DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR THE SLOVAK REPUBLIC

As approved by the Board of Directors at its meeting on 13 November 2012

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EXECUTIVE SUMMARY

The Slovak Republic is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement establishing the Bank.

The Slovak Republic is an advanced transition country, which implemented the body of EU market regulation prior to its EU accession in 2004 and which has benefited from integration into the EU internal market through substantial capital inflows and growing trade shares with the rest of the EU. While the global economic crisis hit Slovakia hard in 2009, the economy posted a strong recovery with GDP growth of over 4 per cent in 2010 and 3.3 per cent in 2011, well above the regional average. However, growth remains closely correlated with, and hence vulnerable to, the cycle in German industrial production. Total exports account for 80 per cent of GDP and value-added in manufacturing for about 35 per cent of GDP, and this sector is in turn concentrated in a few products, importantly vehicles and electrical equipment.

By contrast with Slovakia's export sector, domestic demand remains subdued by high structural unemployment (at around 14 per cent) and ongoing budgetary austerity measures. As the budget deficit and public debt rose sharply following the 2009 recession, the previous government implemented a significant consolidation, including public sector pay cuts and an increase in the VAT rate over the course of 2011 that led to a renewed fall in net disposable income. The new government under Prime Minister Fico has committed itself to further fiscal consolidation through a mixture of expenditure cuts and a wide-ranging reform of the tax system. While Slovakia's public debt remains the seventh lowest in the EU, the ratio of debt to GDP is expected to have doubled to 53 per cent by 2013. Through these new measures the budget balance could reach the EU-mandated target of 3 per cent by 2013.

Unlike in several other economies of the central Europe region, capital flows into the Slovak banking system have been limited, resulting in sound funding structures, and overheating and destructive asset bubbles have been mostly avoided. At the same time, foreign direct investment flows into export-oriented industries have been limited to a small number of cyclical industries. As a result, Slovakia remains highly exposed to adverse external developments. Also, regional disparities remain large and are correlated with long-term unemployment. Unemployment remains very high for the country as a whole, despite moderate GDP growth since the 2009 crisis. Insufficient and narrowly-based R&D spending also remains a challenge.

The Slovak Republic has made solid progress in building functioning market institutions in most sectors of the economy. However, there remain significant transition challenges in terms of market structure in a number of areas, including sustainable energy, infrastructure, MSME financing and capital markets. The private equity market is also underdeveloped. The uncertain external environment makes it especially important to addressing these remaining transition challenges. Against this background, the new government's programme as laid out in the manifesto of May 2012 lays the foundations of more durable and evenly-based growth, in particular through investment in physical infrastructure and addressing skills mismatches.

Strategic directions

As Slovakia is an advanced country expected to graduate during the CRR4 period (2011-2015), the Bank's activities will focus on a limited number of priorities during the upcoming strategy period. The Bank will provide support in the core areas where transition challenges remain, recovery from the financial crisis still requires support, and where reforms can be accelerated to improve the competitiveness of the country as a member of the eurozone. The priorities in the next strategy period include:

- **Deepening financial intermediation and support for SMEs**. The Bank's engagement in the financial institutions sector will focus on further enhancement of the availability of credit finance to the small and medium size local enterprises as well as to small municipalities, with an emphasis on deepening financial intermediation to SMEs in the less developed regions of Slovakia. The Bank will also seek to expand the successful financing programmes implemented through commercial banks providing funding and expert assistance for small energy efficiency and renewable energy investments of private and public sector entities. The Bank will also pursue other opportunities with financial intermediaries on equity and mezzanine financing.
- **Supporting investments in infrastructure, energy security and energy efficiency.** The Bank aims to support the development of and take part in viable financing structures allowing to secure long term financing for projects in the commercial infrastructure sector, through co-operation with other IFIs and private sector participants. On the energy side, the Bank will promote diversification of energy supply with a focus on renewable energy sources and energy efficiency throughout sectors to enhance energy security, reduce energy intensity and meet required EU environmental targets set to combat climate change.
- **Support cross border co-operation and investments** of leading local entities in other countries of EBRD operations in order to enhance their regional presence.

1. THE BANK’S EXPERIENCE AND PORTFOLIO

1.1 Overview of the activities to date

The EBRD has signed 124 operations in Slovakia to date with a net cumulative business volume of EUR 1.63 billion and a total project value of EUR 6.06 billion. On a cumulative basis approximately 32 per cent of the investments have been in the Financial Institutions sector, 32 per cent in Industry, Commerce and Agribusiness, 19 per cent in Power and Energy and 17 per cent in the Infrastructure sector.

Table 1: Portfolio Development in Slovakia as at 31 May 2012

SECTOR	NET CUMULATIVE BUSINESS VOLUME				CURRENT PORTFOLIO STOCK				
Amount in EUR million	No of Projects	Total Project Value	EBRD Finance	EBRD % of Total	No of Projects	Portfolio	% of Portfolio	Operating Assets	% of Operating Assets
Power and Energy	**10**	**1 592**	**313,4**	**19%**	**3**	**63**	**11%**	**62,3**	**13%**
Financial Institutions	**42**	**946**	**528,2**	**32%**	**13**	**172,4**	**30%**	**163,9**	**35%**
Bank Equity	10	526	150,1	9%	1	1,2	0%	1,2	0%
Bank Lending	24	309	279,6	17%	11	122,1	21%	113,6	24%
Insurance & Financial Services	8	111	98,6	6%	1	49,2	8%	49,2	10%
Industry, Commerce & Agribusiness	**62**	**1 898**	**512,6**	**32%**	**27**	**86,8**	**15%**	**36,8**	**8%**
Agribusiness	7	56	29,9	2%	0	0	0%	0	0%
Equity Funds	30	313	95,4	6%	20	38,6	7%	19,2	4%
Telecoms, Infom., Media	8	709	105,5	6%	2	23,9	4%	0,5	0%
Manufacturing and Services	8	566	216,4	13%	0	0	0%	0	0%
Property and Tourism	9	254	65,5	4%	5	24,3	4%	17,1	4%
Infrastructure	**10**	**1 505**	**278,7**	**17%**	**6**	**257,2**	**44%**	**210,5**	**44%**
MEI	7	126	43,9	3%	4	37,4	6%	21,3	4%
Transport	3	1 379	234,8	14%	2	219,8	38%	189,2	40%
TOTAL	**124**	**6 063**	**1 633,0**	100%	49	579,5	**100%**	473,5	**100%**

Note: Equity Funds includes various regional funds with allocations to Slovakia

The Bank’s cumulative business volume and portfolio increased significantly during the previous strategy period, as demonstrated in Table 2 below. The Bank committed EUR 395 million of new business in 25 operations during this period.

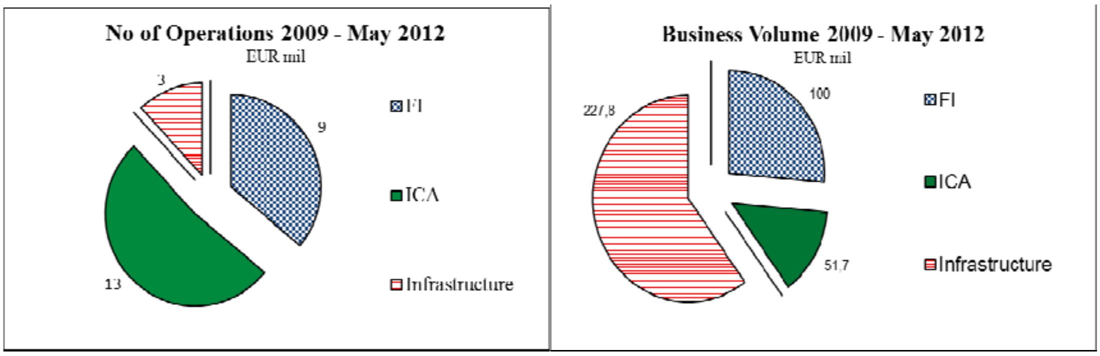
Table 2: Portfolio Development in Slovakia 2009 – 2012

Amount in EUR Million	**2008**	**2009**	**2010**	**2011**	**2012/05**	**Development 2009-2012**
						End 2008 vs May 2012
Net Cumulative Business Volume	1 257	1 471	1 554	1 614	1 652	+24%
Number of Operations (#)	105	114	120	123	125	+16%
Current Portfolio Stock	281	466	533	567	584	+52%
Number of Operations (#)	49	49	54	48	50	2%
Operating Assets	213	238	371	471	497	+57%
% Undrawn	22%	48%	29%	16%	14%	
						Cumulative 2009-May 2012
Annual Business Volume	3	227	63	68	28	€386mn
Number of Operations (#)	2	8	7	8	2	25 projects
Gross Disbursements	42	57	125	132	37	€351mn
Annual Cancelations	8	6	2	1	0	€ 9mn
Active Pipeline Stock	256	376	77	76	158	
Private Sector Share (% Portfolio)	100%	100%	100%	100%	100%	
Non-Sovereign (% Portfolio)	100%	100%	100%	100%	100%	

Notes: per cent undrawn excludes guarantees. Current Portfolio includes active operations only. Active Pipeline Stock includes regional projects

In the previous Strategy period the Infrastructure sector represented 60 per cent of the Bank's total lending as a result of a single very large transport infrastructure project. The Financial Institutions sector represented 26 per cent while Industry, Commerce and Agribusiness represented 14 per cent of the business volume. There were no direct EBRD investments in the Power and Energy sector during this period, although this sector was represented under the SLOVSEFF programme as described below.

Figure 1: Sector Split of New Business in Slovakia, 2009 – 2012



1.2 Implementation of previous country strategy

The previous Country Strategy for Slovakia was approved in February 2009, by which point the effects of the financial crises had started to take a toll. The 2009 Country Strategy targeted the following operational objectives:

- Ensure the continued availability of credit to SMEs and municipalities.
- Participate in a co-ordinated IFI effort to contribute towards financing of viable public-private concession projects in transport infrastructure.
- Consider investments to improve energy efficiency and support selected new generation projects, particularly from renewable sources.
- In light of the decrease in available debt financing, support local companies, most of which are SMEs, with equity capital.
- Actively manage the Bank's portfolio to maintain its high quality.

During the strategy period all signed operations were in line with the above strategic goals of the Bank and formed the important crisis response support in Slovakia.

Most notably, the Bank signed its largest project in Slovakia in August 2009, the R1 Motorway, the first public-private partnership (PPP) project in the transport infrastructure in the country. The Bank's commitment of EUR 199.8 million, complementing scarce commercial resources at the time of the crisis, was instrumental to the project's financial closure, allowing for the implementation of this pioneering public-private partnership transport infrastructure project in Slovakia. The project is now largely completed and operational, with full completion planned for the autumn 2012.

The Bank continued to deploy funding to local banks through the successful SLOVSEFF programme which started in 2007. The second phase of this programme consisted of EUR 90 million of EBRD funding and EUR 15 million of grant funding – provided by Bohunice International Decommissioning Support Fund – for small energy efficiency and renewable energy projects. Five leading local banks took part in SLOVSEFF II and EUR 90 million of EBRD funding is now fully disbursed and largely committed to eligible sub-projects. One loan of EUR 15 million was signed under the Municipal Financial Facility, a similar programme designed for small municipalities.

Since 2009 the Bank has committed investments in several regional equity funds with notional indicative allocations to Slovakia of EUR 56 million. Actual investments out of these funds in Slovakia so far represent EUR 8.2 million.

The EBRD has engaged in policy dialogue with Slovak authorities in order to develop PPP structures which resulted in the first road concession and PPP-funded project. Policy dialogue was also intensive with regard to identification of additional sources of TC and investment grant funding for the continuation of the energy efficiency targeted programmes.

1.3 Transition impact of the Bank's portfolio and lessons learned

Since 2009, when the previous Country Strategy was adopted, four transition-rated operations have been signed by the Bank in the Slovak Republic.[1] Three of these operations were in the Financial Institutions sector (bank lending) and one in the Transport sector. All four new projects in the Slovak Republic were *ex ante* rated as having "Good" or "Excellent" transition impact potential, which is in line with the institution-wide target of 80 per cent of projects to be assessed "Good" or better.

