Economic and Social Contexts of Slovakia's Accession to the EU – benefits and risks

Summary

1. A study elaborated on the basis of Governmental Resolution No. 248 of 13 March 2002
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INTRODUCTION

The accession to the European Union represents a unique historical chance and an existential necessity, which, from the standpoint of national and state interests, has no reasonable alternative. The elaboration of an initial study on the economic and social contexts of Slovakia's accession to the EU is an organic part of the successful endeavour to catch up with the first group of candidate countries. It was elaborated by the Institute of Slovak and World Economy of the Slovak Academy of Sciences on the basis of Governmental Resolution No. 248 of 13 March 2002.

A section of the Institute's capacity paid attention to research on theoretical issues and the actual course of the integration process in the EU, as well as certain implications related to Slovakia, already in the previous years. The preparation of the present study, however, required that the focus of analytical attention be shifted to a relatively comprehensive national economic assessment of the relevant economic and social aspects of Slovakia's accession to the EU, identification of its strengths and weaknesses from this standpoint and the approximate quantification of the anticipated effects and costs. To meet this demanding goal, it was necessary to substantially extend the subject of exploration to include a number of new issues; update the results of previous researches; collect and, in accordance with the chosen methodological approach, recast and synthesise information from individual ministries' background documentation; involve the necessary scope of external authors and institutions in the elaboration of a number of topics; incorporate the results of researches on the readiness and expectations of the enterprise sphere; and, to take into account information acquired through talks with representatives of the Association of Industrial Unions, Slovak Chamber of Commerce and Industry, Confederation of Trade Unions and the Confederation of Employer Unions and Associations, as well as from the discussion at the seminar on the preliminary results of the study being prepared.

The basic goal of the present study was to elaborate relatively comprehensive scientific arguments on economic and social contexts explaining the existential necessity of Slovakia's political and strategic direction to the EU. At the same time, it attempts to provide a balanced view of both the benefits and risks. On the one hand, it identifies certain potential problems and probable, in particular initial time limited risks, the reduction or elimination of which will require attention already in the preparatory period. On the other hand, it explains a wide range of benefits, the rational utilisation of which will give a guarantee of clear long-term advantageousness of Slovakia's integration to the EU.

The following partial goals, focused on specific advancement in knowledge and applicability in the economic, political, as well as general social pre-accession practice, were subordinated to the aforementioned basic goal:

- unveil the existing disparities in Slovakia's economy compared with the EU at the macroeconomic, sectoral and branch levels and explain the key importance of increasing competitiveness;
- on this basis, simulate the relevant scenarios of possible developments in the Slovak economy and their social implications as regards approximation to the EU;
- approximately quantify the anticipated costs and benefits of Slovakia's accession or non-accession to the EU in aggregate, sectoral and cross-sectional structure;
- identify the priorities of the accession process and extend the arguments for the need for transition periods;
- characterise the readiness of the Slovak enterprise sphere for the adaptation to the conditions of Slovakia's integration to the EU;
• for the purposes of updating the medium-term economic policy, provide ideas for mitigating integration risks and creating suitable conditions for the utilisation of the benefits of integration;
• provide the initial integration orientation for the elaboration of sectoral, branch and regional policies and concepts;
• encourage entrepreneurs and turn their attention to the swift organic incorporation of integration contexts and conditions of the adaptation strategy;
• provide objective arguments to make the expectations of the public and social partners more realistic as regards Slovakia's accession to the EU.

The experience from the preparation and course of the seminar on the preliminary results of this study, and above all the nature of several opinions and positions presented in the mass media in connection with this, demonstrated that besides the above goals it should help fulfil several specific goals.

The results of the study should significantly help overcome the low and insufficient availability of information and the consequential unrealistically optimistic and overly pessimistic expectations. Also related to this is the somewhat wide-spread presumption that a large scope of problems and difficulties in our economy and, in particular, the demanding nature of their resolution are or will be connected with and brought about by the integration into the EU. In this context, the study is designed to show that amid sharpened global competition we will have to cope with a major section of the problems anyway and the integration process is something that can facilitate and speed up the necessary adaptation to globalisation. If we prepare for accession to the EU effectively and make use of the chances and possibilities related to it efficiently, the integration into the single economic area will act as a catalyst of the effective adaptation of our economy. In this respect, the study also pursues a certain mobilisation goal to help overcome the passive wait-and-see opinions and attitudes and increase motivation so that all structural parts of our economy, at every level, make the best use of the time remaining before Slovakia accedes to the EU and thus improve our readiness to make use of the advantages and manage the risks of integration.

Certain facts should be underlined concerning the concept of the present study and the expressive value of its conclusions. Even though the authors could use experience from similar foreign works, in a number of respects the preparation of this study has a pioneering nature. Not only is this the first work of this kind in our country, its preparation also had to build upon significantly different conditions as regards the specific situation and state of the Slovak economy, as well as the relatively small scientific capacity available, scope and quality of background information, availability of certain specific data, as well as the short amount of time due to the tight deadline set.

As regards understanding the expressive value of the study, it needs to be pointed out that it is conditional upon a number of factors, the most important of them being the fact that the accession process and integration into EU structures has the nature of "docking" to a moving target. This means that the results of the authors' effort to quantify the costs and benefits from perspectives as relevant as possible cannot be interpreted as "hard" data. Quantifications, even if acquired through model simulations and calculations, provide only the basic idea of the possible directions of the relevant processes, while the actual data on the real course of the processes can and typically will, to a varying extent, oscillate within a certain interval depending on the developments and changes in specific conditions in both the EU and our economy. This is the reason why regular updates of studies on economic and social contexts of accession to and existence in the EU are necessary.
The full version of the study prepared (393 pages) is divided into two basic sections. The first presents an analysis of the initial economic and social position of Slovakia at the current stage of the process of preparation for accession to the EU. The second, core section of the study provides a relatively comprehensive identification of specific benefits and risks related to Slovakia's accession to the EU. The study also includes this Summary, which synthesises the most important conclusions and formulates economic policy recommendations. It can be found in the submitted paper.

The authors realise that the present study could not give exhaustive answers to all relevant questions and a number of issues remain open. In the next round of work, still prior to the expected date of accession to the EU, it will be necessary to not only update, but also improve and enhance the study as regards methodology and content. For this reason, we appreciate the comments from our opponents and the ideas brought forth at the seminar, which we have already applied in this version of the Summary.

1. SLOVAKIA’S ECONOMIC AND SOCIAL POSITION ON THE EU's DOORSTEP

**Macroeconomic and institutional framework of accession to the EU**

One of the fundamental (Copenhagen) criteria that must be met by countries integrating into the EU is the creation of a functioning market economy. The first sign of it is the achievement of lasting economic growth (GDP growth) at a level that confirms the country's sufficient competitiveness and ability to gradually eliminate its economic lagging behind the current EU member states (ability to deal with the convergence task).

The economic convergence of Slovakia to the EU cannot be reduced to the extension of economic activities or production in their current form and at any rate. The decisive part of Slovakia's convergence task is to carry out qualitative changes in production and the structure of production of goods and services on the basis of structural changes in the systemic and institutional framework. Only then will it be possible to ensure that per capita GDP in Slovakia approaches that of the EU-15 at about the same pace as the economic performance of Western Europe approached the performance of the USA after World War II.

Developments in transition economies and their comparison with economic development in EU countries prove that steadiness of growth is an indispensable condition for ensuring permanent growth at a pace sufficient to resolve the convergence task. This in turn (as experience shows) is largely conditional upon maintaining the economy in a state of balance, which requires both responsible economic policy, and, in Slovakia and in other transition countries, in particular the full completion of reforms.

By underlining the importance of maintaining macroeconomic stability for the achievement of a long-term high-rate economic growth (and thus the convergence of the Slovak economy to EU countries), the requirement of balance should not be made superior to the need to increase economic performance. Even more so if this involved achieving the balance at any cost, even at the cost of restricting development resources and results. The causality works in both directions in the relationship between stability and growth. The reason why emphasis was placed on just one of its sides, in particular on the direction of impulses flowing from balance to growth, is that Slovakia, endeavouring to accede to the EU, has a transition economy with strong imbalance creating factors and a poorly effective balance creating mechanism. Overall, it can be said that the purpose of the relationship between growth and balance, rid of any bias, is undoubtedly
economic growth ensuring the gradual modernisation of the Slovak economy as a basis for the economic convergence of Slovakia to EU countries understood in terms of quality.

The cycles of weaker and stronger macroeconomic balance are typical even for countries that joined the EU in the previous rounds of enlargement. However, it cannot be confirmed whether EU accession in itself has clearly contributed to the (de)stabilisation of macroeconomic development in the short- or medium run.

It is not the integration itself, but rather the current internal characteristics of the functioning of the Slovak economy that are the main risk factors threatening its stability. The chronic inclination toward imbalance caused by the insufficient level of competitiveness has been, on a number of occasions, eliminated only temporarily through various packages of stabilisation measures.

The high intermediate consumption and import intensity embedded in production makes the economy vulnerable. This is further amplified by the inclination of public finance to reproduce deficits and debts.

Even after several attempts to achieve macroeconomic stabilisation, we cannot say it has an enduringly satisfactory state. The final stage of preparations for accession to the EU must therefore be a phase of prudent fiscal policy combined with an effort to reform the problematic areas of the public sector. Along with the elimination of other deformations of the market environment, this should lead to the creation of conditions enabling the Slovak economy to behave as a standard market economy and thus eliminate the specific transformation factors affecting the cycles of balance fluctuation.

The maintenance of permanently high amount of investments in the Slovak economy can be regarded as its comparative advantage helping to preserve the long-term high-rate GDP growth. Compared with other transition economies, the investment intensity of economic growth in Slovakia reached a satisfactory level on the whole. It was also lower than the average in the EU-15 and in its south wing.

In 1993-2000 Slovakia's accumulation resources were extended by foreign resources to a greater extent than in other transitive economies. This on the one hand strengthened Slovakia's investment potential, but on the other hand endangered its macroeconomic stability, because, in particular before 1998 inclusively, loans (to a substantial extent state-guaranteed loans) prevailed over foreign direct investment in foreign resources.

One serious issue is the impact of EU accession on developments in the labour market. The analysis of trends present in it indicates that forces already exist in the Slovak transforming economy, which, in the medium run (after the current downturn of the world economy is overcome), i.e. by the time of Slovakia's potential accession to the EU, will be able to make a more permanent turn in the so far negative development in employment and unemployment.

Fiscal policy was marked by imbalance in public finance in the monitored period. In 1996-1998 this was a result of the exaggerated effort to support economic growth directly and in 1999-2001 this was a result of the expenditure on the restructuring of the banking sector, while reforms in the healthcare, social security and education sectors progressed inadequately.

