

## COMPETITIVENESS OF SLOVAKIA AND THE ECONOMIC CRISIS

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**Abstract:** *The impacts of financial crisis in the beginning of this year have also been felt by the Slovak economy. It could be argued that the competitiveness of Slovakia is under the influence of the world economic crisis, as it is a small, open and pro-export oriented economy, hence influenced by foreign markets. Because of limited extent of domestic market, the foreign demand plays a key role in economic growth, a role that depends on the development of international economic affairs. As the biggest Slovak trade partners are in a deep recession, it induces a slowdown in the domestic economy as well. Financial problems of numerous banks in these countries, in combination with the growing lack of trust in the performance of the economies have resulted in a decline in demand and consumption, which had its effects on Slovakia as well. Based on our analysis of the manifestations and consequences of the financial crisis we show the effects on competitiveness of Slovakia, as well as on public policy.*

**Keywords:** *National competitiveness, economic crisis, public policy, economic growth, Slovak economy*

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### Introduction

The phenomenon of world economic depression began to fully resonate in September 2008 when a rapid fall of stock prices occurred and exchanges all over the world recorded considerable losses. A year later, the situation is still critical and volatility dominates in world economy. Strauss-Kahn, managing director of the International Monetary Fund, expressed a belief in April 2009 that the depression had not come anywhere near the end and would continue for several long months until a recovery of world economy occurred (Wroughton 2009). In September 2009 Strauss-Kahn confirmed again that depression was still persisting despite a slight improvement in the performance of large European economies such as Germany and France (Spiegel 2009).

Complicated situation at financial markets brought European countries to the edge of economic precipice. The European Commission (2009a) indicated in its Driving European Recovery study in March 2009 that Europe had been under unprecedented pressure of global economic depression since September 2008. The depression primarily affected the world's banking and financial sectors. Only a coordinated intervention by governments saved it from complete collapse. Governments all over the world are continuously forced to adopt an entire series of measures as a consequence of a serious failure of unregulated world financial system. Krugman (The Associated Press 2009) concluded in August 2009 (at a conference in Kuala Lumpur) that just because of governments' incentives the world succeeded to avoid another Great Depression, while stating that depressions were a penalty for globalization (Krugman 2000). According to OECD (2009b), the current depression has revealed major problems in the functioning of financial markets and showed a failure of previous controlling and managing structures in the area of market stability. Globalization and related processes make all economies affected, including the most advanced ones. Šikula (2009) holds the opinion that globalization

increased excessively an asymmetric detachment from real economy, degradation of control mechanisms, and risks of depressions and their devastating impacts on real economies.

The Slovak Republic (SR) as a small, highly open and export-oriented economy depends on foreign markets fundamentally. Because of the limited range of internal market, foreign demand plays a key role in its growth and, according to Šikulová (2007: 570), “its successfulness depends to a great extent on the development of external economic relations.” The largest business partners of Slovakia find themselves in deep recession and a deterioration of external environment is the largest factor in the decrease of Slovak economy as well. Financial problems of many banks in these countries, in combination with increasing distrust in economies, resulted in a decrease of demand for consumption which naturally resulted in a production decrease. The depression in SR became fully apparent in the 3<sup>rd</sup> quarter of 2008, when some employers began layoffs as a result of decreased demand for their production.

In our paper, we want to point out the depression signs in the Slovak economy, the response of public policy to the new market situation, and the political and economic measures taken by government to moderate depression impacts on population, public finance and companies.

The main objective of our paper is to describe symptoms of the crisis and find solutions available to the government. It is not the objective of our paper to measure the impact of the crisis statistically or otherwise. The methods used in the article are purely descriptive in nature.

## Economic development and competitiveness of Slovakia before the depression

It is possible to characterize the economic development of Slovakia for the last 3 years by positive trends. It is possible to qualify 2006 and 2007 as years of enormous growth and 2008 as a year under the influence of economic depression. These characteristics are regarded to be the most typical for Slovak economy in recent times, since the total economic development as well as creation and utilization of instruments of public or economic policy were qualified and set by these elements.

The reforms implemented in years 1999–2003 are regarded as the main reason of favourable macroeconomic indicators and especially economic growth. Reforms became made the country attractive to foreign companies, especially due to low taxes and ease of starting a business. Based on these steps, the Government of the Slovak Republic was indicated as “the world’s number

one reforming economy in 2003” economy by the World Bank (2005). The Slovak economy reported considerable increases of GDP in 2006 as well as in 2007 thanks to reforms and multiplication effects of inflow of foreign investments as well (Ručinská 2007).

The Slovak Republic has established itself as a European car making power over the last years, since important automobile companies, such as Volkswagen, PSA Peugeot Citroën and Kia Motors decided to establish their works in SR. Financial Times Deutschland (2007) recognized SR as “Detroit of the East” at the beginning of 2007. Automotive industry started to be regarded as a workhorse of the Slovak economy, contributing one-quarter of the GDP (TASR 2008) and approximately 30% of total Slovak exports. Slovak economy is connected to the development of surrounding economies since more than 85% of its total exports are directed to the EU (Ministry of Economy of the Slovak Republic 2008).

It is obvious that we can consider the competitiveness of an economy or a country at various levels. Theoretically, the competitiveness of an economy means the capability to create growth in the long term. The main factors of competitiveness include not only production factors but also the capability to utilize them efficiently and in combination, providing long-term sustainability of total production and, at the same time, relative satisfaction of the population. Therefore, it should be true that factors influencing the competitiveness of a country are, at the same time, related to the long-term growth of its economy. Departing especially from Porter’s (2009) approach, we perceive competitiveness as the capability of a nation to innovate and thus achieve competitive advantage against other nations (Ručinská, 2008).

