

## Solutions to high unemployment rate – Case of Slovakia

DRAFT ANALYSIS

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The document offers a brief overview of key facts and hypotheses about reasons of persistently high unemployment rate in Slovakia. It includes an overview of key applied or planned policies to solve this problem as well as some of key challenges discussed in the country. Among other solutions, INEKO recommends to continue in reduction of social and health contributions for people with low income, to decrease the rate of social benefits reduction when raising the legal income, and to link public funding of secondary and tertiary schools to the unemployment rates and salaries of their graduates.

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The Institute for economic and social reforms (INEKO) is a Bratislava-based non-governmental non-profit organization established in support of economic and social reforms which aim to remove barriers to the long-term positive development of the Slovak economy and society. See also <http://www.ineko.sk/>.

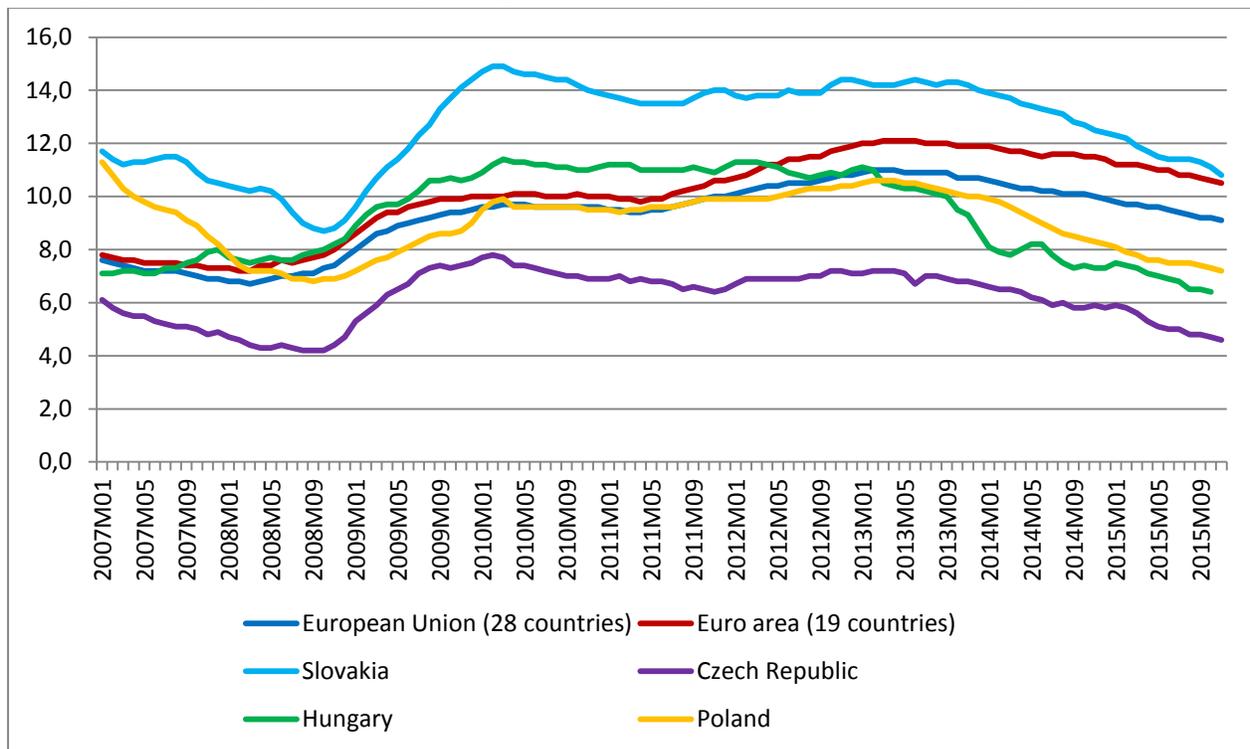
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<sup>1</sup> See <http://www.ineko.sk/projekty/visegrad-fund>.