The developments in public finance in 2002 show that its reform has not reached a state that would ensure its enduring positive impact on macroeconomic stability.
Even though the lagging behind of institutional reforms (typical for the stages of transformation that have taken place so far) has made it possible to achieve short-term positive results in monetary developments, this was at the cost of greater long-term problems and decrease in the Slovak crown's exchange rate. It has thus turned out that nominal convergence will not become realistically achievable until all structural changes necessary for the Slovak economy to become a standard functioning market economy have been carried out.

The experience from the transformation of smaller open economies indicates that if Slovakia's pro-integration direction is to be successful, a more long-term stabilisation of monetary balance will be required, which, in the small Slovak economy (sensitive to external influences) requires a significant degree of flexibility and swift adaptation to external influences. From the monetary standpoint, this will involve ensuring a pace of economic growth that will encourage stable and steady monetary development. For these reasons, the endeavour to achieve early monetary integration by joining the single currency system cannot be considered realistic until the decisive transformation tasks are completed.

One of the key prerequisites for Slovakia's accession to the EU is the creation of an institutional structure corresponding with that of EU member states.

The main area of the present institutional reforms is the harmonisation of Slovakia's legal system with that of the EU (the adoption of the acquis communautaire). The purpose of the acquis is the creation of an institutional framework suitable for the effective execution of economic, social, administrative and other activities. Slovakia has managed to catch up with other candidate countries relatively fast as regards the closing of negotiating chapters.

One part of institutional reforms is the reinforcement of law enforceability, which is not only determined by formal institutions (the mechanisms of judiciary's and prosecution's operation), but also informal institutions. The ongoing reform of the judiciary, focused on improvements in judges' work and reduction of the time necessary for resolving individual cases, should help reach progress in formal institutions. Change in informal institutions, which involves value orientations and behavioural patterns, is of a more long-term nature.

The strengthening of institutions and mechanisms related to the effective and controllable management of EC funds remains to be an important task in the field of institutional reforms.

**Initial level of the Slovak economy's competitiveness**

The key priority for candidate countries in the preparation for accession to the EU is the real convergence of economy. The identification of the problems of real convergence is usually examined from the standpoint of the achieved level of the economy's competitiveness, which is generally considered as a fairly exhaustive and functional manifestation of the real economy. Even the Copenhagen criteria, which, inter alia, emphasise the importance of the ability to cope with competitive pressures and market forces within the EU, are based on it.

Being an EU membership candidate, the Slovak Republic is also facing the task of meeting the above criterion, because the level of the Slovak economy's competitiveness (compared with developed countries) is as yet relatively low in general.

In gross domestic product (GDP), measured by per capita purchasing power parities (PPPs), Slovakia reaches only 49% of the EU average. From among Central European candidate countries, this indicator is lower only in Poland.
Another manifestation of low competitiveness is the trade balance deficit. In the 1994-1999 period, Slovakia, again together with Poland, had the highest deficit as a share of GDP (-7.2%). The low competitiveness is further confirmed by the fact that compared with other candidate countries the Slovak economy has the lowest share of domestic production in domestic demand (consumption and investments).

The most serious fact, however, is that the main risks to the Slovak economy's competitiveness on the doorstep to the EU are caused by the considerable lagging behind in productivity. It only reaches roughly a half of the EU average (GDP per employee using the US$ / PPPs) and only about 20% when calculated using the current exchange rate. Other Central European candidate countries (except Poland) have a relatively higher level of productivity.

At the same time, the low comparative level of productivity caused that the rise in prices in 1994-1999 was reflected in the depreciation of the exchange rate, although only partially because by 1998 the exchange rate was fixed. Therefore no rapid increase in the comparative price level or decrease in exchange rate deviation occurred, which are other important indicators of the level of an economy's competitiveness. This is why at the end of 2000 the price level in Slovakia reached only 36% of the EU average and Exchange Rate Deviation Index (ERDI) was at about 3.0. Levels reached in other candidate countries at the end of the 90s are significantly more favourable: the comparative price level (CPL) in the Czech Republic reached 39%, in Hungary 43%, in Poland 48% and in Slovenia as much as 65% of the EU-15 average. CPL in Spain, Portugal and Greece in the year of accession oscillated between 50-70% of the then European Community average.

Even though the decisive cause of the low CPL is poor labour productivity, which reflects the low level of Slovakia's competitiveness in terms of quality, especially in the manufacturing, the relatively low inflation rate maintained in the 1994-1999 period also played a certain role in this. While the average inflation rate in Slovakia in this period was at the level of 8.7%, Hungary and Poland recorded inflation as high as 18%. Slovenia, despite considerably high inflation at the beginning of the 90s and even before, still recorded inflation of 9% in 1994 to 1999.

Difficult sales conditions in the world markets also play a role in the low comparative price level. A considerable section of product markets is controlled by multinational corporations, which are in most cases brand name companies with good tradition and reputation (goodwill). Success in these markets is only possible by becoming a part of these companies, mainly in the form of joint ventures, or accepting considerable price concessions in the form of price discounts. Moreover, producers from candidate countries must usually cope with buyers' distrust, mainly in the case of final products, because they come from the former Eastern bloc, which is automatically associated with low quality, i.e. risky business. This unflattering reputation of new unknown companies and brands from candidate countries is unfairly generalised and usually results in price discounts as a compensation for these disadvantages.

In addition, there is the factor of internal corporate prices set in a non-market manner for exports. These prices can be lower than market prices thanks to the redistribution processes inside these corporations.

Besides the obvious macroeconomic dimension, the international competitiveness of an economy also needs to be monitored at the lower aggregate level - at the level of sectors or homogenous product groups.
The structure of Slovak exports has improved substantially in recent years, in particular by reducing the group of raw material, energy and capital intensive commodities in favour of science and research intensive commodities, generally called sophisticated. Their share reached approximately 44% in 2000 and became much closer to that in economically advanced EU countries, as well as in the Czech Republic, Hungary and Slovenia.

Slovakia records relatively higher competitiveness for less processed products (raw material, energy, capital and labour intensive commodities) compared with science and research intensive commodities, the share of which in exports has increased. Compared with other candidate countries, Slovakia has the highest competitive advantages in the EU market for raw material, energy and capital intensive goods, while Poland and Slovenia have a better position in labour intensive goods. As regards science and research intensive goods, from among candidate countries, Hungary, Slovenia and the Czech Republic are among serious competitors of Slovakia in EU markets.

The low qualitative competitiveness is still reflected in unfavourable absolute terms of trade. Export unit values in 2000 were still lower than import unit values (i.e. in comparison with foreign economies), even though some improvements had occurred. The highest disparity has been recorded in energy and capital intensive commodities (basically goods with a low degree of processing), which is also evidence of their highest competitiveness through prices. It is pleasing that export and import unit values of sophisticated products became much closer in 2000. This is possibly caused above all by companies with foreign participation, such as Volkswagen and others.

Analyses of the competitiveness of the Slovak economy carried out so far have confirmed the hypothesis that labour productivity is the decisive determinant for increasing competitiveness. This means that the key problem of increasing the Slovak economy's competitiveness lies in the reduction of the lagging behind in labour productivity, combined with an increase in the share of value added in gross production.

In 1997, for tradable goods (in industry) Slovakia reached only 32% of the labour productivity level in selected developed EU countries, when using value added as a measure. This was a result of the substantially higher productivity when using gross production as a measure (49%) and, contrarily, substantially lower value added rate (23% compared with 36%). Slovenia and the Czech Republic have the most favourable relation in this respect, when reaching a relatively higher value added rate, along with higher productivity when measured by gross production.

As the trends in advanced economies show, the road to increasing labour productivity in the production of tradable goods goes above all through the international intrasectoral micro-specialisation. It is as yet insufficiently developed in the Slovak manufacturing, mainly in sophisticated productions, where it is most typical. As a result of changes in intrasectoral micro-specialisation, the nature of foreign trade relations is also changing. The weight of intersectoral foreign trade is declining and the importance of intrasectoral trade is rising.

Despite the fact that trade liberalisation was included in the Europe Agreement, it has not brought about any significant rise in intrasectoral trade between Slovakia and the EU in the recent past and intersectoral trade thus continues to prevail.

In connection with low labour productivity and low value added rate in the Slovak industry compared with the EU average, Slovakia also records low per employee wages.
In 1997, Slovak nominal monthly wages per employee in the production of tradable goods reached only 10.3% of the level in advanced EU countries, 11.1% of the level in Austria, 9.1% of the level in Germany, and 17% of the level in Spain. Obviously, real wages per employee (measured by PPPs) were higher. Yet they were still only 28% of the level in selected EU countries.

The relatively low level of per employee wages in the Slovak industry is also reflected in the unit labour costs, which are lower than in other candidate countries, except Hungary. This again confirms that Slovakia succeeds in world tradable goods markets mostly thanks to competitive prices, in which low wages play an important role.

**Structure of the Slovak economy**

The sectoral structure of the Slovak economy has changed substantially since 1989 and its proportions have become more similar to the proportions typical for EU member states; the differences found by a comparison with selected EU countries are no greater than those existing within the EU. However, if we divide the structure of production and services into more detailed layers, the lower share of modern technology and knowledge intensive activities is apparent, not only in comparison with developed EU countries, but also for instance in comparison with Hungary. The lower volume of foreign direct investment in the Slovak manufacturing with the other V4 countries - in particular in the form of green field investments - has clearly led to a slower pace of qualitative structural changes in Slovakia. It can be expected that Slovakia's accession to the EU will bring positive changes in this respect.

Slovakia achieves roughly a half of the EU labour productivity (which is several points less than in the Czech Republic and Hungary, but more than in Poland). In individual sectors, these relations are quite varied (compared with Austria). The highest relative level of labour productivity is in agriculture, which is mostly a result of the different size structure of agricultural companies in Austria and Slovakia, as well as the sharp decline in employment in the Slovak agriculture. On the contrary, the worst results are currently in the construction sector; both international and national indicators suggest that overcoming the negative tendencies in the development of labour productivity in this sector will require more flexible adaptation of construction enterprises to the demand for construction work.

Slovakia achieves a relatively high level of labour productivity in the service sector, both in international comparison and intersectoral comparison within Slovakia. What is particularly important is that labour productivity in this sector is increasing along with the increase in employment. Still, an international comparison of a more detailed structure of the service sector shows that most dynamically developing services in modern economies (financial services, research, and the whole spectrum of business services) are less developed in Slovakia. Their share in employment reaches only half of the level in developed economies. The insufficient development of this group of services clearly indicates that Slovakia lags behind developed economies in an area that creates the necessary background for increasing the success of the export sector in quality competition.