Based on this, it is possible to characterize total macroeconomic competitiveness of economy as depending on the ability to combine and utilize production sources as efficiently as possible and, at the same time, on policies influencing the factors of utilization of production sources. Factors influencing the labour factor include: labour market, social policy, demographic development and migration. The following are among the factors of capital as production factor: capital and financial markets, fiscal policy, monetary policy and international capital flows (Slaný et al. 2008). Both groups of factors are continuously influenced by economic policy, innovation and education, public policy, politics and legislature, and now also the world financial depression.

This approach is just a theoretical one and it is one of many similar ones. Several renowned institutions and subjects try to define and assess country competitiveness. Let us select just one indicator, business environment, for the characterization of competitiveness. The World Bank has monitored and assessed the quality of business environment all over the world in its Do-

ing Business news for seven years (Jaroš 2009). The World Economic Forum (WEF) also indicates global competitiveness by international comparison of world economies in its ranking list, Global Competitiveness Report. WEF defines competitiveness as a set of institutions, policies, and factors that determine the level of productivity of a country. Since 2005, the WEF has based its competitiveness analysis on the Global Competitiveness Index which captures the microeconomic and macroeconomic foundations of national competitiveness (World Economic Forum 2009). Ranking in the IMD World Competitiveness Yearbook is another important indicator of competitiveness. IMD defines competitiveness as “how nations and businesses are managing the totality of their competencies to achieve greater prosperity”. The study of competitiveness is not just about growth or economic performance but should also take into consideration “soft factors” such as the environment, quality of life, technology, knowledge etc. (IMD 2009). The assessments of those renowned centres were still quite positive in 2008. But the World Bank ranked SR 42<sup>nd</sup> in Doing Business for the previous year, what means that our position was worse by 7 places than it was a year ago, but still better than the positions of our traditional local competitors, Poland, Hungary and the Czech Republic. According to the Economic Freedom Index produced by the Economic Freedom Network, Slovakia went six steps down and was twenty-sixth among 141 countries assessed. Global comparison is based available data for 2007 (Jaroš 2009), i.e., data which are not influenced by the depression. At the beginning of September, the World Economic Forum brought its annual evaluation based on an international comparison of country competitiveness based on a set of 12 pillars. Slovakia went one step down in this ranking and took the forty-seventh place among 133 countries (World Economic Forum 2009).

## Effects of the world financial crisis in the Slovak Republic

According to International Monetary Fund (2009), the world economy occurs in a deep recession due to extensive financial and economic crisis. All EU member states excluding Romania observed a decrease of economic growth. Latvia, as the most progressive economy within the Union over the last years, suffered the most significant contraction. Its GDP achieved a growth of 10% in 2007, yet dropped by 4.6% in 2008. The direct cause was a significant and permanent decrease of exports due to the outbreak of global financial depression and consequent suspension of the flow of loans and investments into the entire Baltic region. The European Commission (2009b) forecasts the largest contraction within the Union for the Baltic States this year. “It is naive to guess that the re-

cession now occurring in the countries of the eurozone or the ones of our key economic partners will not affect us” stated Governor of the National Bank of Slovakia early in December (SITA 2008).

The Slovak Republic achieved the highest growth in GDP among OECD countries in 2006 and 2007 and a high growth was expected as well in forecasts for subsequent years. The rate of economic growth declined considerably in the fourth quarter 2008, when the consequences of depression started to be evident in real economy. Compared with the first quarter 2008, when GDP growth achieved 9.3%, the economy decreased in the last quarter 2008 by 6.8% to 2.5%. This considerable slump of our economy was generally associated with an ease-off of foreign demand resulting in a decrease of Slovak exports, slowdown of production, growth of unemployment, and drop in total domestic demand (Table 1).

**Table 1**—Forecast of GNP development in Slovakia in 2009 (%)

Forecast of National Bank of Slovakia	
July 2008	6.6
December 2008	4.7
February 2009	2.1
April 2009	-2.4
September 2009	-5.6
Forecast of Ministry of Finance of the Slovak Republic	
January 2009	4.6
February 2009	2.4
April 2009	2.4/ -1*
June 2009	-6.2
September 2009	-5.7
Forecast of European Commission	
October 2008	4.9
January 2009	2.7
April 2009	-2.6

Source: Blaabjerg (2009), Ročár (2009), Machlica and Šilan (2009), National Bank of Slovakia and Ministry of Finance of the Slovak Republic (2009), Eurostat (2009b)

\* pessimistic forecast.

Thus, lower growth of GDP in Slovakia was caused by pending and deepening economic recession in the countries of its largest business partners (especially Germany) and related lower demand for Slovak goods. An OECD forecast (2009a) of February 2009 confirmed that Slovak exports would be affected by global decrease of demand. This was evidenced by the fact that total Slovak exports decreased by 28.4% in the first half of 2009, compared with the same period of 2008. As for the most important business partners of SR, there was a decrease in exports to Germany by 30.6%, the Czech Republic by 29.6%, France by 12.6%, Poland by 25.1%, Italy by 25.3%, Hungary by 26%, Austria by 27%, United Kingdom by 23.1%, Russian Federation by 8.4%, The Netherlands by 28.1% and Spain by 31.6%. The country's major economic groupings recorded a decrease of exports into EU countries by 28.5% (those comprised 85.4% of total exports) and by 28.7% into OECD countries (Statistical Office of the Slovak Republic 2009c).

Considerable increase of the number of unemployed people is a negative consequence and sign of economic depression all over the world. Several industries in the Slovak Republic cut down employment as a consequence of decreasing orders. The declining global demand resulted in cutbacks or even halts of production<sup>1</sup> in Slovakia and, in some cases, bankruptcy. The above-mentioned facts necessarily caused layoffs of employees<sup>2</sup> (Table 2).

The largest sector of the economy of the Slovak republic, automotive industry, has the key role in the development of its GDP, exports and employment; it has positive influence on the inflow of foreign direct investment (Ministry of Economy of the Slovak Republic 2009b). The orientation of Slovakia to automotive industry is documented by the fact that 575,776 automotive vehicles were produced in Slovakia in 2008, which meant the first place in the world with 105.7 vehicles per 1,000 inhabitants.

