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Slovak Republic

Summary of Joint IMF/EC Technical Assistance Follow-up Mission in Support of Expenditure Review

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Technical Assistance Report

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CONTENTS

PREFACE

In response to a request from the Ministry of Finance (MoF) of the Slovak Republic, a joint International Monetary Fund (IMF) and European Commission (EC) technical assistance (TA) mission visited Bratislava during November 28–December 1, 2017, to review progress in the management and implementation of the rolling expenditure review process. The mission comprised: David Coady and Jason Harris (both IMF staff), Natalia Zbirciog-Vandenberghe (EC/SRSS), Ignatius De Bidegain and Raphaelle Hours (both IMF experts), and Hans Kordik (World Bank).

The mission participated in a series of workshops organized by staff of the MoF's Value for Money Division. Other participants in the workshops included staff from the relevant line ministries and a range of external stakeholders. The mission also met with staff from the newly formed Implementation Unit to discuss progress and challenges in implementing agreed spending measures and strengthening the institutional infrastructure of the spending review process.

The mission would like to express its appreciation to all its Slovak counterparts for their excellent collaboration and in particular to Stefan Kiss, Juraj Mach, and Matej Kurian for all of their support to the work of the mission prior to and during its visit to Bratislava.

I. BACKGROUND

1. **A joint IMF/EC technical assistance team visited Slovakia at the end of November 2017 as part of its ongoing support for the Slovak Expenditure Review (SER) project.** The purpose of the mission was to:

- Review progress in strengthening the institutional infrastructure supporting the SER project, including building on the results of the first round of spending reviews (covering health spending, transport spending, and IT spending) and the second round of spending reviews (covering environment, education spending, and social benefits and labor).
- Help launch the third round of spending reviews covering public wage bill spending, spending on agriculture and rural development, and spending in support of socially marginalized groups.
- Discuss next steps in the SER project and areas where ongoing technical support is most useful.

The discussion below summarizes the key issues discussed during the mission, including areas where further action is needed to enhance the effectiveness of the SER.

II. STRENGTHENING INSTITUTIONAL INFRASTRUCTURE

A. Background

2. **The government has continued to strengthen the capacity of the Implementation Unit (IU) to ensure adequate monitoring and implementation of measures agreed under the spending reviews.** The unit was set up in the Office of the Deputy Prime Minister as of June 1, 2017, and a unit head appointed. The unit is now composed of the head and two senior staff, with room for two additional junior staff.

3. **The staff of the IU have already started to engage with relevant line ministries from the first and second rounds of review to ensure commitments are being delivered.** The IU has developed three tools to support this activity: Implementation Plans, Quarterly Dashboards, and Implementation Reports. Implementation Plans have been prepared for both rounds of spending reviews covering six line ministries, primarily extending the set of indicators that can be used to monitor progress towards attaining identified savings, value and process measures proposed in the spending reviews. The Implementation Plan includes a detailed schedule and target values to be achieved in 2018-2020 budget cycle. Based on agreed indicators, progress will be reported in a Quarterly Dashboard, which is intended to flag areas where greater effort is needed. Overall progress will then be summarized in an interim and annual Implementation Report.

4. **The spending review continues to be very visible within and outside of government.** Each of the final reports of the second round of spending reviews was publicly launched with an official press release by the MoF and the relevant line ministry. The "Main Book" of the 2018 budget documentation includes the key findings of the spending reviews in four sectors:

health, environment, education, and labor and social benefits. Annexes to the budget contain the full final reports from the second round of reviews covering labor and social benefits, education, and the environment, as well as the Interim Implementation Report of the IU on the 2016 reviews (health, transport, and IT). A full Implementation Report is scheduled for May 2018.

5. The focus of the third round of spending reviews has been agreed and successfully launched. The reviews will cover spending by the Ministry of Agriculture and Rural Development, as well as public wage bill spending and spending on marginalized social groups. Progress in each of these areas, as well as areas for further strengthening, are discussed below.