## Introduction

After 1998 Slovakia adopted major structural reforms starting with privatization of banking sector, telecommunications and energy sector. In 2003-2005 it adopted series of profound reforms in the labor market, taxes, social benefits, pensions and others. All this resulted in improvement of business environment, inflow of foreign direct investment, rapid economic growth and boosting employment. Slovakia succeeded to decrease unemployment rate to below 9% by the end of 2008 which was just above the averages of the EU and the Eurozone. With the onset of global financial crisis in 2009, the unemployment rate increased back to almost 15% in 2010 and remained almost unchanged until late 2013. The turn for better started in 2014 and the unemployment rate fell below 11% by the end of 2015. Despite recent positive development, the unemployment rate in Slovakia is still double of that in the Czech Republic and around 4 percentage points higher than in Poland and Hungary.

Unemployment rate (in %, monthly averages, seasonally adjusted, Labor Force Survey)

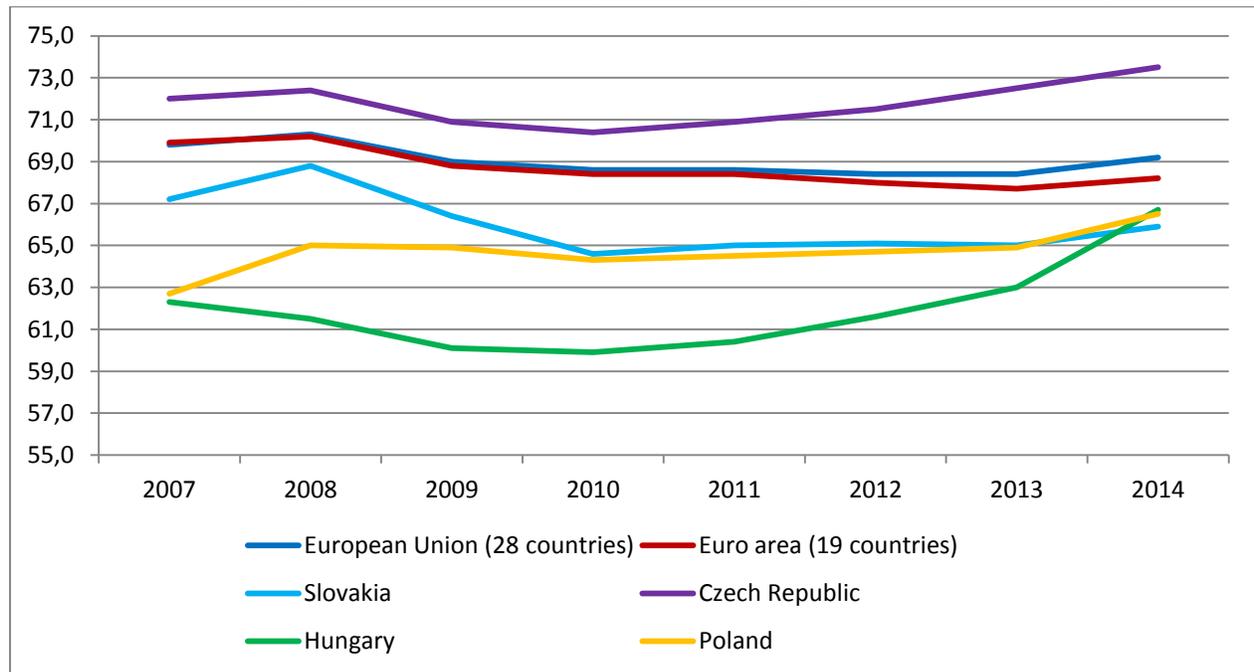


Source: Eurostat

The development of the employment rate is similar with increase until 2008, decrease after the onset of financial crises and improvement in recent years. Interestingly, Slovakia does not lag behind Poland and Hungary if we look at the employment rates. In other words, in all three countries almost the same proportion of people in active age (20-64 years) work. Nevertheless, Slovakia has higher unemployment rate. It seems that in Poland and Hungary, compared to Slovakia, there are more people in the active age who do not work and, at the same time, do not belong to the unemployed. These may be inactive people taking social benefits such as old-age and disability pensions, sickness benefits, people on maternity leave, but also students or simply discouraged people who believe there are no jobs available. Many of

them meet the OECD definition of “marginally attached workers” who “are persons aged 15 and over, neither employed, not actively looking for work, but are willing/desire to work and are available for taking a job”. According to the OECD statistics for 2014, there were 1.7% marginally attached people as a share of the labor force in Slovakia, compared to 3.7% in Poland, 4.0% in Hungary and just 0.9% in the Czech Republic.