1 Volkswagen Slovakia suspended manufacturing for the third time on May 11–15, 2009, due to falling orders. The first two suspensions took place on February 16–25 and April 6–17, respectively. Due to a rapid decline of orders, U.S. Steel Košice had to shorten working hours to four days weekly from February 2009 to June 2009, while for the fifth day wage compensation in the amount of 60% was paid. There were 12,227 employees working in the company in 2008, a decrease in comparison with 13,342 employees in 2007. In October 2008, due to a deep slump in metallurgical industry, USS Košice did not renew employment contracts to more than 700 employees hired through intermediaries.

2 For example, metallurgical company Železiarne Podbrezová carried out two mass lay-offs during 2009, affecting 361 and 190 employees in January and March, respectively. The current number of employees is 2,935. In addition, the company shortened working hours from 37.5 hours to 30 hours per week from August 1, 2009 to January 31, 2010.

**Table 2**—Overview of mass lay-offs between October 2008 and January 2009

Region of	Number of affected districts	Number of employers	Total number of employees	Planned number of endangered employees	Actually laid-off employees	Number of persons registered as unemployed
Banská Bystrica	5	15	6,869	2,312	56	0
Bratislava	1	2	1,068	230	17	0
Košice	4	8	3,962	827	309	48
Nitra	4	16	13,548	1,703	199	31
Prešov	5	12	4,166	1,190	308	0
Trenčín	6	12	4,890	1,432	208	20
Trnava	5	13	8,256	1,019	89	15
Žilina	8	15	7,821	1,283	127	72
SR	38	93	50,580	9,996	1,313	186

Source: Ministry of Labour, Social Affairs and Family of the Slovak Republic (2009)

According to OECD (2009a), the specialization of SR in the production of automotive vehicles, which contributed to its high economic growth in the past, is a disadvantage under the present circumstances. Even in 2008 there were signs—ones that fully showed in 2009—that the global slowdown would hit especially considerably the automotive industry.

Development at the Slovak job market is therefore closely connected with development of the economies of our most important business partners. Business sector in the Slovak Republic shows high sensitivity to economic decline abroad, therefore the slump of foreign demand and slowdown of economic growth pushed back profits as well as investment growth and pressured lay-offs of employees and slower growth of wages, with impact on household consumption. Since October 2008, there has been a continuous rise in the number of unemployed persons in Slovakia (Table 3, Table 4), while this negative development is to continue in 2010 as well.

**Table 3**—Unemployment development in SR over the period of time monitored (September 2008–February 2009)

Indicators	Sept. 2008	Oct. 2008	Nov. 2008	Dec. 2008	Jan. 2009	Feb. 2009
Number of unemployed persons	228,659	228,194	235,230	248,556	269,465	289,608
Intermonth increase	2.84%	-0.20%	3.08%	5.67%	8.41%	7.48%
Interannual increase	-6.77%	-4.30%	-0.21%	3.59%	11.16%	22.19%
Unemployment rate	7.54%	7.51%	7.80%	8.39%	9.03%	9.72%
Intermonth increase	0.18%	-0.03%	0.29%	0.59%	0.64%	0.69%
Interannual increase	-0.76%	-0.41%	0.04%	0.40%	0.97%	1.88%

Source: Authors according to data from Centre of Labour, Social Affairs and Family (2009a).

**Table 4**—Unemployment development in SR over the period of time monitored (March 2009–August 2009)

Indicators	Mar. 2009	Apr. 2009	May 2009	June 2009	July 2009	Aug. 2009
Number of unemployed persons	311,763	325,648	336,926	348,628	355,862	355,041
Intermonth increase	7.65%	4.45%	3.46%	3.47%	2.07%	-0.23%
Interannual increase	35.80%	45.86%	51.59%	56.39%	58.32%	59.69%
Unemployment rate	10.33%	10.92%	11.39%	11.81%	12.07%	12.05%
Intermonth increase	0.61%	0.59%	0.47%	0.42%	0.26%	-0.02%
Interannual increase	2.74%	3.54%	3.95%	4.39%	4.60%	4.69%

Source: Authors according to data from: Centre of Labour, Social Affairs and Family (2009a).

The only one positive macroeconomic indicator at the time of depression is the development of inflation. We can say in a simplified fashion that the current world depression has a positive effect on price development. Price decline was an unavoidable consequence of weakened economic activity, as documented by decline in sales, reduction of foreign trade activities, decrease of employment, increase of unemployment, as well as a slump of indicators of economic sentiment (National Bank of Slovakia 2009b). For consumers, the low level of inflation represents a relevant fact because it maintains the purchasing power of the population despite an actual slowdown of growth of wages and consumption decrease.

Price increase during 2008 was a response to considerable worldwide increase of oil and food prices, due to the pending destabilization financial markets, especially the commodity ones. Inflation in EU member states reached the highest values in September 2008. In this period of time, HICP inflation was 4.2% in the EU, according to Eurostat (2009a), while in March 2009 it was 1.3%. A critical slowdown of inflation came in January 2009, with a decrease of global demand due to pending depression.

According to data of National Bank of Slovakia (2009b) from March 2009, the decrease of inflation rate has been continuing in Slovakia, especially the prices of durable consumer goods were lowered (cars and electronics) and at the same time, the growth of food and energy prices slowed down. The average inflation rate (HICP) reached 1.9% in 2007, and 3.9% in 2008. In the wake of depression, the rate of inflation according to Eurostat (2009a) in SR continuously decreased from September 2008 and reached just 0.6% in July 2009. According to a European Commission forecast (2009b) the inflation rate should reach 2.0% in Slovakia and 0.9% within the entire EU in 2009.