The transition objectives of projects signed during the strategy period reflect the Bank's specific activities in the Slovak Republic in 2009-2012, namely, energy efficiency finance and PPP-based road construction. This includes one Excellent-rated project in transport: the construction of a motorway on a public-private partnership basis has the potential of further demonstrating the viability of motorway concessions in the transition region, through increased private ownership in one of the key transport corridors in the region with the participation of a strategic foreign sponsor. As a result, key transition objectives across projects have focused on demonstration effects related to the introduction of new financial products, as well as market expansion.

Transition gaps for both energy efficiency and transport sectors are medium in the Slovak Republic. As on-lending to energy efficiency and sustainable energy operations is still relatively new for the country and, as such, has strong demonstration effects of rational energy utilisation investment, the successful realisation of these three operations in Slovakia's financial sector has significant transition impact potential.

[1] There were 3 additional operations under the SEFF II framework which were not individually assessed for their transition; these are assessed and monitored on the facility level.

All five projects in the Bank's portfolio[2] are on track to achieving their transition potential as of end-May 2012. Out of these five projects, three active operations in Slovakia have a rank in the range from 1 to 3 – in other words, they have mostly achieved their desired transition impact.[3] The remaining operation is currently ranked 4, which indicates that it is on the way to achieving its transition objectives. The average rank of the active Slovak TIMS portfolio at 2.6 is therefore significantly better than average for all operations of the Bank. Four operations that were completed in 2009-2012 and as such do not form part of the Bank's portfolio have also largely achieved their desired transition objectives. Finally, the Sustainable Energy Financing Facility for the Slovak Republic has so far performed well from a transition perspective, with achievement of key transition objectives currently firmly on track.

2. OPERATIONAL ENVIRONMENT

2.1 Political context

On 11 October 2011 the centre-right coalition government led by Prime Minister Radicova fell following parliament's rejection of the eurozone's EFSF rescue fund, which was linked to a vote of confidence in the coalition government. On March 10 2012 early parliamentary elections were held in which the centre-left SMER-Social Democracy Party secured 44 per cent of the vote yielding 83 seats in the 150-seat parliament.

Following the elections, SMER formed a single party government, which is unprecedented in Slovakia's post-Communist history. A single party government promises a higher degree of political stability than previous coalitions. However, SMER now faces the politically difficult task of implementing fiscal consolidation policies over the next two years, in the face of potentially strong opposition from the five other parties represented in the parliament.

A key political challenge that will also affect the business climate is the low level of confidence in the judiciary. Recent surveys suggest a lack of confidence in the impartiality of judges, perceptions of corruption and complaints about the slow pace of legal procedures. The new government manifesto, endorsed by parliament, pledges to adopt measures to build greater confidence in the rule of law and create conditions to enhance the quality and stability of the legal system. This is seen as a prerequisite to improving the quality of decision-making by courts and other public authorities, ensuring the effective protection of fundamental rights and freedoms, improving the enforcement of rights, and reducing delays in proceedings.

See Annex 1 for a more detailed assessment of the political context.

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[2] Projects in the Bank's portfolio refers to all active operations that are more than six months since signing and have been monitored for their transition impact at least once.

[3] Rank is a combination of the relevant rating for transition impact potential and risks to transition impact. Expected transition of operations is usually monitored once a year and is ranked numerically from 1 to 8, with 1 to 3 indicating the mostly realised impact, 3 to 6 – generally on track to achieve transition objectives, and 7 to 8 – minimum transition impact or excessive risks.

2.2 Macroeconomic context

The Slovak Republic has shown a very rapid recovery from the severe 2009 recession, with growth in 2010 over 4 per cent, and at 3.3 per cent in 2011 well above the regional average. Growth remains closely correlated with, and hence vulnerable to, the cycle in German industrial production. Total exports account for 80 per cent of GDP and value added in manufacturing for about 35 per cent of GDP, and this sector is in turn concentrated in a few products, importantly vehicles and electrical equipment. After a brief weakening at the end of last year, recent indicators in early 2012 for exports and industrial production again showed signs of surprisingly strong revival, primarily driven by automotive related industrial production.

By contrast, domestic demand remains weighed down by the continued high structural unemployment (at around 14 per cent) and ongoing budgetary austerity measures. As the budget deficit and public debt had risen sharply following the 2009 recession, the previous government under PM Radicova already implemented a significant consolidation, reducing the deficit from 7.7 per cent of GDP in 2010 to 4.8 per cent in 2011. Public sector pay cuts and an increase in the VAT rate over the course of 2011 led to a renewed fall in net disposable income.

The new government under PM Fico has strongly committed itself to further fiscal consolidation through a mixture of further expenditure cuts and a wide-ranging reform of the tax system. While Slovakia's public debt remains the seventh lowest in the EU, the ratio of debt to GDP is expected to have doubled to 53 per cent by 2013. Through these new measures the budget balance could reach the EU-mandated target of 3 per cent by 2013. The previous government still adopted a new constitutional debt limit (at 50 per cent of GDP), and fiscal performance will now be monitored by a reasonably well resourced fiscal council.

Over the strategy period, Slovakia's growth will therefore continue to remain heavily dependent on the industrial production cycle in the eurozone with little impetus from private domestic demand. Growth in 2012-13 is projected at about 2.6 per cent. The revival in public infrastructure projects could bring some acceleration in the following year. The Slovak National Reform Programme assumes a growth in potential output of about 3 per cent up to 2015, though does not expect such relatively modest growth rates to make a dent in structural unemployment.

See Annex 6 for a table with Selected Economic Indicators.

2.3 Structural reform context

Over recent years the Slovak Republic has experienced several political re-orientations in rapid succession. The new government under PM Fico now has a chance to implement the reform programme more consistently, and has set out its vision in the Updated National Reform Programme approved by the Government in June 2012. The goal of Reform Programme is to foster economic growth and employment in line with the Stability and Growth Pact and the Europe 2020 strategy. The Programme highlights the need to address the following priority areas: (1) education, science and innovation, (2) employment and social inclusion, (3) business environment, (4) transparency and rule of law, and (5) health.

Deficit reduction remains a key guiding principle of that programme, although the new government has committed to safeguard growth-enhancing expenditure such as education and transport infrastructure which are its long-term political priorities. Strengthened tax collection and administration is a central theme of the government's efforts in this area. In a significant departure from the longstanding model of a flat personal tax (which currently stands at 19 per cent), the government has announced that a second tax band for high earners will be introduced. Further, the corporate income tax may be raised from 19 to 23 per cent, and a one-off levy on regulated enterprises (telecommunications, utilities and banks) may be introduced.

There will also be a revised bank tax. The tax is already substantial (0.4 per cent on liabilities net of insured deposits and equity), which is particularly burdensome for banks relying on corporate deposits. The tax could now be partially extended to retail deposits, though would be limited until a certain revenue target is reached, and revenues would be earmarked for a specific resolution fund. These measures would penalise those smaller banks that rely primarily on corporate business.

Privatisation had not progressed much under the previous government and there are indications that the current government is likely to proceed cautiously in this area. The government's manifesto envisages a review of the privatisation programme, aimed in particular at district heating companies.

The government will seek to use EU structural funds as a priority to finance infrastructure projects, importantly for the unfinished parts of the highway to eastern Slovakia, though it also remains open to the use of PPP schemes, possibly in combination with structural funds.

The pension funds industry will also again come under scrutiny. A reduction of the employer contributions into the funds from 9 to around 4 per cent of gross salaries is now being considered. The industry is particularly opposed to the guarantee requirements which have skewed portfolios into defensive allocations, though some more growth-oriented fund allocations with more long term guarantee requirements could now emerge as regulation has been partially liberalised.

Otherwise the financial sector is well regulated. Capital and liquidity ratios are generally sound; several bank subsidiaries utilised the ECB refinancing instruments, though few concerns about liquidity lines from parents have emerged so far. The central bank in January announced new measures to raise mandatory capital standards, limit dividend payments within a certain range of capital ratios, and enforce a cap on loan-to-deposit ratios. While these prudential measures are not binding on most banks, they have underlined the central bank's determination to resist any deleveraging pressures. The central bank has indicated its interest in coordinating such measure with other relevant supervisors, including possibly under the Vienna II framework.

The new government does not question Slovakia's long-standing growth model – attracting export oriented investment in a few cyclical industries. As with the previous government, the Smer administration will seek to complement this with support to technology intensive local enterprises and other SMEs, in particular focused on job creation in the more remote parts of the country. A strategy for the knowledge economy ('Minerva 2.0') was drawn up by the previous government and lists 26 measures in the areas of human resources, support of scientific and innovative research and the reform of the institutional and legal framework. A close collaboration in this area was envisaged between government, educational institutions and business.

See Annex 2 for a detailed assessment of the remaining sector transition challenges.

2.4 Business environment

According to cross-country surveys, the business environment is relatively sound. In the World Bank's *Doing Business* 2012 survey Slovakia was ranked 48th globally (a slight decline since 2011), ahead of some neighbouring countries in central and eastern Europe. The economy scores well in registering property (ranked 10th globally) and in handling insolvency though it lags behind in terms of getting connected to electricity and in terms of tax administration (on the latter, ranked only 130th out of 183 countries, the lowest score in the central and eastern Europe and the Baltics region).

Despite the region-wide drop in FDI flows to central Europe during the crisis, Slovakia has done reasonably well in attracting investments into its manufacturing sector. FDI flows dropped from about 5 per cent of GDP in 2008 to about 1.5 per cent in 2011, though this is likely to increase as a number of investments in important automotive plants will be implemented (see Section 4.1).

The Slovak Republic was ranked 66th in the latest Corruption Perceptions Index by Transparency International published in 2011, below the OECD average and 26th overall in Europe. At the same time the shadow economy is estimated to be significantly lower than in the other CEB economies. In 2007 the World Bank calculated that it accounts for just above 20 per cent of GDP, half the size of the shadow economy share in Estonia or Latvia.

The 2009 EBRD/World Bank Business Environment and Enterprise Survey identified high tax rates (despite the fact that these have been held at a flat rate of 19 per cent since 2004) and skills mismatches in the workforce as the major obstacles to doing business, followed by problems due to the overregulated labour market.

The previous government already adopted a list of 100 measures to comprehensively cut administrative burdens (the so-called Project Singapore). According to Slovakia's Updated National Reform Programme, which was approved by the new government in June 2012, the key measures for improving the business environment are now focused on reducing the administrative burden, further improvements in transparency and on the modernisation of transport infrastructure. Some ambitious goals have been set: by 2020 the Slovak Republic aims at a ranking among the top 15 countries globally in the *Doing Business* report and at further improving its score in the OECD Product Market Regulation Index.

2.5 Social context

The Slovak Republic has experienced significant progress in living standards since the beginning of transition. The UN Human Development Index (a measure of general wellbeing) has been improving since 1990 and ranks the economy 35th worldwide. Slovakia performs relatively well when compared to the other CEB countries on most indicators. Scores for average years of schooling and gross national income per capita are only second to Estonia and Slovenia. According to Eurostat, only 12 per cent of the population was at risk of poverty in 2010, the lowest proportion across the CEB region.

Inequality in Slovak Republic is relatively low. The Gini coefficient is below the EU average and significantly outperforms that of the Baltic States. However the indicator masks the issue of exclusion of the Roma community, the second largest minority group. Some of the most recent research suggests that, as a result of structural changes during the transition period, Roma living conditions deteriorated.[4] High unemployment, low levels of educational attainment, poor housing conditions and resulting ill health hinder Roma chances to integrate into mainstream society.[5]

Unemployment rates in Slovak Republic increased notably over the last few years, peaking at just under 15 per cent in early 2010. The ratio has shown some downward trends but still remains high at 13.7 per cent driven by youth unemployment at 39 per cent, the highest in the CEB region. The employment rate at around 59 per cent is well below the EU-wide target of 75 per cent.