B. Remaining Issues and Recommendations

6. The role of the Budget Directorate (BD) needs to be significantly strengthened. In the absence of strong engagement by the BD in the SER process, many of the duties related to monitoring, facilitating and enforcing commitments by line ministries under the review that are typically undertaken by the BD have fallen on the IU. For instance, as part of its mandate, the IU has been engaged in a detailed dialogue with the Ministry of Health (MoH) to ensure commitments are met. This has involved intensive and hands-on engagement by the IU in health policy issues. The IU also appears to be directly involved in further extending the savings focus beyond existing commitments identified through the spending reviews through the use of "Experimentation Projects" aimed at improving operational procedures in hospitals to increase throughput and reduce waiting times. While this initiative may prove valuable going forward in the health sector and beyond, it is more properly undertaken by line ministries, possibly with support from specialized unit in the BD or Value for Money unit.

Recommendation 1.1: A clear plan and timeline needs to be developed to strengthen the engagement of the BD. *This should facilitate the gradual transfer of many of the activities currently being undertaken by the IU as the SER process matures and the capacity of the BD is strengthened.*

7. Political ownership of the spending review remains mixed. In the second round of reviews, the extent of ownership by line ministries varied and this is reflected in limited commitments to spending measures:

- *Environment*: The Ministry of Environment took the lead in the expenditure review and therefore had very strong ownership of the analysis and commitment to identifying spending measures. In total, the review identified savings of the order of Euro 130 million. These measures focused on improving the operational efficiency of environmental bodies, the removal of various tax emptions, and the introduction of new financing instruments for nature conservation. Additional measures to enhance value for money were also discussed in the report.

- *Education*: While the Ministry of Education (MoE) provided technical support and data, the MoF took the lead in the spending review and identified savings of the order of EUR 88 million (or around 2.9 percent of total sectoral spending). Most of savings measures focused on consolidation of the primary school network, phasing out the system of salary "credits" to teachers, and reduction in the length of university degrees. The savings from these measures could be reallocated to finance salary increases and improvements in teacher training through a range of measures also recommended in the report. However, in the absence of agreement with the MoE, no specific measures were incorporated into the 2018 budget.

- *Labor and Social Benefits*: While the Ministry for Labor and Social Policy (MLSP) provided technical support and data, the MoF took the lead in the spending review and identified savings of the order of EUR 49 million (or around 1.6 percent of total sectoral spending). Most of measures focused on limiting eligibility to tax allowances, child allowances, and paternity leave. However, in the absence of agreement with the MLSP, no specific measures were incorporated into the 2018 budget.

Recommendation 1.2: The MoF should continue to engage with the MoE and MLSP to try to generate consensus on spending measures to enhance value for money, which can be incorporated into future budgets. *This may require consultation at higher levels of government and could possibly be incentivized by linking some portion of future spending increases (e.g., for teachers) to such measures.*

8. Technical teams for the third round of reviews should learn from lessons learnt in the first two rounds. The experience of the IU suggest that review teams need to develop more granular measures with clearer timelines and indicators to agree a reform program and monitor progress.

Recommendation 1.3: The IU should provide feedback on their experiences with the first two rounds of reviews to the Value for Money (VfM) team and the technical teams for the third round of reviews. *This should happen as soon as possible. In the first instance, it could take the form of a presentation by the IU to the VfM and technical teams on lessons learnt and challenges identified from the first two rounds. This could be followed up in February or March 2018 by a presentation by each of the technical teams separately to the IU and VfM team on how they are addressing these challenges. Leaders from the three technical teams could participate in each of these presentations to facilitate cross-learning.*

Recommendation 1.4: The IU should provide input to the current spending reviews at around the three-quarter mark, to guide the development of measures and how they can be tracked. *This should be undertaken once spending review teams have prepared their first or second drafts of the measures, with the IU providing guidance on whether they are practical and what indicators to define for measurement purposes. These indicators should then be included within the design and write up of the measure, which the IU can then track progress upon completion of the review.*

III. PUBLIC WAGE BILL SPENDING REVIEW

A. Background

9. The Public Wage Bill Spending Review has got off to a strong start and has already made substantial progress in collecting and analyzing data.

a. ***A technical team drawing on staff from the VfM team.*** The team has already done some preliminary data collection and analysis, and presented a summary analysis of the data collected to date.

