items in the Act, the necessity to introduce repression to areas where a specific complaint has spun out of control was not decreased, according to them.

In the case of each tax, thus solidarity greater than zero, there will be motivation to avoid it. The performance of the solidarity principle thus requires supervision, ergo monitoring of illicit work. In the case of the introduction of effective inspection, the Act may yield improvement of the labour market quality. However, according to a critical point of view, the originators of the Act forgot to strengthen the inspection departments of Labour Offices, from a personal and financial side (at the expense of other departments of state bodies), since in order to maintain the effectiveness of inspections, numerous inspection teams must perform the inspections, not individuals or pairs who may fail to notice something; moreover, they may be threatened or bribed more easily.

According to sceptical opinions, a problem may occur in the execution of the Act itself, which would mean the risk of a negative net effect of the measure – illicit work would not be eliminated and employer expenditures would increase, in this case.

A lot of respondents perceived an increase of the administrative demandingness of employing and registering employees as a negative issue. Enhancing employees' accounting and registration obligations towards the Social Insurance Agency created administrative barriers for entrepreneurs. Critics expressed the fear that the "chicanery" of employers may occur on the part of the Social Insurance Agency, the administrative capacity of which has been enlarged and its "overhead expenses" increased, meaning a reflux of funds that could be used otherwise. The new obligations have created certain pressure on employers, mainly small and medium-sized businesses, which may even to a larger extent force employees not to enter a classical labour-law relationship, but to start a business. In this event, the social impact of the measure on employees is rather questionable.

### **Pilot Project of Reimbursement of Travel Expenses Related to Commuting (maximum of SKK 2,000 for the duration of 3 months) for the unemployed in border regions that start to work in neighbouring EU countries**

The Ministry of Labour, Social Affairs and Family of the Slovak Republic and the Central Office of Labour, Social Affairs and Family started to coordinate the implementation of a pilot project for the formation of a new tool of the active labour market policy from 1 April 2005. The aim of the project was to increase the motivation of the unemployed in border regions to look for a job in Hungary, Austria, Poland and the Czech Republic by means of reimbursing part of their commuting costs.

Based on their application, the job applicants were granted reimbursement of part of their travel expenses in order to assist them in the early period of their new work in the foreign country that is associated with increased costs, particularly public transport expenses from the location of permanent residence to the location of work and back (travel expenses incurred when travelling by car were not reimbursed). The contribution was being administered by the Offices of Labour, Social Affairs and Family to the job applicants with permanent residence in border regions who found a job either through the mediation of the Labour Office or on their own outside of the place of their permanent residence and commuted to an EU country immediately bordering the region of their permanent residence.

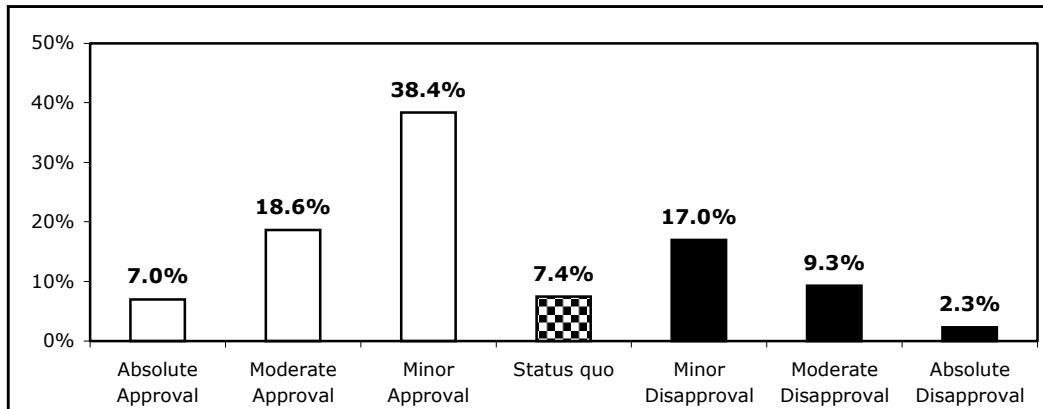
The contribution was being paid monthly on the basis of a written agreement concluded between the Labour Office and the job applicant amounting to up to 100% of the documented expenses, but not exceeding the maximum of SKK 2,000. The contribution was provided by the Labour Office for the duration of 3 months from the effective start date of the employment relationship. The contribution could be claimed by each job applicant who fulfilled the prescribed conditions, but it was limited to the number of 4,000 unemployed persons registered with the Labour Offices in border regions. Formerly unemployed could apply for the contribution if they were registered with the Office for at least 3 months prior to the effectual start date of the employment relationship with the employer for the minimum duration of 1 month.

The Ministry of Labour project was criticised by some Austrian representatives as a demonstration of lack of solidarity with the EU since it handled the problem of unemployment at the expense of neighbouring countries. The Secretary of the Austrian social-democratic party SPÖ Ms. Doris Buares declared in response to the project that Slovakia wanted to export its problems with unemployment to the neighbouring countries. The Slovak Ministry of Labour emphasised that the aim of the project was to attempt to support the labour mobility of job applicants in border regions and not to solve its unemployment problems at the expense of other EU states. The Ministry planned that if the project was successful, the offices of PSVR could start providing contributions to the unemployed to also commute to other regions (the November Amendment to the Employment Services Act (see page 70) introduced a new contribution for commuting to work for the purposes of support of the regional, inter-regional and cross-border commuting, the amount of which should be determined by distance from the location of work (under 30 km – maximum of SKK 500, over 600 km – maximum of SKK 2,000 per month).

Reimbursement of the travel expenses to job applicants in border regions was most popular on the borders with Hungary. This initiative was also welcomed by Czech entrepreneurs who use the Slovak workforce as a substitute for local inhabitants who are not interested in certain positions.

The implementation period of the pilot project lasted from 1 April 2005 to 1 April 2006.

#### **Evaluation of the Experts' Committee:**



One of the factors affecting the development of unemployment in the Slovak Republic is the unwillingness of the unemployed to commute within the EU. Part of the Experts' Committee, therefore, welcomed this initiative and expressed hopes that it could at least partly increase the motivation of the unemployed to look for a new job. It should, however, be ensured in the future that the state benefits are not higher than the state costs per unemployed person. One of the respondents appreciated that the measure was first tested in a pilot project rather than implemented globally straight away and only then adjusted, or cancelled altogether.

The project application was questionable, according to many, because those who want to work had already found themselves a job in the border regions. Demand for the reimbursement of travel expenses related to commuting could be higher in other than border regions of the SR, given that a number of foreign companies organise/support transport of workers from border regions.

A considerable part of the evaluation committee criticised the pilot project of the Slovak Ministry of Labour, Social Affairs and Family. They used terms such as a measure unfair to the internal employees given that only a part of the inhabitants was preferentially treated, unfair competition, dumping, and an unfair move against V4 (Czech Republic, Poland, Hungary) neighbouring countries that between themselves did not restrict access to the labour markets. All things considered, the measure could have provoked unnecessary misunderstandings. It created inequality on the single European labour market and in the process was violating principles of the EU functioning. It was labelled as a subsidised export of the unemployment, and the SR in so doing was curing its ailments at the expense of others. Numerous experts questioned any substantial effects of the measure on the decrease of unemployment. The Ministry of Labour was devising new "motivating" measures that were in the end used only by a few tens of people (e.g. contribution for movement to work). In the process, the administrative costs in the country were increased as well as (and mostly) the costs incurred from the incorrect identification of the problem and its solution.

**Amendment to the Employment Services Act (less frequent duty of calls of active unemployed at the Labour Offices; reduction of the maximum amount of the contribution to education and labour market preparation of the job applicant depending on the number of educational activities; increase of the contribution to graduate practice by SKK 200 to SKK 1,700 per month; cancellation of the contribution (SKK 1,000 per month) to employers with which the graduate practice is executed; cancellation of the contribution to moving for jobs (maximum of SKK 10,000 in two years); introduction of a new contribution to commuting to work (maximum of SKK 2,000 per month for 1 year) for disadvantaged unemployed; expansion of the category of so-called disadvantaged job applicants; limitation of the maximum amount of the contribution to employer toward employing a disadvantaged job applicant in dependence on the average wage in the Slovak economy)**

The Amendment to the Employment Services Act as of 9 November 2005 specified the **periodicity of calls of job applicants** who participate in the activities within the instituted active labour market measures, at the **Labour Offices** in such a way as to decrease the number of obligatory

calls at the Labour Office for the active unemployed (once a month; the others have 7- (long-term unemployed) or 14-day periodicity).

Increase in the maximum amount of the contribution that can be offered by the Labour Office to a person interested in employment toward **education and labour market preparation** up to 100% of the costs (hitherto 50%) of one education activity in the course of 2 years during which he/she has been registered as a person interested in employment. A person interested in employment is defined as a citizen who is seeking different employment, or is interested in the provision of professional consultancy services and services of education and labour market preparation and is not a job applicant, i.e. he is not a registered unemployed person.

Within the provisions on education and preparation for the labour market, the Amendment enabled education for job applicants and persons interested in employment targeted at completion of the primary school education or study in high school based on the projects and programmes as defined by the Act. According to the data of the Ministry of Labour, Social Affairs and Family of the SR there are currently 14,359 unemployed people without primary education (4.4% out of the total number of unemployed) and 101,273 job applicants without secondary education (30.9% out of the total number of unemployed).

The Amendment restricted the extent of re-qualifications of the unemployed financed by the Labour Offices. Up to now the Labour Office could reimburse to the provider of education and preparation for the labour market costs for education and labour market preparation of a job applicant up to 100% and costs of a person interested in employment up to 50% regardless of the number of education activities. According to the new provisions, however, the Labour Office could provide contribution for education and preparation for the labour market for a job applicant up to 100% of the costs of the first activity, up to 75% of the costs of the second activity and up to 50% of the costs of every further education activity during the period of 2 years from the starting date of the first activity. Education and preparation for a particular job opportunity on the grounds of employment commitment by the employer or start of the operation or performance of self-employment should be reinforced. The Amendment stipulates that the Labour Office will provide contribution up to 100% of the costs also on every further education activity (not only on the first one) if the job applicant is removed from the register of job applicants within 3 months of the termination of the education activity for the reason of finding employment or starting the operation or performance of self-employment. An additional charge amounting to up to 100% paid by the job applicant to the provider of the education and labour market preparation service can be reimbursed by the Labour Office.

Spokesman of the Slovak Ministry of Labour Mr. Martin Danko acknowledged that there would be a reduction in the total re-qualifications, but the money thus saved can be targeted in a greater extent at the right type of qualification. He added that *"it is reduction in the quantity in favour of quality"*. Mr. Pavel Hanšut from the Association for Social Reform remarked that *"manufacturing re-qualified unemployed"* was hardly of any use, and he also posed the question of why a businessman should select a long-term unemployed person *"who would require investments of time, money and the risk of an uncertain result"* rather than someone qualified with working habits. The ex-Minister of Labour Mr. Ľudovít Kaník said that he considered the new Amendment *"rather a significant change"* because in his opinion it would bring about a decrease in re-qualifications.

The Amendment increased the contribution to a graduate (under the age of 25) to cover his expenses during the execution of graduate practice (**contribution to graduate practice**) by SKK 200 from SKK 1,500 to SKK 1,700. The practice shall be executed in the extent of 20 hours per week and according to the new provision for 6 months at most. In accordance with the new Amendment, the state does not contribute to the employers who employ graduates for practice any more. The employers hence lost the lump-sum contribution in the amount of SKK 1,000 per month as a reimbursement of their unavoidable expenses linked to the execution of graduate practice per one graduate. This contribution proved to be unnecessary according to the Ministry of Labour, because the employers generated enough jobs for the graduate practice even without this incentive. The Member of the Slovak Parliament Ms. Edita Angyalová (SMER-Social Democracy) declared this argumentation unproven, and considered the measure that took away SKK 1,000 from the employers and added as little as SKK 200 to the graduates, unsubstantiated. Mr. Pavel Hanšut from the non-governmental Association for Social Reform criticised cancellation of the contribution to employers and pointed out the negative effects primarily on the non-governmental organisations for which the contribution could represent the decisive factor for generation of a job for graduate practice.

The category of so-called **disadvantaged job applicants** was enlarged by the Amendment to cover parents caring for 3 and more children, lone citizens caring for an unprovided-for child (up to now only children under the age of 10 were considered) and asylum seekers. Other disadvantaged job applicants are as follows: unemployed graduates under the age of 25, citizens over the age of 50, long-term unemployed (citizens kept in the register of the labour office for at least 12 months in the last 16 months), citizens who couldn't harmonise their working or

educational duties with fulfilment of parental obligations, citizens who lost their ability to carry out their current employment on medical grounds, disabled citizens and citizens moving within the EU.

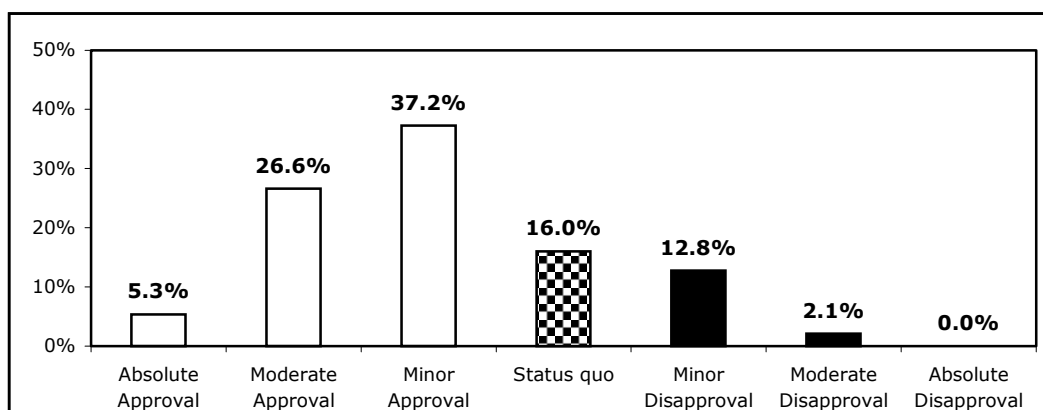
The Amendment also changed the provisions on the **contribution for employing a disadvantaged job applicant** registered in the register of job applicants for the specified duration of time. The contribution is provided to the employer monthly covering up to 100% of the total price of work (wage + social security contributions paid by the employer) per disadvantaged job applicant hired to a generated job, but not exceeding the total price of work calculated from the average monthly gross wage in the Slovak economy for the previous calendar year (up to now the maximum amount of the contribution was not restricted by the average wage in the economy). The sum and duration of the contribution depend on the affiliation of the region where the job is generated, the type of the region entitled to receive the state's assistance and the average registered rate of unemployment in the region. The contribution can be provided for the maximum of 24 months and the employer is obliged to preserve the generated job for which the contribution is granted for the minimum of 2 years (up to now the employer was required to employ the disadvantaged job applicant continuously for the duration of 12 months). The Amendment expanded the category of job applicants that are entitled to provision of the contribution. It was designed to increase the motivation and space for the self-realisation of disadvantaged citizens in a greater extent than used to be the case.

**The contribution to moving for jobs was cancelled**, because it apparently was not sufficiently motivating in its existing maximum amount (the ex-Minister of Labour Ľ. Kaník originally intended to increase the contribution to SKK 30,000). It was awarded to 51 applicants in 2004 and 68 in 2005. **A new contribution to commuting to work** was introduced for the purposes of support of regional, inter-regional and cross-border commuting to work, the amount of which should be determined by the distance from the location of work or the location of the operation or performance of self-employment activity to the location of permanent or temporary residence. Contribution in the maximum amount of SKK 500 is provided if the distance is under 30 km, contribution in the maximum amount of SKK 2,000 per month is awarded if the distance is over 600 km. The commuting contribution shall be awarded to a citizen registered as a disadvantaged job applicant for a minimum of 6 months, for the duration corresponding to his last registration time in the register of job applicants, but not to exceed 1 year from the entry to the employment or starting of self-employment.

Mr. Luboš Vagač from the Centre for Economic Development approved of the proposal of the Minister of Labour Mrs. Iveta Radičová concerning the cancellation of the contribution to moving for jobs. Not even an increase in the contribution would, according to him, bring about any change, because the conditions of entitlement did not support mobility of the labour force. Mr. Hanšút from the Association for Social Reform perceived the new commuting contribution in terms of introduction of an "unsystematic and lump-sum benefit". "Someone can manage to commute for SKK 800 per month, while another cannot get by with SKK 2,000", he said. According to the proponents, the essence of social benefits is to partially assist with rather than fully reimburse the expenses.

According to the SR Ministry of Labour estimate, the Amendment will require spending in the total amount of SKK 1.066bn in 2006.

#### Evaluation of the Experts' Committee:



Studies have indicated that the effectiveness of active labour market policy measures depends primarily on the mode of their implementation. At present we cannot say whether some measures do not work because of the flawed content or because of the incorrect implementation. Despite that, there is a tendency towards changes of content, while the implementation phase is rarely subject to critical analysis. For example, the contribution to moving for jobs could have been



successful in combination with a functioning housing market. The fact that this wasn't the case could have been a consequence of poor design of the measure, or a consequence of inadequate functioning of the housing market. Should the latter case apply, cancellation of the contribution would be suboptimal.

Even normally beneficial measures can have negative consequences on society if they are too frequent. However, introductions of new and cancellations of old measures add up to a lack of transparency of the system and do not even solve the problems of the employment issue – price of work and social security contributions, both of which are major obstacles for those who cannot find a job. The situation required strategically managed systemic change rather than partial ad hoc solutions grounded in mere statements and feelings, while ignoring serious analytical evaluation of the measures.