The European Commission's 2012 Ageing Report suggests that over the next fifty years, the total Slovak population is foreseen to decrease by 6.1 per cent (the lowest decrease among the CEB economies) with a parallel drop in the total workforce of almost 30 per cent. As a result of these trends, the dependency ratio (population aged 65 and over relative to the workforce 15-64) is expected to increase from 19 to 68 per cent between 2010 and 2060. It will inevitably put sustainability of the public pension system under severe pressure.

Total health care expenditure stood at about 8.6 per cent of GDP in 2009, of which public health spending was about 6 per cent. Population ageing and cost pressures will raise expenditures on health and old-age care over the next decades unless mitigating measures are taken.

Education expenditure is Slovak Republic is at 3.5 per cent of GDP, the lowest level in the EU. The average years of schooling in 2010 was 11.6, slightly above the OECD average of 11.4 years. In the 2009 OECD Programme for International Student Assessment, the country ranked 35th out of 66 with a below OECD-average rating for reading and science but with an average score for mathematics.

[4] See Katarina Korytkova, Poverty and Social Exclusion in the Slovak Republic: the Case of Roma Ethnic Minority, *Edinburgh Research Archive*, 2011, http://www.era.lib.ed.ac/handle/1842/5366.

[5] See Republic of Slovakia's Roma Integration Strategy, approved January 2012.

2.6 Legal context

The Bank's recent assessments of the commercial laws of the Slovak Republic show that the country has a relatively advanced set of commercial laws. The EU alignment mechanism has played a crucial role in this process.

The legal framework for PPPs is largely governed by the Public Procurement Act, which contains provisions to reflect the EU principles of non-discrimination, transparency and efficiency during the selection process. The laws provide sufficient provisions to ensure bankability of projects through the creation of a range of security interests. It is noteworthy that the sections of the Public Procurement Act relating to PPPs are fairly brief. Should the Government wish to use the mechanism of PPPs there is room for improvement of PPP rules, in particular, by way of developing those related to the provision of economic and financial support on the part of the public authorities.

In the energy efficiency sphere, further work will be required to implement the EU's Third Energy Package and to support the effective implementation of energy policies.

The latest EBRD assessments on corporate governance have shown that the legislative framework is in high compliance with OECD principles. It will be important to continue to assess the effectiveness of these laws and a survey should be undertaken to measure compliance levels.

The judicial reform process has faced continuing delays. Amendments to the Judges and Lay Judges Act, which aim to increase the transparency of judicial proceedings, were delayed following a presidential veto, which was subsequently overruled by the parliament. The amendments are pending before the Constitutional Court, who should rule about their constitutionality.

See Annex 3 for a more detailed assessment of the legal environment.

2.7 Energy efficiency and climate change context

The Slovak Republic's energy intensity has decreased by an impressive 33 per cent between 2002 and 2008 but the economy remains very greenhouse gas (GHG) intensive.[6] Energy-related carbon dioxide emissions account for more than 70 per cent of the country's total GHG emissions and the country's energy intensity is still 1.9 times higher than the EU average and remains among the highest in the OECD. Slovakia is heavily dependent on oil and gas imports, with a large share coming from the Russian Federation.

A legal and institutional framework for sustainable energy is in place but implementation and project activity lags behind. According to the EBRD Index of Sustainable Energy, the Slovak Republic scores very low compared to other new EU member countries in terms of renewable energy and climate change outcomes, although visible progress has been achieved recently in decreasing energy intensity in

[6] OECD Environmental Performance Reviews: Slovak Republic 2011.

various sectors. Energy prices are high compared to the EU average and encourage some energy efficiency investments. An Energy Efficiency Action Plan for the years 2008-2010 has been in place since 2007. Support systems for energy efficiency and renewable energy are in line with EU practices.

Adoption of renewable energy technologies can further reduce the country's carbon footprint as well as increase energy security and industrial competitiveness. Also the potential for energy efficiency remains high, including the modernisation of district heating.

A climate policy is in place and on track to achieve EU 20/20/20 targets: the Slovak Republic is expected produce 15.3 per cent of electricity from renewable sources by 2020, exceeding its 14 per cent renewable energy target, and achieved the largest reduction in the energy intensity of the economy among the OECD countries between 2002-2008. Emissions are projected to grow, however, especially in the transport and industry sectors, creating potential challenges for Slovakia to meet its long-term reduction targets, such as for 2030 and 2050, once they are adopted by the EU.

As an EU member State since 2004, Slovakia has made great progress in aligning its environmental regulatory framework with the obligations of EU membership. More efforts are still needed to engage the business community in a constructive dialogue on environmental issues, and to promote a more proactive approach in which environment is seen also as an opportunity. To address this challenge, Slovakia will have to further strengthen its policies and institutions, and establish a clear and comprehensive framework linking climate, energy and transport policies.

The current Slovakia Energy Efficiency Action Plan (AP) 2011–2013 defines measures and financial and legal instruments to achieve the energy savings target by 2016. As a percentage, this target is identical in all EU Member States; in order to meet it, energy efficiency measures need to be set so that it is possible to demonstrate energy savings equivalent to 9 per cent of the average final energy consumption in the 2001–2005 period.[7]

3. STRATEGIC ORIENTATIONS

3.1 Transition challenges

The Slovak Republic is an advanced transition country, which has implemented the body of EU market regulation prior to its EU accession in 2004, and which has benefited from integration into the EU internal market through substantial capital inflows and growing trade shares with the rest of the EU (see Figure 2 below).

Unlike in several other economies of the central Europe region, capital flows into the banking system have been limited, as is evident in the banking system's sound funding ratios, and overheating and destructive asset bubbles have been avoided. At the same time, foreign direct investment flows into export-oriented industries were limited to a small number of cyclical industries, and Slovakia remains highly exposed

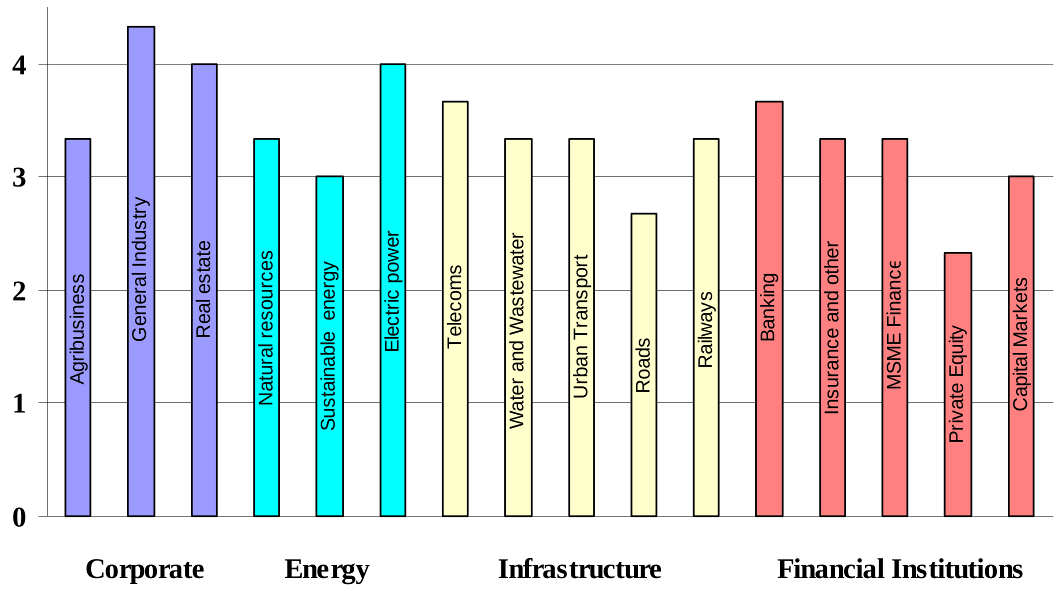
[7] Slovakia Energy Efficiency Action Plan 2011–2013

to adverse external developments. Also, regional disparities remain large and are correlated with long-term unemployment. Unemployment remains very high for the country as a whole (at 13.4 per cent according to Eurostat), despite over three years of growth since the 2009 crisis. Insufficient and narrowly-based R&D spending is flagged in several external assessments.[8]

The 2011 Assessment of Transition Challenges identified on the whole small or negligible transition gaps, with the exceptions of the agribusiness, roads and railways sectors (the latter two sectors suffering from uncertain private financing options). In terms of the market structure there is a broader dispersion of outcomes, with 'medium' gaps still evident in sustainable energy, a number of infrastructure sectors, in MSME financing and capital markets; private equity showed a 'large' gap in terms of market penetration. Addressing these transition challenges will be key given the uncertain external environment for Slovakia.

Against this background, the new government's programme, as laid out in the manifesto of May 2012, lays the foundations of more durable and evenly-based growth, in particular through investment in physical infrastructure and addressing skills mismatches.

Figure 2: EBRD transition indicators for Slovakia, 2011



3.2 Bank's priorities for the strategy period

As Slovakia is an advanced country expected to graduate during the CRR4 period (2011-2015), the Bank's activities will become focused on a limited number of priorities during the upcoming strategy period. The Bank will provide support in the core areas where transition challenges remain, recovery from the financial crisis still

[8] See Commission Staff Working Document: Assessment of the 2012 National Reform Programme and Stability Programme.

requires support, and where reforms can be accelerated to improve the competitiveness of the country as a member of the eurozone.

In light of the impact of the market challenges, the difficult external environment and the remaining transition challenges outlined above, the Bank's activities in Slovakia will focus on the following core strategic priorities:

- **Deepening financial intermediation and support for SMEs**. The Bank's engagement in the financial institutions sector will focus on further enhancement of the availability of credit finance to the small and medium size local enterprises as well as to small municipalities, with an emphasis on deepening financial intermediation to SMEs in the less developed regions of Slovakia. The Bank will also seek to expand the successful financing programmes implemented through commercial banks providing funding and expert assistance for small energy efficiency and renewable energy investments of private and public sector entities. The Bank will also pursue other opportunities with financial intermediaries on equity and mezzanine financing.
- **Supporting investments in infrastructure, energy security and energy efficiency**: The Bank aims to support the development of and take part in viable financing structures allowing to secure long term financing for projects in the commercial infrastructure sector, through co-operation with other IFIs and private sector participants. On the energy side, the Bank will promote diversification of energy supply with a focus on renewable energy sources and energy efficiency throughout sectors to enhance energy security, reduce energy intensity and meet required EU environmental targets set to combat climate change.
- **Support cross border co-operation and investments** of leading local entities in other countries of EBRD operations in order to enhance their regional presence.

In addition to these priority areas, the Bank may selectively consider other opportunities where significant transition gaps remain, the Bank's finance is additional and high transition impact can be achieved. This could involve, for example, projects with local companies in less developed regions with high unemployment, or furthering Slovakia's knowledge economy agenda through investing in innovation and research. Such opportunities are likely to be cross-cutting, and therefore may materialise across various sectors.

3.3 Sectoral Challenges and Bank Operational Response

3.3.1 Financial Institutions

Sectoral challenges

- The banking sector is almost 90 per cent foreign owned and highly concentrated among a small number of institutions. Banks are well-funded through domestic deposits, and have remained profitable. However, in the context of a continuing tightening in credit standards, in part imposed by parent banks, private sector participants seek greater variety in debt instruments, possibly in the form of local bond issuance.

- Given the growing concern by the regulator over reverse funding flows to parents, close cooperation with financial supervisors in European home countries remains essential.
- According to Eurostat, SMEs' access to credit as measured by the success rate in obtaining loan finance deteriorated between 2007 and 2010, as happened in most CEB countries. The previous government stepped up its support to the state development bank, in part in response to this negative trend.

Bank's operational response

To address gaps in access to finance for SMEs, the Bank will focus on further enhancement of the availability of credit financing to the small and medium size local enterprises as well as to small municipalities, with a particular emphasis on deepening financial intermediation to SMEs in less developed regions. The Bank will continue to deploy and aim to expand the successful financing programmes implemented through the local banks that provide funding and expert assistance for small energy efficiency and renewable energy investments of private and public sector entities. The Bank is actively pursuing innovative routes for finding additional sources of TC and investment grant funding for these programmes.

