Structural reforms - past and present
(neverending story...)

Conference on European Economic Integration (CEEI) 2017: “A modern take on structural reforms – past and future challenges for CESEE countries and Europe at large”, 20–21 November 2017, Vienna Marriott Hotel, Austria

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Evolution of reforms

Slovak reform roadmap

Slovakia started the new millennium with privatisation and restructuring of banks and monopolies, and with reform processes related to EU accession.

**2000**
- **Tax reform**: introduction of 19% flat tax (later modified)
- **Pension reform**: 2nd and 3rd pillars (later modified)
- **Labour market reform**: hiring flexibility increased; lower income replacement rates for unemployed

**2004**
- **EU Accession**
- **FDI inflows**
- **EU funds**

**2009**
- **Euro area entry**
- **Recession**
- **Reforms continued**
  - **Fiscal reform**: Fiscal Responsibility Act (debt brake); Fiscal Compact implementation; Value for Money project
  - **Labour market reform**: tax wedge reduction; increase in female participation; dual education; employment subsidies for youth and long term unemployed; labour mobility allowances

**Still not enough**

**Reforms must go on**

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Slovakia started the new millennium with privatisation and restructuring of banks and monopolies, and with reform processes related to EU accession.
Did our reforms work?  
– in nominal and real terms

The Slovak economy coped with exchange rate appreciation of more than 20% during ERM II, as its equilibrium appreciation was supported by productivity, investment and exports development.

Equilibrium appreciation continues, creating a competitiveness buffer.

Convergence towards EU average speeded up significantly (we caught up with neighbours).

Nominal bilateral equilibrium exchange rate

Nominal and real convergence (EU28=100)
Did our reforms work?  
- in terms of the economy and labour market

Potential output increased significantly (on account of FDI-related productivity acceleration that pushed GDP growth to almost 11% in 2007).

Long-term unemployment benefited from both reforms and strong economic growth. New reforms were needed in order to return to pre-crisis levels.

Potential output growth and its structure

Long-term and standard unemployment rate (LT UR and UR; percentages)
Recent measures’ positive impact on the labour market

Recent new challenges: labour shortages

Successes in some areas: increase in participation rate supported by encouraging elderly to work, allowances for childcare costs, expanding kindergarten capacities, job sharing, subsidising employers to create jobs (to employ long-term unemployed and young people), retraining projects, lowering of social contributions for low wage earners, dual education project.

Okun’s Law indicates a positive impact of recent reforms (employment growth in recent years was higher than economic growth suggests)

Participation rate (15 - 64 years, %)

New entrants in training projects

Okun's law

Policy measures' impact

- Employment estimated from Okun's law (2013 - present)
- Actual employment
Further reforms are still needed, as...

...long-term unemployment is among the **highest** among peers and spending on active labour market policies (ALMP) is among the **lowest**. In addition, hiring foreign workers takes several months and the employment protection indicator has recently increased. The minimum wage is still comparatively low, but rising sharply.

Other important areas related to labour market outcomes include health care and education.
Other areas requiring structural reforms

**Health care:** increase its quality; avoid debt accumulation; increase average age with positive consequences for participation rate (which is still below EA average).

**Education:** address weak and worsening PISA results; ensure education meets business requirements to a much greater extent than is now the case.

**R&D and IT support:** more support required since this area brings important innovations (such as “Industry 4.0”) that further accelerate potential output.
Public finances are on a consolidation path, but the medium-term objective is receding.

According to the no policy change (NPC) scenario, there is some room for extra spending (concentrated in capital spending, compensation, and social transfers).

- The Value for Money initiative has the potential to increase the effectiveness of public finances. It should, however, be incorporated into the State Budget Act.
- Public debt is sustainable and the debt brake works. The question is whether there should be an exemption for infrastructure projects.
In conclusion

Everybody knows that structural reforms are of utmost importance for sustainable growth, for better welfare, and for eliminating macroeconomic imbalances. The EC has recommended almost 200 of them to European countries.

So why such reluctance to implement them?

- Short-term losses within the political cycle matter the most. Hence international institutions, especially the IMF, have recommended taking the business cycle into account (good times are better for reforms) and implementing strong and focused demand-supporting policies (having regard to the Gini coefficient).
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Thank you for your attention...

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