Employment rate 20-64 years (in %, annual averages, seasonally adjusted, Labor Force Survey)



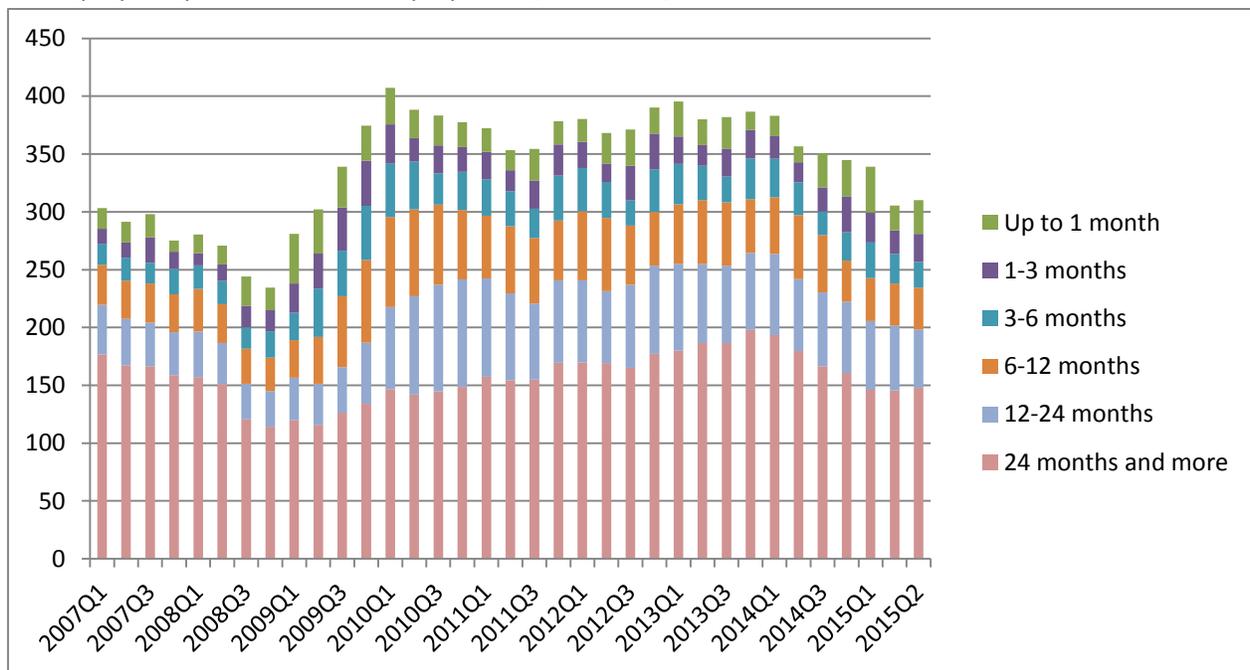
Source: Eurostat

## Hypothesis about the reasons of high unemployment rate<sup>2</sup>

**High structural unemployment:** Slovakia belongs to European countries with the highest long-term unemployment rate. Around two thirds of unemployed people in Slovakia are without a job for at least 12 months, i.e. they are long-term unemployed. Around half of unemployed have no job for at least 24 months. Most of these people have low qualification. The unemployment rate of low-skilled (ISCED 0-2, people with primary education) is the highest in the EU with 36.9% in Q3/2015 compared to the EU 28 average of 16.3% (Eurostat). People with primary education account for almost 20% of unemployed, people with secondary education without final exam (former “apprentice” schools) for 33% and people with secondary vocational education for 24% of all unemployed (Statistical Office of the SR, Q3/2015).