## Signs of financial crisis in the Slovak banking sector

The mortgage crisis and following financial depression spilled over from the U.S. to the European banking sector due to the engagement of several banks in toxic U.S. financial products, which caused them enormous financial losses. Major European banking houses began to have liquidity difficulties, what impaired confidence among banks. The concerns of banks in the provision of interbank loans resulted in a lack of funds at the market, while no relevant information was available about possible red numbers in the banks. The result consisted especially of the increase of money price at the interbank market. The banks started to apply loan restrictions and provided lower amounts of loans to the business sector and households.<sup>3</sup>

3 The International Monetary Fund (2009) stated in its report of April 2009 that losses of the world's financial institutions due to depression would amount more than 4 billion USD. The most affected European bank was the Swiss giant UBS, which had to write off 49 billion USD for 2008 as a consequence of the U.S. mortgage crisis (Dmitracova 2009) and its extensive engagement in the segment of U.S. securities which became toxic (illiquid) after the outbreak of the mortgage crisis. The UBS obtained financial support from the Swiss government in October 2008 in the amount of CHF 6 billion and the Swiss government obtained a 9% share in the UBS in return (in the meantime, the Swiss government sold it on August 20 for CHF 5.5 billion + CHF 1.8 billion in lost interests (Miedema and Cage 2009). Furthermore, the UBS earmarked illiquid assets in the amount of USD 60 billion for a separate fund, which would be financed from a loan provided by the Swiss central bank in the amount of USD 54 billion. The remaining amount of USD 6 bil-

The crisis of the U.S. mortgage market resulted in large financial losses to banks in the Europe that were involved in securitized financial instruments and many of them got into existence troubles. To prevent passing the problems into the real economy and causing a chain bankruptcy of financial institutions, the governments of several European countries provided interventions to banks. The aid was in the form of rescue financial packages which served predominantly as a guarantee for interbank loans, since most of the banks had difficulties with insufficient liquidity. Table 5 below includes overviews of the packages of financial aid adopted by bank sector in Europe in September and October 2008 after the commencement of financial crisis.

The impact of the world financial depression on Slovak bank sector has been moderate in comparison with most affected countries. A study by the National Bank of Slovakia (2009a) from April 2009 states as a reason of the less negative impact of the depression on Slovak banks in 2008 a relatively strong connection with domestic economy and small investments in high-risk American mortgage markets. Banks operating in SR minimized their involvement in securitized financial instruments, which suffered considerable financial losses and are considered to be the largest source of the current economic depression for the time being.

An important factor in the current adverse development in the world's financial sector is that banks in Slovakia did not need official support for the present in connection with the depression, since they had not recorded losses or significant slumps of profits as banks in other countries. To the contrary, they are achieving positive income in the long term. Financially expensive "pre-privatization restructuring" in 1999–2000 in Slovakia (Tkáčová 2001: 17) largely left banks in Slovakia in good condition. At that time banks were in very bad financial positions, especially due to high portions of classified loans of low liquidity as well as deep undercapitalization (Kračinovský 2008). Recovery of banks and their subsequent selling to private owners brought an increase of profitability from 2000.

While sustained global recession that gradually spread from the financial market into the real economy caused that even year 2008 was successful<sup>4</sup> for Slovak banks, in comparison with the bank sector worldwide, the impact of economic depression on the economic results of Slovak banks was negative in

the first half year 2009. According to data of the National Bank of Slovakia from August 2009 (National Bank of Slovakia 2009c), banks in Slovakia achieved a net profit in the amount of EUR 204.9 million for the first seven months of this year. In comparison with the same period of last year it is a decrease of profitability by 50%.

A similar scenario of considerably shrinking potential of profitability growth for the Slovak bank sector was advised by the central bank in its study from April 2009 (National Bank of Slovakia 2009a). The cause was stagnation at the loan market which would negatively influence interest revenues and revenues from foreign-exchange operations. At the same time, the decline of interest margins will stop due to growth of credit risk. Due to negative economic development, the cost of creating loss reserves will increase for commercial banks in 2009.

According to a common report by National Bank of Slovakia and Ministry of Finance of the Slovak Republic<sup>5</sup> (2009) from September 2009, the amount of loans provided by banks to the company sector decreased by approximately 6% between the beginning of 2009 and June 2009. The decrease of loans was undoubtedly determined by impaired foreign and domestic economic development which affected significantly the growth of the economy of the Slovak Republic. According to a report by National Bank of Slovakia<sup>6</sup> (2009d), reduced demand of companies for long-term loans signaled a decrease of their investment activities. The slump of demand at relevant foreign markets resulted in a decrease of production<sup>7</sup> and profitability<sup>8</sup> for the domestic business sector, which inevitably led to a degradation of their financial situation. This fact logically had an impact on the capability of companies to settle their liabilities. As a consequence, banks tightened their terms of providing new loans for fear of a significant slump of performance and financial indicators in the business sector. Thus, due to growing credit risk, banks responded to the worsening economic environment and growing uncertainty (National Bank of Slovakia and Ministry of Finance of the Slovak Republic 2009).

lion will be funded by UBS through the sale of its own assets (Goldstein 2009). UBS reported a net loss of CHF 19.7 billion for 2008, the largest loss in the history of the Swiss company (UBS 2009). Its net loss for 2007 amounted CHF 4.38 billion as a consequence of writing off bad investments in the amount of USD 18.4 billion, in comparison to a net profit in the amount of CHF 12.26 billion in 2006.

4 Banks in Slovakia has generated the profit of € 0.55 bil. in 2008.

5 Report on the business loan options of the Slovak banking sector.

6 Report on the situation and development of the financial market in 2008.

7 Industrial production of Slovakia slumped by 21.7% during the first seven months of 2009. The largest decrease was in the production of automotive vehicles—by 41.9%, in the production of machines and equipment—by 30.9%, and in the production of chemicals and chemical products—by 30.7% (Statistical Office of the Slovak Republic 2009a).