The estimated relations between labour productivity in Slovakia and Austria in industry, as well as the manufacturing, are less favourable for Slovakia than for the Czech Republic and Hungary. Labour productivity in the Slovak manufacturing in 1999 reached around 40% of that in Austria. Increasing the industry's labour productivity will probably be very difficult, since it does not depend solely on the producers themselves, but also on the conditions in foreign markets. Due to the low level of wages and unit labour costs in the manufacturing
(roughly a quarter of that in Austria) and a great excess of supply over demand in the labour market, producers are not motivated towards technological innovation. Moreover, with the continuous limited access to credit resources, producers are restricted by the extent of their own resources. In this respect, we see the improved financial situation in manufacturing enterprises in the past three years and the decline in the share of non-profitable enterprises in its output and employment as a positive signal.

Changes in the structure of manufacturing production carried out during transformation indicate that it is gradually becoming more similar to the structure typical for developed EU countries. It differs from the structure in less developed EU countries, on the one hand, by the lower share of consumer goods and foodstuffs production and, on the other hand, by the considerably higher share of production of investment goods. This means that the key problem of the Slovak manufacturing is no longer its structure at the level of sectors, but above all the slow introduction of new technology and knowledge intensive productions within individual sectors, without which faster increase in qualitative competitiveness is not possible.

A number of positive trends can be seen in the developments in Slovakia's foreign trade in industrial goods. In the structure of its exports, the share of human capital intensive goods has risen to 46% (compared with 33% in 1994) and the share of raw material intensive goods has fallen to 23% (from 38% in 1994).

Certain progress has been achieved in the relation between import and export unit values. While in 1994 only 23% of total exports of industrial goods was in the group of goods (at the SITC three digit level) with unit values higher in exports than in imports, in 2001 it was as much as 42%; in quality competition (higher unit values in exports than in imports, along with a positive trade balance) 17% was successful in 1994 and as much as 34% in 2001. The share of successful items in price competition (lower unit values in exports than in imports and a positive trade balance) decreased from 63% in 1994 to 36% in 2001.

The position of Slovak enterprises is also gradually changing with respect to reached foreign trade prices in the EU market - the difference between export prices in the Slovak manufacturing and the EU average improved by about 10 percentage points between 1995 and 1999 and is considerably more favourable than in the Czech Republic and Poland.

**Regional disparities and their reduction in the period of Slovakia's integration into the EU**

The analyses prepared show that Slovakia's economic development, marked by permanent GDP growth, is accompanied by the creation and deepening of disparities between regions (administrative regions, but especially districts).

The per capita GDP generated in the economically most developed Bratislava region in 2000 was twice the Slovak average and more than three times the per capita GDP in the least developed Prešov region. In the same year there was 56.7 job opportunities per 100 inhabitants in the Bratislava region, 29.8 in the Prešov region and between 33.2 and 40.8 in other regions. The average monthly income from work per capita in 2000 reached SKK 3328 in Slovakia, while it was SKK 1791 in the Prešov region and SKK 10434 in the Bratislava region. The unemployment rate in 2001 reached 24.8% in the Košice region, 23.1% in the Nitra region, 22.7% in the Prešov region, 22.4% in the Banská Bystrica region, 18.9% in the Žilina region, 18.0% in the Trnava region, 13.4 % in the Trenčín region, and 8.3% in the Bratislava region. From among the many factors affecting regional disparities in Slovakia, the most important are foreign development investments, the export base of regions, the
development of small and medium-sized enterprises (establishment of new enterprises in regions), innovation potential and qualifications, the condition of technical infrastructure, and the activities of institutions promoting regional development.

We used the following scenarios to assess the possibilities for diminishing regional differences in Slovakia:

- scenario without accession to the EU,
- scenario with accession to the EU with the following variants:
  - growth scenario,
  - equalisation scenario,
  - growth-equalisation scenario.

Based on an assessment of the advantages and disadvantages of individual scenarios, we recommend that regional policy be carried out in accordance with the growth-equalisation scenario. It combines two goals of regional development, with the inevitable compromises. The first goal is to enhance the economic standard of regions at NUTS levels II and III. Within these levels, the interregional disparities at NUTS level IV would be further extended. The second goal is to ensure the positive influence of the development of regions on the economic growth of the whole of Slovakia.

With the absence of a distinct regional policy, the allocation mechanisms typical for the "without accession to the EU" scenario have been mostly used until now. However, this can continue even after accession to the EU, because in the conditions of a more liberal market, the low competitiveness (attractiveness) of regions, which already lag behind economically (above all stagnating and depressed regions) will manifest itself even more strongly.

This trend will continue, if conditions for the completion of a national planning and regulation system for regional development capable of adopting and implementing measures of the mature and considerably subsidised EU regional policy are not created in the fields of planning and programming, implementation of programming measures, as well as monitoring and assessment of the effects of implemented measures and projects.

This requires the completion of the institutional framework for an integral system so that no parallel institutional structures, typical for the use of the PHARE pre-accession fund, are created.

These conditions should be created in the pre-accession phase already so that we can acquire finance from structural funds and the Cohesion Fund (SF and CF), preliminary budgeted to reach EU 1.8 billion in 2004-2006, during the first years following accession to the EU.

In connection with this, it can be stated that the budgeted EU funds combined with funds from Slovak public budgets will have a positive impact on the attractiveness of regions as regards enterprises' decisions on the placement of their activities and investments, which are the decisive factors for the economic development of regions and suppression of the potential negative tendencies towards expansion of regional disparities.

The course of the pre-accession process so far indicates serious risks that we will be unable to meet all the conditions for the completion of an effectively functioning national system, and hence the EU's conditions for drawing on funding from the SF and CF, in the remaining time (1.5 years).

Access to the funds is dependant on the process of preparation and mutual approval of the Community Support Framework (CSF). The first condition is the negotiation of the National Development Plan (NDP). This alone is the first problem because the European Commission (EC) has raised a whole range of serious reservations about the National Plan for Regional
Development of Slovakia (NPRD) prepared. The implementation plan prepared and recommended by the EC anticipates that the NDP - the reworked NPRD, including operational programmes and ex ante evaluation, will be completed in November 2002 and submitted by the government to the European Commission in January 2003.

The revision of the NPRD, to bring its content in line with the NDP, is organised by the Ministry of Construction and Regional Development of the SR in a situation where the staff of regional and district departments for regional development, who participated in the preparation of the original NPRD, are no longer available, since a large proportion of them have not transferred to regional self-government offices.

The second, even more serious problem is the creation of the corresponding institutional structure, not only the administrative capacity of authorities that will function as management, payment and monitoring units vis-à-vis individual SFs, but above all institutions - implementing units - with sufficient capacity to carry out the whole process of preparation and assessment of implementation projects.

A model of the institutional framework for the system proposed for the creation of a network of implementing units, with extensive capacity for all areas of assistance, was elaborated within the framework of the Special Preparatory Programme.

In view of the fact that a number of R&D and engineering and project organisations able to serve as implementing units ceased to exist, it will probably not be possible to establish the implementing units and complete them with personnel for all areas of assistance prior to accession to the EU. There is a real risk that the situation, when much smaller amounts of finance from pre-accession funds remained unused due to the lack of quality projects, will occur again.

In practice, this will mean that the acquisition of massive support for the planned sectoral operational programmes (SOP), but mainly the Regional Operational Programme of Slovakia (ROP), will be postponed by at least two to three years. This will consequently cause a postponement of the positive impacts on the development of individual regions meaning that even after accession to the EU there will be a lack of resources to stop the current trend towards extending regional disparities.

As experience from the low use of pre-accession funds shows, this situation may have further negative non-economic impacts. It may result in disillusion of a section of the population as regards the expected benefits of accession to the EU presented politically, especially if the negative impacts on certain sectors and regions are not compensated with these funds.

A pragmatic solution to this problem (within the framework of the growth-equalisation scenario) would be to concentrate the capacity of already functioning implementing units on the preparation of a smaller number of large, investment intensive projects, oriented mainly on the restructuring and development of regions' production potential, improvement of their accessibility and the completion of the technical infrastructure in their territories.

2. BENEFITS AND RISKS OF SLOVAKIA'S ACCESION TO THE EU

Integration effects

In general, the integration effects are associated above all with the benefits of the customs union. These are effects arising from the removal of trade barriers, which expands the market and is a precondition for the further development of trade.
The process of preparation for membership in the EU Customs Union did not start until the Europe Agreement between the European Union and the Slovak Republic was concluded and gradually implemented.

Through the gradual implementation of the Europe Agreement over the period of 10 years, i.e. by the end of 2000, a free-trade zone in industrial products was created. This has considerably contributed to the sizeable increase in the volume of mutual trade. At present, almost 60% of Slovakia's exports go to the EU and 50% of its imports come from the EU. Therefore, it is not expected that the adoption of the Common Customs Tariff will have a major impact on increase in the trade volume between Slovakia and the current EU Member States.

As regards territorial application, for Slovakia the introduction of the Common Customs Tariff will basically mean continuation of the current situation, since it will relate to the same group of countries, for which Slovakia already applies conventional customs duties. From the standpoint of the customs duties, the introduction of the Common Customs Tariff will lead to a rise in certain Slovak conventional customs duties (mainly for agricultural commodities), however, since this will concern only a small group of countries, with a 4.3% share in Slovak imports, this fact is not of great importance.

The accession to the European Union will also mean the adoption of all EU preferential tariff regimes. Since their territorial scope is greater than that of Slovak preferential regimes, their adoption will result in wider application of preferential tariffs by Slovakia than at present. In addition to CEFTA, EFTA, the Baltic States and countries of the generalized system of preferences, to which Slovakia provides special preferential tariffs already, it will have to also provide preferential tariffs to a numerous group of developing countries from Africa, the Caribbean and Pacific, as well as Mediterranean developing countries. Nevertheless, there is little probability that the adoption of EU preferential regimes will have a major impact on mutual trade between Slovakia and the countries that they cover.

Overall, it can be said that Slovakia's accession to the EU and the related adoption of the EU's common trade policy should not have a major impact on Slovakia's foreign trade with countries of the future EU and third countries, nor its commodity structure.

As regards EU non-tariff measures, most commonly used are agreements on voluntary export restraints, which cover almost 14% of the EU's mutual trade exchange, which is approx. 6% of imports of all countries. As for commodities, the highest protection by means of quotas, another form of non-tariff measures, is provided for textile and agricultural commodities. These are continuously updated in accordance with the results of GATT/WTO negotiations and bilateral agreements. This concerns commodities that are also sensitive for Slovakia's trade exchange.

In EU practice, extensive non-tariff measures are used for the protection of consumers, the environment, plants and animals. They are to a major extent already contained in the Slovak legislation, especially as far as international agreements are concerned. Important non-tariff measures at the governmental level include technical barriers, different VAT rates and excise duties.

Unlike in the EU, Slovak non-tariff measures have had only a negligible impact on Slovakia's foreign trade in recent years. In 1997-2001, the value of imports of goods subject to safeguards was at the level of 0.2%. For this reason, it can be expected that the adoption of the EU system of non-tariff measures will result in a slightly higher protection of the Slovak economy.
Slovakia's integration into the EU will have a decisive impact on qualitative competitiveness, which can be measured in particular by growth in productivity and price levels, and by shifts in the sectoral structure of the economy and structure of the manufacturing.