Similar numbers can be observed over most of the existence of the Slovak Republic which points at structural reasons of high unemployment, i.e. it may be caused by wrong institutional settings rather than by short term fluctuations such as economic cycles. In other words it can be a result of wrong structural incentives set in the tax and social benefit systems, labor market rules, education system, etc.

Unemployed by duration of unemployment (thousands)

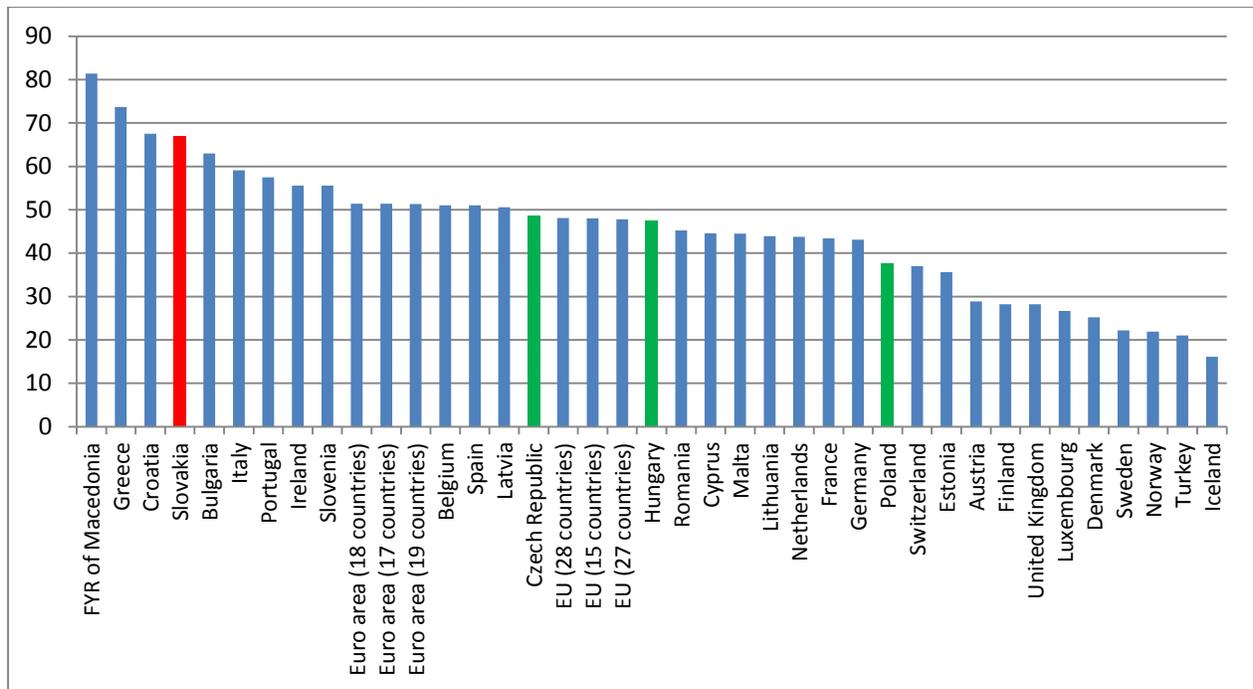


Source: Statistical Office of the SR

The long-term unemployment is after Greece and Croatia the third highest in the EU when 67% of Slovak unemployed do not have a job for over 1 year (Eurostat, Q3/2015). The share of unemployed for longer than 2 years was 48% in Q2/2015 (Statistical Office of the SR).

<sup>2</sup> See also Goliaš (2014)