**Ladislav Balko:** *„Even though the sector of employment with a level of unemployment is needed for the state, there are too many and too frequent changes in the sector. That gives testimony about the lack of any conception in the sector. The policy of employment and the struggle with unemployment should be set up in such a way as to create some long-term rules of the game that could bring about some of the effects only in a long-term horizon. In the existing fashion, something is passed one year and is subject to change shortly afterwards. I urge the setting up of a real long-term policy in this sector. If the goal is clear – reduction of unemployment and development of the policy of active unemployment, then the means needs to be subordinated to the goal, and this needs to be done not only in the short-term.“*

**Martin Krekáč:** *„The summary of the measures embodies non-conceptual ad hoc steps dealing with arising situations. It is necessary to design a fundamental solution of the motivation of the unemployed that will not require constant interventions according to the momentary situation and need.“*

**Robert Žitňanský:** *„The attempt to adjust the social system according to the situation is fine, but this Act only illustrates the incredible complexity of the system. Major simplification is very much needed.“*

**Juraj Lazový:** *„An ideal social system should most efficiently, on the one hand motivate citizens to work and gain education, and on the other hand protect people legitimately dependent on social assistance from poverty. I am unable to evaluate to what extent the passed Amendment to the Act can improve the existing situation. In any case the entire system gives me the impression of being too complicated, while I cannot judge its effectiveness.“*

**Peter Schutz:** *„The effect of these specific measures is disputable, and I can't evaluate it, but I know that it would save an awful lot of money and trouble should the state abandon the "active labour market policy". Even if some individual measure is beneficial, there is no more sense to it all than the self-indulgence of bureaucrats who always come up with something new that can be re-written by the successors.“*

**Igor Daniš:** *„This Amendment does nothing to change the state of things when the Labour Offices aren't anything but passive players in the market. The Labour Offices are pure formalities!! Active players that do not, in fact, form the labour market by means of, for example, harmonisation of market supply and demand in a specific town, region or for specific functions; they do not act: they passively recommend and passively process their agenda, i.e. they habitually impose sanctions and punishments. Also worthy of consideration would be personnel reorganisation and change of the "single-sex" personnel structure.“*

**Juraj Nemec:** *„A large number of changes that can hardly be assessed as a whole. Each measure has its pros and cons.“*

A number of respondents appreciated the shift represented by the Amendment towards re-qualification and education of the unemployed. One of the respondents saw the need for greater support for long-term employment opportunities. Another disagreed with cancellation of the contribution of SKK 1,000 to the employers for graduate practice.

## **Health Care Policy**

**Amendments to Health Care Acts (adjustment of the band of state insurance holders; shifting of the annual clearance of accounts of health insurance premiums to the end of June; health insurance companies will be the classic business subjects – the profit can be divided between shareholders; determination of the maximum level of patient's co-payments for health care related services and their relation to the subsistence minimum; determination of the maximum, or minimum proportion of diagnoses that can be fully charged or must be fully covered by the public health insurance – increase in the scope of diseases with a full public health insurance coverage)**

On 13 December 2005, the Members of the Slovak Parliament approved the Amendment to the Health Insurance Act, which also modified other health care acts. It was already the third Amendment to the Health Insurance Act since Autumn 2004, when the health care reform was approved.

**The Amendment to the Health Insurance Act** has contributed the following innovations:

- the Amendment has adjusted the band of people, for whom the insurance premium is paid by the State (the regulations increase as well as reduce the number of state insurance holders),
- according to this Amendment, the employees will already pay also health insurance premiums from paid profit shares, which companies used as a form of employee remuneration (this does not concern CEOs and others that have capital share in the company (partners in a limited liability company, shareholders, members of co-operatives); the Advisor of the Minister of Health has explained this modification by the fact, that employers abused profit shares by paying their employees the minimal salary and paying the rest of the money as a profit share in order to avoid the payment of payroll taxes,
- the health insurance will allow self-employed persons to carry out advance payments to a lower amount or to forfeit them completely, if the self-employed person is in temporary insolvency, but only under the condition that there is a reasonable assumption that at the annual clearance of accounts of health insurance premiums the due amounts of insurance premiums will be paid,
- the Amendment has specified and unified the regulations related to the annual clearance of accounts of insurance premiums where the premium overpayments and arrears of the payments will be compensated; all accountable persons must submit a declaration to their health insurance companies by the end of March, however, the deadline for the 2005 transitory period, which has been historically the first annual clearance of premiums, has been shifted to the end of June 2006, so that everybody might be better prepared for this innovation.

### **Amendment to the Health Insurance Companies Act**

The regulations relating to the register of insurance holders awaiting for the provision of planned, i.e. postponable health care (so-called waiting lists). Health insurance companies will be obliged to provide the insurance holders with the settlement for planned health care at the latest up to 12 months from the date of the registration of the insurance holder on the waiting list, except for cases, where the expenses for the provision of this planned treatment will endanger the settlement of the urgent health care. Health insurance companies will be obliged to create to the date of the closing of the books a technical reserve for the settlement of planned health care for insurance holders classified in the register for a period more than two months from the date of their registration. The technical reserves can be used exclusively for this aim. As long as the health insurance company has patients on its waiting lists, it cannot show a profit in accounting.

### **Amendment to the Income Tax Act**

With this Amendment, the health insurance companies became classic business subjects. They will pay income tax and their profit can be divided up in the form of dividends between shareholders. Up to now, the health insurance companies had been classified in the Act among organisations that are not founded or established for business, however following their transformation, they became the subjects of the private law. The Chairman of the Health Committee of the Parliament Mr. Ján Bielik (Christian Democratic Movement (KDH)) has expressed the opinion that the Health Insurance Companies Act controls the use of the profit of health insurance companies. They namely will be not able to divide profits between shareholders, if they have insurance holders on

the waiting lists. Bielik added that the accounting of health insurance companies can be controlled by the Health Care Surveillance Authority, whereby the insurance companies are obliged to present an audit every year. A Member of the Parliament has remarked, that the risk that the health insurance companies could divide the profit at the patients' expense is implausible in regards to the many restricting legal norms. The General Secretary of the Slovak Medical Chamber, Mr. Eduard Kováč, has considered this measure in the system of a compulsory health insurance, from which you can not resign, as unique in the world. Health insurance companies will dispose with public sources, however, they will also be pushed by shareholders to create profit, with which they can dispose independently as a business subject. According to Kováč, in this way the health care providers will receive less payments, which means that, with the restricted volume of resources, it will be necessary to solve this problem partly with higher patients' co-payments for health care related services, partly with charges for diagnoses.

### **Amendment to the Act on the Scope of Health Care Covered by Public Health Insurance**

The Amendment has fixed the maximum limits of charges for services related to the provision of health care (for visit to the outpatients, emergency ward, for stays in hospital, for a prescription, for transportation). Their maximal possible amount will be derived every year from the subsistence minimum. The amount of the subsistence minimum (at present SKK 4,980) will be adjusted every year on 1 July, based on the coefficients of the growth of net cash income per person or of the growth of living costs of low-income households. The actual amount of the charges however will be determined by the Government with its regulation, that will be obligatory for health care providers.

#### Maximum limits of flat payments for health care related services:

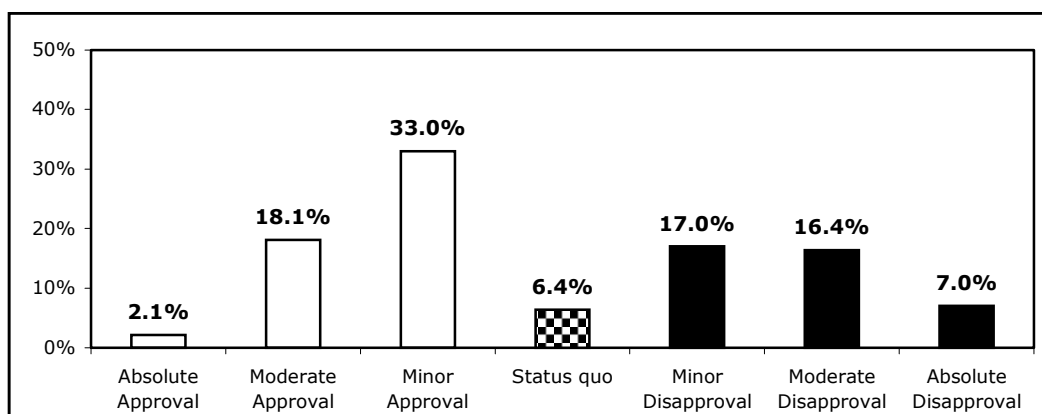
- for visit to the outpatients - maximum 0.64% of the amount of the subsistence minimum, in 2005 it could be SKK 30 (nowadays it is SKK 20),
- for a prescription – maximum 0.64% of the amount of the subsistence minimum – in 2005 it could be SKK 30 (nowadays SKK 20),
- for medical transportation - maximum 0.085% of the amount of the subsistence minimum – in 2005 it could be SKK 4 (nowadays SKK 2),
- for a visit to the emergency ward - maximum 1.7% of the amount of the subsistence minimum – in 2005 it could be SKK 80 (nowadays SKK 60),
- for one day of stay in the hospital or in the spa for diseases classified in group A - maximum 1.5% of the amount of the subsistence minimum – in 2005 it could be SKK 70 (nowadays SKK 50),
- for a stay as an accompanying person in the hospital - maximum 2,8% of the amount of the subsistence minimum – in 2005 it could be SKK 132 (nowadays SKK 100 ),
- for one day of stay in the spa for diseases classified in group B out of season (1<sup>st</sup> and 4<sup>th</sup> quarter) - maximum 3.9% - in 2005 it could be SKK 184 (nowadays SKK 150),
- for one day of stay in the spa for diseases classified in group B in the main season (2<sup>nd</sup> and 3<sup>rd</sup> quarter) - maximum 5.3% - in 2005 it could be SKK 250 (nowadays SKK 220).

Political opposition, as well some professional organisations, have seen behind this measure the threat of increase in patients' co-payments. The Minister of Health Mr. Rudolf Zajac has mentioned that the Government of Mikuláš Dzurinda will not increase these flat payments, because the public health care is in a good financial condition at present. On the contrary, the Act should specify the exact rules and protect the patient against more radical increases in charges, i.e. with the arrival of a new Government. According to him, the aim was only to determine the highest possible amount, up to which any Government would be able to define charges. According to the Minister, it is convenient for the patients who gained legal security against the state before the Amendment, when the limit did not exist to determine the maximum amount of the charges by the Act. The Association for the Protection of Patients' Rights in the Slovak Republic has criticised the relation of the maximum limits of charges to the subsistence minimum. According to this, the subsistence minimum is determined because the expenses of citizens are increased, so why should be increased at the same time as the patients' co-payments. According to the Association this fact is not logical. According to its Vice Chairman, Ms. Anna Reháková, the possibility has thus arisen every year to increase the charges together with the valorisation of the subsistence minimum. She was also afraid of the situation, that is common in Slovakia according to her, that in the end the highest possible amount will be collected.

Amended Act on the Scope of Health Care has also determined the maximal, resp. minimal proportions of diagnosis that can be charged, or must be completely paid by the public health insurance. The original Act dating from the autumn 2004 has determined in its Attachment a so-called List of priority diseases (contains approx. 6,500 diagnoses), the diagnostic and treatment of which are paid completely by the public health insurance. Other diseases (approx. 4,500 diagnoses) did not exist in the Attachment of the Act and the amount of the participation for the diagnostic and treatment of these so-called non-priority diseases could be determined by the Government with a Categorisation Regulation. The actual Amendment has increased the scope of diseases, for which the costs for treatment must be paid completely by the public health

insurance. The Amendment has determined that at least in one third of so-called non-priority diseases, (approx. 1,500 diagnoses) medical treatments will be completely paid by the public health insurance. This means that the health insurance companies will pay completely all 6,500 priority diagnoses including 1,500 non-priority diagnoses. The Amendment further determined that for at most one sixth of non-priority diseases (approx. 750 diagnoses) the medical treatment will be paid completely by patients. According to the Minister of Health, it has handled in fact the reflection of the current state, when patients pay for plastic surgery, some eye operations, some stomatologic operations, induced abortion on own request and similar operations. For other non-priority diseases (approx. 2,250 diagnoses) the treatments will be partly paid through the health insurance, whereby the amount of the payment from the public health insurance must be at least 80% (so the patient will pay a maximum of 20% of the costs related to the treatment). For non-priority diagnoses, the list of which was part of the Attachment in the Act, the Government will build a list of diseases by a Regulation, where the amount of the patients' participation will be set as well. The Dzurinda Government, however, did not manage to publish this list including the prices for the operations for each diagnosis. In Slovakia, according to the words of Minister Zajac 14% of private sources and 86% of public sources flow into the health care system.

#### Evaluation of the Experts' Committee:



The Amendments to Health Care Acts have brought a number of modifications and contradictions. They had reacted to the situation which had emerged in the health care service. They were a compromise between the market regulation of the health care and so-called state centralised model of the health care system. According to one responder, it was not possible to do more at this moment. For this reason, it was not possible to evaluate this measure as an entity. For example, the entrepreneurship of health insurance companies is the key element to the whole reform, but the health care market is not deregulated and the environment for health insurance companies is far from the market one (absent is, e.g., the entry of foreign insurance companies). So in fact, only three private owners (only two important) and the State were left in play and the State influences approx. 70% of the market (General Health Insurance Company, Common Health Insurance Company). Sometimes good intentions can cause problems.

Another of the responders said, that on the one side the interest of shareholders of health insurance companies will lead to savings in the system expenses, on the other hand it will lead to a possible decrease in the quality of health services. Patients with serious, or chronic diagnoses will be useful to remove from the system, the determination of the provision place of the services will prohibit the selection of the doctor etc. to the clients. He had been afraid that the Health Care Surveillance Authority is not capable of controlling the conflict of the health insurance company and the patient and sufficiently protect the interest of the patient. The establishment of an effective surveillance will probably be more expensive than the saving of the expenses after the reform. Also, according to him corruption will be not eliminated in approving and prescribing drugs.

The majority of experts have perceived as negative the annual clearance of accounts of health insurance premiums. It deals with a bureaucratic measure, that unnecessarily burdens on one side the employers, on the other side the employees. Following one opinion, the forms of the declaration has been the expression of utter inability, so far for solving a simple problem more than 10 different forms with extensive „instruction for use“ have been needed.

**Milan Velecký:** „Maintenance amendments, some of them incomprehensible. The determination of the maximum amount of the flat charges in the Act seems childish, as if it was assumed, that in Slovakia there will be another Government and another majority in Parliament. Just unnecessarily complicated. The relation to the subsistence minimum is not a bad solution, and if this has been opened in the form of the act, so the act should bring rather the mechanism of automatic valorisation to these charges. And not to leave it on the decisions of the Government,

that could, for example, doubt this prior to the elections. The shifting of the premiums clearance – nothing else has been possible, they should rather cancel the maximum assessment base (as it happens for the personal income tax), and thereafter such a wide clearance of accounts (13 different forms) will be not necessary at all. And for determining the proportion of diagnoses – this is not enough in 4 years of the reform. Some of the diagnoses should be charged already. Even if it is clear to me, that it is not so simple, in particular in the area of outpatients clinics, I would rather down the path for payment for operations, and not for diagnoses. But the charges for diagnoses have been chosen by the authors of the reform themselves, and that they have chosen incorrectly is shown by the fact that they have not implemented charges for any diagnoses. They have only said, how many have to be without charges, and how many have to be charged. And this is in four years of the reform really very little."

**Juraj Lazový:** „The aims of the health care reform, that Mikuláš Dzurinda’s Government has started, I consider as correct – an increase in the responsibility of the individual for his health and the improvement of economic efficiency of the system, which should bring as a final consequence an increase in the quality of health services. However, the own mode of carrying out the reforms I consider as bad, untransparent and not mastered well from the marketing point of view. (compared with e.g. pension reform). In this regard I evaluate also the approved amendments to health care acts."

**Karol Sudor:** „The cancellation of the socialist model in the health care has been a necessity, there was a lack in motivation not to waste resources and to make efficient the processes in the health care. As a deficit can be seen not mastered communication with the public that identifies until today the reform exclusively with 20 and 50-Korunas banknotes. The surrender of certain intervention is also negative and following a softening of some previous intentions of the reform (e.g. cancellation of useless hospitals in Bratislava). I am missing the solution for one subject – today we must compulsorily (through the health insurance) pay the full amount even in the case, if as patients we are not satisfied with the qualification and attitude of the doctor, or the health service staff."

**Peter Schutz:** „My evaluation is influenced fundamentally by the annual clearance of accounts of insurance premiums, which is the most absurd and worst measure of the whole health care reform. It does not have to be shifted to the end of June, but cancelled forever. The increase in the scope of diseases paid completely from the public health insurance is also baleful, populist and illogical measure in situations, when reputedly the money in the system is absent."

**Juraj Nemec:** „The amendments contain many modifications, that as an entity it is not possible to evaluate. The annual clearance of accounts of insurance premiums has caused many confusions in practice between the employees. Is the market of the health insurance fully competitive? – if not, none of the authorities will force the insurance companies to operate as a real regulator. Flat co-payments – the calculations could be complicated, rather this social problem should be solved with social benefits."

**Igor Daniš:** „For health insurance companies, the ideologists make evident contradictions in principles: public health is founded on the principle of solidarity, using different forms. For this reason the individual and public sources into the sector are limited. The restriction of sources from the side of the clients (nobody is paying themselves for cancer treatment; it never will be possible for normal people to pay for it, they would die) is in contradiction with the requirement of classic market instruments, because it can not work effectively by itself. The implementation of the principle of enterprise and profit can be effective only because of the fact, that it can gain from the pressure on certain principles, supported by the Constitution of the Slovak Republic and the acts; limited sources. It is about making profit from uneven market conditions, or in other words tunnelling the sources or extortion."

**Ladislav Balko:** „The measure on the edge of decency towards citizens and in the contradiction with the moral of the State, that the Constitution binds to take care about the health of those who make up this State – namely citizens. Under the prism of setting an order into the financing of health care is the unlawfulness the fact, that the payments in the health insurance companies represent power (namely based on the act) dispossession of the part of the citizen’s property (their earnings are property) are consigned in the regime of a business subject – joint-stock company, that is the enterprising subject according to the Commercial Code, and as such must execute the activity in its own name, on its own responsibility with the aim of reaching the profit. So is also a threat, that the main aim of health insurance companies will be to make profit, and not to fulfil its duties of the provision of public goods, which is the financial coverage of provision of the health care. We cannot mention the future competition between the health insurance companies at all (we should consider the competition of the banks)."