The Bank will also investigate other opportunities with financial institutions in order to broaden the availability of financing products for their clients, including equity and mezzanine financing to support recovery. To enhance the sources of finance to the real economy the Bank will co-operate closely with private equity or mezzanine funds and investors active in the region as well as evaluate the use of risk sharing facilities, as appropriate.

The Bank will promote the development of local capital markets and stand ready to work with financial institutions to facilitate the issuance of corporate bonds and securitisation of banking or other assets.

Policy dialogue

The Bank is pursuing a continuing dialogue with the authorities with regard to the development of a new scheme for mobilising grant funds allowing for the continuation of energy efficiency programmes for small beneficiaries. The scheme involves the sale of carbon credit allowances and the creation of the underlying green investment programme.

The government is in the process of designing a capital markets development strategy with a view to opening alternative funding sources for local companies, in particular SMEs, and creating more liquid local bond and equity markets. The Bank stands ready to advise on this objective, and specific measures, such as sales of equity stakes in state owned companies, bearing in mind that Slovakia's limited market size and its integration in the Eurozone capital markets impose certain limitations. The government is committed to establishing a more predictable regulatory framework for private pension funds which could become important local institutional investor base in support of this broader ambition. While employer contributions may be cut as part of the fiscal consolidation effort, an opening of investment opportunities and a relaxation of guarantee requirements (which make private pension funds liable to past losses) is being considered. The Bank will be prepared to offer advice on the appropriate management of funds and organisation of the industry, given social policy prerogatives and risk tolerance of the insured.

3.3.2. Infrastructure and Energy

Sectoral challenges

- Public investment in the Slovak Republic has traditionally been very low, and coverage of road infrastructure is therefore assessed as poor by most indicators (e.g. those of the World Economic Forum). Poor road access reinforces regional income disparities, in particular in the east of the country.
- There remain important gaps in the financing of road infrastructure. The R1 motorway represented important progress in structuring a PPP contract, though this has not been replicated as the previous government preferred to rely on EU structural funds to finance motorway construction. Integrity issues with contractors and fiscal accounting of contingent liabilities were added concerns.
- A sustainable energy framework is in place, although investment lags behind regulatory and institutional development. In the development of renewable energy projects the country is well below the EU average.

Bank's operational response

To address gaps in the financing of the transport sector the Bank will continue an active dialogue and co-operation with the Slovak authorities regarding the introduction of sound financing structures allowing to secure long term financing for viable commercial projects in the infrastructure sector involving public-private partnerships. While it is understood that the priority of the authorities will be to finance these investments through public sources co-financed with EU Cohesion Funds, PPPs may in selected cases constitute a complementary approach. At a time of fiscal consolidation, co-operation with other IFIs and private sector participants will be crucial to achieve this goal. The prime focus will be on the finalisation of the core transport infrastructure allowing for a better integration and faster development of the eastern regions of the country that so far suffer from limited investor interest and high unemployment.

To address gaps in sustainable energy investment, the Bank will promote diversification of energy supply with the focus on renewable energy sources and energy efficiency across sectors to enhance energy security, reduce energy intensity and meet EU environmental targets. The Bank will build on the success of the on-going energy efficiency programmes implemented with the local financial intermediaries and will pursue expansion of these programmes including those aimed at residential customers. The Bank will also seek to work directly with corporate or municipal clients in order to complement existing support programmes for energy efficiency and renewable energy investment. Recognising the importance of investments linked to the introduction of new technologies, energy services and improving demand side energy, EBRD may also pursue projects in the area of ESCOs. The Bank will continue to assist in identification of new sources of grant funding and in developing efficient financing structures for energy efficiency programmes, with high leverage of grant components.

The Bank will consider supporting potential investors in privatising several infrastructure companies (transport, municipal and energy sectors), should the new government reopen these tenders.

In both the energy and infrastructure sectors, opportunities to co-finance with grants from EU structural funds and/or in co-operation with the EIB may arise, in particular given the constrained capacity of the local banking sector to extend the needed long term credits. This could also be in relation to complex PPP structures (so-called 'hybrid' models that draw on commercial, state and EU grant funds). The Bank will examine these opportunities for consistency with the Slovak Government's priorities as well as its own operational priorities and transition mandate, and offer funding on its usual terms while ensuring that the grant element is appropriately calibrated.

Policy dialogue

In the public sector, the Bank's assistance will focus on improving procurement standards and transparency. The Bank will also help to address challenges in the areas of climate finance arrangements and other policies consistent with the EBRD transition objectives and allowing the country to reach EU targets.

The Bank will also continue the dialogue concerning the use of hybrid PPPs with the new government, in particular with regard to roads and other infrastructure. In this context the Bank may explore cooperation with the EU structural funds, under which countries are encouraged to increasingly attract commercial funding.

3.4 Environmental and social implications of the Bank's proposed activities

As a European Union member, Slovakia has adopted environmental and social legislation that is harmonised with EU *acquis* and is aligned with EBRD's Environmental and Social Policy and Performance Requirements.

The Bank's Environmental and Social Policy will apply to all projects in Slovakia. The focus on energy efficiency, infrastructure and transport, and financial institutions will raise the normal range of issues associated with these sectors. In transport infrastructure sector, public consultation and information disclosure will be an important part of project development, particularly where there is the potential to impact on vulnerable groups and minorities. Transport infrastructure projects require EBRD to apply precautionary approaches as these projects have the potential to adversely impact biodiversity and sensitive habitats, including Natural 2000 sites. Where privatisation of infrastructure companies (transport, municipal and energy sectors) requires labour restructuring and rationalisation programmes, EBRD will aim to ensure that redundancies are done in a transparent, consultative and non-discriminatory way. Energy efficiency projects financed either directly by EBRD or via financial programmes with local banks focusing on small energy efficiency and renewable energy projects present significant opportunities to reduce greenhouse gas emissions.

Health and safety is an important consideration for all EBRD projects, and is a particularly important issue with transport infrastructure, both because of risks to worker safety during construction, and public safety once operational. EBRD will work with clients in transport sector to minimise the risk of accidents and fatalities through good project design and best practice in safety management.

4. ACCESS TO CAPITAL

4.1 Private sources of capital

Slovakia's sovereign rating stands at A+/A/A2 according to Fitch/S&P/Moody's, which is one of the highest sovereign credit qualities in emerging Europe. While S&P and Moody's revised down their ratings in January and February 2012 respectively, along with those of most other eurozone countries, Fitch has kept its rating unchanged throughout the financial crisis of 2008-09. Given persistent financing needs following the financial crisis, the government has issued considerable amounts in both external (Eurobond) and domestic markets, though overall, the stock of external liabilities of government bonds is small at about 19 per cent of GDP. With the exception of some bank-issued mortgage bonds there have been no private bonds. Large companies which would normally be the typical issuers are also predominantly foreign owned.

The stock of inward foreign direct investment is substantial (about 56 per cent of GDP, according to the 2011 international investment position). Net flows of foreign direct investment (FDI) were large before the crisis (at around 5.5 per cent of GDP in the five years to 2008), though then dropped sharply, as in other countries in the region. In 2011 gross FDI inflows amounted to 2.3 per cent of GDP. These flows are primarily directed at the manufacturing sector, with reinvested earnings of established investors accounting for more than half of inflows in the past years.

Private equity, a component of FDI flows, remains much needed for innovative enterprises, though the sector is underserved (see the Assessment of Transition Challenges in Annex 2). There has been few meaningful private equity transactions, with only EUR 14 mln in transactions recorded by the European Venture Capital Association in 2010 and total active capital estimated at only 0.3 per cent of GDP. Capital available for investment relative to GDP is estimated at 0.4 per cent. There are no institutionally backed country dedicated fund managers, but over ten regional fund managers have been included Slovakia in their scope of potential investments. Local institutional investors have yet to participate in private equity to any significant degree, with limited participation by individuals and banks, and no activity by pension funds and insurance companies.

Slovakia has not been prone to wide swings in external funding by commercial banks. Net flows of bank liabilities fell from 6 per cent of GDP in 2009 to about 2.3 per cent of GDP in 2011, though remarkably Slovakia's banking sector remained a net foreign creditor in 2011, and prudent funding practices are also evident in the very low loan-to-deposit ratio of about 90 per cent. The supervisor nevertheless sees a risk in European deleveraging pressures, and to address this risk imposed some limitations on foreign credit positions on domestic banks (see Section 2.3 above). The stock of domestic credit to the private sector remains relatively low (at about 46 per cent of GDP at end-2011), and both corporate and household credit have shown some increases.

4.2 MDB finance and cooperation with other IFIs and multilateral donors

- Slovakia concluded its last IMF programme in 1996 and graduated from World Bank financing operations in 2008.

- **European Union.** Slovakia is eligible for considerable grant funding under EU Cohesion funds. For the 2007–13 period, Slovakia was allocated EUR 11.7 billion in total: EUR 10.9 billion under the Convergence 1 Objective, EUR 0.5 billion under the Regional Competitiveness and Employment Objective, and EUR 0.2 billion under the European Territorial Cooperation Objective. According to government material, EUR 8.2 billion has still to be drawn by the end of 2015, and the commitment level of some operational programmes is as low as 60 per cent. Currently the Government seeks EU approval for re-allocation of up to EUR 300 million to support youth employment and competitiveness of SMEs. Some programmes suffer from budgetary constraints on the side of municipalities which cannot mobilise the small share of co-financing that is required. Several projects employed innovative financing techniques, as for instance the Trecin Water System, a project in which private loans and equity complemented EU and local authority funds in a hybrid PPP structure.

- The Bank, in its capacity as manager of the **Bohunice International Decommissioning Support Fund** – a donor-funded vehicle designed to support the closure of V1 Jaslovske Bohunice nuclear power plant – will continue to work closely with the European Commission and other donors to guarantee the efficient and transparent use of these funds.

- **The European Investment Bank** (EIB) has signed loans totalling EUR 2.189 billion in Slovakia in 35 projects since 2009. Credit lines to banks and other financial intermediaries for on-lending to SMEs and medium sized companies represented EUR 669 million in 22 operations. Industrial projects received EUR 220 million of funding, major recipients being companies in the automotive and electronic industries. In 2010 the Slovak government signed a financing framework for EUR 1.3 billion with the EIB for co-financing of the implementation of projects receiving EU grants from the Cohesion and Structural Funds in the programming period 2007-2013. These investments have been identified as priorities under the Slovak National Strategic Reference Framework. The EIB loan will co-finance schemes under 11 operational programmes involving the development of infrastructure and regional accessibility, knowledge-based economy and human resources.

- **The European Investment Fund** manages the JEREMIE Holding Fund in Slovakia with a total commitment of EUR 100 million which is financed from the EU Structural Funds, budgeting period 2007-2013, under three national Operational Programmes (Operational Programme Competitiveness and Economic Growth, Operational Programme Research and Development, Operational Programme Bratislava Region). The programme aims to facilitate access to finance for SMEs through various instruments such as bank guarantees, seed capital and venture capital. The Bank continues its dialogue with the EIF to explore co-operation with regard to the potential involvement in the venture capital fund under the JEREMIE programme, aiming to offer equity funding to SMEs in Slovakia with the particular focus on innovative/knowledge based sectors of economy.

- The **Council of Europe Development Bank** committed EUR 230 million of loan funding to Slovak banks during the period 2010-2012. This included three loans provided to VUB Bank: a EUR 50 million loan to finance improvements to living conditions, protection of the environment and rehabilitation of historic and cultural heritage; a EUR 25 million loan for on-lending to SMEs; and a EUR 25 million loan for rehabilitation of panel housing to achieve energy savings. Similarly, CSOB in Slovakia obtained two loans for a total EUR 50 million to finance investments of municipalities, regions and other public entities with a view of modernising municipal environment infrastructure and achieve lasting improvements in local social infrastructure. In May 2012 an EUR 30 million loan to Slovenska Sporitelna for energy efficiency building rehabilitation was approved.

ANNEX 1 – Political Assessment

The Slovak Republic (Slovakia) is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement establishing the Bank.