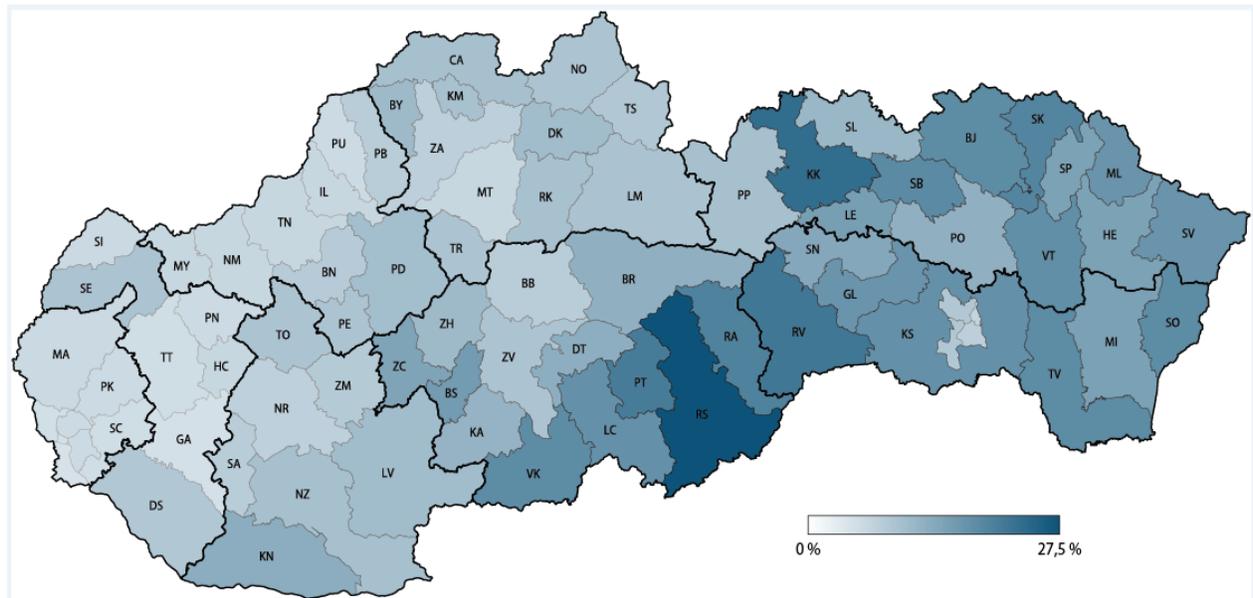
Long-term (over 12 months) unemployment in % of unemployment (Q3/2015)



Source: Eurostat

There are significant differences in the unemployment rate in various regions. The lowest rate can be observed in the western Slovakia and the highest in the southern and eastern Slovakia.

Unemployment rate in different Slovak regions (December 2015)



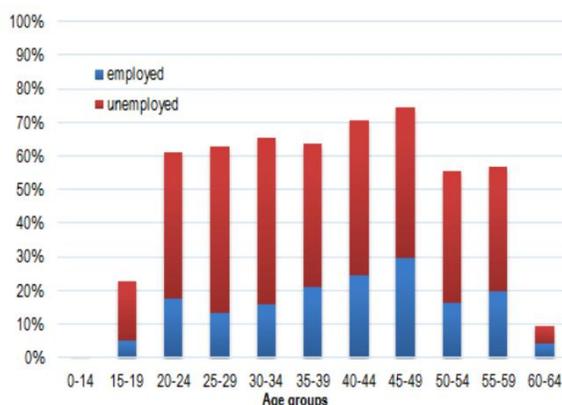
Source: INEKO based on data from the Central Office of Labor, Social Affairs and Family

**Roma factor:** There is evidence that one of key reasons of high unemployment rate in Slovakia is a high number of Roma populations who are often low educated, discriminated and living in poverty in segregated settlements. For example, the Institute for Financial Policy at the Ministry of Finance of the SR writes in its 2014 study<sup>3</sup>:

*“Estimates suggest there are approximately 400 thousand Roma in Slovakia, while about 130 thousand of Roma are registered as jobseekers. (...) If the Roma population on the labour market achieved the average results of the majority population, the overall unemployment rate would be approx. 4 percentage points lower.”*

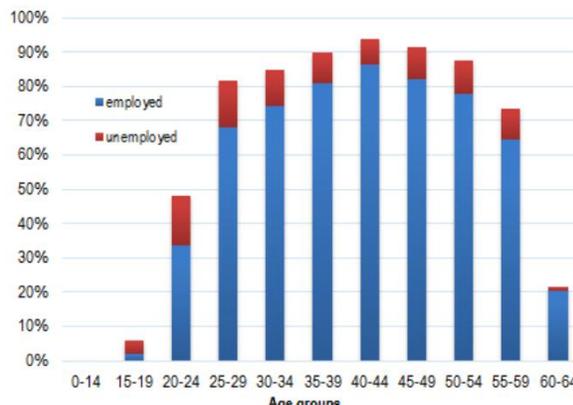
### Most of the economic active Roma are unemployed