According to another responder with a critical opinion, health became again the goods. According to him, it was a further period of commercialisation and privatisation of the constitutional right of citizens. At the same time he asked, what will be the real consequence e.g. for persons with lower earnings? The implementation of such modifications in the constitutional rights of citizens should be not solved with a referendum?

## Education Policy

### **Amendment to the Higher Education Act (non-sanctioning of unaccredited branches of foreign universities (from the EU and EFTA countries) in Slovakia; introduction of motivational student scholarships financed from the State Budget)**

On 29 June 2005 the National Council of the Slovak Republic (Slovak Parliament) passed the Amendment to the Higher Education Act put forth by a group of parliamentary representatives from ANO (Alliance of the New Citizen) and SMK (Party of the Hungarian Coalition). According to the submitters, this amendment was to remove the option of penalties of up to SKK 5m for private universities or legal entities providing university education in the Slovak Republic without government approval (accreditation) from the Ministry of Education of the Slovak Republic.

During the parliamentary hearings on the norm, Members of the Parliament supported the initiative of Mr. Ferdinand Devínsky (Slovak Democratic and Christian Union (SDKU)) – even though they excluded the subject paragraph, they amended the Act and included the **sanctions** in its other parts. The sanction is currently applicable to legal entities providing university education in the SR **without accreditation**, unless these are branches of universities established in another EU Member State, Norway, Lichtenstein, Iceland, or Switzerland (members of the European Free Trade Association (EFTA)), and are founded and accredited in accordance with the law of the particular country.

The Member of the Parliament Mr. František Mikloško (Christian Democratic Movement (KDH)) has put forth an amending submission which enables, in addition to the existing social scholarships, the introduction of **motivational scholarships for students**. According to the passed submission, a university grants motivational scholarships to students for "*exceptional achievements*". They are financed through the State Budget and their proportions, as well as other circumstances, are governed by the Regulation of the Ministry of Education.

The Regulation divides the scholarships into merit and exceptional scholarships. A **merit scholarship** is awarded to a full-time student for excellent fulfilment of studies in the previous academic term and, in the case of freshmen, in the previous semester or trimester, unless he/she was on a leave of absence in the previous term. According to this Regulation, motivational scholarships are not awarded to students of third-level studies (doctorates). The top 10% of students of each faculty are automatically eligible for the merit scholarship, provided that they fulfil the particular faculty's scholarship criteria (e.g. a certain grade point average (GPA) from core courses, minimum credits acquired, number of tries allowed for completion of a course, not repeating a term, etc.). The Ministry of Education only states the basic rules and conditions for awarding a scholarship under this Regulation. The President of the Slovak Rector Conference, Mr. Vladimír Bálesš, stated that "*if scholarships were awarded to students with a certain GPA, it would be simpler. This way, two students with unequal GPA's can both be awarded a scholarship*". According to the Minister of Education Mr. Martin Fronc, however, "*the difficulty and conditions in particular fields of study vary, therefore we did not want to take into consideration the GPA of the entire school*", which could lead to unequal distribution of resources among the faculties. The requirements of eligibility for motivational scholarships are made available by the faculty/school at the beginning of the academic year. In the academic year of 2005/2006, the top 5% of students were awarded SKK 20,000, and the next 5% were eligible for SKK 10,000 per academic year. A merit scholarship is paid out in two (in the case of semesters) or three (trimesters) equal instalments during the year based on academic results of the previous year. They were paid out for the first time at the turn of 2005 and 2006 due to delayed publication of the Regulation and methodology guidelines. In the interest of retaining transparency, names of the students fulfilling the criteria and thus being awarded the scholarships have to be publicised (for example, on the faculty's main bulletin board and on its website).

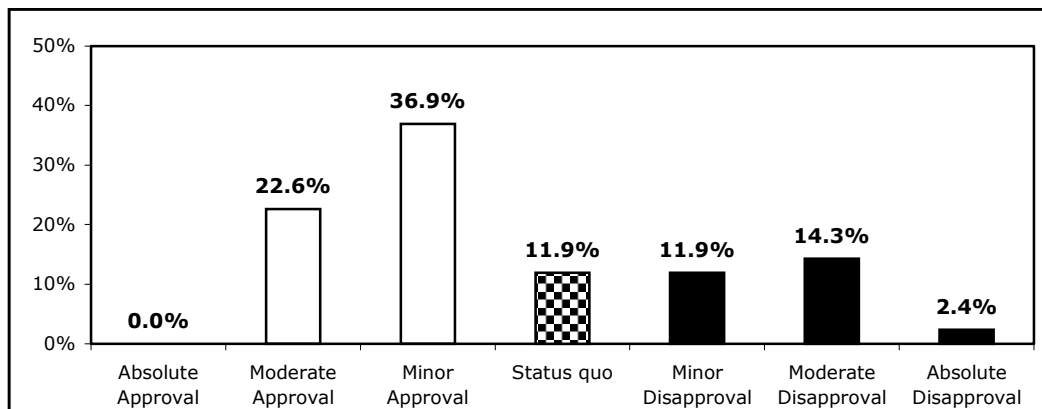
A one-time non-claimable **exceptional scholarship** of up to SKK 11,000 can be awarded to full-time students for excellent achievements in scientific, artistic, or sport activities, for successful representation of the faculty, the entire university, or the Slovak Republic in artistic, sport, or knowledge contests, for excellent fulfilment of responsibilities during the student's entire studies, or for an extraordinarily qualified final paper. It was estimated that exceptional scholarships would be awarded to 2% of students. An excellent student can thus be awarded motivational (merit + exceptional) scholarships of up to SKK 31,000.

Financing of the motivational scholarships will be covered, in the first two years, by the State Budget reserves in the amount of SKK 300m. The Ministry of Education allocated SKK 92.67m for motivational scholarships in 2005 (SKK 81.45m of merit scholarships for 10,860 awardees and SKK 12.2m of exceptional scholarships). There should be an estimated SKK 203m allocated for

scholarships in 2006. Logically, the most awardees of motivational scholarships will be from the largest Slovak university – Comenius University (UK) in Bratislava – which was allocated almost SKK 16m in scholarships in 2005.

The initiator of motivational scholarships, Minister of Education Martin Fronc, considered motivating the students toward better performance an important tool for improving the quality of universities. The regulation for motivational scholarships was welcomed by the schools themselves as well. According to the voices of opponents, the reason why somebody should be paid from public funds for studying well was not entirely clear. Knowledge should be the ultimate personal interest of a student (personal wealth). Good study accomplishments proportionally increase his/her price and employment in the market. A feasible solution would be financing scholarships from savings of the universities allocated to the elite of extraordinary talents, as opposed to flat allotments to thousands of students. The critics also stated that it was a populist pre-election move, as education represents an attractive incentive for voters. This step was in stark contrast to the many-times-refused complex university system reform tied with introducing paid university education.

#### Evaluation of the Experts' Committee:



The Amendment to the Higher Education Act, based on which branches of foreign universities from the EU and EFTA countries will be able to establish themselves in Slovakia without sanctions (if accredited in their home country), and which introduced motivational scholarships financed by the State Budget, was received controversially by the expert public. The reasons are significantly opposing opinions on both of the mentioned provisions of the Amendment.

According to one side of the opinion spectrum, one can agree with the support of developing activities of foreign universities. Simplification of access for branches of foreign universities to Slovakia was regarded as a positive step. Even abroad, however, one can find both schools providing quality education and schools aiming for profits while disregarding quality. It is therefore essential to guard the quality of this education to avoid such a situation where a branch comes to Slovakia only to earn profit, without providing adequately fitting education. The best pedagogues from foreign universities will hardly come to teach at a branch even for the prestige. The question remains as to whether the most prestigious schools will risk diminishing their reputation by opening any foreign branches. Based on these reasons, one of the experts expressed his fear that the proclaimed branches of foreign universities will more probably be of the lower qualitative category, and their reasons for establishing themselves here will only be of a financial character.

The conduct of the Minister of Education, in trying to limit operations of foreign accredited university programmes in the SR, was according to many respondents an inept attempt to maintain the monopolistic character of provision of university education by Slovak universities. It was also in conflict with the principle of free movement of services within the EU. Plurality and competition can work well in this field; and what is more, a system banning somebody from voluntarily paying for his education is an anachronism. Even though the deregulation of barriers for foreign universities was a positive step, the question of equal competition with relation to an equal normative subsidy from the State – allocated to Slovak public universities – was not solved.

To the contrary, experts from the other side of the opinion spectrum maintained that the mentioned provisions of the Amendment brought into question the very process of accreditation which guarantees a certain standard of education not to be lowered. Every university in the SR should be accredited by the Slovak Ministry of Education. Operation of unaccredited subjects can diminish the quality of university education. The Ministry is responsible for analysing their qualitative level and bears responsibility for the entire system of the educational process. According to these opinions, acceleration of establishing branches of foreign universities will not improve the quality of education provided in Slovakia.

The second of the two provisions of the Amendment was rejected by most respondents. Introduction of State Budget-financed motivational student scholarships was incorrect, unsystematic, and significantly inefficient in use of public resources, as well as a measure reminiscent of a populist gesture. It was also in conflict with the principle of not increasing the expenses of unreformed sectors. The financial resources of the state should only be used to fund (if they are to be funded) scholarships for the very best and socially weaker students. Families with monthly income at a certain level should not have this eligibility. Students, in principle, should not be paid from the State Budget for doing well in their studies. Knowledge should be their ultimate personal interest, because it improves their employment opportunities on the market and increases the price of their work. Every student prepares for practice differently and only in practice does one see how responsibly the student approached his education.



## Judiciary

**Recodification of Criminal Law (new Penal Code – more severe punishments for crimes of violence; modification of criminal liability from 15 to 14 years; alternative punishment modes (house arrest, punishment work-off); disapproval of the criminal liability of the companies; new Criminal Procedure Code – shifting of first-level agenda from Regional to District Courts; institution of the judge for preliminary proceedings; process parties will propose and carry on the testimonial evidence, not a judge; alternative modes of accelerated proceedings – criminal order and agreement on guilt and punishment; reduction of the maximal prison duration from 5 to 4 years; Appeal Courts will decide in a major scope on the cases; the possibility of appeal against the Appeal Court for the accused case; disapproval of public defenders ex officio - henceforward counsellors ex officio; "agent-provocateur" can initiatively encourage the corruption of public officials)**

With the recodification of the **Penal Code** of 20 May 2005 the previous one, approved still during the last regime in 1961, has been substituted. Together with the approved Criminal Procedure Code (see below) the grounds of criminal law have been newly defined, have brought more conceptual and structural modifications and new regulations.

According to one of the members of the recodification committee taking part in the formation of new criminal norms it is based more on continental law than on Anglo-Saxon law. The systems of criminal law in Germany and Austria, some judicative law of Great Britain, Swedish law and Swiss criminal regulations were compared. The new Penal Code is according to its proposers a modern norm, that will not give opportunities to criminal offenders, but to those who that respect the law. It has responded to the increasing brutality of violent offences, whose offenders will be punished more strictly according to the new legislation, and has introduced a new variety of punishments, that had no parallel until today in Slovakia.

The above-mentioned norm has brought, as well as many other modifications, **a modification in the classification of crimes** and their disposition in offences and crimes. The offences represents the lightest category, including crimes committed by carelessness or wilful crimes, which entails an imprisonment for a maximum of 5 years. As crimes are considered all wilful crimes, which entail a punishment for more than 5 years. Especially more serious crime according to this Code is such a crime, for which the criminal penalty is at least 8 years. Violent crimes are judged more strictly, and the rule "three times and enough" is also kept. The **"two times and enough"** rule, however, is new; according to this a person condemned in the past for premeditated murder (a newly defined term in the Code) will automatically receive life imprisonment if he again commits such a murder and will be declared guilty for it. The premeditated murder in "dangerous grouping" (criminal or terrorist group) or in a crisis situation will be punished with immediate life imprisonment, which should mean life imprisonment for offenders of so-called "mafia murders".

For **less serious crimes**, the offender does not need to be in prison, the punishment could be also:

- punishment by house arrest, exclusively for offences with an upper boundary of 1 year,
- punishment by compulsory work in the leisure time and without the claim to remuneration up to the amount of 40 to 300 hours and only with the approval of the offender.

The execution of both above-mentioned punishment modes are supervised by probation officers and in the case of a breach of the punishment conditions an unconditional punishment will follow. For the future it has been considered, that the compliance with house arrest could be monitored electronically. As a reaction against the increasing criminal activity of minors and their increasing brutality, the new Code **reduced the age limit of criminal liability** from 15 to 14 years, which means, that less minors will escape punishment than in the past.

The norm also contains such **newly defined terms** as exigency, private defence, justified use of arms, allowed risk etc., that represent circumstances excluding the illegality of the act. The modification should signify extended possibilities for victims of the crimes, if they must defend themselves. The victim can use arms in his house, even in the case, when his private defence is

not yet involved. The use of this circumstance will be excluded only in the situation, if it results in a wilful killing.

**The judgement of aggravating and extenuating circumstances** has also been modified. If, at the judgement, aggravating circumstances prevail, the lower boundary of the punishment will increase (if extenuating circumstances prevail, this will decrease the upper boundary) by level defined in the Code (1/3, half or 2/3). The basic modification is the enumerating definition of circumstances, that is more specified than the previous valid adjustment.

Among the new items in the Penal Code, we can also note new facts in the case of **violation of confidentiality of verbal statement** and other statements of a personal nature. The crime is committed by a person, who without justification will record privately the presented words of another person, will make this record accessible to a third person, and with this will inflict serious legal detriment. For such crime a punishment of imprisonment for 2 years impends. The opponents to this measure have confirmed, that the mentioned regulation can complicate in practice the work e.g. of journalists. The original – first Bill approved by the Government, did not include the objective section.

Another new fact in criminal cases is **the crime of the abuse of property of another by painting** or spraying, that can be sanctioned with arrest with an upper boundary of 1 to 10 years depending on the damage caused. Regardless of the pursuit of the Minister of Justice to exclude from criminal law **verbal delicts** (defamation of race, nation, belief) these further remain valid. The new wording of the Code already also contains **the definition of the support and activity for criminous and terrorist organisations**, as well as the concoction and establishing of such group.

Probably the most medialised part of the Bill, **the criminal liability of the legal entities has not been approved** after all. The withdrawal of this proposed regulation has been enforced by Members of the Parliament during the repeated approval of the Code even in spite of the fact that the presenters have moderated the previous Bill of Criminal Infliction for Legal Entities. In the Bill they have especially reduced the scope and quantity of triable acts, that prior to this had not been specified and had included all crimes, and had kept only crimes related to drugs-trafficking, money laundering, falsification of money, terrorists- and criminous groups support, corruption, crimes against the environment or pimping. According to the Government Bill every organisation, which is conceded the status of a legal entity by law should be criminally liable, whereby this liability should not be related to the Government and state offices, including the National Bank of Slovakia. Up to the present it has been valid, that for a crime committed the CEO of the legal entity is condemned, but the company continues to operate without sanctions. The legal entity should condemn the crime in the case, where the statutory authority, member of supervisory authority or another person authorised to act on behalf of legal entity should act in conflict with the law. If the criminal liability of the companies has been approved in the Parliament, the court could inflict the company some of the following punishments:

- penalty from SKK 500.000 to SKK 500 million ,
- cancellation of legal entity,
- forfeiture of the property,
- forfeiture of the concern,
- prohibition of a determined activity,
- prohibition or restriction to accept the public grants or subventions,
- prohibition in the participation in public procurement.

The presenter of the Bill has stated on the margin of the introduction of the criminal liability of the companies, that it is about time in commercial companies for the person liable to be the owner, and "not only the porter". As one of the arguments, the authors of the Bill mentioned that the legal entities are acting more and more often as instruments, with whose help serious crimes are committed.

The critics of the intention to introduce the criminal liability of the legal entities confirmed, that it would entail the introduction of collective guilt against all businessmen. For everything, natural development is necessary, and according to them Slovakia is not mature for such measures. The opponents have also expressed concerns, that at present, the criminal liability of the companies could be abused for ignoble competition fight between the companies by submitting complaints. According to the statement of Republic Union of Employers (RÚZ), if the court cancels the company, the employees will lose their jobs, but they have not done anything wrong. The small stockholders will suffer, because they would lose their property.

On the other hand, the representatives of the SR Ministry of Justice have refused claims about collective guilt and have pointed to the existence of similar acts in Belgium or France. On top of this, the cancellation of the company would only be taken into consideration for such crimes as e.g. money laundering. The Minister of Justice Mr. Daniel Lipšic has expressed discontent with the release of criminal liability of the companies. According to him it should be a step forward, that for determined delicts commercial companies should also take liability.

Several businessmen have expressed general satisfaction with the result of the negotiations with the authors of the Penal Code. For **crimes related with enterprising** there have been changes and a major part of the questions have been solved. As deficits they have marked the sometimes vague definitions of some economic crimes and the potential length of imprisonment e.g. for falsification of economic and commercial data, abuse of participation in economical competition, responsibility for bankruptcy, non-payment of the salary and severance pay or capital fraud.

According to opponents, the new Penal Code is craftily strict and it is not putting stress on prevention. According to one of the representatives of Slovak Bar Association (SAK) in the last 4 years punishments have been continuously increased, but there are no statistics proving that a proportional decrease of crime rate is taking place.

Regardless of multiple critical comments, the Penal Code has mostly met with positive reactions not only with prosecutors and judges. The Chairman of the Supreme Court of the Slovak Republic has welcomed the new Code and also in spite of the disapproval of criminal liability of legal entities stated, that it contains many modifications, that will lead to the better protection of the rights of nationals and the protection of society.

**New Criminal Procedure Code** as of 24 May 2005 is the norm, that is connected with the new Penal Code (*see above*). The Criminal Procedure Code solves in general the procedure of the authorities acting in criminal procedure, it covers the procedures as to how to investigate the crimes and how to punish the offenders. The main goal of the recodification has been to make it more effective, simpler, faster and with a higher efficiency of criminal process, in order to ensure a more effective protection of the basic rights of physical legal entities, as well as the protection of public interests in the whole of society. The new Criminal Procedure Code will achieve according to the presenter, that punishments will be not only just, but also promptly imposed and enforced. To reach the stated goals the new Code has made stricter the duties of all participants in criminal proceedings (police, prosecutors, defendants, defenders, witnesses and judges), but it has released the process for example with agreement on guilt and punishment.