b. ***The terms of reference (TOR) for the review has clearly identified the focus and objective of the review.*** The review will identify reforms aimed at increasing the efficiency of wage bill spending in the general government sector, excluding the education and health sectors (the focus of previous reviews) as well as those employed under special acts such as police officers and military (the focus of future reviews). The review therefore covers around 234,000 employees accounting for Euro 3.3 billion in wage bill spending (4.1 percent of GDP and 9.8 percent of total government spending), or just under half total general government employment and wage bill spending.

c. ***Clear deadlines for delivery of reports have been established and included in the terms of reference.*** An interim report is to be delivered by end October 2018 to facilitate broader stakeholder consultation, and a final report containing spending measures is scheduled to be completed and published by end March 2019.

d. ***The workshop has helped to initiate consultation with external experts to learn from experiences in other countries, seek guidance on the overall approach to the review, and identify available resource material.*** An expert from the UK participated in the workshop, discussing the extensive experience in the UK with wage bill spending reviews. The expert also provided feedback on the preliminary analysis and possible areas for further analysis.

B. Remaining Issues and Recommendations

10. The preliminary analysis has focused primarily on international benchmarking. The analysis highlights that although aggregate wage bill spending as a share of GDP is not especially high compared to other countries in the region, it has been increasing steadily over the last five years. This increase reflects a combination of increasing employment (mainly due to reclassification) and some increases in compensation levels from relatively low levels. However, the analysis points to possibly high public employment in some areas (including public administration) so that there may be room to reduce employment through increasing productivity. Compensation levels also appear to vary substantially across sectors, and to be relatively higher in central government and budgetary organizations. This variation across the public sector likely reflects the fragmented employment and compensation setting processes with different parts of general government having significant autonomy for determining employment and compensation levels.

Recommendation 2.1: The analysis should now switch from international benchmarking to developing a deeper understanding of the factors behind variations in employment and wage levels across general government. *This analysis will require identifying, gaining access to, and consolidating data on employment and compensation across general government. Analysis of these data can be combined with analysis of household-level and enterprise-level data to determine if public compensation is competitive with the private sector and how this varies across government sectors, as well as age and skill groups.*

11. Recent initiatives to increase wages for low-wage employees provides a basis for setting a target for savings, but should be anchored in a clear public wage bill baseline and a comprehensive plan for achieving value for money. Increasing compensation levels for employees below minimum wage levels has recently become a flagship government initiative. It has been estimated that this could cost as much as Euro 220 million, or approximately 10 percent of wage bill spending in the sectors covered by the review. While this is a laudable objective, it should be incorporated into the overall objective of enhancing value for money. Therefore, analysis of compensation levels should be combined with an analysis of employment levels with the aim of financing wage increases through productivity improvements, ideally informed by functional reviews and an evaluation of promotion and performance pay procedures and compensation structures. The identification of "savings" should also be anchored in a clear baseline for public wage bill spending reflecting natural wage drift due to promotions and ageing of the workforce.

Recommendation 2.2: The team should incorporate the recent flagship government initiative into a broader discussion of employment and compensation reforms in support of productivity improvements that produce target savings. *These savings should be clearly anchored in a detailed wage bill spending baseline that reflects standard wage drift; the construction of a baseline could be usefully informed by an analysis of budgeted versus actual wage bill outturns since the latter seem to have greatly exceeded the former over recent years. This discussion should also be informed by detailed analysis of employment and compensation levels across sectors to identify better targeted policy measures for sectors with relatively high employment and compensation levels.*

12. The fragmented employment and compensation framework means that data has not been adequately centralized. The team should therefore quickly identify the data that exists and areas where data are lacking. While some of these data gaps can be addressed as part of the review, others may take longer. It will be important to get data on the component parts of total compensation (i.e., base wages, allowances, overtime and bonuses) and how these have evolved over recent years as wage levels have increased, as well as data on expenditure on contractors and agency staff. Administrative data should be analyzed alongside household and enterprise survey data to determine how competitive public compensation is compared to the private sector across different parts of government as well as age and skill groups. This analysis should be combined with an analysis of attrition and retention patterns to identify pressure areas.