Representative and Accountable Government

Free, fair and competitive elections

The Constitution and the laws of Slovakia provide citizens the right to change their government through periodic, free, and fair elections based on universal suffrage.

Since independence in 1993 Slovakia has held six parliamentary elections, five municipal elections, three regional elections, three presidential elections and two elections to the European Parliament, all of which were judged free and fair by domestic and international monitors. OSCE/ODIHR's final report on the 2010 parliamentary elections noted that "the elections were conducted in a pluralistic environment characterised by general respect for fundamental rights and freedoms, equitable campaign conditions and a high degree of public trust in the impartiality of the election administration". Some deficiencies were noted regarding party and campaign financing and the participation of national minorities in elections. International NGOs, such as Transparency International, raised questions about the administration and oversight of elections by the Central Electoral Commission, which has been created temporarily for each election and does not have explicit procedural rules for its work.

The previous government drafted a new electoral code, but did not complete the parliamentary approval procedures before the government fell in October 2011. The new government pledged to continue electoral reforms by introducing transparent rules for election campaigns, consistent control of campaign spending and by establishing permanent electoral oversight authorities. The OSCE/ODIHR Needs Assessment Mission prior to the March 2012 early parliamentary elections recommended that no observer mission be sent, noting "a marked confidence of the majority of its interlocutors in the integrity of the electoral process and in the professionalism and impartiality of the election administration."

Representative government that is accountable to the legislature and electorate

Most executive power lies with the Prime Minister, who is usually the leader of the party that gains the most votes in parliamentary elections and is responsible for forming a coalition in parliament. The cabinet reports to Parliament, which has the right to dissolve it. The President can veto laws adopted by the Parliament, but laws can be passed with the support of a qualified parliamentary majority.

The National Council (parliament) of the Slovak Republic is a sovereign representative body, the sole legislative and constituent assembly, and is autonomous from the executive. It has sufficient resources and capacities for the creation and enactment of bills. Parliamentary deputies frequently question cabinet members and exercise oversight of state and public institutions. Parliamentary deliberations are open to the public and media (except for closed sessions on classified matters, such as intelligence and secret service issues). The entire legislative process – including transcripts of meetings, full text of legislative bills, and the results of assembly votes – is made available to the public via Parliament's website.

Effective power to govern of elected officials

The Slovak Republic has established institutional, legal and financial arrangements for elected officials to exercise effective power to govern and they are not constrained by any non-democratic veto powers. A January 2012 Transparency International report on Slovakia concluded that "the legislature, the executive and political parties [operate] freely with no severe intervention from the third parties."

Freedom to form political parties and existence of organised opposition

Slovakia is a pluralist democracy with an established and well-functioning multiparty system. Political parties are required to submit a petition with at least 10,000 signatures in order to register. In 2011, 56 political parties were registered with the Ministry of the Interior. Six parties are presently represented in the Parliament and six Slovak parties are represented in the European Parliament. Political parties operate freely and are subject only to reasonable oversight from the authorities. The legal framework provides safeguards that prevent unwarranted external influence in the activities of political parties. All major political parties have their charters available on their websites. While all major parties elect their leadership, in the last decade only a few leadership elections were contested.

Party financing and campaign financing have been identified as problem areas by domestic and international observers. At the end of 2010, the Council of Europe's Group of States against Corruption (GRECO) in its interim compliance report on the Slovak Republic concluded that "no tangible progress has been achieved by the Slovak Republic" with regards to political party and campaign financing. The new government's manifesto pledges to reassess the existing system of financing of political parties in order to introduce more accurate and transparent rules, identification of donors and sponsors, and public disclosure of financial information.

Civil Society, Media and Participation

Scale and independence of civil society

In October 2010, the Ministry of Interior listed over 30,000 organisations considered non-governmental organisations (NGOs), including clubs, societies, unions, domestic and international NGOs, foundations, and a variety of cultural and religious associations. The legal and regulatory environment for civil society is free from excessive state pressure and impediments to registration. A recent Transparency International report noted that there has been no serious interference into the functioning of civil society in Slovakia. Slovak NGOs enjoy favourable tax laws. The introduction of a two per cent income tax assignation by individuals and legal entities allocated to registered NGOs prompted the healthy growth in registered civil society organisations over the past decade.

Independent pluralistic media that operates without censorship

The media environment in the Slovak Republic is pluralistic with a wide variety of commercial and public broadcasters and print media. According to the Law on Broadcasting and Retransmission, broadcast media should ensure plurality of opinion as well as objectivity and impartiality of news and current affairs programmes. The Council for Broadcasting and Retransmission is empowered to act upon complaints and upon its own initiative. OSCE/ODIHR raised questions about the lack of a clear definition of "objectivity" and urged the Council to publicise its decisions. The print media are self-regulating.

The 2012 OSCE ODIHR Needs Assessment Mission noted that the recent merger of *Slovenska Televizia* and *Slovensky rozhlas* into the Radia and Television of Slovakia was viewed as a political decision aimed at addressing concerns about impartiality and its dependence on the previous ruling coalition government. In 2011 the parliament, overturning a presidential veto, completed the legislative process of amending the controversial 2008 Press Act, which obliged the media to publish a rebuttal if an article impinged on an individual's honour, dignity and privacy, regardless of their truthfulness. The OSCE Representative on the Freedom of the Media commended Slovakia for "a significant improvement over prior legislation."

There were no government restrictions on access to the internet or reports that the government monitored e-mails or internet chat rooms. However, police monitor websites hosting hate speech. Individuals and groups can otherwise engage in the peaceful expression of views via the internet, including by email. Internet access for individual and companies in Slovakia stood at 67 and 98 per cent respectively, around the EU average.

Multiple channels of civic and political participation

Civil society in Slovakia has a strong track record in influencing the policy-making process and contributing to country's democratic evolution over the past two decades. During the period 2004 – 2011, more than 200 campaigns, calls, petitions, initiatives, declarations and public reviews of proposed legislation appeared on the website of the Slovak civil society internet resource www.changenet.sk. They were supported by tens of thousands of citizens.

According to Slovak experts, in recent years the most effective instruments for NGO participation include the Office of the Government of the Slovak Republic for Non-Governmental Non-Profit Organisations, set up in 1999 to engage NGOs in dialogue on key government policies; the provision for participation of citizens in the legislative process introduced by the government in 2003 and which enables 500 citizens to petition to change legislation; and the law on freedom of information which was adopted as a result of campaigning by civil society organisations. In addition, the previous government created a Government Plenipotentiary for the Development of Civil Society, an advisory body on strengthening engagement by citizens and their position in relation to the state.

The new government has announced that it will continue to support active dialogue with civil society and representatives of the non-profit sector. Newly appointed ministers engaged civil society representatives and wider group of stakeholders in consultations during the drafting of its manifesto. However, some civil society groups remain concerned about the prospects for dialogue with the authorities.

Like a number of central European states, Slovakia has experienced declining level of citizen participation in public affairs in recent years, including declining voter participation. The EBRD/World Bank Life in Transition Survey indicates a more than 20 per cent drop in support for democracy in the Slovak Republic between 2006 and 2010, one of the largest declines in Central Europe. Slovak experts point to declining social trust and emigration of some of the most activist parts of the population as key drivers of this trend. On the other hand, large public rallies have been organised, primarily by urban youth, in reaction to the high profile corruption scandal that took place prior to the 2012 parliamentary elections, leading to higher than expected voter turnout.

Rule of Law and Access to Justice

Separation of powers and effective checks and balances

The Slovak Republic is a stable democracy with an effective system of checks and balances.

The no-confidence vote in the previous government exposed a deficiency in Slovakia's Constitution which obliges the president not only to dissolve the government but also revokes the president's power to extend the term of the cabinet until the new government is elected. In order to allow this extension the parliament had to pass a constitutional amendment substantially extending the president's authority over the cabinet until a new government is in place. However, some provisions of the amendment dealing with shared competencies have not been defined clearly and risk precipitating conflicts between the two institutions.

The Constitutional Court is an independent element of the judicial system, and its verdicts are legally binding. The right to appeal to the Constitutional Court regarding the constitutionality of laws, government regulations, and other legal rules applied by the public administration rests with parliamentary deputies (at least 30 are required to launch an appeal), as well as the president, the cabinet, courts, the attorney general, and the ombudsman for human rights. Citizens can appeal to the Constitutional Court if they believe their constitutional rights have been violated by a state institution.

Supremacy of the law

Supremacy of the law is observed in Slovakia. Politicians and other elected officials are fully subjects of the law and no unelected figures are able to place themselves above the law.

Government and citizens equally subject to the law

The Constitution of the Slovak Republic guarantees all citizens equality before the law. However, allegations of corruption and close links between officials and powerful business interests have marred Slovak politics for many years. The previous coalition government introduced compulsory online disclosure of all contracts, invoices, and financial transactions involving public funds and introducing electronic auctions as a mandatory form of procurement. However, the government has not prosecuted any cases of corruption that emerged under its predecessors.

In December 2011 a major corruption scandal – the so-called 'The Gorilla file' – was triggered by the release of transcripts from secret tapes allegedly recorded by the Slovak Intelligence Service (SIS), the authenticity of which has yet to be fully investigated, which suggest inappropriate links between senior politicians and powerful business groups during the 2005-2006 government in relation to privatisation deals and public procurement contracts.

The Ministry of Interior is responsible for developing the government's overall strategy for combating corruption, with a specific focus on investigation and enforcement. The Special Prosecutor's Office is responsible for most prosecution efforts related to corruption offences. The general prosecutor, who is appointed by the National Council and independent of the executive and judicial branches, also plays a leading role in prosecuting corruption. The Government Office of the Slovak Republic, which oversees the state administration and answers to the prime minister, also plays a role in developing anti-corruption legislation and regulations.

Independence of the judiciary

The judiciary in Slovakia has guaranteed independence and is self-regulating. However, this independence has at times led to questions regarding accountability and transparency, fuelling public mistrust. The EBRD/World Bank Life in Transition Survey indicates that trust in courts in Slovakia stands at about half of the western European average and people are particularly concerned about law and order and the ability of the court system to defend individual rights.

According to surveys and expert opinion the judiciary in Slovakia faces problems with corruption, official intimidation of judges, inefficiency, and a lack of integrity and accountability which undermine judicial independence. In some cases judges have alleged to have been subject to high-level influence and pressure by the judicial hierarchy, including in some cases from the Judicial Council.

In 2011, parliament supported reforms proposed by the Ministry of Justice amending the laws governing the justice system. These reforms introduced open competition for the recruitment of judges, heads of courts and positions at the prosecutor's office, which were previously filled through appointments by the prosecutor general. New state prosecutors will be selected by a six-member committee, with three committee members proposed by the general prosecutor's office and three by parliament. Chief prosecutors can serve only two consecutive five-year terms and the prosecutor general and the special prosecutor will be limited to only one term. Financial statements from the prosecutor's office as well as all judicial decisions from courts must be published on the internet. Judges now have to pass an evaluation every five years and publish annual statistical reviews of their activities online.

The new government has pledged to build confidence in the rule of law and enhance the quality and stability of the legal system. This could lead to a review of changes made in the judicial system in the years 2010-2011 in order to ensure that all laws and regulations governing the judiciary are in full compliance with the Constitution and recommendations issued by international institutions.

Civil and Political Rights

Freedom of speech, information, religion and conscience, movement, association and assembly

The Constitution and the laws of the Slovak Republic provide for freedom of speech and the press and freedom of movement and assembly. These freedoms are generally respected in Slovakia. The law prohibits the defamation of nationalities, punishable by up to three years in prison. Slovakia's constitution guarantees the right to free retrieval, collection, and dissemination of information. In October 2011 parliament approved an amendment strengthening the 2000 Law on Access to Information, making it difficult for state administration and quasi-state bodies to ignore citizens' formal requests for information.

A variety of domestic and international human rights groups generally operate without government restriction, investigating and publishing their findings on human rights cases. Most NGOs are independent, although some receive funding from the state budget. Government officials are generally cooperative, although NGOs report that at times government officials seemed to view their activities with suspicion or mistrust.