8 Corporations in SR experienced a decrease of profits by 38.9% in the first half of 2009. Profits of non-financial corporations decreased by 41.7% interannually. Profits decreased by € 1,344.6 mil. in industrial production and by € 674 mil. in trade, in comparison with the same period in 2008, respectively. (Statistical Office of the Slovak Republic 2009b)

The growing degree of risk of company loans documents an increase of unsecured loans in banks, when the ratio of failed loans reached 4.5%, compared to 4% in May 2009. Since the end of January 2009, the amount of failed loans increased by approximately 117 million EUR, which represents an increase by almost of 35% (National Bank of Slovakia and Ministry of Finance of the Slovak Republic 2009). Situation in the provision of loans for the household sector was slightly different, according to National Bank of Slovakia (2009d). The selected indicators turned for the worse as well, but not as considerably as for companies. The lower growth rate of loans for households was caused especially by the decrease of demand due to an expectation of continued decrease of the population's economic sentiment in connection with their future economic situation.

The above-mentioned approach of banks could be qualified as a responsible and reasonable one, since banks are business entities administering mostly liabilities and have to be exceptionally careful in investment. The loan restrictions by banks are only logical as a response to aggravated domestic and foreign economic environment.

## Impact of the financial crisis on public finance in the Slovak Republic

The recession decreases the revenues of state budgets and measures stimulating economic recovery increase the deficit of public finance. Reinhart and Rogoff (2008) state that recessions are almost always accompanied with massive increase of government debt. The budget deficit of the European Union will amount to 6% of GDP in this year. The deficit was at the level of 2.3% of GDP (European Commission 2009b) in the previous year. French minister of economy Christine Lagarde proposed in the beginning of June 2009 to accept the deficit of public finance in the EU as a temporary exception from the rules of the Stability and Growth Pact (deficits up to 3% of GDP) without subsequent sanctions for violating the set limit (Proissl and Meier 2009). But the French proposal has been declined by the ministries of finance of the eurozone and thus the Maastricht criteria on permitted deficit remain in force (Willis 2009).

The worst economic recession for the last 80 years has increased the budget deficit of every country in the EU. The increasing budget deficits were caused especially by high expenditures spent by governments on anti-depression stimulation measures and lower tax revenues as a result of decreasing economic production. According to a spring forecast by the European Commission (2009b), the highest deficits in 2009 will be in Ireland—12%—and Great

Britain—11.5%. Generally, according to the forecast of the EC, up to 21 countries will break the 3% budget deficit rule.

The Council of the EU<sup>9</sup> asked France, Greece, Ireland, Spain and Great Britain in April 2009 to decrease their budget deficits. Greece has to decrease its budget deficit under 3% of GDP until 2010, France and Spain have to do the same until 2012, Ireland has to decrease its deficit until 2013, and Great Britain, which is not a member of the eurozone, has to decrease the budget deficit until 2013–2014. In its recommendations, the Council set the deadline for adopting measures for deficit elimination at October 27, 2009. The EU Council opened excessive deficit procedures with other countries as well—Latvia, Lithuania, Malta, Poland and Romania. At the same time it issued revised recommendations to Hungary on measures to be taken in order to correct its excessive deficit. Malta has to reduce its deficit below the 3% of GDP threshold by 2010, Lithuania, Hungary and Romania by 2011 and Poland and Latvia have to do so by 2012. The Council set 7 January 2010 as a deadline for all six member states to take action to correct their excessive deficits. Commissioner responsible for Economic and Monetary Affairs, Joaquín Almunia, stated on 7 July 2009 that excessive deficit procedures by the EU Council would be also opened against other countries, most probably including Slovakia, by the end of 2009 (Reuters 2009).

The deficit of the budget of public administration for 2009 was planned in the amount of € 1.527 billion, which means 2.08% of GDP in the Slovak Republic. According to the expectations of the Ministry of Finance of the Slovak Republic (2009c) from September 2009, the influence of the revenue drop would result in a budget deficit in the amount of 6.29% of GDP. Nominally, the deficit would increase by € 2.5 billion in comparison with the originally approved budget, to € 4.027 billion. According to the Ministry of Finance report (2009c), the excess of originally established deficit is a consequence of the action of automatic stabilizers and anti-depression measures adopted by the Government of SR. But the Ministry of Finance (2009b) expected the deficit in the amount of the three per cent of GDP as late as in April 2009. Government plans a gradual consolidation of public finance by reducing the deficit from 6.29% of GDP in this year to 5.5% in 2010, 4.2% in 2011 and below 3% in 2012. (Gomez and Tomek 2009) For achieving this aim, the Ministry of Finance plans to re-organize the structure of ministries and cut down their expenditures in drawing up the budget for 2010.

9 Recommendations of the Council are included in the following documents: United Kingdom 7956/09, Ireland 7902/09, France 7898/09, Spain 7904/09, Greece 7900/09, Latvia – 11660/09, Lithuania – 11398/09, Hungary – 11404/09, Malta – 11396/09, Poland – 11400/09, Romania – 11402/09.

According to our opinion, the considerable increase of deficit (Table 5) was also caused by failure of public policy and the government to act, since they only took symbolic actions on the expenditure side such as reduction in the purchase of cars and copy devices. At the time of depression it is very important to orientate fiscal policy especially on eliminating less efficient expenditures, and government failed to do so in spite of the fact that negative economic development was indicated as early as in the last quarter of 2008 and in the first half of 2009. If more considerable savings had been implemented from the beginning of the year, the deficit would not have been at the level of 6.29% of GDP.

We suppose it will be very difficult to begin the intended consolidation of public finance in 2010, considering also the fact that parliamentary elections will be held in Slovakia. It could be supposed that the government will not adopt measures which could threaten a favourable election result. Of course, Slovakia is not an isolated exception with a deficit of public finance exceeding the Maastricht criteria, but it must be noted that the government does not have to spend billions of Euros to save the banks as many other member states of the EU did. This is another reason why we consider that the deficit should have been lower.

