Slovakia: Well positioned for economic growth

**Earl L. Wright**

*Meeting with Allen & Overy, a UK law firm with an office in Bratislava. Article information from Earl L. Wright.*

Slovakia’s economy and governance issues were the subjects of a meeting Forum members had with two attorneys at Allen & Overy’s Bratislava office.

Allen & Overy, whose practice centers on clients in the corporate, banking and financial sectors, enjoys an international reputation. It was the first UK law firm to establish a presence in Bratislava in 1999. Thirty staff attorneys provide clients with advice on international and major Slovak and UK transactions.

On the economy, there was not much new to talk about, says Wright. Slovakia’s transition from a centrally planned economy to a modern market economy has generally gone well. In the period 2001-03 the economy did better than expected, despite the slowdown in Europe. Privatizations have progressed on schedule and foreign direct investment has picked up.

There are still problems, however. At 15 percent (03), the unemployment rate remains too high, as does inflation at 8.6 percent (03).

Some of the details provided insight into the pension system, says Wright.

“The government has privatized the Social Security system, as have many of the new EU countries.” Radical pension reform, which was introduced in 2003, is based on three pillars.

The first pillar is mandatory, public and financed by equal contributions by employers and employees.

The second pillar is mandatory, fundamentally private and fully funded. Resources come from the split of total contributions originally paid to the first pillar, a so-called ‘carve-out’ approach. In this tier, employees can allocate 9 percent of their share paid under the first pillar to be invested in a private pension fund.

The third pillar is voluntary, fully funded and private. “There are three funds an employee can pick from: growth, balanced and conservative,” says Wright. “If you are over 50 years of age, you are not allowed to invest in the more aggressive funds that are available.”

Attorneys at Allen and Overy “expect that 50 percent of the private pension monies will be invested internationally and 50 percent in Slovakian bonds and/or stocks. They do not think this will last very long because Slovakian stocks and bonds will be overwhelmed by the amount of money that will be invested in this arena.

“The private pension funds will have qualified pension fund managers to invest their monies, primarily in major European insurance companies and banks,” says Wright. “I was told that the banks most likely to be favored by the populace for investments would be the relatively local banks of Vienna, which is less than 100 kilometers from Bratislava.”

Pension fund managers will be required to meet certain performance criteria in line with group performance. “Their returns will have to be within 70-120 percent of what the management group for their investment style is doing,” Wright explains. “For example, if the average manager over a six-month period is at 10 percent return and there is a manager amongst the group that is at 5 percent return, that manager must make up the difference between the 5 percent and 10 percent average return. After the first six
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months or a comparable period, that return must be made up on a monthly basis. This is rather unusual as a means of trying to make certain there is a guaranteed return to the private investor.

“It is my belief that a significant amount of those funds will have to be in bonds and government bonds, with varying degrees (0-40 percent) in stocks.

“The retirement age for the public pension continues to rise to accommodate the financing that is needed to support the aging population.” As a means of motivating an increased birth rate, which in time translates to an increase in the labor force, the government is looking at the possibility of offering a special tax deduction for new births.”

Slovakia’s skilled and low-wage labor force is the engine that drives the economy. Says Wright: “According to the director of purchasing for Volkswagen Works in Slovakia, there is very little difference in skill level between their factory workers in Slovakia versus those in Germany, where wages are much higher. But Slovakian workers have a significantly better attitude with regards to work, productivity efficiencies and flexibility.

“The Tuerag, being made in a similar line at the Bratislava plant, is one of Volkswagen’s highest end, more precision cars. Their margins are better at that facility than in Germany. This is true of all of the automobile manufacturers that have come to Slovakia and set up new plants in the last decade.

“The purchasing power of Slovakia will grow as the production capability of Slovakia grows, resulting in a significant increase in the overall economy.”

**Slovakia Vital Signs**

Capital: Bratislava  
Population: 5.4 million  
Population growth rate: 0.14% (03)  
Labor force: 3 million (99)  
Unemployment rate: 15% (03 est)  
Language: Slovak  
Literacy: N/A