More intensive inflow of foreign direct investment (FDI) to the Slovak economy is how the integration into the EU can help the most to ensure productivity growth, which is the key factor of a substantial increase in competitiveness. It can be expected that the EU single market will provide more opportunities for Slovakia in the field of foreign direct investment inflow by advancing the processes of intrasectoral micro-specialisation aimed at greater utilisation of economies of scale, as well as by deepening the process of product differentiation in the EU and imitation in Slovakia. Both of these processes will mean the deepening of the process of international redistribution of production within the enlarged EU, which is closely related to direct investment abroad.

This should lead to the gradual alignment of the volume of FDI in Slovakia with the volume usual in EU countries, where per capita FDI volume is substantially higher than in Slovakia at present (approx. US$ 800 in Slovakia). The EU average is around US$ 3,000.

When estimating the volume of FDI after accession to the EU, we built upon the premise that by around 2008 Slovakia could approach the per capita FDI volume in the Czech Republic, which reached US$ 2,300 in 2000.

The estimated productivity growth is therefore based on the hypothesis that the FDI inflow to the Slovak economy will be more intensive after accession to the EU and the presumption that domestic investors' investments will become substantially more effective.

The key purpose of both forms of investment should be major modernisation of technologies and intensification of product innovation, which should then be reflected in significant productivity growth. According to model calculations, taking into account the above estimate of the developments in the FDI volume, productivity in Slovakia could grow at the average annual pace of 3.7% in 2004-2008, compared with 2.5% in 2001-2003.

If productivity grows as expected, the exchange rate deviation could fall from the level of 2.7 in 2001 to 2.0 at the end of 2008, which would be a considerable improvement compared with its stagnation, or rather increase, in the last decade. The comparative price level could become substantially closer to the EU average, from current 36% to around 46% in 2006 and 49.7% in 2008. This convergence should be mainly the result of increased domestic prices, but thanks to the rise in productivity, also the slight appreciation of the exchange rate.

Wages should increase together with the rise in comparative price level, which should mean an apparent shift from the low wages model, which provides little support for technology modernisation and product innovation, to the higher wages - higher quality model. At the same time, this should ensure that the transition to the expected faster rise in prices will be carried out while the population's living standard and real wages will be rising (average annual rise of 2.7% is expected in 2004-2006).

Slovakia's integration to the EU could have a further positive effect on the rise in comparative price level and rise in productivity in that the phenomenon of price discounts provided to EU buyers for the so-called goods imported from the east could be reduced or gradually fully eliminated.

The problem of eliminating differences in price levels is concentrated on the area of tradable goods. Within this area, it mostly concerns foodstuffs, clothing and shoes, and household
equipment. However, as regards the convergence of the overall price level to that in the EU, due to price deregulations we must expect further, gradual rises in prices for those goods and services that are still cheaper than in the EU (fuel, energy, rent, healthcare, education, culture, etc.).

From the consumer's standpoint, the prices of foodstuffs are of a decisive importance. The majority of compared consumer prices of foodstuffs in Slovakia are in the interval of 50-80% of the level in Germany. Certain types of foodstuffs (e.g. bread, potatoes) are substantially cheaper (20-30% of German prices), while other types (certain dairy products, vegetable oils) have already exceeded consumer prices in Germany.

According to model calculations, by the time of accession consumer prices of foodstuffs should increase by a further 6% (annual average), right after accession in 2004 they could increase by a further 8% and in 2005 and 2006 by 8.9%. The average annual rise in these prices should decrease to around 6.8% by 2008. The rise in these prices after accession should not, however, create downward pressure on the population's living standard, since, with the expected growth in productivity, nominal wages per employee should simultaneously rise by 9.6% in 2004-2006.

As for the sectoral structure of economy, although the effect of Slovakia's integration into the EU in the period before 2008 should be reflected in increased value added based on a further increase in the primary sector's productivity, it will also result in a decrease in its share in the Slovak economy's total value added. On the other hand, the secondary sector's overall share in the total value added could rise, especially due to a substantial increase in value added from gross production based on the high effectiveness of investments. This applies above all to the manufacturing.

The rise in the secondary sector's share should leave the share of the service sector basically unchanged, even though the rate of value added and labour productivity might substantially increase here.

Sectors such as manufacture of machinery, electrical and transport equipment, as well as the manufacture of chemical and pulp-paper products should gain greater importance in the structure of the manufacturing. Rubber industry, manufacture of non-metallic mineral products and the food industry will probably retain their current share. The share of metal, textile, clothing, and leather production, and simple wood processing in the total value added will probably decrease (even though it will continue to grow in absolute terms).

These estimated trends could provide a certain idea and simultaneously be a challenge for the enterprise sector, where a considerable level of healthy emotional attitude should be manifested.

We also used the CGE (Computable General Equilibrium) model to estimate the impacts of integration on the developments in the sectorally divided structure of economy. According to this model calculation, it appears that in domestic production the greatest rise in production will be achieved by the manufacturing (excluding chemical and food industry). Agricultural and food production and market services will also rise, although less significantly. The volume of the production of chemical raw materials and products, and construction production will remain unchanged after accession to the EU. A certain decrease will probably occur in the production of non-market services and in electricity, gas and hot water supply.
According to the above methodology, Slovakia's foreign trade with the EU should increase due to deepening of production specialisation and co-operation and as a result of the economy's higher competitiveness. The removal of customs barriers, especially as regards agricultural and other "sensitive" products, will also play a role. The abolishment of customs tariffs on imports from the EU will on the other hand cause a decline in the prices of imports and subsequently an increase in their volume.

According to the calculations of the overall effect on GDP growth of changes in the area of taxes and infrastructure investments within the framework of the acquis following accession to the EU, an additional growth of around 1%, accompanied with a tendency toward the appreciation of the Slovak crown's exchange rate, has been estimated.

From the standpoint of the effective adaptation of Slovak enterprises to the competitive pressures in the EU, the 2000 Lisbon European Council, which specified education, science and research and innovation potential as the most effective factors for increasing the competitiveness of EU countries in the increasingly globalised market, was of great importance. Slovakia seriously lags behind in this area.

Expenditure on education as a share of GDP in Slovakia is more than a third lower than in the EU. Even though the educational level of the Slovak population in productive age is only slightly under the average of small EU countries, this is not true of the proportion of population with university degree, which reaches only 8.7% in this age group, compared with 24% in small EU countries. In the middle of 2003, every school leaver in the EU will be computer literate. Despite the Infovek programme adopted, of the 3340 schools in Slovakia only 540 have Internet access.

Expenditure on research as a percentage of GDP is 0.37% in the EU and only 0.07% in Slovakia, despite the fact that students' participation in research is generally considered as the basic condition for the development of their creative and innovative capabilities.

Research and development expenditure per hundred thousand inhabitants is roughly 6 times greater in the EU than in Slovakia. Its share in GDP in Slovakia is 0.68%, while it is 1.86% in the EU.

There is also a low level of expenditure on the enterprise sector's innovation activities. This is a result of preferring imports of modern technology with the aim of reducing the risk of developing it in the domestic environment, as well as a result of the lack of funding.

The share of innovative enterprises in the total number of enterprises in the manufacturing is 3 times higher in the EU than in Slovakia.

Good financial standing is one of the internal building blocks for a company's development and one of the conditions for swift adaptation to the conditions of the EU Single Market. An analysis of the results of a survey in selected enterprises shows that, as regards financial standing, approximately a quarter of large industrial enterprises are not competitive. The trend toward growing indebtedness and worsening liquidity is typical for them. Low indebtedness indicates higher growth in wages and labour productivity. Investing in human resources is more difficult for companies facing problematic financial situation. Insufficient interest of employees in increasing qualifications is typical for the most indebted companies.

Financial standing also influences innovation policy. The majority of the most indebted companies have no strategic plan for innovations and reach insufficient technological level. Price competition is typical for the group of the most indebted companies. The decline of their
share in the relevant market is accompanied with deterioration of the companies' financial position. It has been confirmed that sectors with better financial standing sell their production in foreign markets more effectively, i.e. with better terms of trade.

In certain cases, we find the way companies see themselves as regards competitiveness disputable. For instance, a half of the most indebted companies consider themselves competitive.

Companies with worse financial standing dominate in positive expectations of future conditions for access to loans. With the continuously low transparency of the majority of enterprises, these expectations are irrational. Enterprises with a high share of debts will be more vulnerable when the conditions become tighter on their markets. This poses risks for the future.

Only companies with excellent financial standing will be able to make use of the advantages arising from the decline in interest rates and the new access to the capital market. The practice of companies preferring the high concentration of ownership, whereby creating a barrier to the acquisition of financial resources on the capital market, is to their disadvantage.

The overall readiness of the enterprise sphere to enter the EU Single Market is inadequate. This conclusion arose from surveys carried out by experts from the Association of European Chambers of Commerce and Industry - Eurochambres - in ten candidate countries. According to them, almost a half of Slovak companies have yet to start preparations for entering the EU Single Market. Despite this, as many as 64% of Slovak companies are optimistic about their future prospects in the Single Market.

These conclusions were also confirmed in a survey of the Institute of Slovak and World Economy of the SAS. 30-40% of the total number of surveyed companies expect improvement and 40-60% continuation of the current situation. They expect substantial improvement in the possibilities of gaining access to investment resources and operational credits and better access to the capital market.

It is apparent that, to a great extent, these unrealistic expectations and the underestimation of the importance of preparation result from the insufficient availability of information to companies about the areas in which they will have to adapt to the conditions in the EU, including the implementation of EU standards and regulations.

These characteristics can present a relatively great risk in that the presumptions on which the integration effects are based will not be sufficiently fulfilled. Enterprises will be the element of the Slovak economy that will have the greatest impact on how quickly the gap between Slovakia's and the EU's competitiveness is reduced and on progress in the real convergence to the EU.

**Budgetary effects**

Important effects of Slovakia's accession to the EU are associated with budgetary effects, which will be influenced by the application of the principle of cohesion, provision of structural assistance, co-financing of assistance, payment of a contribution to the EU common budget, payment of a larger section of import duty revenues to the EU budget, new position of the state budget in respect of agriculture, and so forth.

The revenue side of the state budget will be influenced particularly by the process of tax harmonisation, which will concern mainly indirect taxes, i.e. value added tax and excise duties, but will also be reflected in the area of direct taxes. The key goal of tax harmonisation is to significantly restrict tax competition between member states.
The role of VAT revenues for member states' budgets varies - the EU average for the standard VAT rate is around 21% and 5-10% for the reduced rate. Therefore, for the time being the European Union's goal will not be to completely unify the VAT rates, which should be neutral in principle, but to achieve a narrow VAT range (15-25%). This naturally means that compared with the current rates in Slovakia (10% and 23%), the average of these rates should increase by around 5 percentage points after accession to the EU. This is a relatively high increase that will be reflected in state budget revenues, but will simultaneously cause a rise in the price level.