Structural modifications have been approved based on **the shifting of competencies between policemen, prosecutors and courts**. In preliminary proceedings, the policemen under supervision of the prosecutor will independently and initiatively resolve the crime. Therefore the responsibility of the police is stressed for searching and performing proofs in this stage. On the other hand, the so-called accusative principle, according to which only the prosecutor can submit the accusal, has underlined the importance of prosecutor supervision in preliminary proceedings and has continuously increased the responsibility of the prosecutor for submitted accusal and for concerns submitted to the court. If the accusal cannot be proven and necessary proofs are not provided for the decision of the court, the court will release the defendant. The court will have the right to continue to perform initiatively the proofs, but will be not bound by an obligation to investigate the objective verity.

One of the basic modifications of the Code is **the shifting of the criminal agenda from previous one-level regional courts to district courts** as the main units of the legal system. The reason for this measure is the preservation of the natural hierarchy of the courts, a better overview of the competencies and quest to hear the cases as close as possible to the place of the commission of the crime. The Supreme Court of the SR has gained back the previous title to decide on extraordinary solutions and unifying activity for the elaboration of the statements.

Another of the basic modifications is considered to be the stimulation of contradictory components, on which is based the main legal proceedings in the form of a "case". **Process parties (prosecutor and advocate) will propose and perform the proofs or hear the witnesses**, the judge will continue to lead the process and decide on the proofing. It is expected that this adjustment will facilitate evidently the chairman of the senate (resp. self-judge) from the care of the process leading and parallel proofing performance.

It has introduced the **institution of the judge for preliminary proceedings**, who has the role to decide on the admissibility of interventions in the basic rights and liberties prior to the beginning of criminal prosecution (for arrest, house and personal inspection, use of monitoring and other actions of detention and also for complaints against the prosecutor decisions). Up to present, this role has also been carried out by judges classified for other than criminal section, those that have not done such practice in their daily activity.

Modifications have also been carried out with **the period of arrest duration**, that depends on the criminal rate impending to the accused for the committed crime. For an offence, the maximal period of the arrest will be 1 year, for a crime 3 years, for especially serious crime 4 years, whereby the maximal arrest duration is decreased from 5 to 4 years. The first half of this period will be at disposal for its work to the police and prosecutor, the second half to the court. If the authorities in preliminary proceedings do not come in time in their period to file an accusal, the accused must be released from arrest. Though according to the opinion of the Slovak Bar Association (SAK) the reduction of maximal period has been insufficient, 3 years should be a sufficiently long time for the investigation of real facts.

The situation **undisciplined witnesses** is solved in a new way, that avoids the main proceedings, and therefore prolongs the whole proceeding. A witness who is absent at the proceedings without justification, can have his personal freedom restricted up to the duration of 72 hours, determined for him taking part in the questioning and interrogation, that will be recorded and could be read at the main proceeding. The representatives of the SAK have considered this regulation as an unacceptable infringement of witness freedom, who according to them could spend 3 days in the jail of provisional detention, whereby for the enforcement of witness participation the threat of a 50 000 SKK penalty could be sufficient.

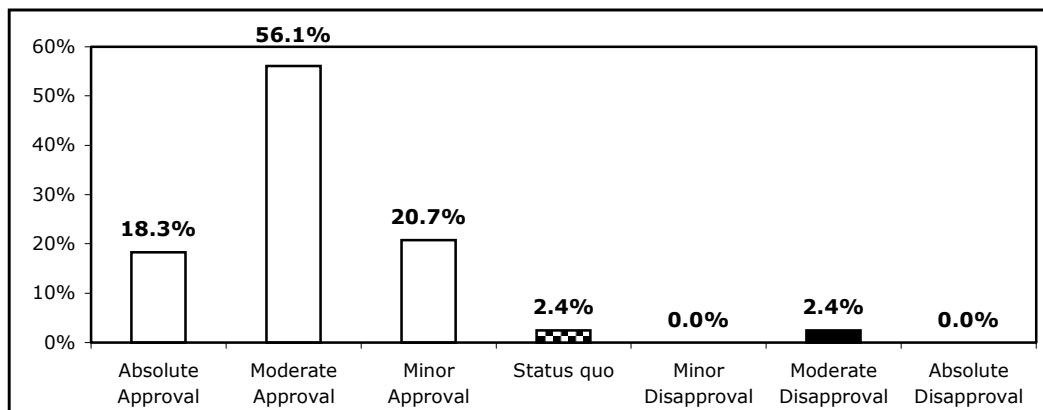
The expectations of the Criminal Procedure Code are that the basic part of criminal concerns will be performed away from the main proceedings. An important role in the future will be held by the performance of **criminal order** (without the hearing on the main proceedings, if the facts on the case are proven reliably), e.g. imprisonment up to 3 years, imposition of compulsory work or house arrest. A wider application should be found in the performance of the affair with the conditional cessation of criminal prosecution and with conciliation, as well as in the preliminary proceedings. A high importance should be obtained by a fully new component of the Criminal Procedure Code – **process on the agreement about the guilt and punishment** between the prosecutor and the accused, that consists in the admission of the guilt by the accused and in the acceptance of the proposed punishment. According to the statement of a member of the Recodification Committee the prosecutor can offer the accused "a remuneration" for cooperating and saving the time and money of the society by proposing a punishment at the lower boundary of the criminal rate. The Penal Code in addition allows to lower this boundary by up to one third (but not less than 20 years for wilful murder, genocide or terrorism). If the agreement is approved by the court, it will be not necessary to hear it at the main proceedings. The court must be convinced that the accused has understood the base of the confession, the complete acceptance of imposed punishment, and that he understand, that after this agreement he cannot submit a remedy. The presenter has justified this new institution with the fact that a less severe punishment imposed on the offender as soon as possible after having committed the crime has a higher prevention effect and importance for the society than a more severe punishment after 3 or 4 years of investigation. The mentioned forms of reduced hearings should unburden the courts from hearings of affairs in the main proceeding, but these will remain the basic form of judging and the accused can always insist on it.

**Appeal Courts will decide directly in many affairs** and will not send them back to the lower courts for new proceedings. The appropriate regulations has been modified, so that the appeal court should not cancel the verdict of the court of first level whenever there is a slight possibility, but that it should provide the affair with proofs itself, as long as it does not concern cardinal or decisive proof, whose execution could be linked with inadequate difficulties, or that could lead to other factual intentions, for it to decide itself in an affair, whereby it will terminate lawfully the criminal prosecution. This followed the acceleration and rationalisation of legal proceedings.

In the system of extraordinary remedies the cancellation of complaint for violation of the law has come about, but indeed two **new extraordinary remedies – the cancellation of lawful verdicts in preliminary proceedings and the review** have been created. The review comparing with the verdict of the Appeal Court can be submitted to the Supreme Court of the SR not only by the Minister of Justice and General Prosecutor, but also by the accused, whereby this will not have the postponable impact. The Appeal Court will be the Regional Court.

As a controversial regulation to the Criminal Procedure Code the **institution of agent for detection of criminal activity (so-called the agent-provocateur)** has appeared. This can be a member of the Police of the SR or the police of another country contributing to the detection of offenders of the crime, corruption (for corruption it can also be another person who is not a member of the police), the crime of abuse of power of a public official and the crime of legalisation of income from criminal activity. Its use is admissible only, if the detection and conviction of the offenders has been obstructed and acquired knowledge motivates the suspicion, that a crime was (or should have be) committed. The proposal, that the "agent-provocateur" could initiatively induce to criminal activity was controversial, whereby the opinion has been enforced, according to which the agent can act in this way only in cases of corruption of public officials, including the foreign ones.

The previous proposal for the recodified Criminal Procedure Code has included **the introduction of the institution of public defender**. The public defenders should act in cases, when it will be need to allot a defender to the accused, whereby the advocates would be excluded from the defence ex offa. The representatives of the Slovak Bar Association (SAK), have expressed an opinion against this regulation; according to them it will be, apart from other facts, very difficult to ensure the sovereignty of the public defender from the state – investigator, prosecutor or the court. The status of the public defenders had to adjust the special Act, but the Members of the National Council of the SR have **refused** the proposed introduction of the institution of public defender.

**Evaluation of the Experts' Committee:**

The recodification of the Slovak criminal law, that among other things has brought more serious punishments for violent crimes, has introduced alternative forms of punishments, as well as alternative forms of criminal proceedings and other wide modifications, was an univocally required measure. Nearly all Members of the HESO Experts' Committee agreed on this. Up to now, the valid adjustment of the criminal law has been valid from the beginning of the 1960s. Nowadays it was not tolerable, that the society is protected with legal norms which are more than 40 years old, that were approved in a completely different social structure, in another politic, economic and social environment. These acts have been morally, as well concretely outdated for a long time and in regards to the current conditions an updating was inevitable. With the postponement of recodification the situation would have been more complicated and the crime rate would have evidently increased.

According to many responders the new Penal Code, as well as the Criminal Procedure Code bring the positives points as a better protection of private property, an improvement in right enforcement, solution of raggedness of the courts in their proceeding. The positive is, that are introduced innovative elements, that gave perspective for more a smooth and efficient operation of the courts, and that created the space to impose alternative punishments. The reduction of the boundary of criminal liability has been a very important measure, that corresponds with the current trend of the faster pubescence of the young people, and is related to the negative manifestations. Its decrease from 15 to 14 years has been enforced in particular with an increasing extent of the crime rate in minors over the last years. We have to monitor the use of the institution of the "agent provocateur" with the right to encourage initiatively the public officials to corruption, that could be abused politically. On the spot is the need to solve the control of these agents and eliminate the risk of the corruption from their side also. The opinion has also been presented, how the role of the agent should be extended to all civil servants.

Some of the evaluating experts have considered as disputable, whether the reduction of the criminal liability and increase of the punishments will contribute to a decrease in the crime rate. Acts for system modification are not enough on their own and only practice will show, if the recodification of the Criminal Procedure Code will reduce the legal proceedings and will improve law enforcement. On the other hand, one responder is not sure, whether the higher criminal rates are the most effective prevention against the commission of criminal activity, but he has not heard of better prevention. Freedom does not exist without exactly determined rules and if these are soft, and therewith often abused, they should be tightened. One of the reasons for the increase in the crime rate in a mature world in other decades is among other things the existence of leaky legislation, that is the support of the offenders. Democracy and freedom are determined only partly by the strictness of the rules, the main obligation lays in public discussion and activity of the citizens. As one of the responders mentioned, the question could be interpreted in the following way: *„What good is legislation ensuring a quantity of rights and freedoms, when one is afraid to go on the streets?“*.

The thinking of the people, that operate in field of the authorities acting in the criminal proceeding, namely policemen (investigators), prosecutors, judges and also advocates, should be changed. According to one responder there must be a change in generation, in order to break up relations to the organised crime and relations to different "friends", and only then could major modifications be introduced in the field of criminal. An opinion also appeared, according to which there is no guarantee, that in the field of criminal law the corruption in judiciary and police bodies will persist further. The new Government should rank the application of the criminal law among the priorities of the first years. It has to be monitored, if the Codes will be applied in practice and in particular this, if there is a rebirth in the thinking of the judges, policemen, prosecutors, advocates or if they continue in their old ways just by applying new legal regulations. One of the weaknesses can be according to one responder the fact, that policemen are not competent for

explaining the facts. The Police Forces namely lack different experts, without which they could solve the crime. Such modifications need more than only a cosmetic adjustment. But the aspiration and courage of the Ministry of Justice has to be appreciated in any case.

The majority of the experts expressed an affirmative standpoint with the disapproval of criminal liability of legal entities. In regards to the conditions of the Slovak society, in the case of its approval there might exist a real risk of abuse of this regulation in competitive economic, but also political battle.

One of the evaluating responders has designated as systemless partly the "Americanization" of the Slovak criminal law by the Minister of Justice Mr. Daniel Lipšic. The process of the legal proceedings in the form of a dispute between prosecutor and advocate, where the process parties propose and perform the proofs and the judge leads the process, will decide on the proof and on guilt and innocence, is typical for the American legal code. The difference is, that in the American legal process there is a jury, that does not figure in the legal process in Slovakia, whereby some hybrid has been implemented. The possibility of the delegation to propose and especially execute the proofs on process parties bears in addition therein the danger of violation of equality before the law. The reason could be different economic and social position of the actors of both parties, which will be expressed in the quality of legal representation before the court (high amounts are paid for the services of good advocates and detective agencies ).

One of the responders has criticised the regulation reducing the maximal duration of detention on remand from 5 years to 4 years. He esteemed it as completely insufficient. The period indicates little effectiveness to the point and proof of helpless investigative authorities and represent the means of their pressure on the investigated person. The abuse of the institution of detention on remand had been medialised in the past in multiple causes.

## ***Slovakia and the European Union***

**Relaunch of the Lisbon Strategy from the Year 2000 (new strategy to support economic growth and employment in the EU; focusing on fewer objectives and removing time intention – year 2010 – to achieve the most competitive economy in the world; accent on the so-called knowledge-based economy – backing education, science, research, innovation and improving the quality of human capital; creating more and better job opportunities; responsibility of each Member State for Strategy implementation – elaborating own national Lisbon strategies and action plans; creating national co-ordinators)**

At the beginning of February 2005, the European Commission (EC) presented a proposal to reform the Lisbon agenda. The aim of this step is to improve the chances of a successful implementation since according to the representatives of the Commission, the original plans of 2000 failed.

The need to revise the Lisbon Strategy was clearly declared in the critical report of the workgroup analysing the condition of the "Lisbon". The report said that it was necessary to concentrate more on economic growth and employment. It stated that too many goals can not be reached. The responsibility for the failure is borne by the Member States, mainly due to lack of courage and political will. The enlargement of the EU did not support the reaching of the Lisbon aims either. New Member States, though with a high potential, start from a low base.

The Commission defined a specific action programme for the EU and its Member States in order to create permanent economic growth and a higher number of better employment opportunities. The unrealistic goal to overcome the USA in terms of competitiveness by 2010 was deleted from the proposal by the Commission.

The renewed Strategy did not bring a lot of new contents. Its main priorities are: **make Europe a more attractive place for investments and work, support obtaining knowledge and innovation to induce growth and create more and better job opportunities.**

Another step leading to revision of the original Lisbon Strategy was the creation of the positions of national coordinators. Besides, each country should elaborate one action plan of its own and one implementation report. This strengthened the responsibility of the states, promising a better result of the new Strategy compared to its original version. Once a year, the Commission will evaluate and compare the fulfilment of aims with the Member States.

According to Mikuláš Dzurinda, the Slovak Prime Minister, the Strategy is a good tool that can lead to increased competitiveness of the EU and to a higher quality of life of our people. He believes that a knowledge-based economy, investments in human resources, and building of an education-based competitive economy is the best way for Slovakia as well. The Government of the Slovak Republic believed that this Strategy can only be successful if it concentrates more to growth of competitiveness and employment with respect to the rules of sustainable development.

6 years ago, the original Lisbon Strategy set the goal for the EU to become the best performing knowledge-based economy in the world, to reach an average economic growth of 3% of GDP per year and to create 20 million new jobs, all by 2010. The Union has also undertaken to increase the spending on science and research to 3% of GDP. The representatives of the EU agreed that for reaching these goals, it will be necessary to concentrate on the transfer to a knowledge-oriented economy and society by supporting the information society, research and development, as well as by speeding up the process of structural reforms for the competitiveness and innovation and completion of the building of the common market. The second target area was to modernise the European social model, invest into human capital and fight social exclusion. The third area of the original Lisbon Strategy was a sustainable and healthy economic situation and growth by applying a suitable mix of macroeconomic policies. In the middle of the implementation phase (year 2005), many critics noted that no progress is visible in the reaching of the Lisbon targets.

The London-based Centre for European Reform (CER) elaborated a report (Lisbon Scorecard V), evaluation of EU countries from the viewpoint of fulfilling of the original Lisbon Strategy according to its areas.

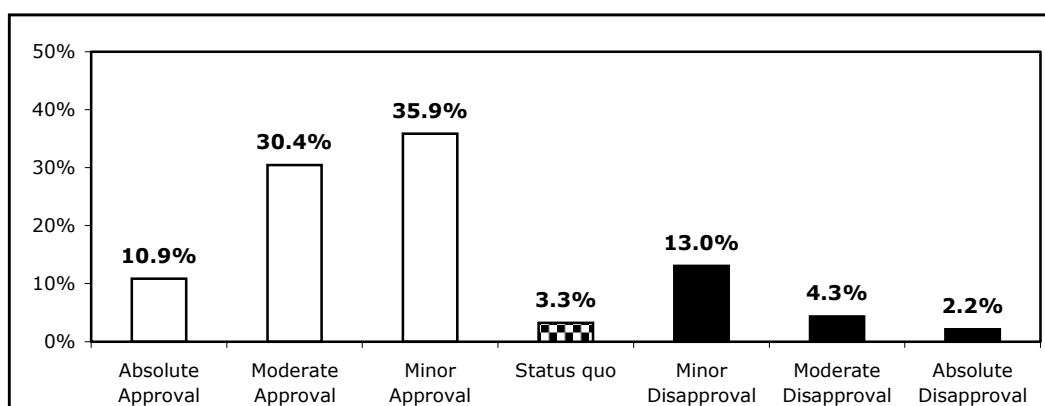
<b>Evaluation of the EU countries performance in areas of the Lisbon strategy</b>			
	<i>Rating</i>	<i>Heroes</i>	<i>Villains</i>
Information society	B	Denmark, Estonia, Slovenia	Bulgaria, Greece, Romania
Research and development	C-	Finland, Slovenia, Sweden	Greece, Poland, <b>Slovakia</b>
Liberalisation of telecoms and utilities	C+	Latvia, Great Britain	Germany, Italy, <b>Slovakia</b>
Liberalisation of transport	C+	European Commission	Belgium, Spain
Liberalisation of financial and general services	B-	Great Britain	France, Italy
Business start-up environment	C	Ireland, Spain	Greece, Portugal
Regulatory burden	C+	<b>Slovakia</b> , Great Britain	France, Italy
State aid and competition policy	C+	Estonia, Latvia	Germany, Poland
Bringing people into the workforce	C	Cyprus, Denmark, Sweden	Belgium, Poland
Upgrading skills	C+	Finland, Poland	Italy, Malta
Modernising social protection	B-	Czech Republic, Sweden	Belgium, Ireland, Great Britain
Climate change	C-	Germany, Netherlands	Portugal, Slovenia
Natural environment	C	Finland, Sweden	France, Ireland
<b>Overall assessment of the EU</b>	<b>C</b>		
<b>The Lisbon process assessment</b>		<b>Sweden</b>	<b>Italy</b>

Note: the "A" grade stands for the best rating

Source: Centre for European Reform, weekly TREND

The leaders of EU Member States have discussed and appraised the proposal of the revised Lisbon Strategy at the March EU Summit in Brussels. Based on the results of the Summit, on 12 April 2005 the EC submitted the integrated guidelines on the basis of which the Member States will elaborate their 3-year national reform programmes to fulfil the targets of the Lisbon Strategy. Reform programmes had to be submitted by the Member States to the European Commission no later than on 15 October 2005, and these programmes were supposed to mark the most emergent challenges for their economies and explain what steps they will take to face these challenges. The Member States are obliged to report to the EC on the performing of the tasks each autumn.