**Table 5**—Preliminary forecast of the balance of public administration of SR for 2009 (ESA 95)

	million EUR	% HDP
Deficit of PA after approving particular budgets	<b>-1527.0</b>	<b>-2.08</b>
State budget	-1438.9	-2.25
Extrabudgetary accounts	-430.3	-0.67
Other subjects of public administration:	-631.4	-0.99
– Social Insurance Company	-475.9	-0.74
– Health insurance companies	-38.3	-0.06
– State funds	28.5	0.04
– Municipalities and Regions	-104.5	-0.16
– Other	-41.2	-0.06
Actual forecast of deficit of public administration	<b>- 4027.6</b>	<b>-6.29</b>
including: increase of deficit due to updated GDP forecast		-0.80

Source: Ministry of Finance of the Slovak Republic (2009c)

According to a forecast by the Institute of Financial Policy (IFP) from July 2009, tax revenues will decline by € 1.6 billion in comparison with expectations, as a direct consequence of the economic depression in the Slovak Republic in 2009. State budget of SR for 2009 expected tax revenues in the amount of € 9.885 billion, but according to the IFP forecast they will amount to € 8.285 billion only (Gábik and Novysedlák 2009).

Reductions in collected corporate income tax in the amount of € 598.9 million, value added tax in the amount of € 479.6 million, employment income tax of € 323.6 million, and consumption tax of € 193.8 million will create the largest share of lower tax revenues. Lower income by the state will decrease the proceeds of the Social Insurance Company by € 475.9 million and those of health insurance companies by € 38.3 million. In comparison with approved budget, other than tax revenues will decrease by € 783.3 million. This amount includes a decrease of income from grants and transfers of € 646.6 and a decrease of non-tax income in the amount of € 136.7 million. According to the Ministry of Finance report (2009c), the reduction of revenues from grants and transfers influences the expenditures of public administration equally, and therefore, their general impact on deficit of public administration is neutral.

## Anti-crisis measures of the Government of the Slovak Republic

The bankruptcy of the U.S. investment bank Lehman Brothers on 15 September 2008 is the synonym for the beginning of financial crisis, which hit the entire financial sector in unprecedented scale. The fall of the fourth largest investment bank in the U.S. started a chain reaction of further bankruptcies and existence difficulties of financial corporations, which resulted in enormous uncertainty and loss of confidence on the financial market. The system of inter-bank loans virtually ceased to operate from day to day due to doubts about the solvency of several financial institutions. Lack of liquidity and more difficult loan availability on financial markets became the problem and, as a consequence, a series of bankruptcies, forced sales and state interventions occurred, especially in the U.S. and Europe. Governments all over the world were forced to provide expensive rescue packages to prevent the fall of banks and a collapse of the world financial system.

Despite the fact that banks in Slovakia were not affected by the mortgage crisis and government did not need to provide them with state interventions, for the benefit of calming of situation and increasing of confidence of banks,

the Slovak Republic adopted full government guarantees for inaccessible deposits, effective as of November 1, 2008<sup>10</sup>.

It is necessary to note that the government has no direct means of addressing the depression since it is caused by external environment, but it can moderate the consequences of the depression through the measures taken. Therefore the Slovak Republic has adopted a series of three anti-depression packages for moderating the consequences of global economic depression (which had spilled over into the real economy through the loan crisis). The total costs of anti-depression measures adopted by the Slovak Republic will amount € 1.462 billion (2.3% of GDP) in 2009. This includes a budget expansion in the amount of € 282 million (0.4% of GDP). Total costs for anti-depression measures will amount to € 579 million (0.9% of GDP), including a large budget expansion in the amount of € 393 million (0.6% of GDP). (Národný program reforiem... 2009)

The government adopted the first anti-depression package on November 6, 2008 in the form of a "Proposal of the Government of SR for overcoming of impacts of global financial crisis" (Ministry of Economy and Ministry of Finance of the Slovak Republic 2008). The proposal included 27 measures oriented on several spheres of economic policy<sup>11</sup>. The first package consisted of only very generally defined measures, which had been more or less defined in previously adopted documents and declarations of the government<sup>12</sup>. This set of measures was limited, although some of them were supposed to be pursued irrespective of depression and others did not directly address depression. According to our opinion, the general nature of the first package of measures is shown by fact that government did not earmark any, even approximate, financial amounts for their implementation.

We consider the support of PPP projects in the sphere of highways<sup>13</sup> within the package to be beneficial, having real and relevant significance in the effort to moderate the impacts of the depression. By implementing the public-private partnership project, the government can stimulate employment and

production in the construction industry which suffered large losses due to the depression. Also other branches of the economy will profit from this kind of partnership (e.g., the metallurgical and transportation industries) and in any case we appreciate the total effect of it.

The second, long-term aspect of this measure involves an increase of the competitiveness of SR. A quality transport infrastructure is one of the basic presumptions of economic development in every country. In addition to facilitating the inflow of investments and efficient business, this aspect also has direct influence on the living standards of population. Slovakia has had considerable deficits in highway network construction for many years. The necessity of highway construction is not a new idea in Slovakia and to be strict, we have to state that this initiative was included in the Program Declaration of the government as early as in 2006, when the depression did not exist.

We consider as added value the fact that the government decided to implement the demanding project of highway construction in this stage of economic cycle of the Slovak economy. The investment of financial resources into the construction of road infrastructure will have a positive effect for the economy within a relatively short time.

In the area of financial market, the government focuses on supporting small and medium-sized entrepreneurs through two state-owned banks—*Slovenská záručná a rozvojová banka (SZRB)* and *Exportno-importná banka SR (Eximbanka)*. The task of the SZRB within the anti-depression measures is to expand existing programs for small and medium-sized entrepreneurs and to prepare the drawing of a loan line from the European Investment Bank in the amount of € 30–40 million for the development of small and medium-sized business. On the other hand, the Eximbanka will expand its financing of export loans in the segment of small and medium-sized enterprises. The measure has, in our opinion, a reasonable basis. After expected tightening of loan conditions by banks, some companies found themselves without the necessary liquidity due to a fear of increasing unsettled loans. As a consequence of loan restriction by commercial banks, loan options will run out, especially for smaller companies, which have financed their activities through the commercial banking sector. Therefore, under the given circumstances, we consider the increased support of the domestic business sector to be a measure which will really help those subjects.