The Office of the Ombudsman submits an annual report on human rights problems to the president. The annual report for the period February 2010 to March 2011 focused on court delays, violations of children's rights, and procedural shortcomings by state institutions. In general the Ombudsman's work was not subject to executive interference. In addition, in 2011 the previous government established the Council on Human Rights, National Minorities and Gender Equality to advise on human rights issues. Under the new Government the Council is headed by Miroslav Lajčák, Deputy Prime-Minister and Minister of Foreign Affairs of the Slovak Republic and includes officials and civil society representatives.

Political inclusiveness

The population is 80.7 per cent Slovak. Hungarians are the largest minority. Roma are the second largest minority with a population of 106,000 according to the 2011 census. Experts estimate that the Roma population is actually between 350,000 and 500,000.

Ethnic Hungarian parties are active in politics and two Hungarian parties contested the most recent elections: Most-Hid and the Party of Hungarian Coalition (SMK).Most-Hid (Bridge) has been represented in successive parliaments and was part of the previous five-party coalition. The Hungarian community is concerned with its cultural and linguistic rights. Slovak law provides for the imposition of fines on government institutions, civil servants, and legal entities that do not provide information required by law in Slovak. Members of the ethnic Hungarian minority criticised the provision as discriminatory and a restriction on their right to free speech. Another issue of great importance to Slovakia's large Hungarian minority is the restriction on dual citizenship introduced by the government in July 2010. In September 2011, a group of 44 MPs asked the constitutional court to examine whether the restriction is constitutional.

Roma are less involved in politics: one Roma party ran in the recent elections and eight Roma candidates were included in the candidate lists of other parties; one Roma MP was elected.

The Commissioner for Human Rights of the Council of Europe reported in September in 2011 that "racist and notably anti-Roma discourse, sometimes of a distinctively aggressive nature, is still common among mainstream politicians in Slovakia. Anti-Gypsyism also often surfaces in the broadcasting and print media" He urged the Slovak authorities to take measures against these phenomena, including by promoting self-regulation within political parties and the media. The use of ethnic stereotypes in campaigns and instances of intolerant rhetoric were noted in recent regional elections.

Recently, Prime Minister Fico abolished the post of Deputy Prime Minister for national minorities and human rights, which had existed since 1998, drawing criticism from Slovak civil society organisations.. The new government set up the Office of the Government Plenipotentiary for National Minorities and Civic Society. The post of the Plenipotentiary was offered to and taken up by László Nagy, a representative of Most-Hid party representing mostly Slovak Hungarian minority. Mr. Nagy was formerly the Chairman of the Committee on Human Rights and Minorities at the Slovak parliament.

Freedom from harassment, intimidation and torture

The Slovak Constitution and laws prohibit arbitrary arrest and detention, torture and other cruel, inhuman, and degrading treatment or punishment, and the government mostly respected these provisions in practice. NGOs and members of the Roma community cited a continuing trend of mistreatment of Roma suspects by police officers during arrest and while in custody. According to the report by the Commissioner for Human Rights of the Council of Europe, there are not many successful prosecutions of police for alleged misconduct against, among others, members of ethnic minorities. This undermines public trust in the police. The government responded by initiating training courses for policemen on policing in a multi-ethnic environment, focusing on areas inhabited by the Roma minority and making efforts to recruit Roma into the police force.

Cases of involuntary sterilisation of Roma women in Eastern Slovakia were recorded in a December 2011 report by the Council of Europe Commissioner for Human Rights. The Committee for the Prevention of Torture of the Council of Europe urged the Slovak government to investigate these allegations and to educate doctors about their criminal liability for performing sterilisation without consent.

Civil society organisations and political parties operate in Slovakia without threat of harassment and intimidation from state agencies.

ANNEX 2 – Assessment of Transition Challenges

Agribusiness

Market structure: *Small*
Market institutions: *Medium*

Since accession to the EU in 2004, Slovakia has been integrating into the EU's Common Agriculture Policy (CAP). As an EU member, the country benefits from substantial EU agricultural support, though this is considerably less than in some other EU member states. The transformation of collective farms and the privatisation of state farms has been completed, but land ownership is still highly fragmented, the land market is not very active and its use as collateral limited. Privatisation of agribusinesses has been completed, but efficiency improvements are still necessary. FDI into the sector has been limited to industries such as sugar, confectionary, dairy, beer and malt. Infrastructure servicing the sector still needs further improvement. The development of competitive distribution/packaging industries and improvements in the traceability of produce remain a challenge. The retail sector is by now very developed with many of the big international players present. High risk stemming from undercapitalisation, ongoing fragmentation of ownership, high debt levels, and poor credit history have limited the access of the farm sector to credit, but the situation has improved in recent years. Lending against warehouse receipts and supplier's credit schemes are well advanced.

Manufacturing and Services

Market structure: *Negligible*
Market institutions: *Negligible*

Slovakia ranks as one of the most competitive economies in the CEB region. Important improvements to the regulatory environment and labour market regulation in the past have made Slovakia an attractive destination for FDI, particularly into the automotive and electronics sectors. Sectors such as these have been exposed to international competition, and have made impressive progress in catching up to the productivity levels seen in more advanced EU countries, despite being affected by the global economic downturn. The business environment can be further improved to facilitate enterprise entry. Challenges also remains in undertaking more R&D intensive activities as expenditures in these areas are low in regional comparison. In addition, Slovak firms have shown limited interest in investing outside of the country as a result of their size, a general lack of equity finance (since banks are reluctant to finance foreign expansion) but also relatively favorable local conditions (low wages and qualified labour).

Real estate

Market structure: *Small*
Market institutions: *Negligible*

The real estate sector has significantly developed over the past decade, including new types of property as well as financing instruments. A few regional property funds have become active in the country, but the development of secondary property markets is still impaired by a lack of liquidity and a scarcity of market entities capable of providing depth, such as large-scale institutional investors. The retail and office property market segments have become increasingly saturated due to tightened financing conditions and lower demand in the context of the global financial crisis. There are comprehensive restitution laws in the Slovak Republic, and secured interests in property are recognized and enforced. The mortgage market is growing and the legal framework for mortgages is efficient. Primary and secondary legislation supporting the sustainability of real estate (energy efficiency, impact on environment) is well developed and public awareness of the sustainability issues is also reasonable.

Telecommunication
Market structure: *Small*
Market institutions: *Small*

Amendments to the telecommunications law adopted in April 2010 strengthened the independence of the regulator, thus allowing the EU to close the related infringement procedure against Slovakia in June 2010. However, local loop unbundling (LLU) has not yet been used extensively. The fixed-line market has been liberalised since 2003, but the incumbent Slovak Telekom (controlled by Deutsche Telekom) retains its dominant market position and the competition has been undermined by network connection issues (the first LLU agreement was signed as late as in 2009). The state continues to hold a significant minority stake in Slovak Telekom which the government intends to privatize. Competition in the mobile market intensified with the entry of the third network operator, Telefonica O2 Slovakia, in December 2006. A number of alternative operators have entered the market for Internet access provision. Broadband market, which is dominated by Slovak Telekom, has seen high growth in recent years.

Natural Resources
Market structure: *Small*
Market institutions: *Small*

Although a very small producer of natural gas, the country is an important transit corridor. The country’s per capita natural gas consumption is very high, with more than 80 per cent of Slovak households connected to the natural gas network. Most of the coal produced is used for electricity production. The main domestic oil and gas operators have been corporatised and partially privatised. The former state oil company Slovnaft is now owned by Hungarian energy group MOL. The gas company, SPP, formally unbundled its transmission and distribution activities as of July 1 2006 to comply with EU legislation, forming two wholly-owned subsidiaries - SPP-Preprava, in charge of gas transmission, and SPP-Distribúcia, in charge of gas distribution. In April 2009, the state regained control of the oil pipeline operator Transpetrol, by acquiring the 49 per cent stake owned by Yukos. The gas market was fully liberalised for industrial customers in January 2005 and for households in July 2007, along with the electricity market. The oil downstream industry is moderately competitive, as Slovnaft retains a dominant position and runs the country’s only refinery. IOC downstream involvement is almost exclusively restricted to fuels distribution. Tariffs have been brought to cost-recovery level but the regulator has been rejecting requests from SPP to raise household tariffs in the past. In a positive move, the Slovak parliament has recently annulled the energy tariff regulation which was approved in October 2008 and enabled the government to intervene in the electricity and gas price setting for large energy companies.

Sustainable Energy
Market structure: *Medium*
Market institutions: *Small*

A legal and institutional framework for sustainable energy is in place but implementation and project activity is still to be seen. Energy prices are high compared to EU average and encourage some energy efficiency investments. Energy Efficiency Action Plan for years 2008-2010 has been in place since 2007. Support systems for energy efficiency and renewable energy are in line with EU practices. Also, to increase the attractiveness of green investments, the country has adopted in 2009 a new legislation supporting renewable technology. Outcomes are still lagging behind EU average, partly because Slovakia's feed-in tariffs have been short term and not differentiated by size. A Climate policy is in place and on track to achieve EU 20/20/20 targets. Slovakia was the first country in the region to sell AAUs, but through a substandard transaction leading to dismissal of the Minister of Environment.

Power
Market structure: *Small*
Market institutions: *Small*

The Slovak power sector has been unbundled with independent transmission, distribution and generation companies. Some further progress has been made in improving the market structure. The sale of a 66 per cent stake in the dominant electricity generator Slovenske Elektrarne to ENEL (the Italian electricity company) was finalised in 2006. In addition, 49 per cent stakes in the three regional distribution companies were sold to the private sector. However the planned sale of the remaining 51 per cent stakes to the minority shareholders has been put on hold. Also, the market has been gradually liberalised reaching full opening in 2007. A regulator for network industries is in place since January 2002. Tariffs were brought to cost-recovery levels over 2003-04. In July 2008 the government increased its involvement in the institutional framework for the sector by giving the Regulatory Office for Network Industries (URSO) powers to further regulate the price of energy. Moreover, in October 2008 Parliament passed a new law imposing new regulations on the setting of energy tariffs from 2009, which gives the government greater control in setting gas and electricity prices for households and SMEs. A feed-in tariff mechanism to support the development renewable energy is in place. The government is subject to infringement proceedings for failure to appropriately implement rules aimed at increasing the capacity and transparency of gas and electricity markets. The European Commission has also referred the government to the European Court of Justice for failure to adequately implement non-discriminatory access to the transmission system.

Water and wastewater
Market structure: *Medium*
Market institutions: *Small*

Local infrastructure has been decentralised and utilities are today corporatised into joint stock companies. Financial and operational performance is adequate, collection rates are high, but there is room for improvement still in smaller municipalities. Private sector participation is limited. Good contractual arrangements with the necessary incentives and clear performance targets have also been introduced in some municipalities outside the larger cities. Tariffs are approved by the national regulator based on full cost recovery principles and cross-subsidies between consumer groups have been abolished throughout the country. Remaining transition challenges include development of strong contractual arrangements between municipalities and local utility companies throughout the country which will help increase transparency, improve corporate governance and raise service levels.

Urban Transport
Market structure: *Medium*
Market institutions: *Small*

The transport companies have been decentralised and corporatised. Majority of urban transport companies today is under municipal control. The private sector participation is limited and there is little liberalisation of urban bus routes. Good contractual arrangements with the necessary incentives and clear performance targets have also been introduced in several municipalities and financial and operational performance is generally adequate although there is room for improvement in smaller municipalities. Remaining transition challenges include further liberalisation of the urban transport markets and development of strong contractual arrangements between municipalities and local transport companies throughout the country. There is also room for further development of PPP structures.

Roads
Market structure: *Medium*
Market institutions: *Medium*

In roads, a National Highway Company was established in 2005 to develop highways and motorways under the Ministry of Transport, Post and Communications. The government policy for the sector has significantly changed with the new government elected in May 2010. The progress achieved in PPP structuring, contract award and financial close of the R1 motorway PPP has been halted and two contracts awarded for the phased construction of the D1 motorway under PPP approaches have been cancelled. Moreover, the previous government disbanded the PPP Project Implementation Unit. In July 2011 the government approved a four-year motorway and dual carriageway programme with the core priority of the programme being the completion of nine stretches of the main D1 motorway. The project will now be funded through EU structural funds. Under these circumstances, the transition challenges remain in enhancement of competition and efficiency under publicly-funded projects, and the (re-) development of the government's capacity to develop, monitor, and renegotiate the PPP transactions.