This means that the VAT harmonisation will result in higher state budget revenues and a higher price level, which will thus be partially brought into line with the EU average. The rise in prices will have a negative impact on consumers, therefore its optimal timing should be considered. This rise in prices will be probably reflected in development in nominal wages, pensions, social benefits, and so forth.

Another area where harmonisation is expected is excise duties, the amount of which should increase by around 20%. The effects of excise duties harmonisation will be similar to the effects of VAT harmonisation.

In the area of direct taxes, the tax burden on both natural persons and legal entities should be gradually reduced, which can be reflected in a certain decline in tax revenues.

The aggregate effect of the future tax harmonisation (rise in revenues from indirect taxes and decline in revenues from direct taxes) should be beneficial for the Slovak state budget as well as for the co-financing of structural projects. However, the decrease in direct taxes can be a stimulus for the development of the economy's supply side (introduction of modern technologies, product innovations, etc.).

An important benefit of Slovakia's accession to the EU will be the EU's assistance provided via structural funds and the Cohesion Fund. In the preparatory period, the EU provides assistance to candidate countries from the so-called pre-accession funds, in particular PHARE, ISPA and SAPARD.

Following accession to the EU, Slovakia will participate in EU structural funds and the Cohesion Fund. The key structural fund, from which assistance is provided to EU regions that lag behind (regions with GDP lower than 75% of EU average) is the European Regional Development Fund (ERDF). An important principle for the operation of this fund is the principle of additionality (co-financing), which means that assistance from the ERDF is only an additional resource to the resources of national governments for the financing of a given project.

Another structural fund is the European Social Fund (ESF), from which assistance can be obtained for the development of human resources, especially initiatives related to training and education.

The European Agricultural Guidance and Guarantee Fund (EAGGF), which helps implement the common agricultural policy, also plays an important role in the system of structural funds. This fund has a guarantee section (as much as 95% of expenditure related to market regulation) and guidance section (5% of expenditure to support active structural changes in agriculture).

The Financial Instrument for Fisheries Guidance (FIFG) helps restructure the EU fishery industry.
In a narrower sense, we should add the Cohesion Fund (CF) to the above four structural funds. This fund serves to mitigate the economic differences between individual member states and was designed for Ireland, Spain, Portugal and Greece, whose per capita GDP at the time this fund was established was lower than 90% of the EU average. Funding for large projects in the field of transport infrastructure and infrastructure promoting the quality of the environment can be acquired from this fund. The following three factors are the criteria for the distribution of resources from the Cohesion Fund: size of population, GDP per capita and the land area of a given country.

EU directives specify 3 basic goals, which should guide the provision of assistance from structural funds in 2000-2006.

Objective 1: The development and structural adjustment of regions whose development is lagging behind
Objective 2: The development of regions in economic and social conversion difficulties
Objective 3: The development of human resources.

Structural funds will not become a source of funding for Slovakia until accession to the EU.

The total amount of pre-accession assistance for Slovakia in 2001-2004 could reach €414-614 million, which is SKK 18-27 billion. Based on the signed Financing Memoranda, which also include funds from the previous years, Slovakia should acquire SKK 9.4 billion from EU pre-accession funds in 2002 alone. Co-financing in 2002 would require the allocation of SKK 4.8 billion from state budget expenditure.

Following accession to the EU, Slovakia will make use of the resources from EU structural funds and the Cohesion Fund. These receipts should not exceed 4% of GDP. The experience from other countries shows that Slovakia's capacity to absorb transfers from the EU will increase only gradually. The study estimates that in the 2004-2008 period Slovakia could realistically absorb funding from EU structural funds amounting to approx. SKK 12-18 billion annually (€0.3-0.4 billion), i.e. approx. 1.1% of GDP. This would require that in the above period Slovakia annually allocate around SKK 15-20 billion in the state budget to co-finance the relevant projects. However, to maintain even this lower financial and budgetary absorption capacity, intensified activity of competent authorities and institutions, in particular in the area of preparation of quality and synergy-oriented projects, will be necessary.

The EC has meanwhile specified the procedure for the calculation of contributions from the new member states, which, according to preliminary estimates of the Slovak Finance Ministry, should reach around SKK 13 billion in 2004 (i.e. around 1.1% of GDP). The final amount of the contribution will be determined at the December EU summit.

As regards transfers of import duty revenues, from the standpoint of the effects of Slovakia's accession to the EU, the fact that Slovakia will have to transfer 75% of its annual import duty revenues to the EU Common Budget will be important. Even though the prevailing section of the current revenues from Slovak imports will disappear after Slovakia's accession to the EU, import duty revenues from imports to the enlarged EU passing the Slovak-Ukrainian border will be acquired. Based on these differences, Slovakia's total import duty revenues following accession to the EU will fall from SKK 3.6 billion in 2001 to around 0.5 billion in 2004.

Following Slovakia's accession to the EU, major changes will also occur in state budget support of agriculture as a result of the adoption of the Common Agricultural Policy (CAP). The essence of these changes will be the new arrangement of agricultural subsidies.
In view of the need to get closer to the lower world prices of agricultural products and the necessity to simultaneously approach EU standards, the European Commission proposed that direct payments to candidate countries in 2004-2006 be substantially lower than the level of payments in the Union (25%, 30% and 35%). Nevertheless, all candidate countries refused this stance of the EC. In the negotiating process, the Slovak Republic raised the request to align the commodity support with the existing level. If the Slovak agriculture is to meet the demand for foodstuffs in its effective commodity structure, an increase in certain production quotas should also be requested in the negotiating process.

According to rough calculations, the overall effect of Slovakia's accession to the EU from the standpoint of the above key items of public finance appears to be positive. Risks that could reduce this positive impact include the inadequate utilisation of resources from EU structural funds, which would disrupt the balance between receipts from and payments to the EU, and the potential foreign debt caused by the acquisition of extra-budgetary resources for the financing of projects related to the implementation of EU standards and regulations.

**Costs associated with the implementation of EU standards and regulations**

Slovakia's accession to the EU will be associated with relatively high, mostly investment costs. Their basic cause is not the integration itself, but the forty-year long interruption in the development of a market economy in which individual areas were very neglected and destructed.

The benefits of the implementation of EU directives will have a long-term effect; yet, the costs related to it are mostly concentrated into a short or medium-term time span.

As regards the implementation of European regulations, the area of the environment will require the most extensive expenditure from the state budget, as well as the enterprise sphere and population.

As for the scope of expenditure in the environment sector, one of the critical items will be waste management, especially municipal waste landfills. Surveys carried out in co-operation with the EU (Ministry of the Environment of the SR, 1997) estimate that the expenditure needed in this area will amount to SKK 30 to 40 billion in 2001-2007.

Another item of special importance is water protection. Total expenditure brought about by the transition to EU standards and regulations in the area of water supply and wastewater sewerage is estimated at SKK 50-60 billion. These are the highest items within the environment sector. Nevertheless, the need for investment costs to implement the water protection acquis will also have indirect effects. This concerns the expansion of Slovak construction firms' subcontractor operations, activities of self-government authorities in all regions of Slovakia, the creation of new jobs when implementing these projects, and the overall revival and improved attractiveness of individual regions of Slovakia with respect to tourism.

The third important segment of the environmental protection system is air protection. This covers the problems of municipalities (municipal waste incineration plants) and environmental problems in the enterprise sector. Investments in this area are expected to amount to approx. SKK 10 billion.

The integrated pollution prevention and control system forms a separate item. It is a comprehensive system for the monitoring of and protection from dangerous substances and its
focus is in the enterprise sector. In view of the low standard of technology in Slovak enterprises, the costs of the implementation of integrated pollution prevention and control regulations can be estimated at approx. SKK 25-30 billion.

The total cost of achieving compliance with EU standards and regulations in the field of the environment by 2007, or 2015, can be estimated at SKK 120-140 billion (in 2001 prices). On the presumption that transitional periods are provided, this burden can be distributed in such a way that around 20% of the total cost would be incurred by 2003 (approx. SKK 27 billion) and the remaining 80% (approx. SKK 90 to 110 billion) in stages, mostly between 2004 and 2007.

It can be expected that the cost of the implementation of EU environmental standards will increase prices of services in the relevant infrastructure sectors for the enterprise sectors, as well as the population (higher waste collection charges, drinking water and water treatment prices, and environmental charges). This can indirectly cause a rise in industrial enterprises' expenditure and consequently a cost-related increase in their product prices.

There appear to be especially large gaps in the area of safety and health at work, since even the standards in force until now have not been observed thoroughly. Therefore, the adoption of the acquis in this area will be a relatively complicated and costly process. This concerns above all the implementation of framework Directive No 89/391/EEC on the minimum requirements for safety and health protections of workers and the related directives. These directives establish the minimum safety and health standards for specific work situations. They relate to the requirements on workplaces, work equipment, construction sites, safety signposting, as well as other requirements on safety and health at work.

The total expenditure of enterprises incurred by the implementation of all safety and health standards is estimated at SKK 20-30 billion. But this estimate is very approximate, because not all costs can be attributed to work safety.

The transposition of the acquis into Slovak social protection laws means, inter alia, the assurance of equal rights, equal treatment in employment and occupation, as well as the right of all citizens to equal treatment regardless of gender, race, nationality, or religion, and to protection from discrimination in employment.

The Slovak legislation has been aligned with directives concerning equal treatment of men and women, especially as regards equal access to employment, vocational training and promotion - Directive No 76/207/EEC, as well as the application of the principle of equal pay for men and women - Directive No 75/117/EEC. Since the application of these directives has been taking place for several years, it will not be very costly.

In the field of labour law, Directive No 93/104/EEC on certain aspects of the organisation of working time causes certain problems. Its transposition to the Labour Code, which specified the maximum permissible working week of 48 hours, including overtime, caused mostly problems of other than financial nature (in the transport, posts and culture sectors). Certain problems, including financial, are associated with the section of the Directive related to rest periods and paid leave.

Special attention should be paid to the implementation of Directive No 96/71/EC on the posted workers in the framework of the provision of services, especially in connection with health insurance. The quantification of the costs of its implementation is very complicated, since it is virtually impossible to make a trustworthy and qualified ex ante estimate of the number of employees and family members posted, the period of their work in member states, and their potential pay, and quantify, for instance, health insurance costs on this basis.
In addition, the accession to the EU requires amendments to regulations concerning health insurance to align them with EU regulations - Regulation (EEC) 1408/71 on the application of social security schemes to employed persons, to self-employed persons and to members of their families moving within the Community. The Slovak Republic will have to apply these regulations immediately after accession. Therefore, it undertook to introduce the so-called family-type insurance through the new health insurance act.