At the labour market, the government focuses on making its active labour market policies more efficient and on modernizing employment services. However the way the measures are defined is too vague and furthermore these activities would be an implied duty of government policy irrespective of depression.

10 Previous wording guaranteed a compensation of 90% of inaccessible deposits, but not above the amount of EUR 20,000.

11 The document was updated on December 17, 2008 to include measures approved by the European Commission and the European Council in their Plan of Economic Recovery for Europe.

12 For example, the National Reform Program for the years 2008–2010; Program Declaration of the Government of SR, August 2006.

13 On August 27, 2009, Slovakia entered the historically first PPP project, called Gravia, for construction of a 52 km expressway "R1" from Nitra to Tekovské Nemce. 13 European banks participate in financing of the project, including the European Bank for Reconstruction and Development, which provided a loan of € 250 mil. The costs of constructing and operating the selected sections of R1 will amount to € 1.8 billion.

The category of measures which increase the competitiveness of SR and, at the same time, should be common activities regardless of the phase of economic cycle include, in our opinion, plans such as assuring the drawing of EU funds according to plan, supporting applied research, innovations and transfer of technologies, reducing the number of bureaucratic obstacles and barriers in doing business or reducing energy intensity and improving energy efficiency.

The second package, which was adopted by the government on February 2, 2009 as “Proposal of measures for moderating the impacts of global financial depression and economic depression on employment,” was more specific in nature (Ministry of Labour, Social Affairs and Family of the Slovak Republic 2009). It included 7 active labour market measures for moderating the impacts of depression. The intention of the package was to support maintaining and creating approximately 63 thousand jobs in 2009 and the same number in 2010. An amount of € 332 million was earmarked for its implementation.

The second package already contained the specific solutions in the sphere of employment and successful measures which helped employers to save as well as create many jobs. We regard the following two as the most successful within the framework:

### **Maintaining employment with employers dealing with the impacts of global financial depression and economic crisis**

The expected annual number of positions within this measure was 20,000 on average.

The contribution for maintaining employment was used by 182 employers by the end of July (Centre of Labour, Social Affairs and Family 2009b). Owing to these contributions, 22,609 job positions were maintained with a total cost of € 8.93 million (by July 31, 2009). This measure is intended to cover social and health insurance provided that employer has trouble operating due to impact of global crisis and at the same time maintains the jobs and pays wage compensations in the amount of 60%. A total amount of € 28 million was planned for 2009–2010.

### **Support for creating new jobs**

The expected annual number of persons supported is 2,500 on average. Employer is required to keep the created job position for at least 12 calendar months.

Owing to this contribution, 1,864 jobs were created during 5 months in Slovakia, with total costs of € 5.93 million. Approximately 50% was drawn from the total budgeted amount of € 12 million for 2009–2010 (by July 31, 2009).

*A contribution to wage for new employees* whose gross monthly wage is 1.7 times the minimum wage or lower, is a less efficient measure. This contribution was applied for by 88 persons by the end of July 2009, while the costs were € 100 thousand. The expected number of supported persons was 7 thousand, with expected costs of € 10.8 million per year. Approximately 0.4% were drawn from the total amount of € 25 million budgeted for 2009–2010.

*Contribution for self-employment* was the least successful measure from among the measures adopted, since only one applicant applied from March to July 2009. The expected number of supported persons was 5,000 per year. The total budgeted amount for 2009–2010 was € 6.9 million. *Contribution for self-employment in the sphere of processing and marketing agricultural products* fell even more disastrously. Nobody applied for this type of contribution. The expected number of supported persons was 3,200 per year. The amount earmarked for this contribution for 2009–2010 was € 4.3 million.

The second package also included two other measures, *Support for creating and maintaining social businesses, with emphasis on creating municipal social companies*, and *Making interregional labour mobility more intensive*.

The third package of measures was adopted on February 9, 2009 under the name “Proposal of a third set of measures for moderating the impacts of economic depression,” and consisted of 24 measures including 5 macro- and 19 micro-measures.

Macro measures focused on starting real PPP projects to enable quick drawing from the EU funds, increasing the non-taxable portion of household income and increasing employee bonuses, shortening the time limits for value added tax refunds, and adjusting the price thresholds for tangible and intangible assets for income tax purposes.

Eight of the proposed micro measures are focused on the sphere of business environment, three micro measures are focused on the sphere of business environment, three micro measures are focused on the sphere of energy, two on the sphere of tourism and six micro measures are focused on supporting research and development (Ministry of Economy and Ministry of Finance of the Slovak Republic 2009).

The basic tax deductibles and employee bonuses were increased for the taxation periods of 2009 and 2010. This measure will come into effect from March 1, 2009 and includes the following:

- increase of tax deductible from 19.2 times the minimum wage to 22.5 times the minimum wage, thus from € 3,435.26 to € 4,017.80.
- the threshold for lower tax deductibles (degressive taxation) decreases from 100-times the minimum wage to 86-times the minimum wage, thus from € 17,892 to € 15,387.

- increase of employee bonus. Low-income groups will be entitled to an additional payment from state. Employees with income up to the level of minimum wage (€ 295.5) are entitled to the employee bonus. The maximum amount of this bonus is € 15.09 monthly.

According to the amendment's preamble, these measures are focused on persons who have the highest tendency to consumption, while higher income groups should profit from the tax reductions. According to the authors of the given changes, it will be possible to create new jobs in addition to the support of aggregate demand within the medium-term horizon.