Figure 2.3: Economic active population – Roma



Source: LFS, IFP

Figure 2.4: Economic active population – Non Roma



Source: LFS, IFP

Source: IFP (2014)

**Inactivity trap:** Low-paid jobs are unattractive because of high taxes and rapid withdrawal of social benefits. For people taking social assistance every legally earned euro means a loss of 75 cents on social assistance.<sup>4</sup> Moreover, they have to pay social and health insurance on their legal income. For an illustration, for the current level of minimum wage at 405 EUR monthly, the total labor costs for an employer are 514.55 EUR from which an employee receives net monthly wage of 355.01 EUR, i.e. his/her net income is 69% of the total labor costs. For self-employed people with revenues of 514.55 EUR monthly, the net income is just 61% of the total labor costs. In reality, net income can be higher

<sup>3</sup> Unemployment in Slovakia, Institute for Financial Policy at the Ministry of Finance of the SR, November 2014, <http://www.finance.gov.sk/Default.aspx?CatID=9888>

<sup>4</sup> The act Nr. 417/2013 on social assistance states in §15 that the assistance is calculated as a difference between nominal assistance and income decreased by 25%. For illustration if nominal assistance is 61.60 EUR (which is current level of the basic assistance) and an individual has legal income of 50 EUR, he would receive assistance of 24.10 EUR (=61.60-0.75\*50). Thus, for 50 EUR earned he would lose 37.50 EUR on social assistance.

depending on number of children of the working person. There is a Tax Bonus increasing net income by 21.41 € monthly for every child.

#### Tax burden on low income

|                        | Employment |          | Self-employment |
|------------------------|------------|----------|-----------------|
|                        | Employee   | Employer |                 |
| Gross monthly income   | 405 €      |          | -               |
| Labor costs (monthly)  | 514.55 €   |          | 514.55 €        |
| Social insurance       | 38.02 €    | 102.05 € | 142.20 €        |
| Health insurance       | 3.00 €     | 7.50 €   | 60.06 €         |
| Tax on income          | 8.92 €     |          | 0.00 €          |
| Net income             | 355.01 €   |          | 312.29 €        |
| Net income/Labor costs | 69%        |          | 61%             |

Source: INEKO

**Weak motivation of schools to prepare students for successful entering the labor market:** There are huge differences in the unemployment rates of graduates from particular schools. For example ranked by the ratio of unemployment rate of graduates and regional unemployment rate the best secondary vocational school had ratio of 0.17 (in Hnúšťa) or 0.22 (Business Academy in Bratislava) for 2013/14 compared to 4.45 for the worst school (Wine-Fruit school in Modra) or 4.36 for the second worst school (Veterinary school in Bratislava)<sup>5</sup>. All these schools had zero students from socially disadvantaged background. The unemployment rate does not influence the public funding of particular secondary schools. On contrary the funding is usually cost-based with more money flowing to schools with traditionally higher costs. This is also the case of schools mentioned above when the best school received 2238 EUR per student in 2013/14 compared to 4262 EUR per student for the worst school. If there are no financial consequences for weak results and if the public is not informed sufficiently about those results there is a high risk that the schools would have weak motivation to improve.

Table 6: Unemployment and public funding of secondary vocational schools, 2013/14

|  | Unemployment index  | Public funding per student |
|--|---------------------|----------------------------|
| Secondary vocational school in Hnúšťa            | 0.17                | 2238 EUR                   |
| Business academy in Bratislava                   | 0.22 (second best)  | 2049 EUR                   |
| All second. vocat. schools in Slovakia (average) | 1.4 (average)       | 2382 EUR                   |
| Veterinary school in Bratislava                  | 4.36 (second worst) | 2643 EUR                   |
| Wine-Fruit school in Modra                       | 4.45 (worst)        | 4262 EUR                   |

Source: INEKO, <http://skoly.ineko.sk/>

Note: Unemployment index is the ratio of the unemployment rate of graduates of particular school and the regional/district unemployment rate.