In the agri-food sector, the implementation of the acquis is associated above all with the transposition of EU technical standards and the completion of institutional structures necessary for the monitoring of their observance. Particularly important is the early preparation of all conditions necessary for the use of EU funds in this sector.

The most important task of the implementation of EU technical standards is to assure the purity of foodstuffs and agricultural raw material. The costs related to this are estimated at around SKK 5-7 billion; the increase in unit production costs in the affected sectors of the food industry is estimated to be in the interval of 1-1.5%. The standards for cage rearing of layer hens, sows and calves will necessitate further costs (approx. SKK 7 to 11 billion). Additional costs (roughly SKK 2-3 billion) will be needed to meet the environmental standards for warehouse and waste management; their impact on increased unit costs, mainly in the breeding of beef cattle and swine, is estimated at 2-3%. The estimated costs of the implementation of EU standards in the main areas of the agri-food sector by 2006 total SKK 14-20 billion. (Finance amounting to SKK 10 to 15 billion can be expected for the given sector from pre-accession and structural funds.)

Transport will play a crucial role with respect to Slovakia's accession to the EU. Slovakia has requested no exemptions or transitional periods for the implementation of the acquis under this chapter.

The Government approved the National Plan for Regional Development for the 2001-2006 Period, which is the Government's official document when requesting finance for the development of transport infrastructure from EU pre-accession funds. The transport infrastructure development programme comprises two priorities co-financed from pre-accession funds - Construction of the Railway Network (4 public works) involving SKK 20.4 billion, and Motorway Construction (3 public works) involving SKK 11.6 billion. The transport sector's basic priority is the Construction and Modernisation of Transport Infrastructure in the approved multimodal corridors. The Slovak Republic has accepted the results of the TINA final report. Unlike in the preceding rounds of EU enlargement, infrastructure needs are integrated into the accession process by means of the TINA process. The TINA report defined a summary of infrastructure projects for the restoration, improvement or building of infrastructure. These projects cover the basic network (multimodal pan-European transport corridors) and supplementary sections. The infrastructure in Slovakia was estimated to need 9% of TINA projects, which is a sizeable extent considering the area of Slovakia. The basic TINA network includes corridor IV (Dresden to Istanbul), corridor VI (Gdansk to Žilina) and the Va branch from Bratislava to Košice and then further to Ukraine. For Slovakia, expenditure on the so-called basic TINA network amounts to €5.7 billion and expenditure on the supplementary network to €1.5 billion.

The European Union concluded that the chapter requires no further negotiations. However, the monitoring of progress in the adoption and implementation of the acquis will continue during further negotiations. The chapter was closed in April 2002, after agreement was reached on cabotage in international freight transport.
As regards the implementation of EU standards, the area of energy is of great importance. With respect to financial demands, Slovakia's accession to the European Union mainly relates to the security of energy supply and nuclear energy in this area.

The currently insufficient capacity of emergency stock of crude oil and petroleum products and the need to align its parameters with Directive No 68/414/EC and Directive No 98/93/EC, i.e. with the required 90, or 120 days, depending on the consumption coefficient, compared with current 39 days, will require around SKK 7 billion from public finance. In this area, Slovakia has negotiated a five-year transitional period by the end of 2008.

Slovakia's commitment to gradually shutdown the Jaslovské Bohunice V1 nuclear power plant units will not have a direct impact on public finance, but will be partially financed from external sources. Slovakia and the EU signed a financing memorandum to support the co-financing of the nuclear power plant's shutdown or other investment activities that might arise in this context, and a special account was created in the European Bank for Reconstruction and Development, in which €150 million (approx. SKK 7 billion) should be accumulated by 2006.

In line with the need to meet the relevant directive by the date of accession in 2004, the Slovak Republic is gradually liberalising its electricity and natural gas markets. The establishment of an independent regulatory authority for network sectors should, in the area of natural monopolies, ensure the protection of customers from the monopoly position of suppliers, transparency in licences, general regulation and, gradually, price regulation.

One specific area of the negotiation and implementation process is the area of internal security, especially the Schengen Agreement. Slovakia's key task in this area is the protection of the Slovak-Ukrainian border - the external border of the enlarged EU. The costs associated with this are estimated roughly at SKK 1 billion. The increased cost of the protection of external borders will, however, be reflected in Slovakia's generally higher external and internal security, the reduced number of illegal migrants, reduced number of customs offences, more effective detection of drug trafficking, and so forth, which, from the economic standpoint, will create conditions for (relative) savings in future state budget expenditure.

Being a future member of the EU, the Slovak Republic can become the target country for an increased number of refugees and asylum seekers (for the time being, Germany receives as much as approx. 43% of all asylum applications in the EU). The number of refugees is expected to rise by approx. 10 thousand persons already in 2003. From the economic standpoint, the improved internal security in Slovakia, thanks to EU membership, can have a positive impact on the country's revenues from active tourism (prospect of the abolishment of border controls, improved operation of the police, etc.).

The Slovak Republic does not have to fulfil the Schengen acquis conditions - access to the Schengen Information System - until the time of accession to the EU; nevertheless, it has to meet the conditions set for the first stage of application of this system. The cost of the first stage (including the preparation of the special SIRENE office, which goes beyond the Schengen acquis framework) is estimated at approx. SKK 150 million by the end of 2004; the cost of the second stage is estimated at approx. SKK 95 million.

The total financial requirements of the implementation of EU standards and regulations under the most cost intensive negotiating chapters is estimated at around SKK 200-250 billion (in 2001 prices) over the whole implementation period, if we take transitional periods (2001-2015) into account. The decisive section (more than 60%) of these, mostly, investment costs should be incurred in the 2004-2008 period. To observe the transitional periods, it will be
necessary to invest around SKK 30 billion on annual average in the relevant sectors, including in the period prior to accession.

The main burden of this cost shock will be borne by public finance (including bank loans acquired by the government and other extra-budgetary sources), the share of which is estimated at 40-45%. EU pre-accession and structural funds should be the second most important source (approx. 30%) and the private sector's share should be around 25%. The provision of governmental guarantees for foreign credits and loans for the enterprise sector to finance the implementation of EU standards and regulations should also be expected. This requires prudence in the conclusion of loan agreements as regards the repayment schedule and interest rates.

The quality and early preparation of projects, including projects that may acquire financing from EU structural funds, also presents a certain risk.

Obviously, as was already stated, there is the risk that the above increased costs in this area will be reflected in increased prices and charges for the relevant sectors' goods and services. Rough calculations show that these increased investment costs will affect prices in the form of an annual amortisation cost, which should increase unit costs only minimally and should not therefore mean any major upward pressure on prices. This risk can be further mitigated by the lag between the time the costs are incurred and the investment activated, when it becomes the actual cost.

Model calculations, which took these estimated costs of the implementation of EU standards and regulations into consideration, also suggest that there should be no major fluctuations in year-on-year price increases (as measured by the consumer price index). It should reach around 6.1% in 2003 and 6.7% (annual average) in the most critical years 2004-2006. Year-on-year inflation should decrease to the annual average of 5.7% in 2007 and 2008.

Selected social contexts of Slovakia's accession to the EU

The developments in employment in Slovakia after accession to the EU will depend on the supply side of the economy and, to an increasing extent, on the ability to sell Slovak companies' goods and services at home and in the enlarged EU market, as well as in other world territories. A whole range of problems and risks can be expected with respect to the maintenance and further employment growth.

Employment in the public sector of the economy will have a stabilising effect. Domestic companies currently working for the public sector within the framework of public procurement will come under greater pressure from foreign companies. However, public procurement export opportunities will also open up for our companies. The danger of a rise in unemployment is coming from unprofitable non-financial organisations (256.3 thousand employees in 2001, which is around 30% of the total employment in the non-financial sector).

Growth in employment is expected in the sector of companies with foreign capital participation. The economic policy will determine which sectors will attract investment, especially foreign direct investment, and what quality it will be.

Conditions for a more effective sale of Slovak companies' production need to be created both on the foreign markets (by means of export policy measures) and the domestic market. A large proportion of foreign investments is purposely directed at internal trade, which creates conditions for the growth in imports to Slovakia, a deterioration in the balance of payments and decrease in employment. The trend toward expanding retail chains needs to be regulated
by measures compliant with EU legislation (in general, only those investments should be supported that are advantageous for employment in Slovakia in the long run). For example, Ireland did not let foreign capital flow into sectors that were and are controlled by the domestic enterprise sector, but is strictly selective about foreign investment.

Compared with EU countries, we spend much less on active employment policy. In 2001 it was only 0.23% of GDP and this figure includes special state subsidies for the long-term unemployed. Excluding these subsidies, it was only 0.058% of GDP, while 9 EU countries regularly spend more than 1% of GDP. The contributions from the National Agency for Small and Medium Enterprises for the creation of new jobs are completely insufficient.

According to the macroeconomic model calculations taking all effects on employment into consideration, it is expected that, compared with 2001, employment will increase by around 170 to 180 thousand employees in 2008. The unemployment rate could thus fall to the level of 15%.

The relatively very low wages in the Slovak economy will continue to be under strong pressure from the high unemployment rate, which further stresses the importance of the employment policy.

A rise in wages can only be based on growth in labour productivity, yet, for a number of reasons, it will not be reflected automatically. Even in companies with the highest labour productivity, wages will correspond with the situation in the respective segment of the Slovak labour market, i.e. with the relationship between supply and demand. The strength of trade unions, which have traditionally placed an upward pressure on wages and affected the share of profit and wages in value added, in wage negotiations has diminished. Companies will want to increase profits even to the detriment of pay rises, so that they can increase investments in new technology and succeed in increasing competition. Foreign companies will maintain the level of wages above the level in domestic companies only to a certain extent, which will be crucial for the level of wages in the foreign sector.

Mainly foreign experts warn that the effect of foreign investment does not necessarily have to result in convergence. It can lead to the divergence of wages compared with current EU countries, should foreign companies divide the production process vertically and place technological production segments that require labour force with low qualifications in countries with low wages (Slovakia). This will further increase brain drain.

Therefore, on the one hand, a selective policy needs to be applied with respect to foreign direct investment and, on the other hand, a pressure from below should be placed on the wage level in foreign companies by means of wage rises in domestic companies (based on growth in labour productivity in the domestic sector of the economy). If the domestic sector continuously and substantially lags behind the foreign sector in productivity, foreign companies will only increase their profits to the detriment of wage rises (experience from Ireland and economically weaker southern states and regions of the EU) and the convergence to developed EU countries will be prolonged.

According to a model calculation, compared with 2001 average nominal wages in Slovakia should increase 1.19 fold in 2003, 1.55 fold in 2006 and 1.88 fold by 2008. While for 2002 and 2003 the estimated growth is 8.7% (annual average), the average annual growth in wages in the 2004-2008 period is estimated at 9.7%.