Recommendation 2.3: Priority needs to be given to quickly identifying the data that exist with a clear plan for consolidating and integrating these data for the analysis. *Remaining data gaps or barriers to the consolidation and integration of existing data should also be identified along with a strategy for addressing these gaps. Where it is not possible to address gaps as part of the review, a strategy for filling these gaps over the medium term should be presented.*

13. The compensation of some employees appears to be indexed to average wages in the economy. Such indexation can constrain the government's ability to reform compensation mechanisms and generate savings in the short term. The pervasiveness this practice across the government sector and its implications for compensation negotiations with line ministries and government bodies as well as trade unions needs to be assessed.

Recommendation 2.4: The team should quickly get a deeper understanding of the nature and extent of compensation indexation. *The rigidities introduced by indexation should be explicitly recognized and their implications should be clearly reflected in the wage bill spending baseline.*

14. Enhanced engagement of ministers and senior officials is needed to ensure that the analysis, conclusions, and recommendations are jointly owned and supported by the MoF, line ministries and other government bodies. Constructive engagement is more likely if the emphasis is placed on improving productivity and ensuring compensation is competitive with the private sector. Given the significant autonomy of line ministries and government bodies in determining employment and compensations levels, as part of wage bill negotiations the MoF could encourage and incentivize these to develop reforms to increase productivity in support of making compensation more competitive. Such reforms should be carefully evaluated and costed to determine if they will deliver value for money over the medium term, including allowing for any up-front cost (e.g., associated with severance pay). The potential for replacing in-house services with outsourced services, or for consolidating services across the public sector, should be evaluated as part of this process, together with existing procedures for incentivizing high performance through the use of promotions and bonuses.

Recommendation 2.5: The technical team should engage with the relevant line ministries and government bodies as soon as possible to encourage them to identify reforms to enhance value for money. *This could be achieved through the presentation of the interim findings of the technical team to ministers and senior policy officials prior to the completion of the interim report. Reforms would need to be rigorously evaluated to ensure value for money and carefully costed over the medium term. The MoF could request departments to suggest productivity measures and performance targets as a condition for unlocking funding to finance higher pay, say, above some common pay award across the public sector.*

IV. AGRICULTURE AND RURAL DEVELOPMENT SPENDING REVIEW

A. Background

15. The Agriculture and Rural Development Spending Review has got off to a solid start, laying the groundwork for a strong analysis of spending.

a. ***A technical team from the VfM has been formed and is supported by the newly created Institute for Agricultural Policy (IAP) at the Ministry of Agriculture and Rural Development (MARD).*** Although the allocated IAP resources are small (one person, half time), this provides a basis for strengthening policy analysis in MARD over time. The team has already done some preliminary data collection and analysis, and presented a summary diagnostic of the data collected to date.

b. ***The terms of reference (TOR) for the review has clearly identified the focus and objective of the review.*** The review will identify reforms for improving the efficiency of spending in the sector, which has been estimated to amount annually to 1.9 percent of GDP

(EUR 1.8 billion) on average over recent years. This covers both spending by the MARD as well as by its affiliated organizations and the largest companies under its managerial competence. The analysis will discuss the allocation of EU money between different components of the EU's Common Agricultural Policy (CAP; direct income support, rural development projects), as well as the design of each component. Efficiency and effectiveness of the Integrated Regional Operational Programme, which is managed by MARD, will also be evaluated. The operational efficiency of the MARD and its affiliated organizations (including state-owned enterprises, including forestry and breeding) will also be evaluated. The analysis is also intended to inform the allocation of EU funding over the next phase covering 2018–2020.

c. ***Clear deadlines for delivery of reports have been established and included in the terms of reference.*** An interim report is to be delivered by end October 2018 to facilitate broader stakeholder consultation, and a final report containing spending measures is scheduled to be completed and published by end March 2019.

d. ***The workshop has helped to initiate consultation with external experts to learn from experiences in other countries, seek guidance on the overall approach to the review, and identify available resource material.*** An expert from France participated in the workshop, discussing their experience with agricultural expenditure reviews. An expert from the World Bank also participated, discussing broader experiences of expenditure reviews within the context of the CAP. The experts also provided feedback on the preliminary analysis and possible areas for further analysis.