#### **Evaluation of the Experts' Committee:**



Most experts of the evaluation Committee considered the revision of the Lisbon Strategy of 2000 to be a good step. In 2000, the European Union set a courageous and ambitious aim in this document – to become the most competitive economy in the world by 2010. To prevent profaning of the Strategy and support its implementation, an expert group was created that reconsidered the aims of the Strategy, with the final evaluation of real implementation clearly showing that most EU countries were lagging behind. The new Member States, ironically, are closest to reaching the Lisbon aims. The beginning of the process of reconsidering of the targets of the Lisbon Strategy was just a question of time.

The new Strategy, targeting support of economic growth and employment in the EU without setting a time schedule and with emphasis on the knowledge-based economy, is considered to be better than its original version by a large proportion of professionals. It provided a real view of the current situation, yet its targets were still sufficiently ambitious. The transfer of responsibility for elaboration of specific plans to a national level was perceived very positively. One of the problems in the Strategy, however, was that it set the aims without analysing the causes of the problems. Despite the aforesaid, in the long term, the revised Lisbon Strategy can be considered a step in the right direction. Its text is significant at least for the setting of targets, horizons and vision of a common platform, though reminding many of the old "perestroika" times.



With regard to the demographic development in Europe, the aim to rebuild EU into most competitive economy in the world within a few years is viewed sceptically. Apart from the USA, there is a high development potential in countries like China and India, and the membership of the new EU Member States, expected accession of Romania and Bulgaria and the high increase of immigration to Europe means, according to critics, no chance of achieving the aim within a horizon of several decades. The European Union should not accept any time horizons for becoming the most competitive economy in the world as stated in the previous wording of the Strategy. First, the conditions for doing business must change in the EU and the position of state influences on the economy must weaken. Certain experts saw the problem of the EU in the socialist governments of several, mainly large, European countries and their inability to push the aims of the Strategy through and to start the necessary structural reforms in their countries. According to several experts, the language of the document is now more a language of modernisers; however, these have no majority in the executive positions and, above all, have no strong political background on a Europe-wide or national level. From time to time, the spirit of the "old Europe" can be found in the document, e.g. in the classical bad habit of propose newer and newer institutions instead of proposing real solutions, in the mixing of targets with tools, etc.

According to several experts, from the economic point of view it was reasonable to concentrate on development of human capital and technological progress. With an inefficient implementation, the economic costs can be higher than the benefits. In the opinion of many experts, however, the main failure of the Strategy is that it treats key questions as marginal or does not treat them at all. Investing in human capital or infrastructure of the information society is beneficial beyond all doubt, but Europe currently needs a reform of the traditional institutions of a social state – social systems, health care and pensions. These changes will be painful especially for the economies with strong social orientation that will have to cut their too generous social programmes. And the longer they defer these necessary changes, the stronger and more painful they will have to be.

According to the criticising expert, the Lisbon Strategy is no more than a meaningless declaratory activist paper since the largest EU economies do almost nothing to increase their competitiveness. The Lisbon Strategy has become another document of the European Commission that lost its authority in decisions sharply inconsistent with its main idea – for example, the disagreement of the large EU Member States with the original, more liberal proposal of the Directive on Services (*see below*). Logically, questions related to the sense of creating such documents arise.

One of the respondents expressed his fear that individual Member States will compete in fulfilling the targets of the Strategy on a national level, thus building internal competition between these countries instead of building a European competitive environment as a whole. A singular opinion that the revised Lisbon Strategy was losing, above all, its original dimensions in the social area was presented.

**Proposal for a Directive on Services in the Internal Market  
(reduction of obstacles for undertaking in the area of services;  
exemption from directive in case of services such as public  
administration, education, financial services, public transportation,  
electronic communication services; country of origin principle when  
not settling down in another EU Member State – providing services  
in the entire EU after fulfilling legal requirements of the home  
country, but also with obligation to respect minimum wage, health  
and safety regulations and standards in the host country)**

The aim of the proposed Directive on Services was to remove legal and administrative barriers and thereby to create a real internal market in provision of services and to support the development of services between Member States. The removal of barriers in provision of services between the Member States should be of crucial importance for the support of integration of the EU and of a balanced and sustainable economic and social progress.

The Directive aims at removal of barriers of doing business in the areas from IT services to electricians. The proposal was related to all services of the private sector, however, it did not relate to areas like public administration or education that are not of a purely "economic nature". It also did not apply to financial services and transportation. Electronic communication services were only subject to this Directive if the regulatory package on electronic communication services of 2000 did not apply to them. All transport services belonging to the public transport policy framework, including city transportation and port services were excluded from the scope of effect of the proposed Directive. The proposal only planned to cover two types of transportation services – transport of valuables by security companies and transport of deceased persons. On the other hand, the Directive did apply to "public" services of an economic nature, such as health and social

services, postal service, supplies of electricity, gas and water, which according to the proposal should have been liberalised within the internal EU market. For these services, the Member States could keep relevant measures related to quality, availability and performance of services. In such case, the Country of Origin Principle would not apply to the provision of service.

The proposal of the Directive treated various forms of provision of services for the cases that:

- The provider settles in another Member State,
- The provider temporarily moves to the country where the customer is located,
- The provider provides services over a distance, from their domestic country, for example over the internet, by telephone or by direct marketing.

**To services provided without settling in a different Member State**, the proposed Directive applied the "**Country of Origin**" Principle. Providers of services should have the opportunity to provide services in another Member State upon meeting administrative and legal requirements in the country they are established in. No meeting of other conditions, such as authorisation or declarations when crossing the border would be required. Practically, this would mean that a company might provide services in the whole EU only upon adhering to the legal standards of the domestic country and would not have to meet various conditions in other Member States. In this point, the proposal contained numerous exceptions from the Country of Origin Principle, such as protection of public health, consumer protection, protection of workers and exceptions valid for extraordinary circumstances in individual cases. In such cases, the provider of the service would have to meet the rules and regulations of the country in which they provide services. The proposal set the **obligation to adhere to the minimum wage, working time and health and safety measures in the host country**.

The Country of Origin Principle should not have applied to **services provided when settled in another Member State**. These services would have to **adhere to all rules of the country**. Settling means creating fixed infrastructure, such as a permanent office or operation that actually performs economic activities. In the case of any service provided from fixed infrastructure and operated by the provider permanently, the provider would be subject to all rules and regulations of the relevant Member State.

The proposal of the Directive simplified the administrative procedures, including the obligation of each Member State to guarantee that potential providers of services will have easily available information on relevant legal and administrative requirements, and can complete all formalities and procedures at a single contact point despite communicating with several bodies.

Changes should have also applied to licensing processes. Setting limiting conditions for settling, such as discrimination on the basis of nationality or place of residence of the shareholders and managers and ban on settling in several Member States, were considered unacceptable by the Directive Proposal.

According to the European Commission (EC), the real common market with services should have become a reality in 2010. That was when all potential transition periods were to end.

Despite the existence of consensus on the need for opening of the services market, the Directive Proposal found resistance especially by the older and large Member States (mainly France). They asked to exclude other sectors from the scope of effect of the Directive (especially health services, public services, construction services). The key Country of Origin Principle was also endangered. According to the current EU Commissioner for the Internal Market and Services Charlie McCreevy, the original proposal prepared by the previous Commissioner Frits Bolkestein was impassable and needed to be redone in cooperation with the Member States and the European Parliament.

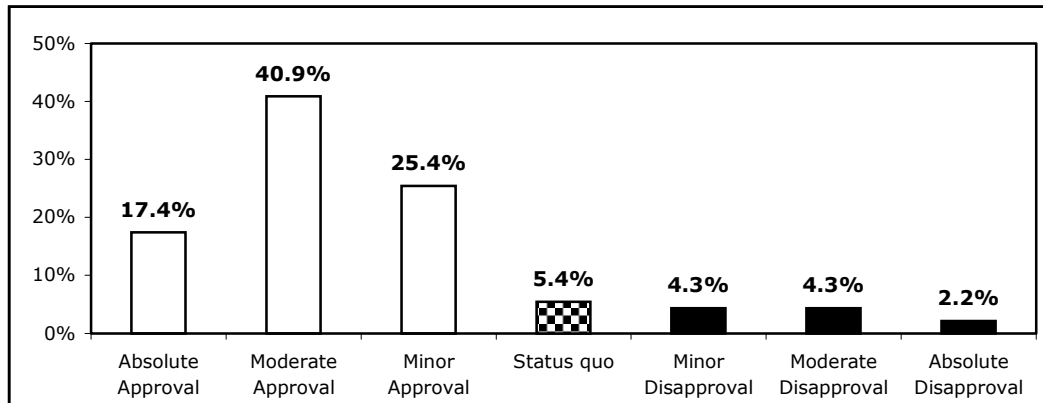
The ideas on the need for redoing the proposed Directive were based in the fears of France, Germany, Austria, Belgium and Sweden of competition of providers of services from other Member States in which provision of services is less expensive. These countries claimed that provision of services by companies from new Member States from Central and Eastern Europe subject to the conditions specified in the national laws of these countries would endanger the jobs and companies in the original EU Member States.

Mr. José Barroso, Chairman of the European Commission, supported the Country of Origin Principle in the Directive on Services. In his opinion, the common internal market does not reflect the needs of a modern business sector, and the largest potential for growth and employment is currently in services. According to the Slovak Minister of Finance Mr. Ivan Mikloš, liberalising the services sector in the EU would reduce costs, bring significant improvement of the competition in the sector and allow most EU inhabitants to benefit from better and less expensive services.

In 2006, the European Commission introduced a weakened version of the Directive that had a chance to be passed in the European Parliament (EP). On 16 February 2006, the Parliament took vote on the Directive in its first reading and changed the Proposal of the EC. The Country of Origin Principle was replaced by a softer obligation to ensure "freedom to provide services" and in the same time many sectors were eliminated that originally came under the "Bolkestein Directive". Member States also got possibility to define more areas, where they would like the Directive not to

be applied. Most of the trade unions and social organisations welcomed the compromise, but the business associations were disappointed. The EC identified with the amended Directive Proposal of the EP. The EU Commissioner Mr. McCreevy expressed belief that the final agreement will be possible to reach before the end of 2006. On 29 May 2006, the Council of Ministers of the EU Member States agreed on the Draft Directive on Services in the outlines it was newly proposed by the EC and amended by the EP. Ratification process of the changed Directive has started again.

#### Evaluation of the Experts' Committee:



Most members of the Experts' Committee considered the proposed European Directive on Services to be a very important measure. Liberalisation of provision of services would be a great benefit. Reduction of barriers of doing business in services and introduction of the "Country of Origin" Principle, which is an opportunity to provide services throughout the EU on the basis of meeting the legal requirements of the domestic country, represented a basic step towards the fulfilment of the mission of the European Union and one of its basic freedoms – freedom to provide services. The implementation of the regulations and conditions specified in the proposed Directive would obviously lead to development and reduction of prices of services (especially by entrepreneurs from new Member States). Small companies providing services would face lower costs and would be allowed to expand more significantly since it is these companies for whom the administrative costs related to obtaining permits in every single state block their cross-border activities. In the end, the Directive could considerably support the revival of the economic growth of the EU.

Together with a positive evaluation of the proposed Directive, professionals raised serious objections against comments of economically strong countries of the Union, especially France. The exceptions that they required and due to which the proposal was withdrawn and redone, represented a significant shift in an undesirable direction. The scope of exceptions should be the smallest possible, and several respondents did not agree, for example, with the exclusion of services in education and restrictions on activities of foreign accredited universities in another EU Member State. The disapproval of the original proposal of the Directive on Services was a major and serious mistake. Though the Directive is still being redone and it is not clear what the final version is going to be, especially after influences of old EU members, above all, Germany and France, but most experts were sceptical that the new Directive will be significantly worse than the originally proposed version, although the original already contained meaningless exceptions and restrictions. One of the respondents expressed their opinion that if the representatives of the European Union are unable to solve a basic problem of the internal market, they should not enter a knowledge-based economy, comparing it to a situation of a person wanting to make their living from explaining the  $e=mc^2$  formula without being able to remember the basic physical relationships – such as  $s=vt$  (distance is the product of speed and time).

One of the experts admitted the relevancy of the fears of developed countries for which the Directive would be a certain danger. However, the rules of the liberal economic market are rough and the stronger and more efficient providers of services win. Globalisation must take place in this sphere as well as in areas where certain services are protected by local interest groups.

#### Relieving the EU's Stability and Growth Pact Rules (allowing "temporary" and "soft" exceeding of the 3% of GDP threshold for fiscal deficit; defining the sphere of factors for which exceeding is allowed)

At the Brussels Summit on 22-23 March 2005, the representatives of EU Member States agreed on modification of the Stability and Growth Pact. This Pact represents a tool to ensure a stabilisation

framework for fiscal policies of Member States that supplements the existing common monetary policy and common currency.

The discussion on the regulation concentrated around two main positions. On one side there was France and Germany, countries that have broken the Stability and Growth Pact year after year since 2002 by large fiscal deficits, and on the other side, smaller countries like the Netherlands, Austria, Finland and Slovakia, insisting on a more strict interpretation of the Pact. Despite a long debate, a compromise solution was found at last. The reference values of the Pact, being the fiscal deficit of 3% of the GDP and 60% share of total public debt on GDP remained unchanged.

The appraisal of exceeding the first criteria was changed. In the case of excess fiscal deficit, extensive exceptions insisted on by France and Germany were approved. Should the exceeding of the deficit be "temporary" and "close" to the reference value, the country may justify its deficit by a "relevant factor" pardoning the deficit and evade the sanctions. Some of possible relevant factors included:

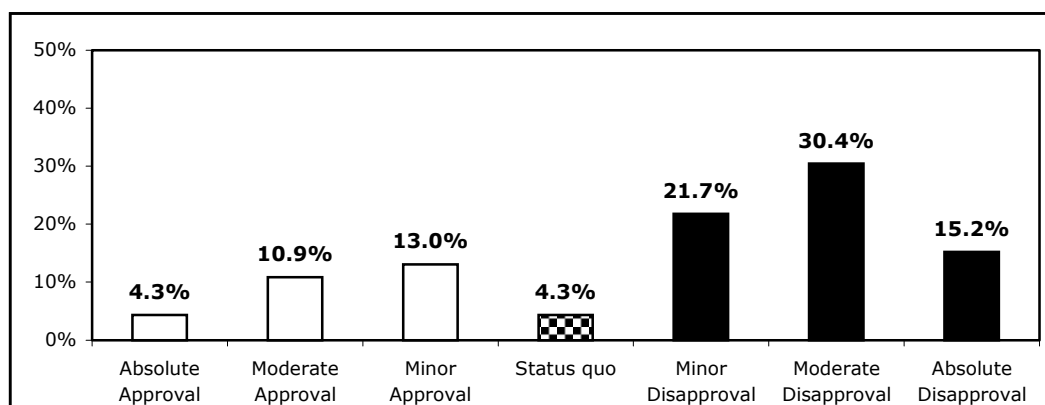
- International solidarity, which is a fulfilled requirement of France not to include development aid and defence expenses in fiscal deficit,
- Meeting the so-called European political aims, including uniting of Europe, representing a fulfilled requirement of Germany not to include the costs for uniting the country,
- Pension reform costs for a period of 5 years after starting it; this is said to be a fulfilled requirement of the new EU Member States, especially Slovakia, Poland and Hungary,
- Fulfilment of the aims of the Lisbon Agenda (science, education, innovation), public investments, reduction of debt and improvement of the condition of public finance.

The deadline for correcting an excess deficit should be 1 year from its identification, with an option to extend it by another year. Countries will have 6 months instead of 4 to adopt measures to correct the deficit, beginning at the moment of receiving the recommendations of the European Commission. The procedure against excess deficit will not start against a country with a negative economic growth or with a long period of slow economic growth (the previous wording of the Pact allowed this for countries in recession and a -2% negative growth).

Besides the aforesaid rules, the Member States also agreed that in periods of strong economic growth, they would use extraordinary fiscal measures to reduce fiscal deficit and public debt. The overall aim is still seen in a close-to-balanced budget or a fiscal surplus.

Some experts said that one of the benefits of the agreement for the new countries of Central and Eastern Europe is the opportunity to implement structural reforms bringing high transformation costs and temporarily creating a higher fiscal deficit without facing the disgrace of the European Commission for exceeding the permitted threshold.

#### Evaluation of the Experts' Committee:



The bending of the rules of the Stability and Growth Pact, allowing the Member States to exceed the 3% threshold for fiscal deficit "temporarily" and "slightly" in case of defined economic situations and governmental expenditure, was a step in the wrong direction. According to the experts, exceptions from the rules are dangerous even if they are beneficial for the new EU countries including Slovakia. In the future, this precedent may lead to benevolence towards conditions of other Member States of the Union and requirements to other exceptions. Unclear definition of exceptions – the scope of factors allowing a country to exceed the 3% deficit threshold, may cause the entire Stability and Growth Pact to collapse. In the future, this measure may also endanger the project of the common European currency, cause problems with further adherence to any other agreements within the EU as well as sharing of higher interest rates by the disciplined countries of the monetary union. The measure liberalised the fiscal rules and thereby permitted fiscal expansion.