The growth in real wages should temporarily slow down after accession to the EU, from the average annual rise of 3.6% in 2002 and 2003 to 2.7% in 2004-2006, due to the temporarily
higher rises in prices in 2004-2006. Their growth could be higher again in 2007 and 2008 and oscillate around 4% (annual average).

Decisive for the future free movement of person are estimates that 3-4% of the population will emigrate from central and eastern European countries to work in EU Member States for a long-term, and 1-2% of the population will regularly return home. According to surveys in V4 countries, the Slovak population has also an inclination toward work emigration should the restrictions on free movement of workers to EU countries be lifted. However, the importance of the surveys and models of the calculation of labour force migration potential is probably overestimated, because the level of inter-country migration will be determined above all by the demand in current EU countries.

It is expected that after accession to the EU, the first to leave will be qualified labour force, which will then be followed by less qualified migrants. The application of a selective policy to attract mostly qualified labour force (the example of "green cards" for computer experts in Germany) is expected in current EU countries.

It is not clear how the enlarged EU will be "divided" with respect to the need for qualified labour force and what investments foreign companies intend to place in CEE countries in the long run, if there is not enough highly qualified labour force there due to work emigration to current EU Member States.

The advantages of the free movement of workers for the sending country include the reduction of the unemployment rate (for instance, if around 80 thousand workers leave the country, the unemployment rate would be reduced by around 2.6 percentage points) and wage transfers, which increase gross domestic product (for instance, if the current 75 thousand workers abroad, including the Czech Republic, transfer just SKK 10 thousand on average per person, this will "bring in" a sum of SKK 9 billion annually). Another advantage could be the experience gained, yet this applies only to the section of labour force that eventually returns to Slovakia. A disadvantage is the loss of the proportional section of public funds spent on the acquisition of qualifications by emigrants. The drain of the most qualified labour force can be partially eliminated by supporting the establishment and growth of domestic high-tech companies.

The introduction of transitional periods for the free movement of workers is clearly more beneficial for the current EU countries. Withholding potential migrants in CEE countries during the transitional period for the free movement of persons will create pressure to maintain the low level of wages in these countries. An increased need for immigrants from CEE countries will appear more intensively later, after the transitional periods expire, when strong population years start to leave the EU labour market.

Basic characteristics of the macroeconomic scenarios of the developments in the Slovak economy by 2008

The elaborated econometric scenarios of the macroeconomic developments in the Slovak economy provide a general overview of economic and social trends. As we have already stated, the revenue and expenditure effects related to the adoption of the principles of EU budgetary policy and implementation of the acquis will add around 1% to GDP growth. However, if accession takes place in 2004, the overall real growth of the Slovak economy in 2004-2006 could reach 4.8% annually (only 3.7% if accession takes place later) and as much as 5% in 2004-2008 (4.1% if accession takes place later). In 2007 and 2008 growth could reach as much as 5.2%, which, under the given conditions, can be considered as the maximum possible pace of GDP growth without substantial deterioration of macroeconomic balance.
Household consumption has the greatest share in the domestic use of GDP (49.2% in 2001). In line with the conditions of a balanced growth, household consumption should continue to increase at a slower rate than GDP in the 2004-2008 period, at a pace of 3.6%, in favour of growth in investment by 6% (annual average). The share of government consumption in GDP in 2001 reached approx. 19.6%. This share should also decrease, to 16.1% by 2008.

The share of gross fixed capital formation in GDP in current prices (investment rate) in 2001 reached 34.6%, which is substantially more than in the majority of OECD countries. In view of faster growth in investment than in GDP, this share, after a decrease to approx. 31% in 2002, should rise to approx. 33.2% by the end of 2008.

Gross national savings reached approx. 26.6% of GDP in 2001, which is 8 percentage points less than the investment rate, meaning that a sizeable proportion of investments was in fact covered by external resources (with simultaneous high current account deficit). According to model projections, this disproportion could be substantially mitigated by 2008, when savings could gradually rise to 31.3% of GDP.

In the area of external economic relations, model projections indicate that if the anticipated increase in competitiveness does materialise, growth in exports will be renewed at the average pace of 12.2% in 2004-2008. At the same time, imports should rise slightly slower than exports and the current account deficit could therefore be gradually reduced to -4.1% of GDP in 2004-2006 and to acceptable -3.2% of GDP in 2008.

As regards the inflation rate, it reached 7.1% in 2001 according to the consumer price index. A significant decrease in inflation to 3.8-5.0% is expected in 2002, mainly as a result of the postponement of the necessary price deregulations. These will, however, have to be carried out in 2003, due to which inflation will rise again to as much as 6.1%.

Model calculations show that inflation will be maintained at the level of around 6.7% in 2004-2006 and should gradually fall to a level typical for developed economies after 2006.

According to model calculations, compared with 2001 average nominal wage should increase roughly 1.55 fold in 2006 and 1.88 fold by the end of 2008. While the average increase of 8.7% annually is expected in 2002 and 2003, it should rise by 9.7% annually between 2004 and 2008 (if accession takes place later, then only 8% annually).

After two years of decline and a slight increase in 2001, real wages could rise by 3.6% (annual average) in 2002 and 2003, while their growth will slow down to around 2.7% annually between 2004 and 2006. Their growth could again oscillate around 4% (annual average) in 2007 and 2008. This pace of growth in real wages is in good conformity with the growth in labour productivity and does not therefore pose a threat on macroeconomic balance.

A slight increase in employment of approx. 1.0% was achieved in 2001 and it could continue to rise at a similar pace in 2002 and 2003. The gradual rise in the pace of GDP growth and more intensive inflow of foreign capital in the following years could result in a rise in employment in 2004-2008 at the average annual pace of 1.2%. The model projections took the decelerating effects of restructuring and the related growth in labour productivity and average wages into account. The unemployment rate could fall from current 19% to the level of around 15% in 2008.

The macroeconomic development in Slovakia that could start after 2004 if Slovakia accedes to the EU, would also mean an important shift in the convergence of Slovakia's economy to
the EU average. At present, the level of Slovakia's economy, as measured by GDP per capita using PPPs, oscillates around 48.5% of the EU average.

Calculations show that Slovakia could reach around 53.1% of the average per capita GDP in the EU in 2006 and the level of 55.5% in 2008.

Prior to, and for a certain period after accession, before Slovakia joins the European Monetary Union, faster real convergence of the economic level and comparative price and wage levels will be possible.

Transitive economies may have too strong anti-inflation monetary policies, which can be a problem, since fierce pressure to reduce inflation can be interpreted as success in the fight against inflation. However, this carries the danger that the cost of disinflation steps will exceed their benefits and that real convergence processes will be hampered.

In view of the fact that the study's theoretical results and empirical analysis demonstrated that the integration into the EU is unquestionably beneficial for Slovakia in the long run and, simultaneously, in the preliminary assessment of risks, identified no serious short-term threats that would make this integration impassable, the alternative of postponing Slovakia's accession to the EU to a time when the implementation of the acquis is completed and the gap in convergence more substantially reduced is counterproductive. This is true not only because Slovakia's overall potential is sufficient for it to be able to become, with help from the EU, a mature competitive economy within a relatively short period of time. The rule that any delays in exploiting chances are difficult to eliminate, if they can be eliminated at all, applies to this situation as well. It is dangerous also because the stability of central and eastern Europe will always depend on the prospects of European integration. It would be a serious mistake not to participate in this process.

**Generalisation of the institutional and legislative benefits of Slovakia's accession to the EU**

The institutional and legislative benefits of Slovakia's integration to the EU are the least quantifiable effects of integration. The European paradigm of the state's role in a society is based on the premise that the state is obliged to protect citizens from damage to life, health and property. In the European Union this paradigm is reflected in the principle of protection of the weaker contracting party. The weaker party is usually an employee in relation to the employer, consumer in relation to the producer or distributor, minority shareholder in relation to the majority shareholder, citizen as the recipient of the effects of the environment on his health in relation to a large industrial polluter, small entrepreneur in relation to his large supplier with great financial strength that can be misused, as well as a creditor in relation to his debtor, or owner of a bank account in relation to the bank's management and its owners.

The consumer protection, a typical weaker party, which usually does not have as strong a negotiating position as the producer or distributor and lacks information, knowledge and experience, is one of the focal points of Community law.

It is apparent that by the transposition of Community law, consumers will attain relatively significant rights and strong instruments of defence against dishonest producers, whether this concerns the right to terminate a contract or the right to objective information about the products purchased.

The increased level of protection of employees, another example of a weaker party, is endorsed especially in the amendment to the Labour Code. According to this amendment,
employers must ensure equal treatment of all employees with respect to working conditions, remuneration for work, race and gender, language, religion and political orientation. The right of employees to information and a wide scope of obligations for employers in relation to employees have been introduced in connection with safety and health protection.

The increased level of protection of citizens as recipients of the impacts of the environment on their health will be another advantage of accession to the EU.

Even though all of the legislative changes will mean a considerable increase in costs for polluters, they will improve the protection of people against damage to health. In the long run, they will also provide protection from financial damage, because if Slovak environmental laws were not adjusted to Community law, it is highly probable that we could expect the Slovak Republic to gradually become a profitable business location at the price of environmental devastation. The cost of eliminating the negative impacts of this type of business would be eventually borne by the weaker party - citizens, being the taxpayers.

The application of the principle of protection of the weaker party under company law is of substantial importance. It is because the relevant acts must protect creditors in the widest sense of the word: credits providers, investors, depositors, employees, shareholders. More efficient transparency and wider access of the public to information on companies, as well as the specification of clear rules in the field of mergers, are expected. The amendments should substantially increase the responsibility of the boards of directors and supervisory boards in joint-stock companies and establish the requirement of good repute and liability to cover the damage they cause. Such legislation will also act against the inflow of speculative capital in its consequences.

The European paradigm of the state's role in economy is based on another premise that the state, in its effort to ensure economic prosperity, has to protect competition.

After the Slovak Republic's accession to the EU, several types of aid provided by the state to a number of organisations, whatever form they may have today - the purchase of bad debts by the state, their transfer to institutions designed for this, open or hidden subsidies provided via the National Property Fund or State Aid Office of the SR, etc., will no longer be compatible with the common market. Thanks to these forms of aid, the existence of many economic organisations that would have otherwise found themselves placed under forced administration, in bankruptcy proceedings or liquidation, was made possible.

The adoption of Community law will undoubtedly mean a higher standard for the economic organisations operating in the Slovak market and the prohibition of a number of competition methods allowed under the Slovak legal system so far.

The economic transformation - not only in the Slovak Republic, but also in other candidate countries - has placed much greater emphasis on macroeconomic stabilisation than institutional reforms.