<sup>5</sup> Source: INEKO, <http://skoly.ineko.sk/>

**Insufficient and inefficient active labor market policies (ALMP):** In 2013, Slovakia spent 0.20% of GDP on ALMP compared to the EU average of 0.66% (Eurostat). It lagged behind mostly in supporting labor market services such as job-search assistance programs (with 0.05% of GDP compared to EU average of 0.20%) or training (0% of GDP in Slovakia compared with 0.19% of GDP in the EU) that belong to more efficient policies.

## **Overview of key existing and planned policies to decrease the unemployment<sup>6</sup>**

Labor market reform: The labor market reform implemented in 2003 led to a significant shift of the Labor Code arrangements towards higher flexibility. It restricted the coercive character of the Labor Code – it only set basic frameworks and assumed that respective employment relations would further be specified at the corporate level, depending on specific circumstances of employers, regions and industries. The main measures included decreasing costs of hiring and firing, introducing more flexible overtime, working hours, fixed-term and part-time contracts, as well as weakening the Labor Unions.

Income Tax Allowance: Since 2004, the basic personal allowance deductible from the tax base has been increased from €968 to €2,021 per taxpayer in 2004 (€3,803 in 2015). As a consequence, everybody with wage below approximately 40% of the average wage in the economy (€317 in 2015) did not pay any income tax at all. Others paid a uniform tax of 19% on the difference between their income and the tax-free income (or 25% since 2013 in case of higher income).

Employment services<sup>7</sup>: Register of vacancies, register of job seekers, consulting, training, financing part of training costs, and various financial contributions such as:

- Contribution to support employment of a disadvantaged job seeker (above 50 years old, low-skilled, without regular job for at least 6 months, etc. the amount of contribution is up to 40% of average wage, during up to 12 months or 24 months in case of people unemployed longer than 24 months)
- Contribution in support of local and regional employment development (above 50 years old, low-skilled, long-term unemployed, etc., contribution amounts up to 50% of average wage, during up to 9 months)
- Contribution for activation activity in the form of small community services (the contribution is taken by a municipality or regional district to finance part of costs of activating long-term unemployed people eligible for social assistance benefits, the activation works can take up to 20 hours/week)
- Contribution for activation activity in the form of a voluntary service (up to 4.5% of average wage plus contribution for commuting to work, up to 20 hours/week, during up to 6 months)

Public works: As for December 2015, there were 18 thousand jobs created in total by using the contributions for the small community services and voluntary service (see above).

Youth Action Plan: Subsidizing youth employment (70 million EUR in 2013, almost 11 thousand new jobs). During one year state pays minimum wage and contributions for young people (who have been registered as unemployed for at least 1 month) up to 29 years of age employed by a firm. The employment has to last for other 6 months without subsidies.

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<sup>6</sup> See also Goliaš (2007) and Zachar (2010).

<sup>7</sup> Source: The Act Nr. 5/2004 on Employment Services, Ministry of Labour, Social Services and Family of the SR, <http://www.employment.gov.sk/sk/praca-zamestnanost/podpora-zamestnanosti/>

Employee Tax Credit: The low-income employees are eligible for an annual tax credit (up to 42.98 EUR in 2014). The measure is not widely used because it is administratively complicated.

Allowance on social contributions for long-term unemployed: Since November 2013, the long-term unemployed (over 12 months) are temporarily (during 1 year) exempted from paying social contributions in case they find low-paid employment (up to 67% of average wage).

Health Care Allowance for employment contracts: Since 2014, the employment contracts for low income have zero health insurance contributions that gradually increase to a standard level in case of higher income. So far, the measure has not been widely used probably due to administrative barriers – it is not applied automatically.

Youth Guarantee: The goal is to ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within four months of becoming unemployed or leaving formal education.

Concurrence of social assistance and employment: Since 2015, more generous temporary social benefits for long-term unemployed who find a job have been applied. Based on this rule, the long-term unemployed can keep the full amount of the social assistance for 6 months after finding a job and half of it for another six months. The Minister of Labor claims this measure to be one of the most successful.