The experts disapproved the steps of the strongest EU countries (Germany and France) with largest fiscal deficit threshold problems, which pushed these conditions into the new Pact. All members of the Union should fulfil the conditions equally, especially because these conditions were set by them in the past on the basis of extensive analyses and negotiations. One of the experts on the committee considered this step to be an unofficial cancelling of the Pact. Another respondent marked the revised Stability and Growth Pact to be the farewell song of the followers of J.M. Keynes – a representative of economists specialising in quality justification of governmental measures ex-post. In the case of the Stability and Growth Pact, the rules should be based, above all, on economic principles and not on political thoughts.

According to the estimate of another expert, the problem of large economies is that they are located close to their potential and their slow growth is a question of slow potential growth. This means that a large part of their high fiscal deficit is formed by a structural deficit. The solution should be to solve the structural deficit, creating space for investments for programmes aimed at fulfilling the Lisbon Strategy and yet meeting the 3% deficit to GDP threshold. The decision on bending the rules thus de facto legalised a structural deficit of approximately 3%. In his opinion, the deficit limit has not been a decisive factor precluding reforms. However, the new, softer rules decreased the motivation for strict reforms and opened the area for dubious fiscal manoeuvres covered under the Lisbon Strategy, developmental aid, etc. Though not all countries have problems with fiscal sectors and the market reacts to undisciplined countries by charging a different interest rate on the debts of these countries depending on their financial standing, the question remains as to whether in a single monetary union states with different real interest rates, different inflation preferences and thus different exchange rates to third countries may exist for a long time. From this point of view, the decision to bend the rules of the Stability and Growth Pact represented a step against long-term stability of the monetary union.

According to consenting opinions, rules must be flexibly adjusted to changing situations in the world. A minority of the experts stated that bending the rules might be justified if it is coherent with building the EU as a competitive economy. This would be reached if a part of the excess deficits was directed to support of science and education. The risk is that in reality, such intention can be transformed to provision of other public consumption.

## **Ratification of the Treaty Establishing a Constitution for Europe by the Slovak Parliament**

On 11 May 2005, Members of the Slovak Parliament expressed their accord with the Treaty establishing a Constitution for Europe. Passing of the Constitutional Treaty could have been implemented in two ways – by Parliament ratification by three fifths of all Parliament members or by an affirmation in a referendum. In October 2004, the Slovak Government decided on the first alternative. This was based on a premise that the EU will not become a single state entity upon the coming into effect of the Constitutional Treaty. That led to the idea that the Constitution for Europe, since it is not an agreement on entering a state entity, does not need to be affirmed by a referendum. The EU Constitution, approved by the Slovak Parliament, would become binding only after coming into effect, for which the approval of all 25 EU Member States is necessary. Various opponents expressed disapproval of the fact that no referendum took place with relation to the subject of the EU Constitution (a citizens' petition for ordering a referendum was also submitted). According to these voices, such an act means entering a state entity, and thus the citizens themselves should approve it. A group of citizens consequently filed a complaint with the Constitutional Court of the SR on 11 July 2005, objecting to the suppression of their fundamental right to take part in the public affairs of the country. The submitters demanded not only recognition of the infringement of their rights, but also annulment of the Parliament's carriage of the EU Constitution. The Constitutional Court accepted the citizens' submission, and began its elaboration, but deferred the proceedings indefinitely on 18 January 2006.

The Constitution should unite the presently existing basic agreements about the EU into one document whose ambition is to simplify the legal basis of the Union and make it more understandable for its citizens. Another aim is more effective and efficient functioning of the Union with relation to its expansion process.

Considering the binding of the EU Constitution to Slovak administration bodies, physical and legal entities, it builds on the principles of community law, which already presently govern the principles of conjunction of the Community law (directives, regulations, etc.) with legal systems of the Member States (principle of precedence and direct effect). Concurrent with the Constitutional Treaty approval would be a reform of the secondary sources of the Community law and getting rid of the division of EU into 3 pillars of operational areas. As a consequence, the current principles of conjunction of the Community law with inter-state law systems should be relevant to the entire law of the EU; hence also relevant to the current third pillar of the EU represented by the judicial

and police cooperation in criminal affairs; and with relation to precedence, even relevant to the current second pillar of the EU – Common Foreign and Security Policy.

The Constitution for Europe has four parts. The first part defines the values, aims, competencies, institutions, and tools of the EU, includes provisions of fundamental rights, citizenship, democratic life, and financing the Union, treats the circumstances of accepting a country into the EU, and consists of 60 articles. The second part is represented by a Charter of Fundamental Rights and includes a 54-article text agreed upon in 2000 in Nice, with some modifications. The most substantial is the third part, which – in 322 articles – deals with the policies and operations of the EU in detail. It includes provisions and the legal basis for particular competencies of the EU, and detailed provisions about the operation of institutions and administrative bodies. The fourth part – general and final provisions – deals with the process of transition from the current contractual basis of the EU to the Constitutional Treaty, its ratification, and means of amendment.

According to the Constitution for Europe, the EU would gain legal subjectivity on the international scene and a clause would be added regulating the option of separation of a Member State from the EU. Citizens of the EU would gain the right to initiate legislation. If a million EU citizens requested a bill, the European Commission would have to propose the bill in the given field.

As opposed to the current state, a position would be created of for a permanent chairman of the European Council, the highest body of the Union, made up of heads of States and Governments of Member States. The Council would elect the chairman for two and a half years; the current rotation chairmanship would be abolished. The position of a Minister of Foreign Affairs of Europe, who would govern the Common Foreign and Security Policy, would also be established. A significant change would be trimming of the number of Members of the European Commission (EC) until 2014, so that it equals two thirds of the number of Member States. The countries would rotate representation in such a way that each state had a representative in the EC two out of three functional terms. Last but not least, the process of voting by the qualified majority would change. According to the Constitutional Treaty, starting November 2009, the qualified majority would be represented by at least 55% of Member States, though not fewer than 15, and further representing at least 65% of citizens of the EU. The decision-making mechanism would thus involve a "safety device" for the small countries against the large ones – at least four countries would be necessary to block a decision. The three most populated countries thus would not be able to block the qualified majority, even though they would have enough citizens to do so (more than 35%). Majority voting would expand into 45 new areas at the expense of unanimity. In 70 of the most sensible cases, however, the principle of veto would be preserved (areas of taxes, budget policy, and foreign policy) or at least the mechanism of a so-called emergency break, which would allow a Member State to defer the majority decision or achieve its change (social policy, judicial cooperation).

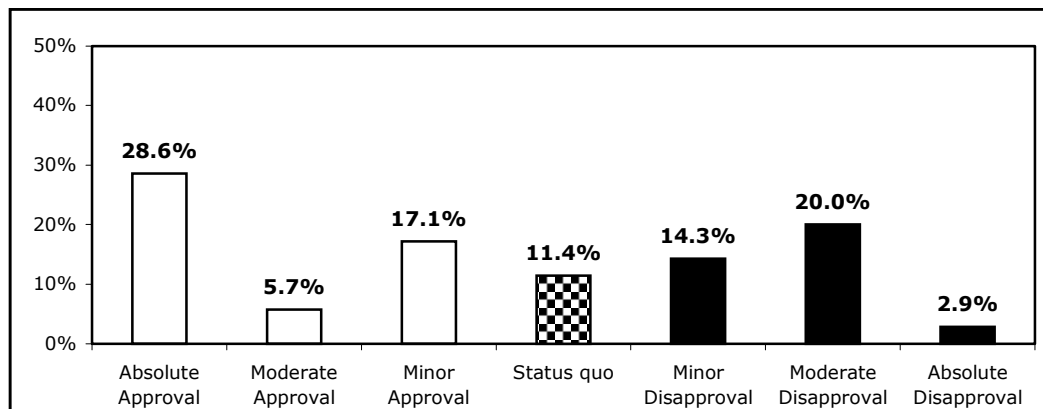
The reactions of Slovak politicians after approval of the Treaty included messages to the citizens echoing that there was no reason for fearing for the sovereignty of the SR. The predominant opinion was that the Constitution was not perfect, but that it represents an acceptable compromise that maintains the autonomy in vital questions, and not only for Slovakia. The EU will remain a union of national states and Member States will retain the right of veto in areas of taxes, foreign policy, and partially even in social policy. A singular opinion occurred regarding an outermost option in the case of approving the Constitution for Europe to separate from the EU. Approval of the EU Constitution is supported even by the Slovak Member of the European Commission, EU Commissioner for Education, Training, Culture and Multilingualism Ján Figel. The Commissioner considers the EU Constitution a tool that will help the EU to be transparent, to be closer to its citizens, and to strengthen its tools including control via the national Parliaments which did not exist so far.

Some of the Members of the Slovak Parliament who voted against the affirmation of the Constitutional Treaty substantiated their actions by dissatisfaction with and disapproval of its content. One of the risks could be the Charter of Fundamental Rights which was included in the Treaty. According to the MPs, the Charter could in the future grow into a tyranny of European judges. As stated by one of the MPs, the Charter involves a risk that, without any sort of voting and agreement, Slovakia would have to accept its provisions (e.g. allowing abortions, or homosexual partnerships). The critique was also directed at the powers of the national Parliaments, which are to be only formal according to the EU Constitution. The unsatisfied MPs also pointed out the fact that in September 2003, the Slovak Parliament passed a resolution summarising its position and the main expectations of the EU Constitution. Not one of their key requirements was satisfied, however, which they considered a reason for Slovakia not to ratify the Treaty. The requirements of the Slovak Parliament mainly included: changing the name of the document to "Constitutional Treaty of the European Union" (the current name is "Treaty Establishing a Constitution for Europe"); a notion of Christianity in the preamble (did not happen); retaining of the principle "one country – one Commissioner" (only 2/3 of countries will have a Commissioner); abolishing the preference for qualified majority voting and maintaining the current status where votes of the small countries are as important as those of the larger ones (the Treaty

was not changed in this point either); not diminishing the policy of unanimity (the proposed Treaty replaces the principle of unanimity in various instances by qualified majority voting); maintaining the rotation of chairmanship of the European Council (according to the proposed Treaty, the Council should have a chairman elected for 2.5 years with the option of re-election).

For the document to go into effect, all Member States of the EU have to ratify it. After signing of the Treaty Establishing a Constitution for Europe on 29 October 2004, by the heads of Governments and States of the EU, the ratification process was initiated in individual Member States. In the spring of 2005, the French and Dutch referenda failed to show necessary support of voters for the EU Constitution, and the entire ratification in the EU was practically blocked. The EU fell into a political crisis, because public voting on the EU Constitution showed a significant disinclination of citizens of two founding states of the European Community from the project of integration and its development in the years since. The Summit of the European Council in June 2006 in Brussels was to decide on the fate of the Constitution, but leaders of the EU were only able to agree on extending the period of reflection – at most until the second half of 2008 when the solution to the problem of the EU Constitution should be put forth.

#### Evaluation of the Experts' Committee:



Opinions of the evaluators on the EU Constitution ratification, as well as on the text of the Constitution itself, could be divided into two groups. Some of the experts considered ratification of the Treaty Establishing a Constitution for Europe a positive and accommodating step toward European integration. Some people need to identify themselves with the society that they live in via symbols; therefore the EU needs its own flag, Constitution, anthem, etc. More important, however, than the symbols, are the particular rules of the EU. At the moment, it is difficult to forecast the future course of the EU, but in the upcoming years, the smaller Member States – including Slovakia – will share a part of this responsibility. By entering the EU, the SR took on not only the advantages, but also the duties resulting from this step. It is a reality that will accompany us in the future and one that has to be accepted. If the EU is to work effectively in the coming years, it has to have its "basic law" from which all legal norms will stem. Even though the Constitution did not succeed in some Member States, which diminished the relevance of ratification in the others, the decision of Slovak MPs was, according to the supporters, a good step. The current model of the EU is not maintainable, and if we wish to realise the ideas of the Lisbon Strategy, we need to make the decision processes more flexible. According to one of the respondents, the ideal model would be the one of the United States of America. Americans, however, have the advantage of a common language.

Some other HESO experts expressed disapproval with the Constitution ratification due to the imperfections of the Treaty. The fact that the EU is trying to become a "superstate" is not good. Instead of creating meaningless measures (treaties), the European bureaucrats should primarily liberate international trade, open the internal market by passing the Directive on Services, they should stop constraining the new Member States (e.g. in the case of free movement of labour), and they should significantly reduce subsidies into sectors of economy and not create barriers to entrepreneurship.

A substantial part of the critique was related to the form of the decision-making process. An affair as important as the EU Constitution should have been decided by a referendum. Members of the Slovak Parliament decided, whether due to political convenience or fear of failure to pass, on a process of ratification which, according to some experts, conflicted with the Slovak Constitution. What is more, they passed the text of the Treaty Establishing a Constitution for Europe without a single one of their requirements which they formulated into a binding resolution before ratifying of the EU Constitution by all representatives of the EU. Even though Slovakia would not enter an entity with another state with this Treaty (*note: that would require, according to the Slovak Constitution, a referendum; one took place by the SR's accession to the EU*), a referendum was

supposed to take place, because the Treaty limits the legislative sovereignty of the EU Member States. Describing the situation expressively, due to the antecedence of the legal norms of the EU before the Slovak legislation, Slovakia would not need a legislative body and the Parliament could be dissolved, since the legal EU norms would have a priority before its laws anyway. The referendum thus could have taken place simply due to the democratic explicitness; during the rule of former Governments, it took place for much greater absurdities. The governing parties should have started a persuasive campaign to get the public consent for the referendum.

An opinion was also presented that the Treaty Establishing a Constitution for Europe is not a constitution in itself, but rather only a compilation of present agreements, in a shorter version. If we look at the issue from this perspective, the EU Constitution practically does not treat anything new, with the exception of some new processes. In this case, it can be said that it was adequate for the SR to ratify it via the Slovak Parliament. Ratification of the Constitutional Treaty by the SR Parliament was, by a minor group of respondents, considered adequate also because of a recent referendum about the Slovakia's accession to the EU, and because of negative experience with the institution of referendum in the SR. One of the respondents stated that the Parliament ratifying the Treaty actually relieved regular citizens from being bothered by a constitution that they did not know anything about and were not interested in. The relevance of the ratification was thereafter diminished by failures of the referenda in France and Holland to approve it.

### **Directive on the Recognition of Professional Qualifications (recognising qualification of professional workers in the EU Member States based on a diploma from the home country on the basis of coordinated minimum standards; in special cases, the possibility of checking of the worker by the host country)**

On 7 June 2005, the EU Competitiveness Council passed the Proposal for a Directive on the Recognition of Professional Qualifications initiated by the European Commission on 7 March 2002. The new legislative norm, from the works of the former EU Commissioner for the Internal Market Frits Bolkestein, is to secure an easy and quick system for recognising of professional (vocational) qualifications of one State by another.

Improvements in the functioning of the system are, in certain circumstances, supposed to automate the recognition of qualification acquired in another Member State. This in turn is to create more space and mobility for talented individuals in the internal EU market, who decide to offer their services in another State or settle there permanently. In spite of the right to free movement of individuals and hence the right to gain employment in any EU Member State, there are still many practical barriers that restrict labour migration of the new Member States. These are not only the transitional periods, which were implemented by almost all States of the "Old 15" to various extents, but also the recognition of professional qualifications, which affects the old Member States as well. In many cases, workers are required to present their professional qualification when seeking employment in another member country. The new Directive took the place of more than 10 old directives dealing with recognition of education, which should remove a lot of red tape and numerous bureaucratic barriers.

Presently, a prospective employee for certain professional and vocational jobs must present all valid documentation to an institution that compares the achieved education, number of years, and field of study and on the basis of reference charts either recognises or disapproves the qualification. Some experts must even pass differential exams to be allowed to work in another Member State. For example, architects must pass the national language test; English alone will not suffice. Lawyers must pass the differential exam or acquire three years of experience in the host country. Physicians, however, don't have problems with getting their qualification recognised.

According to the Directive, a citizen of one Member State can apply for a job in another Member State under the same conditions as the citizens of the host Member State, and his qualification has to be recognised by the host state. For employment in the majority of professions, from paid to free professions, through temporary services to regulated professions of teachers, physicians, medical personnel, pharmacists or architects in the EU, a diploma from the home country or an equivalent set by the Directive is sufficient as proof of completed education. The Directive, however, does not concern all professions – state employees, police officers, notaries and auditors excluded from it. Qualifications will be given on the basis of certain coordinated minimum standards. In the Directive, individual professions have certain minimum sets of requirements related to education and a minimum amount of experience in the given field.

The Directive on the Recognition of Professional Qualifications also specifies the so-called reference levels, reflecting a certain level of education, allowing the comparison of levels of qualification in various Member States. The appropriate details for individual levels are set firmly



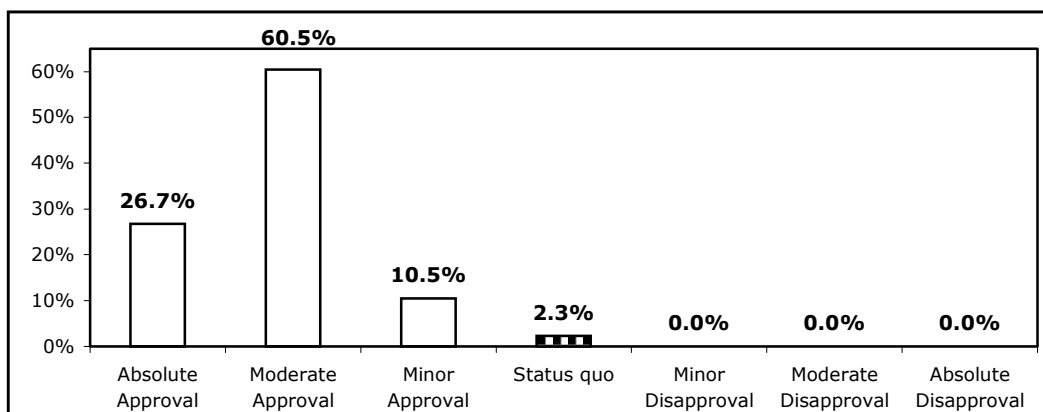
in the Directive, as well as possible requirements for a minimum amount of experience for various kinds of professions and levels of professional education.