The inadequacy of institutions, in particular the absence of a legal framework and law enforceability, has been felt outside as well as inside the country - by both enterprisers operating in the Slovak territory and citizens who daily encounter the consequences of the poor functioning of institutions.

The experience of candidate countries clearly shows that an "external political anchor" can greatly contribute to the building of the institutional framework. EU accession is such an anchor for the Slovak Republic, with respect to the creation of a stable and predictable legal
environment. If a country lacks a quality legal framework, the decision-making of the government and state administration tends toward a certain anarchy, bias and ad hoc decisions. The adoption of the EU legal framework and its thorough implementation should in itself have the strength to improve the quality of the government's and state administration's decision-making.

From the most general standpoint, the return to the European type of state, whose goal is to fulfil the traditional obligations of the state, can be understood as the fundamental long-term benefit of the Slovak Republic's accession to the European Union.

The obligation of this type of state is to ensure that the interests and goals of economic organisations and the means and methods of achieving them do not pose a threat on the society and individuals. The state has to ensure that undertaking does not acquire an intolerable anti-social nature.

Mainly in the initial phases of the economic transformation in Slovakia, the state failed to meet its obligations satisfactorily. It certainly cannot be said that ownership rights were thoroughly protected, when the state allowed for the "tunnelling" of a whole range of enterprises and banks, when it failed to precisely define the protected area of legitimate business activities and put a line between legitimate and illegitimate business activities. The rules created were considerably non-transparent and reflected the requirements of the strongest interest groups of both domestic and foreign origin rather than the basic principles of the functioning of a European type of state. For a relatively long period of time, the state failed to enforce the observance of the set rules effectively and impose sufficient penalties.

Therefore, the adoption of the acquis, and especially its thorough implementation, which can be realistically expected if we do accede to the EU, can be seen as an anchor ensuring the elimination of the weaknesses existing in the legislative and institutional framework in Slovakia and their negative effects.

**Advantages and disadvantages of Slovakia's accession to the European Monetary Union**

In connection with the adoption of the acquis communautaire, Slovakia undertook to join the Economic and Monetary Union, which began its real existence on 1 January 1999. From the 1st of January 2002, the Euro was introduced in cash form and thereby replaced the national currencies of the members of the monetary union.

The establishment of the European Monetary Union (EMU) was preceded by a discussion on what constitutes an optimal monetary area, which is an area where defects occurring in monetary union cause as little imbalance in employment and prices as possible. An optimal monetary area (OMA) should be marked above all by the high mobility of production factors (especially labour force), high volume of mutual trade, a certain degree of production and trade diversification, flexibility of wages and prices, similarity of supply and demand shocks, approximately equal inflation rate, fiscal integration, and the synchronisation of the cyclic development. The actual process of the establishment of the EMU was decisively influenced by the macroeconomic convergence criteria formulated in the Treaty on European Union - inflation indicators, monetary stability, budget deficit, government debt and interest rates. The fulfilment of these criteria is a necessary condition for accession to the EMU (for both the current and future members, including Slovakia).

Various empirical studies on the optimal monetary area usually lead to the conclusion that neither the EU-15 nor EU-12 form an optimal monetary area. One deficiency of the EMU is,
for example, the relatively low labour force mobility and low degree of the so-called fiscal federalism. Certain more optimistic studies include, besides "hard core" countries (Austria, Belgium, the Netherlands, Ireland, or Switzerland), further countries in the European optimal monetary area (tied to Germany), - France, Portugal, Spain and Italy, i.e. 10 countries in total. The situation has probably changed in favour of OMA expansion since the middle of the 90s, when these studies were prepared.

The first serious test of the functioning of the EMU was the recent weakening in economic growth, which the EMU coped with quite successfully. Nevertheless, the approaching EU enlargement will be a more difficult test of the EMU's stability. The decisive factor in the assessment of new candidates for joining the EMU will be the fulfilment of the Maastricht criteria. The criteria that Slovakia has yet to meet include inflation. The fulfilment of this criterion will not be simple due to the necessary deregulation of administrated prices and the need to gradually bring the price and wage levels closer to those of the European Union. Probably the most demanding task of the convergence process will be the fulfilment of the fiscal criteria, i.e. the set state budget and government debt. The chances of meeting the criterion related to long-term interest rates on government bonds are perhaps more favourable. The exchange rate stability criterion is conditional upon the given currency's participation in ERM II and maintenance of its exchange rate within the defined interval for the period of two years. Considering the relative stability of the Slovak crown's exchange rate (SKK/EUR) in the past two years, it should be possible to meet this criterion as well.

There are further factors affecting Slovakia's convergence to the European Monetary Union - especially progress in the real convergence and the fulfilment of the microeconomic criteria created within OMA theories.

Opinions about the timing of accession to the EMU vary. Certain prominent monetary experts from candidate countries advocate early adoption of the Euro by new member states, as it should protect their economies from the threat of monetary turbulences or crises. On the other hand, there are clear positions of the EU, EMU and IMF, which are against the early adoption of the Euro. There is the risk that a swift fulfilment of the Maastricht criteria (especially the effort to achieve low state budget deficit and low inflation rate) could disturb progress in real convergence. Accession to the EMU must be strictly individual - each new country must integrate into the EMU depending on its own possibilities. The natural process of monetary integration should therefore be considered as the most suitable strategy for integration into the EMU.

3. ECONOMIC POLICY RECOMMENDATIONS

To fulfil the Copenhagen criteria, which require the creation of a functioning market economy, it is necessary to maintain macroeconomic stability (balance) as an essential condition for sustainable economic growth at a high pace. The elements of imbalance, typical for the developments in the Slovak economy in 2002, will not be eliminated by market forces and should be eliminated at the very beginning of the next political cycle (at the turn of 2002/2003). In the forthcoming period, the economic policy should focus less on suppressing the effects of imbalance and more on the effort to reform the problematic segments of the public sector and eliminate other sources of imbalance.

It is not advisable to postpone the removal of the remaining price deformations until accession to the EU. In the interest of approaching the conditions of functioning of a standard market economy and in view of the expected equalisation of price levels between Slovakia and EU
countries after its enlargement, it would be suitable to eliminate these deformations still in the pre-accession phase.

The substantial growth in the Slovak economy's qualitative competitiveness should be considered as a priority of the medium and long-term economic policy in the preparatory phase of Slovakia's accession to the EU, as well as after accession. At the same time, competitiveness should not be narrowed down to foreign trade, even though that is where it is eventually manifested. It should be seen particularly as an indicator of the qualitative performance of the whole economy.

Therefore, much greater attention should now be paid to the inflow of foreign direct investment (FDI), which, in the current stage of preparation for accession to the EU, should be regarded as the determinant of how quickly Slovakia will overcome the technological and innovation gap, and the lag in real productivity and overall qualitative competitiveness of the Slovak economy.

From this standpoint, it is necessary to substantially improve the overall approach of the government and individual enterprises to the FDI issue. Attention needs to be paid above all to the preparation of FDI, especially with respect to the active search for foreign investors, orientation of enterprises on international production co-operation and the improvement of investment conditions.

When acquiring foreign direct investment, efforts should be made to increase the share of FDI with a greater proportion of the so-called higher technology, especially in manufacturing with a sophisticated type of production, and place emphasis on the participation of domestic subcontractors, including research and development services.

An intensive inflow of FDI should bring a substantial growth in productivity, but it has to be assured that by increasing its market share, conditions are being created for a rise in employment. The enterprise sector in particular should endeavour to assure this.

Price increases should respect the real circumstances, especially social acceptability. If prices increased to the level in neighbouring EU member states faster than the possibilities for pay rises made possible by increased labour productivity, then real wages and the population's living standard might decline. On the contrary, if we succumbed to wage pressures and wages increased faster than productivity, the competitiveness of enterprises would deteriorate, resulting in redundancies in enterprises and rise in unemployment.

It is also necessary to overcome the instability of regional policy institutions, which are manifested by the absence of a regional development planning system with a good legislative, institutional and financial basis, and, subsequently, in the low utilisation of financial resources from EU pre-accession and structural funds.

In this respect, a national regional development planning and guidance system needs to be build, able to convincingly show the knowledge of its own needs based on elaborated concepts and, at the same time, effectively utilise structural assistance, so that the synergy effect is achieved. This requires the completion of the institutional framework in such a way that no parallel institutional structures for the use of own and external funding develop. Since there is the threat of a lack of quality projects, a pragmatic solution would be to concentrate the capacity of already functioning implementing units on the preparation of a smaller number of large, investment intensive projects, oriented mainly on the restructuring and development of regions' production potential, improvement of their accessibility and the completion of the technical infrastructure in their territories.
In view of the difficulties in the acquisition of budgetary finance for the co-financing of structural operations carried out with assistance from pre-accession funds and, after accession to the European Union, structural funds, the Government (Ministry of Finance of the SR) needs to elaborate a realistic long-term system of co-financing. The optimal use of resources from structural funds requires greater attention to the preparation of the relevant projects, training of the responsible staff at the relevant levels (especially within self-governing regions) and permanent attention to strict financial control.

All relevant entities - the government, enterprises, as well as local and regional institutions, being the key implementers of the adopted standards - must be engaged in the implementation of the Community legal system. In this respect, the provision of information to enterprises on the results of negotiations with the EC, and on the complexity of their implementation in the field of their competence, should be improved. An important condition for the acceptability of the impacts of implementation of the acquis communautaire is the specification of priorities and seeking possibilities for the distribution of costs, financial resources and their redemption over longer periods of time.

By adopting the acquis, Slovakia undertook to join the Economic and Monetary Union. In the stage of preparations for accession to the EMU, we have to avoid a strategy focused on the swift fulfilment of the Maastricht criteria. An effort to quickly adopt the Euro would require a combination of restrictive fiscal policy and restrictive monetary policy, which would lead to a slower growth and thus slower real convergence. The economic policy should therefore concentrate on a natural, gradual process of monetary integration into the EMU, harmonised with V4 countries.

As for other economic policy recommendations, with respect to the effective functioning of the monetary union, we have to emphasise the need for a more flexible labour market (as the experience of a number of OECD members shows), which will make higher labour force mobility and thus a faster adaptation to demand and supply shocks possible.

The key priority of Slovakia's economic and political strategy should be the creation of a pro-growth economic environment, which does not cause, or at least does not accelerate inflation. The exchange rate regime, which, besides the currency's relative stability, should help improve the external economic balance, has to correspond with this priority.

The conclusions of this study lead to the requirement to prepare a strategy for the socio-economic development of Slovakia for the period prior to accession and the years following accession to the EU. The opinions about goals and instruments for the necessary changes in various areas, sections and levels of the economy should be combined into a comprehensive and continuously updated medium-term development concept. It should be created in close co-operation and discussion between both governmental and opposition forces, state and regional institutions, enterprise and academic circles, trade unions and the third sector. The present study and its continuation could be the first steps in the creation of the concept's knowledge base.