Dual education: Since September 2015, businesses can benefit from tax reliefs on contracts concluded with secondary vocational schools offering mixed work-school education. So far, the measure has had weak results, probably due to weak financial motivation.

Special law on regions with high unemployment (effective from December 15, 2015):

- More generous investment stimulus for SMEs: 50% in case of investing at least 200 thousand € and creating at least 10 new jobs in industrial production or 5 jobs in tourism
- More generous state aid for construction of social rental housing
- Extra public funds for municipalities in the region on projects aimed at reducing the unemployment

## Current challenges – Overview of alternative policies to decrease the unemployment

Currently, the government considers applying following measures (details are not yet known):

- Broader and automatic use of Health Insurance Allowance
- Establishing Social Enterprises offering „inclusive employment“ for disadvantaged people, especially long-term unemployed

The options for integrating marginalized Roma have been a regular topic in the public discourse. The most preferred solutions include inclusive employment (see above), higher pre-school enrollment of Roma children and their inclusion in standard (i.e. non-special) primary schools. Less consent is about collecting ethnic data about unemployed and inactive people.

From among other measures, following are being discussed:

- Increasing capacity and more frequent use of pre-school facilities (to increase employment of mothers of children up to 3 years of age)
- Improving the transport infrastructure
- Introducing regional minimum wages with the aim to decrease labor costs for employing people with low qualification and productivity (this is rather academic debate as the Government refused it)

Other recommendations proposed by INEKO:

1. **Continue in reduction and expansion of social and health insurance contributions for people with low income.** The existing payroll-tax allowances should include self-employed people with low revenues as well as all low-income people working on Agreements (special contracts for part-time or one-off jobs). The allowance should be extended to include the social insurance contributions; not just health insurance.
2. **Slow down the reduction of social benefits with rising legal income.** The decrease should be implemented in a several-year transition period to allow for evaluating the impact on employment and public finances. For example the rate of reduction could be decreased from the current level of 75 cents for every legally earned euro by 10 cents every year for a period of three years to the final rate of 45 cents. Based on results further decrease might follow.
3. **Regularly measure and publish the unemployment rates and salaries of graduates of particular secondary and tertiary schools.** Include both indicators into the formula for calculating the public subsidies of particular schools. In both cases, the indicators should be adjusted for regional and sectoral differences.
4. **Regularly measure and publish the efficiency of active labor market policies** (results per euro spent), close inefficient programs and support those that prove to be more efficient. Focus on labor market services such as job-search assistance programs and training; reduce measures aimed at direct job creation. Publish a list of all subjects (both individuals and organizations) receiving financial contributions including the amount of that contribution, time of its spending, number of subsidized jobs, and length of their duration as well as education and age characteristics of participants.

5. **Regularly measure and publish the efficiency of the Labor Offices.** Gradually outsource the provision of employment services and other active labor market policies to private organizations.

In September 2015, INEKO organized a survey<sup>8</sup> among 18 local economic analysts asking for the evaluation of the efficiency of applied or proposed measures to sustainably increase employment in Slovakia. The top three most efficient measures included:

1. “Measure and publish the efficiency of adopted measures; phase-out inefficient and support the most efficient measures” – this was a reaction to current situation when no regular measuring of the efficiency of active labor market policies is taking place.
2. “Reduce the administrative burden especially for small firms, e.g. ease the employment regulations, the hygiene and security requirements and mandatory reporting to official authorities”
3. “Link the public funding of secondary vocational and tertiary schools to graduate’s success in joining the labor market”

The bottom three (least efficient) measures included:

1. “More intensive construction of rental housing in regions with high unemployment rate”
2. “More intensive support of employing young people by subsidizing labor costs”
3. “Introduction of permanent inclusive employment for long-term unemployed – subsidizing/creating permanent jobs by state”

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<sup>8</sup> See the results here (only in Slovak): <http://www.ineko.sk/clanky/vysledky-ankety-ako-udrzatelne-zvysovat-zamestnanost>

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