B. Remaining Issues and Recommendations

16. The preliminary analysis has focused on providing a broad diagnostic of the structure of agriculture in Slovakia, including the allocation of spending under the CAP. On the structure of agriculture, issues highlighted included: the very high concentration of farming in large farms, and the large share of agriculture activity concentrated on cereals compared to fruits and vegetables or animal husbandry. This results in low value added due to the relatively low labor intensity of cereals. On the composition of CAP spending, issues highlighted included: the relatively high share of funding absorbed by direct support payments, most of which accrues to the largest farms, and the thin spread of spending on rural development projects across a large range of projects.

Recommendation 3.1: The technical team should now focus on gaining a deeper understanding of the factors behind the current mix of agricultural activities, and the potential role of spending allocations. *To what extent is the structure of land ownership and of the land market responsible for the low share of labor-intensive activities in agriculture? Can direct payments be restructured to incentivize greater emphasis on these activities, e.g., by targeting farming activities with higher value added, and enhancing transfer progressivity? Can the scope of rural development projects be reduced to concentrate on fewer activities, focused on reducing administrative costs and increasing agricultural productivity on smaller farms? Should a higher share of CAP funding be allocated to rural development projects?*

17. The reliance on CAP funding and the composition of this spending can reduce discretion over spending allocations in the short term. Prior agreement about the allocation of CAP funding over the funding cycle limits possibilities for reallocating this funding between program components. The requirement for matching funds under the rural development scheme also affects the mix of CAP, public and private funding. In the short term, it may be that the potential for spending reallocations are restricted to within-program components. However, the expenditure review can also provide input into discussions around the allocation of CAP and other funding over the next 2018-2020 funding cycle.

Recommendation 3.2: The technical team need to distinguish between discretionary and non-discretionary spending and identify the implications for the government's ability to reallocate spending across activities. *This may require separation of the analysis into short-term reallocations within program components supported by changes in program design, and medium-term reallocations across components as part of CAP negotiations for the next 2018-2020 funding cycle.*

18. Enhanced engagement of ministers and senior officials is needed to ensure that the analysis, conclusions, and recommendations are jointly owned and supported by the MoF and MARD. The leading role played by the VfM reflects the fact that it has built up a strong analytical capacity over recent years as part of the expenditure review process. However, as previously with earlier rounds of the spending review, the review process can be expected to significantly enhance the capacity of the IAP. This can also provide the impetus for enhancing the engagement and ownership of the MARD over the review process.

Recommendation 3.3: The technical team should share the results of the analysis with the MARD well in advance of the interim report to strengthen its input into the analysis and ownership of recommended reforms. *This engagement could take the form of a joint MoF and MARD seminar, which could also include other government and non-government stakeholders.*

V. MARGINALIZED GROUPS SPENDING REVIEW

A. Background

19. The Marginalized Groups Spending Review has established a good foundation for an effective spending review. The review will draw heavily on the analyses already undertaken on topics covered in earlier rounds of the SER, especially education, health, and social benefits and labor.

a. ***A technical team drawing primarily on staff from the Institute for Public Finance (IPF) in the Ministry of Finance (MoF) has been formed.*** However, reflecting the cross-cutting nature of the review, the group has already started to engage with other line ministries and stakeholders. The team presented the findings of some preliminary data analysis, complemented by a presentation by staff from the Office of the Plenipotentiary of the Slovak Government for Roma Communities, which provided an overview of poverty and social exclusion in the Roma community. These presentations facilitated a discussion of possible conceptual frameworks to guide future analysis.

b. ***The terms of reference (TOR) for the review has identified the focus and objective of the review.*** The review will focus on public expenditures and policy instruments intended to address poverty and social exclusion. The TOR identifies some key "gaps" that will be analyzed, including in the areas of income poverty, education, health, housing, employment, regional development, financial inclusion and social discrimination. It also identifies specific "groups" that are known to be particularly disadvantaged across many of these dimensions, including the Roma community, the disabled, single-parent families with dependants, and the homeless. The review will identify key policy instruments across various line ministries intended to address these gaps, evaluate their effectiveness, and suggest reforms based on best practice informed by international experience.