In accordance with the legislative process, the Competitiveness Council approved some changes proposed by the European Parliament (EP) in May 2005. The main compromise that successfully passed the deliberations was the created balance between the free movement of qualified professional labour and the protection of consumers. The EP, as well as the Council, passed – as opposed to the original European Commission's Proposal – the principle of mutual recognition with the control of the host country. That means that the host country will have the right, in certain cases, to check the provided services and qualifications of professionals from other Member States. According to the Directive, the migrating worker will have to comply with the same conditions that are in effect in the host country. A provider of professional services will also have to demonstrate to the beneficiary of these services that he/she has professional liability insurance.

Passing of the Directive is, according to its supporters, a positive step not only for the newer, but also for the older Member States, because it removes another barrier from the EU labour market. The Slovak Member of the EP, Zita Plešinská (Slovak Democratic and Christian Union (SDKÚ) / European People's Party – European Democrats), took part in the EP deliberations and stressed that the removal of barriers to free movement of individuals and services among the Member States is one of the key goals of the European community. She also pointed out the fact that until now, unified rules of recognition of education only applied to eight professions. With the exception of a few professions, the Directive created rules for all other professions that will make it easier to apply the acquired qualification in a much broader space of the EU labour market. The European Commission was also supportive of the passing of the Directive. The EU Commissioner for the Internal Market and Services, Charlie McCreevy, said that the Directive will improve the competitiveness of the Union, mobility of workers within the market, will accelerate the economic growth and will narrow the gap between the EU and the economy of the USA.

The Directive on the Recognition of Professional Qualifications was definitely approved on 7 September 2005. Member States must consequently implement it into their national legislations no later than 20 October 2007.

#### Evaluation of the Experts' Committee:



The EU Directive on the Recognition of Professional Qualifications was welcomed by almost all Members of the HESO Experts' Committee, which was demonstrated by their eminent approval. It was perhaps a late, nevertheless a positive and needed step in accordance to the Bologna Declaration (*note: deals with main changes of higher education and educational systems*). Approval of this norm can also be seen as an effort to diminish the national monopolies of educational institutions. The Directive is, in the eyes of experts, primarily important to liberalisation of the labour market within the EU as a premise to the free movement of labour. The measure opens up new possibilities for applying professionals mainly from the new Member States and gives them an opportunity to use one of the main advantages of EU membership.

If Slovakia is currently a member of the EU, then it should be so with all the privileges and duties. During the accession negotiations the new countries were required to implement all EU norms into their legislations, but on the other hand, new members – including the SR – seem to be "second class" members. It seems as if the old members of the Union did not trust the knowledge and professional level of the new members, especially in relation to those professions that they fail to recognise qualifications for.

The process of complete liberalisation of the labour market, which was certainly aided by the new Directive, still has a long way to go. The Directive was not, for example, finalised in all fields; critical points remain to be substantial exceptions and protective measures. Also lacking is a

Directive on Services that would truly liberalise providing services within the EU and thus improve the relevance of the Directive on the Recognition of Professional Qualifications.

## **European Commission's Proposal to Harmonise the Corporate Tax Base across the EU**

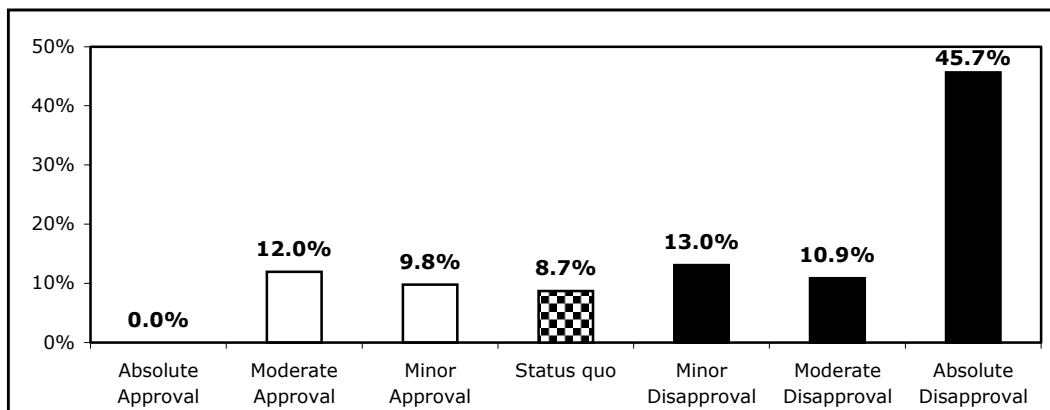
By the end of October 2005 the European Commission (EC) passed a complex plan of measures in the field of taxation and customs (The Contribution of Taxation and Customs Policies to the Lisbon Strategy), in realisation of which the EC aims to support the competitiveness of European companies and aid fulfilling the goals of the Lisbon Strategy (*see page 87*). In its position, the EC stated that the proposed initiatives aim to reduce administrative costs of entrepreneurs operating in various countries of the EU, and thus strengthen the overall competitiveness of Europe in the era of deepening globalisation. According to the submitter of the proposal – EU Commissioner for Taxation and Customs Union László Kovács – an effective tax and customs policy can contribute to the economic efficiency of the entire EU, growth of competitiveness of European companies, development of trade, intensifying of competition in the common market, and support of research and development.

One of the most controversial EC proposals was the request for harmonisation in the field of direct taxation, which falls under the exclusive authority of individual EU States. The Commission proposed a common consolidated corporate tax base for EU businesses (a single basis of assessment for corporate income tax for all EU-wide activities of companies), which varies among the countries and, according to the EC, in this time of growing cross-border activities creates additional (transaction) costs for companies that are thus unable to take advantage of the common market. As the EC states, the proposed measures were not intended to change the structures of the Member States' tax systems, nor were they aimed against the tax sovereignty of the States.

The EU Commissioner Mr. László Kovács stated that the common corporate tax base could probably be very similar to the current Slovak tax base, since the aim of the EC is to introduce a simple and transparent tax base with only a few exceptions and special treatments as currently set in the Slovak tax system, which he advocates for its effectiveness and efficiency. The EC plan was also deliberated by the European Parliament, which was also supportive of it. Aside from decreasing transaction costs of businesses operating in numerous EU States, the harmonisation would also – according to its proponents – decrease the risk of legal disputes resulting from varying tax rules.

For some countries, however, a single tax base without many exceptions and deductibles could in fact mean an increase in taxes. For example, Czech businesses pay a tax of 26%, but they can use a narrower tax base than Slovak businesses with a 19% tax. The Slovak Minister of Finance Mr. Ivan Mikloš also signalled that a harmonisation of tax bases could later grow into a request to unify the tax rates as well. According to him, the SR could agree to a corporate tax base harmonisation only in the case that the unified European tax base is equal or very similar to the Slovak base; otherwise, the result would be worsening of the current Slovak tax system status, which is characterised as highly stable, effective and efficient. Even the EU Commissioner for the Internal Market and Services, Mr. Charlie McCreevy has expressed his negative position toward the corporate tax base harmonisation proposal. Opponents of the harmonisation are of the opinion that such a step would limit the healthy competition of various tax systems, decrease the flexibility, effectiveness and efficiency, and thus reduce the economic growth of all of Europe. The President of the Construction Entrepreneurs Union of Slovakia considered the effort towards corporate tax base harmonisation a lobby of the strong EU Member States. He stated that the Slovak market does not implement such protective measures as the old Member States of the Union, and thus especially tax competitiveness can help new EU members toward a faster economic growth.

The European Commission plans to put forth a concrete proposal for a single corporate tax base in the second half of 2006. Great Britain, Ireland, Estonia, the Czech Republic, and Slovakia are sceptical about the proposal. The EU Commissioner Kovács is resolute about continuing the effort even if he does not get a 100% approval in the Council. He stated that in such a case, some Member States can continue the initiative on the basis of the "strengthened cooperation" procedure, which would mean that only some of the Member States would apply the unified harmonised tax base. The EU Commissioner expected that the proposal would be supported by about 20 EU Member States.

**Evaluation of the Experts' Committee:**

Most of the Members of the HESO Experts' Committee are not proponents of the harmonisation of tax bases. Tax competition is desirable for the growth of the EU, while competing is possible not only through the tax rate, but also through the simplicity of tax calculations. Any Europe-wide harmonisation negates the competitive battle among individual countries, which automatically slows the permanently maintainable growth fuelled by this competitive battle and the improvement in living standards in the individual countries and thus in the entire EU. The fact is that the effort of any country to optimise its taxation system (minimise deformations caused by taxation) could fail on a common standard in the field of a tax base for legal entities. Fixing one parameter of the taxation system would decrease the possibilities of choice in other parameters (e.g. tax rates etc.), and the optimal choice in one country might not be the optimal choice in another. What is more, a country has – even without the directive – the option to voluntarily harmonise its tax base policy with another country, if its Government aims to simplify the administrative processes for international investors. This is an issue that should fall under the exclusive authority of individual States of the EU.

Many respondents stated, it is possible that the SR would lose its competitive advantage over other EU countries in the case that the common European corporate tax base won't be similar, or the same as, the Slovak tax base. At the same time, they pointed out that as is characteristic of the EU, the final passed model will most probably be the most complicated, and in the current constellation of power within the EU, the largest economies with strong social systems and taxation systems full of exceptions will have their way. According to them, there exists a danger that the EU will sink into looking inward, rather than being oriented toward strengthening its global position. They also warned that, with time, the harmonisation of tax bases might grow into a requirement of unifying the tax rates as well.

According to some experts, it will be necessary in the medium term (7-10 years) to unify the tax base for businesses, but they currently do not see suitable grounds for such a step. The situation is not yet transparent enough to see clearly what base would be suitable. And what is more, not all EU Member States belong to the Eurozone, reforms of some policies have not yet been completed (e.g. agriculture), some restrictions to a free movement of persons remain (e.g. in the labour market), and also in question are the ratification process of the EU Constitution and further deepening of integration of the EU. Currently, the new Member States remain markedly economically less developed, and thus harmonisation of taxes would not be beneficial for them just yet; on the contrary, it could defraud them of the comparative advantage they hold in low taxes and simplicity in the taxation systems.

**Radoslav Štefančík:** "This is another intervention of the EU into the sovereignty of the Member States. I believe the issues of taxation systems should remain in the hands of national States."

**Robert Žitňanský:** "Unnecessary and immensely malignant – the only goal is the gradual harmonisation of tax systems. Unacceptable."

**Peter Schutz:** "Aside from the specific issues of taxation, all harmonisations and regulations from Brussels are principally malignant, because they strengthen the political federalisation of Europe, which goes hand in hand with strengthening the bureaucratic power and restricting freedom. Taxes are an exclusive characteristic of state sovereignty and even today's level of harmonisation – setting a bottom boundary on the VAT rate at 15% – should never have been allowed. What if Slovakia, or any other state, arrives at such a budget surplus that 14% VAT suffices? Is it normal that some regulation from Brussels limits a legitimately elected representation from decreasing taxes?"

**Peter Gonda:** "I fundamentally disagree with this proposal and consider it an intermediate step on the way to further harmonisation of other terms of the corporate income tax, including its rate."

*I therefore joined the M.R. Štefánik Conservative Institute in the petition of many pro-market oriented European think-tanks against this initiative of the European Commission."*

**Karol Sudor:** *"This is an absolute nonsense – EU Member States underwent different evolution and do not stand at the same starting line, it is therefore absurd to strip new member countries of one of the few advantages they can offer. From the standpoint of the SR, it is not meaningful to harmonise in areas that de facto directly influence the standard of living of its citizens. The right of company X to seek lower taxes in country Y is fully legitimate, provided that the goal of each company (aside from other things) is to minimise costs. This is an unsystematic measure of the European Commission consequent to its inability to implement reforms in the "old" EU States and to their diminishing competitiveness against the new Member States."*

**Ladislav Balko:** *"Harmonisation of the excise taxes among individual EU countries is O.K., because its aim is to help the fundamental freedoms that the EU is built upon, i.e. free movement of goods, services and capital, and thus also the trade among the EU Member States. If, however, we are talking about direct taxes – and especially income tax – income tax harmonisation acts in the opposite direction. Namely, it will restrict the free movement of individuals – which is another one of the fundamental EU freedoms – especially into the new EU countries with lower direct taxes due to their efforts towards expansive economic policy. Sure, it is a step supported and enforced by the "large" EU countries that by this approach protect themselves against the emergence of attractive investments in the new countries related to lower taxes, which are – aside from the cheap labour – much cheaper for the investors. On the other hand, even the "less developed countries of the EU" will, under the influence of expansive economic policy accompanied by an efficient tax policy in direct taxes, develop faster, approach the old Member States, and will not put such strict demands on cohesive policies. Thus, harmonisation of direct taxes is, in my view, negative."*

**Juraj Nemec:** *"Its implementation is probably impossible; it restricts tax competition, which would handicap the new EU Member States."*

**Juraj Lazový:** *"Only in the case that the corporate tax base harmonisation leads to simplification down to the Slovak model, can it be a measure improving the circumstances for entrepreneurship within the EU. I am not worried that the tax base harmonisation will lead to a tax rate harmonisation (which I don't support). I am more worried that the efforts towards harmonisation will not bring about a simple tax base without numerous exceptions."*

**Igor Daniš:** *"Harmonisation of taxes is an essential act of forming a common market. The point in question should be single basis of assessment for taxes, rather than the individual tax rates. Here, a scope should be determined as to what to unify and where to leave space for competition among individual States; and I don't mean just the corporate income tax."*

One of the respondents presented an opinion that the measure puts all companies in the field of taxation into one starting line created later, and the competition will show the governing capabilities of the managements. It represents, in his view, support of competitiveness, even though it could cause internal-European and national social stratification and influence further economic and social development. The question would then be, to whose benefit (developed countries – stability vs. new countries – convergence)?

## Ranking of All Evaluated Measures in 2005

Note: Measures, which are mentioned and described in this publication, are **bold**.

<b>All Evaluated Slovak Measures ranked by Rating Values</b> (i.e. Contribution to the Economic and Social Development)		<b>RATING</b> [-300; 300]	<b>Quality</b> [-3; 3]	<b>Importance(%)</b>	<b>Evaluated</b> (Q/Year)	<b>Passed</b> (Q/Year)
1.	<b>Extension of supervision authorities of the Supreme Audit Office of the Slovak Republic also to resources used within original competences of local and regional self-governments, to legal entities established by local and regional self-governments, to companies with state shares, to public service institutions, to companies executing activities in the public interest (Amendment to the Constitution of the Slovak Republic)</b>	<b>125.3</b>	1.99	63.0	2/2005	3/2005
2.	<b>Entry of the Slovak Koruna to the Exchange Rate Mechanism II (fixing the SKK/EUR exchange rate for 2 years for the duration of which the Koruna rate can oscillate within the fluctuation band of <math>\pm 15\%</math>)</b>	<b>123.7</b>	1.61	77.0	4/2005	4/2005
3.	Amendment to the Free Access to Information Act (curtailing protected personal data on public officials; changing the time limit for information declassification from 10 calendar days to 8 working days; keeping the duty to declassify also information from administration proceedings in progress; duty to declassify information concerning state or community property transfer to other persons; extending the duty of public discussion in local and regional parliaments; keeping administrative infraction liability for violation of law)	<b>121.7</b>	2.29	53.0	4/2005	4/2005
4.	<b>State Budget for 2006 (state budget deficit – SKK 69bn, fiscal deficit – 2.9% of GDP)</b>	<b>114.4</b>	1.51	75.7	4/2005	4/2005
5.	<b>Recodification of Criminal Law (new Penal Code – more severe punishments for crimes of violence; modification of criminal liability from 15 to 14 years; alternative punishment modes (house arrest, punishment work-off); disapproval of the criminal liability of the companies; new Criminal Procedure Code – shifting of first-level agenda from Regional to District Courts; institution of the judge for preliminary proceedings; process parties will propose and carry on the testimonial evidence, not a judge; alternative modes of accelerated proceedings – criminal order and agreement on guilt and punishment; reduction of the maximal prison duration from 5 to 4 years; Appeal Courts will decide in a major scope on the cases; the possibility of appeal against the Appeal Court for the accused case; disapproval of public defenders ex offo - henceforward counsellors ex offo; "agent-provocateur" can initiatively encourage the corruption of public officials)</b>	<b>114.1</b>	1.83	62.4	2/2005	2/2005
6.	Amendment to the Act on State Debt and State Guarantees (making the approval of state guarantees stricter; the list and maximum amount of state guarantee of individual projects approved under the Act on the State Budget and subsequently by the Government)	<b>110.9</b>	2.21	50.2	3/2005	3/2005
7.	<b>Competitiveness Strategy for the Slovak Republic until 2010 (National Lisbon Strategy)</b>	<b>109.4</b>	1.77	61.7	1/2005	1/2005
8.	<b>Ruling of the Antimonopoly Office of the Slovak Republic on the Abuse of Slovak Telecom's Dominant Position by Refusing Access to its Local Lines (SKK 885m fine imposed; obligation to release the access to local lines within 60 days of the legal validity of the ruling)</b>	<b>107.1</b>	2.04	52.5	2/2005	2/2005
9.	Decisions of the Telecommunications Office of the Slovak Republic on the nomination of Slovak Telecom for a significant enterprise on wholesale markets (duty to discharge the application for network interconnection; duty to lease the end lines (the so-called last mile) to other operators; duty to publish the reference offers)	<b>104.4</b>	2.02	51.7	1/2005	1/2005
10.	<b>Rules in the Field of Individual State Aid Provision to Investors (providing relatively higher investment stimuli for investors who want to do business in regions with a high unemployment rate and in industries with a high added value)</b>	<b>102.1</b>	1.78	57.3	3/2005	4/2005