### Subsidy for purchase of new car—The “Scrap Scheme”

The scrap scheme represents an incentive aiming at supporting the sales of new cars and thus a recovery of the decimated automotive industry. The substance of this measure is a financial subsidy from the state for purchasing a new car in exchange for the scrapping of an older automobile<sup>14</sup>.

Scrap subsidies were offered in two rounds in the Slovak Republic in 2009. 44,200 cars were handed to authorized processors for scrapping. The amount of spent financial resources from state budget: € 55.3 million. The maximum purchase price of a car was determined at € 25,000. The first round of subsidy provision lasted from March 9 to March 25, 2009. The state provided the bonus for one motor vehicle in the amount of € 1,500 provided that the dealer provides a further discount of € 500. Failing the dealer discount, a state contribution of € 1,000 was provided. 22,771 cars were scrapped and state subsidies were provided in the amount of € 33.2 million. The second wave took place from April 6 to April 14. The state provided a scrap subsidy in the amount of € 1,000 provided that dealer also provides a discount in the amount of at least € 1,000. In the second wave, an amount of € 22.1 million was earmarked for the purchase of 21,429 cars (Table 6).

The scrap scheme is the most media-covered, discussed and commented anti-depression measure adopted by the government of SR.

In our opinion, it was just a short-term and unsystematic step, which served as indirect subsidy of automobile manufacturers and dealers. Furthermore, it discriminated against other branches of industry, which did not receive any similar aid from the government administration. Thus, taxpayers

**Table 6**—Statistics of the scrap subsidy scheme in the Slovak Republic (as on July 31, 2009)

	1 <sup>st</sup> round	for 20,858 pcs; from March 9 to July 31, 2009	EUR
Cars invoiced to customer	189,377,699.59 €	Avg. sales price for customer	9,079.34
Subsidy provided	31,226,000.00 €	Avg. subsidy	1,497.07
VAT collected	35,222,893.38 €	Avg. price before subsidy provision	10,576.41
		Avg. dealer subsidy	702.41
		Avg. basic price of car	11,278.60
	2 <sup>nd</sup> round	for 15,803 pcs; from April 6 to July 31, 2009	EUR
Cars invoiced to customer	186,995,293.23 €	Avg. sales price for customer	9,681.27
Subsidy provided	15,803,000.00 €	Avg. subsidy	1,000.00
VAT collected	26,950,639.38 €	Avg. price before subsidy provision	10,681.27
		Avg. dealer subsidy	1,151.63
		Avg. basic price of car	11,832.90

Source: Ministry of Economy of the Slovak Republic (2009b)

supported only one industry from public resources, while several were affected by the depression (construction industry, metallurgical industry) and we can only guess that lobbying by the representatives of automotive industry played a big role in it. In the time of deep recession, when the Slovak Republic fully experienced its consequences, such measures burdening the public finance are not, in our opinion, suitable. On the one hand, demand for automobiles was maintained unnaturally and, on the other hand, the scrap scheme just shifted the planned purchases of cars from future years to 2009. This measure covered only 44.2 thousand automobiles, while 575 thousand vehicles are manufactured in Slovakia annually. According to data from the Ministry of Economy of SR, there only 9.19% (2,654 pcs) of the automobiles sold were manufactured in Slovakia, as at the end of July.

The most important and at the same time the most dangerous aspect of the scrap scheme is the fact that the government artificially initiated the demand for consumption (of new cars) and thus encouraged households to consume on credit. More households got into debts by purchasing new cars due to

14 The European Commission has unified the rules for providing subsidies for the purchase of new motor vehicles in February 2009. The primary requirement of the EC is that the subsidies do not have a protectionist character (as originally proposed by France) and speculations with subsidies by their recipients have to be prevented.

the scrap subsidy and, taking increasing unemployment into account, certain groups of people will have difficulties settling their obligations in future. We see a threat in the analogy with the U.S. administration, whose policy of facilitating consumption on credit was one of the primary reasons behind the U.S. mortgage crisis.

### Program of provision of aid to citizens who lost their ability to pay mortgage due to economic depression

The state subsidy for mortgages payback was approved on July 15, 2009 by resolution of the Government of SR no. 515<sup>15</sup>. The principle of this refundable is a subsidy from the state for citizens who fail their mortgages due to a loss of employment after January 1, 2009 as a consequence of economic depression. The state will pay 70% of the amount of an instalment for the debtor for 6 months and the debtor will pay 30% of the amount of that instalment. The loan must be provided before December 31, 2008 and the debtor must not have any other property or financial resources for loan payback. In case that debtor is duly paying his/her liabilities during the first 6 months, it is possible to extend the period by another 6 months depending on the course of economic depression. The subsidy will only apply to those who have their loans guaranteed by a real estate being their place of permanent residence, while the amount of loan must not exceed € 83 thousand.

Inclusion into the program will be time limited for the period from January 1, 2009 to December 31, 2010. The proposal foresees approximately 1,000 loans being unpaid with every 10,000 new unemployed. The amount of subsidy from state is thus expected to be approximately € 2.8 million per every 1,000 failed loans.

We consider this proposal to be very beneficial because it directly influences the group of inhabitants who find themselves in a situation, without their own fault, when they are temporarily unable to fulfil their liabilities due to the consequences of global economic depression. Such measure is in accordance with the principle of the welfare state which the government in power is trying to build. We see another positive aspect in the fact that this proposal will not burden public finance because it is a returnable subsidy, the recipient of which will return it into state budget in future.

15 Relevant provision of the program of provision of aid to citizens who lost their ability to pay back their mortgage due to economic crisis.




















## Conclusion

We think that the world financial depression has principal influence on micro- as well as macroeconomic environment, affects the selection of instruments of public policy, and distinctly changes the position of countries in the world economy (Třebuňa and Mihok 2008). This consequently means a change in country competitiveness. According to Potůček (2009), future development prospects are open up in configurations that are rather unclear. He says that it will be necessary to make important political decisions at the supranational and national levels (control of global financial markets, increase of tax burden).

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