c. ***Clear deadlines for delivery of reports have been established and included in the TOR.*** An interim report is to be delivered by end October 2018 to facilitate broader stakeholder consultation, and a final report containing spending measures is scheduled to be completed and published by end March 2019.

d. ***The workshop has helped to initiate consultation with external experts to learn from experiences in other countries, seek guidance on the overall approach to the review, and identify areas for possible collaboration.*** An expert from the OECD presented an outline of ongoing analytical work focusing on policies in support of Roma integration and the broader economic benefits of such policies. This work should provide some very useful information for benchmarking Slovakia against other countries in the region with respect to the gaps identified above as well as help identify best practices in addressing these gaps.

B. Remaining Issues and Recommendations

20. There is a need to clarify the conceptual framework that will be used to guide the technical and policy analysis, and the scope of this analysis. The workshop discussion highlighted the importance distinguishing between "gaps" (or dimensions of disadvantage such as education or employment) and "groups" (i.e., identifiable groups that are especially disadvantaged across numerous dimensions). Identification of "groups" first requires a specification of the dimensions across which disadvantage (or "exclusion") will be measured, i.e., the "gaps" to be considered.

Recommendation 4.1: The technical team should prioritize setting out the conceptual framework to be used to guide their analysis and generating consensus among line ministries and other stakeholders. *This requires first setting out the dimensions of disadvantage to be covered by the review (gaps), an analysis of which should then inform possible groups that could be identified for specific consideration. The approach eventually adopted should be amenable to mapping public spending to policy instruments being used to address these gaps, as well as the formulation and promotion of policy reforms.*

21. The analysis should begin by benchmarking poverty and social exclusion indicators in Slovakia against international outcomes. This will facilitate the prioritization of outcomes and gaps to be focused on as part of the analysis as well as lay the groundwork for identifying international best practice in terms of the selection and design of policy instruments. It will also focus attention on data availability and data needs.

Recommendation 4.2: The technical team should immediately start by benchmarking key outcomes in Slovakia against international outcomes. *This should draw heavily on ongoing* *work by the OECD in this area. The analysis should benchmark spending across countries, population groups and time to identify key outcome gaps and trends.*

22. **Data constraints are likely to limit the analysis of spending and its effectiveness.** The cross-sectoral nature of the review will require the team to identify and collect data and information from various line ministries and other stakeholders. The analysis will also require integrating administrative data with household survey data, as well as the use of quantitative and qualitative data.

Recommendation 4.3: The technical team should quickly identify available data and data gaps. *An important output from the review will be the consolidation and integration of existing relevant data from multiple sources. This will facilitate the identification of key data gaps as well as the development of a strategy for filling these gaps both as part of the expenditure review but also over the medium term.*

23. **Identification of policy reforms to enhance the effectiveness of public spending in support of improving key outcomes among disadvantaged populations requires mapping existing spending to policy instruments.** Careful mapping of spending by line ministries and other stakeholders to policy instruments aimed at addressing key outcome gaps will facilitate an evaluation of the effectiveness of these policy instruments. It will also facilitate a comparison of the choice and design of policy instruments with international best practice. Undertaking this analysis will require close collaboration with line ministries and other stakeholders. The analysis of the effectiveness of policy instruments should also address issues related to the fragmentation of responsibilities and the adequacy of the institutional structure in ensuring effective spending

Recommendation 4.4: The technical team should collaborate closely with line ministries and other stakeholders to map spending to relevant policy instruments. *Once key outcome gaps and important socially excluded groups are identified, the team should quickly initiate meetings with relevant line ministries and stakeholders to identify relevant policy instruments that fall in their domain and map their spending to these instruments. It will be important to identify how spending is financed (e.g., national budget, EC financing, and municipal or local financing), and whether it is current or capital spending, since the degree of discretion governments have in the short term over these different components will vary. The analysis should also inform spending over the medium term, e.g., the level and composition of spending for the next EU cycle after 2020.*