11.	<b>Non-passing of Investment State Aid of the Total Amount of nearly SKK 7bn (direct state aid from the State Budget - 21% of the total amount of the investment) to the South Korean Tyre Producer – the Hankook Company</b>	<b>90.3</b>	2.04	44.2	3/2005	3/2005
12.	Amendment to the Act on Prices (deregulation of apartment rental prices from July 2007; complete cancellation of price regulation in tax consultancy; delegation of competencies in the urban mass transport price regulation from the higher territorial units to communities; expanding the competencies of the Antimonopoly Office of the Slovak Republic by appraising and sanctioning the misuse of dominant standing of companies imposing unreasonable prices)	<b>85.2</b>	1.72	49.4	1/2005	1/2005
13.	<b>Amendment to the Income Tax Act (increase in tax-deductible flat expenses for tradesmen from 25% to 40%; child tax bonus increase from SKK 450 to SKK 540 per month; cancellation of old age insurance premium rate decrease by 0.5% per each child; non-approval of lower limit increase and upper limit introduction for the assigned sum of 2% of income taxes for public beneficial services)</b>	<b>80.5</b>	1.66	48.5	4/2005	4/2005
14.	Concept of accelerating the postal service market liberalisation (reduction of postal charges for deliveries up to 50 g from January 1, 2006; fully liberalised market from January 1, 2007)	<b>78.7</b>	1.72	45.7	2/2005	2/2005
15.	Amendment to the Act on Banks (increase of information duties on the part of banks in relation to clients in terms of bank product prices)	<b>77.1</b>	1.76	43.9	4/2005	1/2006
16.	<b>Act on Illicit Work and Illicit Employment (definition of illicit work and illicit employment; straitening the scope for illicit employment; widening the obligations of evidence and registration towards the Social Insurance Agency; extension of inspections; stricter sanctions)</b>	<b>73.6</b>	1.46	50.5	1/2005	1/2005
17.	Amendment to the Act on Remuneration of some employees performing work in the public interest (introduction of new salary tariffs for pedagogy workers; increase of salaries for teachers in elementary and secondary schools on average by SKK 2,000 per month; tariff increase per each taught year by 1% in the case of up to 16 years of practice and by 0.5% per each year in case of 17 to 32 years of practice; allowing for the award of a personal extra pay for methodical education up to the amount of 100% of the salary tariff increased by 24%)	<b>70.1</b>	1.50	46.7	1/2005	1/2005
18.	New Act on Public Procurement (approximation of law to the EU; making the terms of use of discussion proceedings without publication stricter; introduction of electronic auctions; allowing for central procurement organisation incorporation; introduction of bail with claim proceedings)	<b>68.7</b>	1.29	53.3	3/2005	4/2005
19.	Draft Amendment to the Act on Public Procurement (duty to inform the Office for Public Procurement on the selection of the method for discussion proceedings without publication 14 days prior to contract conclusion; fine of SKK 500,000 for non-provision of information; exclusion of the possibility of discussion proceedings without publication in the case of an offer for the so-called bargain price; curtailing the time pressure definition)	<b>66.9</b>	1.58	42.5	1/2005	-
20.	Amendment to the Act on Parental Allowance (parental allowance provision in a single amount of SKK 4,110 – also for working parents who shall ensure child care with another natural person or legal entity; counterbalancing the maternity benefit to the parental allowance level, if the maternity benefit is lower than the parental allowance)	<b>61.6</b>	1.50	41.1	1/2005	2/2005
21.	Amendments to 6 health care acts (leaving at least 51% state shares in transformed medical facilities; non-allowance for pharmacy network establishment; introduction of payroll duty for the voluntarily unemployed; allowing for charging preferential out-patients examination; extending the range of patients exempt from flat service charges; duty to publish criteria for insurance policyholder registration on the waiting list; categorisation of medicines and diseases with regard to the financial possibilities of the state)	<b>60.3</b>	0.96	62.6	2/2005	2/2005
22.	Amendment to the Act on Deposit Protection (change of annual contribution amounts on the part of banks to the Deposit Protection Fund for the duration of debt position thereof from the fixed 0.75% on deposits to the interval of 0.2% - 0.75%; contribution amount in 2006 – 0.2%)	<b>56.5</b>	1.66	34.0	4/2005	4/2005

23.	Tax bonus sum increase from SKK 4,800 to SKK 5,400 per annum (from SKK 400 to SKK 450 per month) (Amendment to the Income Tax Act)	<b>50.8</b>	1.23	41.2	2/2005	2/2005
24.	Amendment to the Act on Railways (amendment to the terms of access to the railway transport road, assignment of capacity thereof, regulation of railway transport, its prices and safety, rights and obligations on the part of regulated subjects; incorporation of the Office for Railway Transport Regulation)	<b>48.4</b>	1.36	35.5	1/2005	1/2005
25.	<b>Concept of Additional Privatisation of 51% Shares of the Západoslovenská energetika Company (direct sale of 41% shares to the current owner - E.ON, sale of 10% shares through public offer on the Bratislava Stock Exchange)</b>	<b>41.9</b>	0.95	44.2	4/2005	4/2005
26.	Dissolution of the Fund for Foreign Trade Support (transfer of employees and property to the Slovak Investment and Trade Development Agency SARIO)	<b>39.5</b>	1.74	22.7	1/2005	1/2005
27.	Deferral of the obligations related to the so-called archives (a file of all the documents produced as a result of business of both the legal entities and natural persons) for 2 years	<b>38.6</b>	1.14	33.8	2/2005	2/2005
28.	<b>Amendment to the Employment Services Act (less frequent duty of calls of active unemployed at the Labour Offices; reduction of the maximum amount of the contribution to education and labour market preparation of the job applicant depending on the number of educational activities; increase of the contribution to graduate practice by SKK 200 to SKK 1,700 per month; cancellation of the contribution (SKK 1,000 per month) to employers with which the graduate practice is executed; cancellation of the contribution to moving for jobs (maximum of SKK 10,000 in two years); introduction of a new contribution to commuting to work (maximum of SKK 2,000 per month for 1 year) for disadvantaged unemployed; expansion of the category of so-called disadvantaged job applicants; limitation of the maximum amount of the contribution to employer toward employing a disadvantaged job applicant in dependence on the average wage in the Slovak economy)</b>	<b>38.2</b>	0.89	42.8	4/2005	4/2005
29.	<b>Pilot Project of Financing and Operating Motorways by Means of Public Private Partnership (PPP) (selection of private concessionaires for sections of motorways for 25 years; state stake in the concessionary company; annual payments to concessionaires first from the State Budget and then from the toll)</b>	<b>37.7</b>	0.85	44.5	2/2005	2/2005
30.	Reduction of the state premium (bonus) for building savings from 14.5% to 10% and the maximum amount from SKK 2,500 to SKK 2,000 (Amendment to the Act on Building Savings)	<b>37.1</b>	1.09	34.2	4/2005	4/2005
31.	Draft Amendment to the Act on Social Security of Policemen (pension for life in service only after the age of 50 and 15 years in service; entitlement to claim for retirement benefits after 10 years in service; higher retirement benefits)	<b>34.6</b>	1.18	29.2	4/2005	-
32.	Pilot project of the Ministry of Culture of the SR - Monitoring the Visit Rate of Cultural Events (getting ready for financing change – financing depending to a higher degree on the number of visitors)	<b>31.4</b>	1.11	28.3	4/2005	4/2005
33.	<b>Differential Increase in Pension Benefits in 2005 Depending on their Amounts (up to 10.2%; 0% in pensions over SKK 15,824; extending of the reference period for calculation of pensions based on earnings from the period starting with 1994 to the period starting with 1984)</b>	<b>30.1</b>	0.58	51.7	2/2005	2/2005
34.	<b>Amendment to the Act on Local Taxes (delimitation of upper limits for local taxes on lands and buildings as 20- and 40-multiple of the lowest rate thereof in the community/town)</b>	<b>29.8</b>	0.63	47.2	3/2005	4/2005
35.	<b>Ratification of the Treaty Establishing a Constitution for Europe by the Slovak Parliament</b>	<b>29.5</b>	0.51	57.4	2/2005	2/2005
36.	Measures proposed by the Ministry of Labour, Social Affairs and Family of the Slovak Republic for compensation of increasing household expenditures on energies (increase in selected social benefits)	<b>28.0</b>	0.66	42.2	3/2005	3/2005

37.	<b>Supplementing the Land Price under the KIA Plant in Žilina up to SKK 350 per square metre to the Owners who Initially Sold them for SKK 136 per square metre and the Purchase of Plots of Land under the Plant Infrastructure for SKK 350 per square metre (supplementing the price was subject to a declaration on their honour from owners to stop court proceedings and to sell the land for the infrastructure)</b>	<b>27.0</b>	0.67	40.1	3/2005	3/2005
38.	New Act on Forests (defining rights and obligations; compensations for ownership rights restriction; allowing for increased harvests in forests; free access for the public also to the private forests)	<b>24.7</b>	0.71	34.8	2/2005	2/2005
39.	Draft Amendment to the Act on Old-Age Pension Savings (voluntary entry to the fully-funded pension scheme also for new entrants to the labour market; 100% state guarantee for the paid contributions to old-age pension savings)	<b>22.4</b>	0.41	54.3	1/2005	-
40.	Strategy for the new Slovak National Theatre (SND) building construction completion, operation and financing (construction completion from public resources; resources can be obtained from the sale of the SND lands and buildings; the new building is in the state ownership; the new building manager – newly established semi-budgetary organisation – Asset Manager; new building use also for commercial purposes)	<b>20.2</b>	0.62	32.7	2/2005	3/2005
41.	Act on Political Parties (making the rules of political parties' economic management stricter; publishing more information on their financing; increasing state contributions for political parties; cancellation of the limit for expenditures on election)	<b>17.8</b>	0.44	40.9	1/2005	1/2005
42.	<b>Pilot Project of Reimbursement of Travel Expenses Related to Commuting (maximum of SKK 2,000 for the duration of 3 months) for the unemployed in border regions that start to work in neighbouring EU countries</b>	<b>17.2</b>	0.54	31.8	2/2005	2/2005
43.	<b>Amendment to the Higher Education Act (non-sanctioning of unaccredited branches of foreign universities (from the EU and EFTA countries) in Slovakia; introduction of motivational student scholarships financed from the State Budget)</b>	<b>14.6</b>	0.35	42.2	2/2005	2/2005
44.	Act on Driving Schools (unification of the legislative regulations concerning driving schools into one act; making the terms and conditions for driving school business stricter; professional trade required; driving school success rate published on Internet)	<b>11.6</b>	0.50	23.2	1/2005	1/2005
45.	Measures of the National Bank of Slovakia against undue appreciation of the Slovak Koruna exchange rate (decrease in interest rates by 1 percentage point, direct interventions on the foreign exchange market, refusal to deposit redundant liquidity of commercial banks)	<b>5.3</b>	0.11	47.4	1/2005	1/2005
46.	<b>Amendments to Health Care Acts (adjustment of the band of state insurance holders; shifting of the annual clearance of accounts of health insurance premiums to the end of June; health insurance companies will be the classic business subjects – the profit can be divided between shareholders; determination of the maximum level of patient's co-payments for health care related services and their relation to the subsistence minimum; determination of the maximum, or minimum proportion of diagnoses that can be fully charged or must be fully covered by the public health insurance – increase in the scope of diseases with a full public health insurance coverage)</b>	<b>2.8</b>	0.05	60.4	4/2005	4/2005
47.	Increase in regulated energy and water prices for households from the beginning of 2006 (gas +5.8%, electricity +5%, heat +17%, water +23.3%)	<b>-0.6</b>	-0.01	55.0	4/2005	4/2005
48.	Minimum wage increase to SKK 6,900 (by 6.2%, or by SKK 400)	<b>-8.0</b>	-0.19	41.4	3/2005	3/2005
49.	Acquisition of a majority 62% share in Slovak Airlines by Austrian Airlines by way of a registered capital increase	<b>-13.3</b>	-0.47	28.4	1/2005	1/2005
50.	<b>Act on the Property Origin Documentation (if the court admits that the property value exceeds the documentable incomes by at least thousand times the minimum wage (SKK 6.5m), this property goes to the state; the division of the burden of proof in civil-legal proceedings between the financial police, the prosecution and the citizen)</b>	<b>-14.9</b>	-0.33	44.6	2/2005	2/2005



51.	Acceleration of the expropriation process in the case of formation of significant investments, highways and roads (in case of significant investments, transfer of expropriation from the communities to the regional building offices; restriction to placing process claims; review of action for expropriation legitimacy by a court within 3 months; Amendment to the Building Act)	<b>-18.8</b>	-0.41	45.5	2/2005	2/2005
52.	Increase in regulated gas prices (by 20%) and heat (by 12%) for households since October 2005	<b>-22.1</b>	-0.46	48.4	3/2005	3/2005
53.	Increase in court charges (Amendment to the Act on Court Charges and Charge for Statement of Criminal Records)	<b>-38.9</b>	-1.02	38.1	3/2005	4/2005
54.	<b>The Procedure of State Bodies and Public Institutions in the Case of Land under the KIA Plant Infrastructure (entrance of construction companies and mechanisms on private land without the consent of owners; start of preparatory terrain arrangements without construction permission; alleged archaeological research)</b>	<b>-109.2</b>	-2.26	48.3	2/2005	2/2005

<b>All Evaluated EU Measures ranked by Rating Values</b> (i.e. Contribution to the Economic and Social Development)		<b>RATING</b> [-300; 300]	<b>Quality</b> [-3; 3]	<b>Impor- tance(%)</b>	<b>Evaluated</b> (Q/Year)
1.	<b>Directive on the Recognition of Professional Qualifications (recognising qualification of professional workers in the EU Member States based on a diploma from the home country on the basis of coordinated minimum standards; in special cases, the possibility of checking of the worker by the host country)</b>	<b>103.5</b>	2.12	48.9	2/2005
2.	<b>Proposal for a Directive on Services in the Internal Market (reduction of obstacles for undertaking in the area of services; exemption from directive in case of services such as public administration, education, financial services, public transportation, electronic communication services; domestic country principle when not settling down in another EU Member State – providing services in the entire EU after fulfilling legal requirements of the home country, but also with obligation to respect minimum wage, health and safety regulations and standards in the host country)</b>	<b>77.0</b>	1.40	55.1	1/2005
3.	New rules for car sale within the European Union (more freedom for car sellers within the entire EU; enabling car sale dealerships outside the territory delimited by the car producers; enabling the sale of several brands in one shop)	<b>62.0</b>	1.78	34.7	3/2005
4.	Draft Amendment to the Directive on Charging of Heavy Goods Vehicles for the Use of Certain Infrastructures (single system and charging formula for cars above 3.5t; within limits – possibility of address delimitation of tollage amount depending on country preferences; possible charging not only of highways but also other communications; flexible use of toll income, in particular, for renovation and investments in the transport infrastructure)	<b>53.1</b>	1.27	41.9	2/2005
5.	Proposal for a Directive on Portability of Enterprise Supplementary Pension Rights of Employees within the EU (possibility for the employee of selecting between leaving the rights with the old supplementary pension system or transferring them to the employee pension scheme with the new employer; delimitation of minimum standards for the terms of acquisition of rights to the enterprise supplementary pension, for terms of keeping the so-called deferred rights to pension and for transferability of acquired rights; 10-year deferral of full transferability of rights for not fully-funded pension schemes)	<b>52.0</b>	1.34	38.7	4/2005
6.	<b>Relaunch of the Lisbon Strategy from the Year 2000 (new strategy to support economic growth and employment in the EU; focusing on fewer objectives and removing time intention – year 2010 – to achieve the most competitive economy in the world; accent on the so-called knowledge-based economy – backing education, science, research, innovation and improving the quality of human capital; creating more and better job opportunities; responsibility of each Member State for Strategy implementation – elaborating own national Lisbon strategies and action plans; creating national co-ordinators)</b>	<b>51.0</b>	1.01	50.5	1/2005
7.	Rejection of the EU Directive on Patentability of Computer-Implemented Inventions by the European Parliament (rejection of the stronger single patent protection within the entire EU)	<b>32.4</b>	0.8	40.4	3/2005
8.	Proposal for a Regulation of the European Parliament and of the Council concerning the registration, evaluation, authorisation and restriction of chemicals - REACH (revision, indication and simplification of legislation regulating the chemical sector; more severe evaluation, authorisation and control of all the chemicals used on the EU market; exceptions only for substances produced in small quantities; more severe conditions for dangerous chemicals; incorporation of the European Chemicals Agency)	<b>29.1</b>	0.80	36.6	4/2005
9.	Single statute for the European Parliament members (single salary in the amount of EUR 7,000 from the EU budget; travel reimbursements according to the actual expense amounts)	<b>17.3</b>	0.81	21.3	2/2005

10.	<i>Proposal for a Directive on Motor Vehicle Third Party Liability Insurance (minimum insurance coverage - EUR 1m per victim or EUR 5m per the whole insurance event – countries can select; 5-year transient period; indemnity from the compulsory motor vehicle liability insurance also for non-vehicle traffic participants; in case of travel to other EU country, the home country compulsory motor vehicle liability insurance; central register of information on accidents)</i>	<b>2.5</b>	0.07	37.1	1/2005
11.	<i>Agreement between the European Union and the People's Republic of China on the Restriction of the Increase of Chinese Textile Export to the EU (maximum limits for permitted import increase – from 8% to 12.5% depending on kind of commodity; measure valid until the end of 2008)</i>	<b>1.6</b>	0.04	43.0	2/2005
12.	<i>Proposal for a Directive on Retention of Data Processed in Connection with the Provision of Public Electronic Communication Services (duty on the part of operators to store the communication data - names, addresses, numbers, time, location, not the content of the communication; record archiving for 6 months up to 1 year; member countries shall reimburse the operators for proved additional costs)</i>	<b>-7.0</b>	-0.17	40.9	3/2005
13.	<b>Relieving the EU's Stability and Growth Pact Rules (allowing "temporary" and "soft" exceeding of the 3% of GDP threshold for fiscal deficit; defining the sphere of factors for which exceeding is allowed)</b>	<b>-45.8</b>	-0.80	56.9	1/2005
14.	<b>European Commission's Proposal to Harmonise the Corporate Tax Base across the EU</b>	<b>-79.0</b>	-1.38	57.2	4/2005

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