Railways
Market structure: *Small*
Market institutions: *Medium*

In railways, operating and policy setting functions have been separated and core railway businesses (infrastructure, passenger, freight, etc.) have been unbundled, while ancillary services have been divested. In June 2004, the government split of the public railway company, Zeleznicna Spolocnost (ZSSK), into two entities in charge of passenger and freight transport, and was planning the privatisation of the freight company. The new government is seeking a long-term strategic partner for the freight company ZSSK Cargo within the framework of a JV strategic partnership. The sector has undergone restructuring, but transition challenges remain with regard to finalising institutional restructuring, further private sector participation in core businesses, and further enhancement of competition.

Banking
Market structure: *Small*
Market institutions: *Small*

As of end 2010, the Slovak banking sector included 31 banks and branches of foreign banks. 92% of total banking system assets are owned by foreign banks. All the main foreign parent banks active in the region have banking subsidiaries in the Slovak Republic. The sector is quite concentrated, with the top five banks holding 72% of total assets. The assets/GDP ratio equals 83% and the deposits/GDP ratio 60% in December 2010. Domestic credit to the private sector, at 45% of GDP, remains low by regional standards (in fact, the lowest in the CEB region).

The sector has proved relatively resilient to the international financial crisis as a result of conservative funding structure relying largely on deposit funding (loans/deposits ratio of 85% in December 2010) and a focus on traditional banking activities. However, due to the downturn in the domestic economy and loss of foreign currency transaction fees with the euro adoption, profitability has declined and asset quality deteriorated. Return on equity more than halved to 7 per cent between 2008 and the first quarter of 2010 and the NPL ratio nearly doubled to 5.8 per cent between beginning of 2009 and end 2010. Profits began to recover in 2010, allowing banks to increase capital (CAR 13%) and liquidity.

The supervision of the financial sector was unified in January 2006, under the auspices of the National Bank of Slovakia. To ensure adequate short-term liquidity, NBS in 2008 introduced a requirement that liquid assets must be as large as volatile liabilities over a one-month horizon. This measure of liquidity increased in 2010 as banks reduced corporate loans and increased government securities holdings. Competition in 2010 led to lower lending rates, which are converging towards those in the Euro area. The share of new mortgage loans with LTV>80% rose from 34% to 43%, and banks have substituted mortgages with other housing loans subject to weaker LTV ratios. Harmonizing regulations on all housing loans is under consideration.

Micro, Small and Medium-sized enterprises
Market structure: *Medium*
Market institutions: *Negligible*

Micro, small and medium businesses accounted for about 55 per cent of employment and generated nearly 47 per cent of value added of non-financial enterprises in 2008. Commercial banks have been actively engaged in MSME lending over many years, although lending to this segment has been affected by the crisis. The share of SME lending to total lending has been estimated at around 22 per cent. The legal and regulatory framework that supports bank lending to SMEs is in place. Public financial support of MSMEs has been oriented towards providing grants for development activities. To improve access to capital for MSMEs and partly eliminate the negative effects of the current financial crisis, the government has increased its capital share in the Slovak Guarantee and Development Bank. Although several programmes for supporting venture capital targeted at SMEs and start-ups have been developed, this area needs further improvement.

Insurance and other financial services
Market structure: *Small*
Market institutions*: Small*

There are 23 insurance companies operating in the Slovak Republic, of which six are in the life insurance sector, four in the non- life sector and the remaining are composite companies. Insurance penetration is at over 3% of GDP with contributions from the life and non- life segment fairly evenly distributed. A broad range of insurance products is available in the market and skill levels are comparable to those present in the Polish and Hungarian markets. Insurance legislation and regulation almost meet IAIS standards. Supervision is generally deemed to be adequate, although capital adequacy of life insurance companies may need to be monitored more closely. The leasing portfolio/GDP ratio is 3.8 percent. 40 leasing companies are present in the market, with the top three having a market share of 40 percent. Following recent pension reform, privately managed pension funds have been operating both voluntary and mandatory pension schemes (pension assets are at 5.03 percent of GDP). However, over the past two years a number of amendments were made to the system that may once again put at risk its long-term sustainability since they induce a shift back into the unfunded pay-as-you-go pillar. New job market entrants' entire contributions again go entirely into Pillar I. These changes have made the operating environment for privately managed pension funds more unstable and can discourage the habit of accumulation of private savings over the long term. However, the government is looking to reverse these changes at least partially. Supervision will need to adapt to the EU's Solvency II framework for insurance and pension providers. Mortgage penetration has scope to develop further, remaining at 16.5 percent of GDP.

Private equity
Market structure: *Large*
Market institutions: *Small*

There have been few meaningful private equity transactions, with only EUR 14 mln in transactions recorded by EVCA in 2010 and total active capital estimated at only 0.3 per cent of GDP. Capital available for investment relative to GDP is estimated at 0.4 per cent. There are no institutionally backed country dedicated fund managers, but over ten regional fund managers have been identified to include Slovakia in their scope. Their committed capital targets buyouts and growth investment. Local institutional investors have yet to participate in private equity to any significant degree, with limited participation by individuals and banks, and no activity by pension funds and insurance companies. Slovakia shows the third highest compliance level with OECD's Principles of Corporate Governance among countries in the EBRD region.

Capital markets
Market structure: Medium
Market institutions: *Small*

In 2010, market capitalization of the Bratislava Stock Exchange was of EUR 3.58bn (5.42% of GDP). The turnover ratio stood at 0.039. Transactions concluded by non-residents accounted for 53.33% of the trading volume. Following the adoption of the EU *acquis communautaire* securities market legislation complies with high international standards. Enforcement of securities standards through the regulator is effective. Stock market capitalisation remains lower than comparator countries. There is no private bond issuance. Restrictive rules on pension funds limit demand for capital market instruments. To comply with the requirement that Pillar II funds post positive returns every six months and the cap on management fees, pension funds hold 32% bank deposits and the rest in short-term government bonds. Pillar III funds are not subject to the same restrictions and hold 15% in equities.

Having joined the Euro in 2009, the Slovak Republic benefits from being part of the Eurozone money market. While liquidity of Slovak government bonds is enhanced by ECB repo operations, the domestic secondary market remains underdeveloped. The debt management agency is taking steps to increase liquidity in the secondary market for government bonds by increasing issuance size and focusing on benchmark issue.

ANNEX 3 – Legal Transition

Overall

Over the last decade, the Slovak Republic has developed a comprehensive set of commercial laws. The EU alignment mechanism has played a crucial role in this process. There remains however some room for improvement in specific areas, for example the development of specific rules enabling state support in public-private partnerships (PPPs), or the introduction of more efficient registration procedures for mortgages.

Below are mentioned some comments on the legal frameworks directly relevant to the Bank's investment strategy during the new period, namely concessions/PPPs and energy efficiency (relevant to investments in Infrastructure and Energy), as well as corporate governance, insolvency and secured transactions (relevant to SME support through Financial Institutions). These comments are based primarily on the Bank's Legal Transition Team's assessment work.

Infrastructure and Energy

Concessions and public-private partnerships (PPPs)

Under Slovak law, PPP projects are governed by a number of different laws and government resolutions. Although such fragmentation is not an obstacle to the implementation of PPP projects, the collection of PPP rules in a single-act Law would provide a more investor friendly approach.

Although the different types of PPPs are not explicitly named by the applicable laws, they would fall under the scope of the public procurement law and relevant by-sector regulations. However, the chapter with rules applicable to PPP projects is rather short and does not provide for any but basic rights and obligations of parties. This may be an obstacle to the development of smaller PPP projects, especially at municipal level.

The Public Procurement Act, the main source of law for the award of PPPs, ensures the enforcement of the EU principles of non-discrimination, transparency and efficiency during the selection process in a sufficient manner. It is noteworthy that the award of projects including restricted cases of awards without a competitive tender, the publicity of the award proceedings and the available legal remedies are all adequately regulated, as well as the possibility of creating reliable security interests over the project assets/rights, thereby enhancing the bankability of a PPP project. The Public Procurement Act has been complemented during 2006-2010 by a number of Governmental Resolutions providing guidance to contracting authorities, and Regulations issued by the Ministry of Finance. However, since the latter is reported to be no longer responsible for providing guidance to contracting authorities the application of such resolutions and guidance is questionable.

The fact that the former Concession Law (adopted in 1996) has been repealed and that reference to concessions are now part of the general Public Procurement Law signifies that the law is not sufficiently specific to concessions and PPPs. Accordingly, if the authorities wish to promote the development of PPP in the Slovak Republic they may consider developing a specific law or substantially expanding the Public Procurement Law.

Energy efficiency

The Slovak Republic has made impressive progress in promoting energy efficiency. Even though energy intensity decreased by 33 per cent between 2002 and 2008 it remains higher than the European average. Significant potential for energy savings exists in most sectors, especially in buildings and transport. Requirements for low-energy and passive buildings should be clearly defined and included in a future revision of the building code, and policy measures aimed at improving fuel efficiency in vehicles should be implemented.

Another concern is the Slovak Republic's ageing energy infrastructure, which results not only in inefficiency, but in high emissions: 70 per cent of emissions come from power generation. Investment in replacement or modernization is required.

Decreasing energy waste in Slovakia's district heating systems (which accounts for nearly half of total final energy consumption) is a major challenge and has traditionally been a low priority for the government, compared with efficiency measures in the electricity and transport sectors. Improvements to the sector should be made with a view of the entire energy chain in mind, including end-user efficiency improvements, such as the installation of "smart" monitoring systems.

An overarching problem regards access to funding for efficiency improvement projects. Access to funding is also made difficult due to a lack of transparency and excessive administrative barriers.

The Slovak Republic is still working on implementing the EU's Third Energy Package. Among other measures, this legislation will increase the powers, independence, and resources of the regulator, RONI. This legislation also promises to make regulation more transparent, as well as to promote the introduction of "smart" distribution networks which will increase the efficient use of energy, and reduce emissions. Overall, the Slovak Republic has introduced sound policies on energy efficiency (e.g., in the building sector). The government should now focus on the effective implementation of these policies, in order to ensure that the envisioned energy savings are actually realised.

Financial Institutions

Corporate governance

The Commercial Code (Act No. 513/1991 Coll. as amended, in force as of 1 January 1992) is the principal legislation concerning corporate governance in the Slovak Republic. The Commercial Code includes general regulations on companies, and applies to all enterprises in the Slovak Republic. As a result of the country's membership in the European Union since May 2004, the Commercial Code has been amended several times so to transpose the relevant Acquis Communautaire.

In September 2002, the Bratislava Stock Exchange, in collaboration with the market regulator, enacted a Code of Corporate Governance. Since 2003, the Listing Rules of the Bratislava Stock Exchange require companies to report their compliance with the Code - under the so-called "comply or explain" rule. In 2007, a new Corporate Governance Code (the "Code") was drafted. Since 1 January 2008, the Code has applied to all companies whose securities have been admitted to trading on the Bratislava Stock Exchange. Since 1 January 2012 companies which are part of supranational groups, or their majority shareholder is a foreign entity can decide to apply another corporate governance code than the Slovak one.

The latest EBRD assessments on corporate governance have shown that corporate governance legislation in the Slovak Republic is in high compliance with the OECD principles. Now policy makers should actively assess the legislation effectiveness. For example, the default rule established by law in joint stock companies organised under the two-tier system, is that the general shareholders meeting appoints both the supervisory board and the executive board. Under this rule, the oversight role of the supervisory board over management might be weakened. The effectiveness of this and other provisions should be assessed.

Further, the listed companies' effort in reporting compliance with the Code should be coupled with some statistics and information on the level of compliance reached. At this moment it seems that no statistics or reports exist on the effectiveness of the Code's implementation and compliance and there seem to be no procedures for measuring the Code's effectiveness.

Insolvency

The Slovak Republic has a well formulated, modern commercial insolvency law framework, which enables liquidation or restructuring of a debtor's business. The sector is governed by the Act on Bankruptcy and Restructuring No. 7/2005 (the "Insolvency Act"), which came into effect on 1 January 2006, replacing the 1991 Act on Bankruptcy and Composition (Act No. 328/ 1991). The EBRD Insolvency Sector Assessment (the "Assessment") completed in late 2009 concluded that the Insolvency Act was of a generally acceptable standard. The law contains reasonable commencement criteria and processes, provides for interim protection for creditors during the observation period, requires delivery of assets and disclosure of relevant information and provides reasonably strong provisions relating to the avoidance of pre-bankruptcy transactions. The Assessment noted that the insolvency law framework could be improved by introducing greater protections for creditors during restructuring proceedings, stronger sanctions for breach of the law and perhaps specialised bankruptcy courts, as opposed to the existing system which provides for a court of general jurisdiction to preside over insolvency cases.

The Insolvency Act, which came into effect in 2006, provided the Slovak Republic with a modern insolvency law framework, containing procedures for bankruptcy and reorganisation. Policy going forward should focus on ensuring that the reorganisation procedure is used effectively and that creditor rights are given due consideration. In addition, the Slovak Republic could consider promoting the development of informal work-out principles, such as the INSOL Principles, which do not exist at present, to encourage pre-insolvency work-outs.

Secured transactions

The provisions of Civil Code relating to secured transactions (covering pledges and mortgages) are the main legal source for taking security in Slovak Republic. The law covers security over real property, movable assets and intangibles (such as rights and receivables). The same provisions apply to charges over movable and immovable property (mortgages). Divergence is encountered only in terms of registration.

The Civil Code regime gives the Slovak Republic one of the most advanced frameworks for secured credit in Europe. The assets may be identified by general description and may include assets to be acquired by the debtor at a future date. It is possible to take security over a group of assets even where the group is constantly changing, such as inventory or trade receivables or even an enterprise. All types of claim may be secured. The secured debt may be denominated in any currency, may be of fixed or varying amount and may include claims that will arise in the future. In order to perfect security a written agreement and registration of the security interest is needed.

Registration of mortgages is governed by the Act on Cadastre. Mortgages are entered and publicised in the Real Estate Register maintained by the Cadastre Offices around the Slovak Republic. The Act on Cadastre was amended in 2009 and one of the objectives of the amendment was to simplify and accelerate the cadastral procedures. The amendment modified deadlines for the entry of property rights into the Cadastre with the aim of speeding up lengthy procedures (a 30-day prescribed period for registration has been shortened to a new 20-day period). However, lengthy procedures for registration still remain an issue. The Slovak government could consider measures aimed at improving the registration of mortgage rights, in particular with the view of cutting down on the time required.

ANNEX 4 – Technical Cooperation

TC Commitments by Donor through EBRD, 2009-2011

Donor	TC Commitments (EUR)
Bohunice International Decommissioning Support Fund	2,417,895
EU	475,565
Nuclear	478,525
Grand Total	**3,371,985**

TC Commitments by Sector through EBRD, 2009-2011

Sector/Team	TC Commitments (EUR)
Financial Institutions	3,371,985
Grand Total	**3,371,985**

Note: Commitment values based on year end or period end data for each year.

ANNEX 5 – Selected Economic Indicators

	2006	2007	2008	2009	2010	2011	2012 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	8.5	10.5	5.8	-4.9	4.2	3.3	2.6
Private consumption	5.9	6.9	6.1	0.2	-0.7	-0.4	na
Public consumption	9.7	0.1	6.1	6.1	1.1	-3.5	na
Gross fixed capital formation	9.3	9.1	4.7	-30.2	22.1	-2.7	na
Exports of goods and services	21.0	14.3	3.1	-15.9	16.5	10.8	na
Imports of goods and services	17.8	9.2	3.1	-18.1	16.3	4.5	na
Industrial gross output	10.1	12.7	3.4	-13.7	na	na	na
Agricultural gross output	-2.4	5.6	-0.3	-21.5	na	na	na
Employment			*(Percentage change)*				
Labour force (annual average)	0.3	-0.2	1.6	0.0	na	na	na
Employment (annual average)	3.8	2.4	3.2	-2.8	na	na	na
			(In per cent of labour force)				
Unemployment (end-year)	12.0	10.4	9.1	14.3	13.7	14.1	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.5	2.8	3.9	0.9	0.7	4.1	4.0
Consumer prices (end-year)	4.3	3.4	4.4	0.5	1.0	na	na
Producer prices (annual average)	8.0	2.2	5.8	-2.2	na	na	na
Producer prices (end-year)	5.6	2.5	6.4	-5.0	na	na	na
Gross average monthly earnings in economy (annual average)	8.6	7.4	8.1	3.0	3.3	na	na
Government sector			*(In per cent of GDP)*				
General government balance	-3.2	-1.8	-2.1	-8.0	-7.7	-4.8	-3.3
General government expenditure	36.6	34.3	35.0	41.5	na	na	na
General government debt	30.5	29.6	27.8	35.4	36.0	na	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	8.2	11.8	5.5	6.4	5.8	na	na
Domestic credit (end-year)	23.3	20.3	25.5	-11.3	0.7	na	na
			(In per cent of GDP)				
Broad money (M2, end-year)	54.7	54.7	53.1	60.0	60.7	na	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	4.8	4.3	2.5	2.5	na	na	na
3-month BRIBOR	4.8	4.3	3.2	0.7	na	na	na
Deposit rate	3.6	3.7	3.8	na	na	na	na
Lending rate	7.7	8.0	5.7	na	na	na	na
			(Korunas per US dollar)				
Exchange rate (end-year)	0.8	0.7	0.7	0.7	0.8	0.7	na
Exchange rate (annual average)	0.8	0.7	0.7	0.7	0.8	0.7	na
External sector							
			(In millions of US dollars)				
Current account	-4,309.8	-3,994.5	-6,195.0	-2,808.4	-1,313.3	na	na
Trade balance	-2,531.8	-865.3	-1,007.5	1,647.4	900.0	na	na
Merchandise exports	41,477.8	57,489.5	69,921.8	55,126.1	60,000.0	na	0.0
Merchandise imports	44,009.7	58,354.8	70,929.3	53,478.7	59,100.0	na	0.0
Foreign direct investment, net	4,177.5	2,881.0	3,155.9	-481.2	198.6	na	0.0
Gross reserves, excluding gold (end-year)	12,684.8	17,674.8	17,854.1	689.3	1,200.0	na	na
External debt stock	32,206.0	44,308.7	52,526.7	65,314.1	65,823.9	na	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.1	3.3	2.7	0.1	0.2	na	na
			(In per cent of exports of goods and services)				
Debt service due	4.7	3.8	3.4	4.2	4.8	na	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	5.4	5.4	5.4	5.4	5.4	5.4	na
GDP (in billions of euros)	55.1	61.6	67.0	63.1	65.9	71.1	na
GDP per capita (in US dollars)	12,785.1	15,543.1	18,122.9	16,172.5	0.0	na	na
Share of industry in GDP (in per cent)	28.2	27.9	27.1	23.3	na	na	na
Share of agriculture in GDP (in per cent)	3.2	3.2	2.8	2.4	na	na	na
Current account/GDP (in per cent)	-6.2	-4.7	-6.3	-3.2	-1.5	na	na
External debt - reserves (in US$ million)	19,521.2	26,633.9	34,672.6	64,624.8	64,623.9	na	na
External debt/GDP (in per cent)	46.6	52.7	53.6	74.6	75.2	na	na
External debt/exports of goods and services (in per cent)	68.7	68.7	67.0	106.4	95.3	na	na

ANNEX 6 – Gender Equality

Gender Inequality and Human Development

According to the UNDP 2011 Human Development Index (HDI), the Slovak Republic is among the countries with a very high human development index. It is ranked 35^{th} out of 187 countries, which is above the regional average for Europe and Central Asia. The HDI is comprised of three dimensions: health, education and decent standard of living. The country ranks slightly better in terms of the UNDP Gender Inequality Index (GII), at 31^{st} globally. The GII is a composite measure, which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labour market participation.

Labour force participation and gender pay gap

Women’s labour market participation is lower as compared to men’s in the Slovak Republic. According to Eurostat 2011, the share of women in employment aged 15 to 64 was 52.7 per cent as compared to 66.3 per cent for men. In 2010, the gender pay gap (GPG) was 20.7 per cent. This compares to an average of 16.4 per cent for EU countries when the gross hourly earnings of women and men are taken into account.

Indicator	Female	Male	Year
Total employment	50.4 per	68.3 per	2011
Gender Pay Gap	20.7 per cent		2010

Source: Eurostat 2010-2011, UNECE 2009

According to UNESCO figures, in 2010 in the Slovak Republic the proportion of women in tertiary education was much higher as compared to that of men (67 per cent for women compared to 43 per cent for men). Of note, however, is that 84 per cent of the female students graduated in the areas of health and welfare, whereas only 31 per cent studied and graduated in subjects such as engineering, manufacturing and construction.

According to the 2012 Women’s Economic Opportunity Index of the Economist Intelligence Unit that ranks 128 countries on their ability to support economic advancement of women, the Slovak Republic is ranked 26^{th} globally and 4^{th} in the EBRD region. The extent and form of women’s participation in the labour force is related to several institutional support mechanisms, such as childcare services, parental leave policies and flexible work arrangements. The Slovak Republic performs well in the area of labour policy and practice. For example, together with Lithuania, the country has received the highest score for the availability, affordability and quality of childcare services in the EBRD region.

This gender segregation in education results into occupational segregation in the labour market, as the table below shows. The GPG may be due, therefore, not only from the fact that women receive less pay for the same work but to a large extent to the fact that a disproportionately large number of women is concentrated in lower-paying sectors of the economy.

The Slovak Republic: total employment by economic activity	Male	Female
Construction	95 per	5 per cent
Mining and Quarrying	90 per	10 per
Electricity, Gas and Water Supply	84 per	16 per
Transport, Storage and Communications	73 per	27 per
Manufacturing	64 per	36 per
Real estate, Renting and Business Activities	53 per	47 per
Financial Intermediation	32 per	68 per
Hotels and Restaurants	40 per	60 per
Education	21 per	79 per
Human health and social work activities	18 per	82 per

Source: Laborsta, International Labour Organisation, 2008

Entrepreneurship, access to finance

There is no gender difference reported in access to formal financial services in the Slovak Republic. According to the World Bank's Global Financial Inclusion database, (surveying approximately 1, 000 people using randomly selected, nationally representative samples) in 2011 80. 3 per cent of male adults and 78.9 per cent of females owned an account at a formal financial institution.

Indicator	**Female**	**ECA***	**Year**
Percent of firms with female participation in ownership	29.6 per cent	36.7 per cent	2009
Percent of firms with a female top manager	19.8 per cent	19.8 per cent	2009
Proportion of full-time workers that are female	38.9 per cent	38.4 per cent	2009

**Eastern Europe and Central Asia*
Source: BEEPS 2009

According to the 2007 report of the European Microfinance Network, women represent only 30 per cent of all entrepreneurs in the Slovak Republic. The reasons for the low female entrepreneurial activity are due mainly to greater responsibility being allocated to women for the running of a household and raising the children, and a few role models of successful female entrepreneurs, amongst others.

According to the 2009 Business Environment and Enterprise Performance Survey (BEEPS), 29.6 per cent of 275 firms surveyed in the Slovak Republic had women among the owners. Of the firms surveyed, women comprised 38.9 per cent of the full time workers and 19.8 per cent of these firms had women in positions of top management. Of the 34 per cent of firms within the BEEPS survey sample that applied for a loan in the Slovak Republic, and had a woman among its owners, 12.1 per cent of these firms were rejected for loans. In comparison, only 8.1 per cent of the 63.9 per cent of firms with no female owners that applied for loans were rejected.