PROMISES AND REALITY

Slovak Economy 1995–1998

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FOREWORD

This publication is intended for those who wish to look into the mirror of economic miracle that was promised by Mečiar's third government at the time of its coming into power, in 1994. The publication presents the views of the independent M.E.S.A. 10 staff and its part-time associates, on the development of the individual sectors of the Slovak economy in the past four years.

At the time of coming into power, in 1994, the government committed itself to numerous positive plans and objectives. However, practical steps that followed oftentimes contradicted the original statements. Even worse was the fact that the steps were at variance with the valid laws and the principles of the State of law, and the fundamentals of fairness and ethics. The outcome of the four years in question have been grave problems practically in all the economic sectors, concealed under the tinsel of positive macroeconomic indicators. It is the HZDS-ZRS-SNS trefoil (i.e. the Movement for a Democratic Slovakia, the Association of the Workers of Slovakia, and the Slovak National Party) that has impeded the process of Slovakia approaching the advanced democratic countries and prompted the establishment of an autocratic regime with a command model of the management of public matters.

The objective of this publication is not only to pinpoint the instances when the law was broken, mistakes made, and the development of the Slovak economy distorted in the years 1994-1998. The authors have endeavoured, in addition to the analysis of the development and its consequences, to also provide an outline of the measures of the recovery process for the nearest future, from both the short and medium-term perspectives.

The Slovak economy, after four years of V. Mečiar's government, is faced with a particularly difficult situation, whereby the early analyses of M. Dzurinda's Cabinet conducted across the individual sectors indicate that the condition of our economy is even more alarming than originally assumed at the time of the pre-election campaign. Fully exposed is not only the actual condition of the public but also the private sector, and it has become apparent how the percolating political and economic power played tricks on the citizens – electorate, tax payers, and employees, and how this power has been living at the expense of the generations to come.

Slovakia, as an independent State, has been indebted and deprived of its assets. The growth of the regional differences in economy has been appalling over the past four years, which, in turn, has negatively impacted the citizens' standard of living. The dangerous model of conduct, supportive of corruption, the percolation of political and economic power, and criminality in economy, got its way. If these trends are not halted and the consequences of the hitherto development are not gradually rectified, it is obvious that ultimately, the Slovak economy will lose its competitiveness in the globalizing and liberalizing world economy, which would bring about all the adverse economic and social consequences.

The hitherto approach is no longer sustainable, and the situation calls for addressing the problems that have piled up and for "settling the debt" generated by the activity of V. Mečiar's government. The rehabilitation process will inevitably entail unpopular measures, such as price deregulation, austerity programs and cutting down public expenditure, and even the devalutation of Slovak crown, if need be. The new coalition government recognizes the gravity of the situation, and its government declaration is an indication of its determination to change the situation. However, without the back-up of the citizens of Slovakia, the period necessary for the implementation of these changes cannot be shortened. A lot of citizens will consider the measures of the new Cabinet a kind of revenge on the former government. To have them understand that this is not the case, that the likely tentative decline of the standard of living is a consequence of the policy of the former government, it is inevitable to bring the

present state of Slovakia to public attention, and show what M. Dzurinda's Cabinet has inherited from its predecessor.
Also, it is essential to make public how the assets of the citizens of this country and their taxes paid to the State and the local government to deliver public service to them, were managed. The citizens of Slovakia have every right to know what is the outcome of the policy of a government that acted in line with the motto After Us the Deluge. Also, this publication is intended as a kind of appeal to the citizens of our country, it is to encourage them to take keener interest in public matters and get them invovled. Their apathy and trust in the goodness of Vladimír Mečiar and his co-rulers also account for the crisis situation in the country. The citizens ought to realize that the weaker the concentration of power, i.e. the more power is shared amongst the citizens, the community, and the region on the one hand, and the State on the other, the more efficient power control on the part of the citizen, and, as seen from the examples of other successful countries, the higher the citizens' standard of living.
M.E.S.A. 10 and its part-time staff do not claim the right to absolute truth. However, it is deemed important to voice our opinion on how the promises of Vladimír Mečiar's government in economy were met and what have been the consequences of its actions.
The project was initiated in September 1998, by the then president of M.E.S.A. 10, Ivan Mikloš. In drafting the book, his numerous economic analyses and opinions of the course of the privatization process in Slovakia were used. Hence, the authors of this publication acknowledge their debt to him for everything that has helped compile it.
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SOCIAL AND POLITICAL BACKGROUND

Diagnosis that will not let you go

(Seven Contexts of Economic Promises and Realities)

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1) Foreword: Slovak Road, or, Mečiarism?

In the 20th century, Slovakia, its policy, economy, and culture, its inhabitants, have undergone a particularly eventful development. In the past 80 years, its territory, as evidenced by historian Ivan Kamenec, has witnessed the coming and going of six state models, three political systems, and several regimes, whereby the greater portion of the time concerned, the country has lived under a totalitarian regime.[1] There is a general consensus – and not only on the part of the historians - that among the crucial periods was also the period of Vladimír Mečiar's government that lasted 60 months altogether, since independent Slovakia was first established in January 1993. The longest and politically most distinct rule falls within the period of his third government that lasted from December 1994, to October 1998. The proponents and allies of the until recently ruling Movement for a Democratic Slovakia (HZDS) refer to the above period as the so-called Slovak Road. Their opponents, i.e., opposition politicians, independent mass media, and other opinion-making personalities, tend to refer to this period, particularly to the style of its rule, as Mečiarism[2].

The above concepts imply a different perception of reality. The avenue, referred to as the Slovak Road, implies something noble, positive, while the term Mečiarism has negative connotations. No matter what name the given period is given by the citizens, the parliamentary elections in 1998 corroborated that the majority of them wished to say good bye to this era. Change was what they were supportive of and craved for.

The word change has become one of the key mottos in the pre-election wrestling, and it reverberated throughout the entire election campaign and approached the electorate from the billboards. An intense pre-election campaign joined by political parties as well as non-governmental organizations which appealed to the electorate and urged its high turnout stressed the right to an individual free choice, thus attracting a particularly high percentage of constituencies, 84.2 per cent, to the ballot-boxes, which ousted the turnout at the 1994 elections by almost 9 per cent. This high turnout gave mandate to a new government which materialized in its constitutional majority in the parliament.

Since the establishment of the independent S.R., this is the first time ever for the Cabinet to dispose of such a support. In fact, this is the broadest support a government has enjoyed ever since 1992. While the government set up by V. Mečiar after the 1992 elections, was supported by 30.5 per cent of all the eligible voters, and the coalition government composed of HZDS, the Association of the Workers of Slovakia (ZRS), the Slovak National Party (SNS) set up in 1994 was supported by 35.4 per cent of voters, the newly-created government coalition – the Slovak Democratic Coalition – comprising the Party of the Democratic Left

(SDL), the Party of the Hungarian Coalition (SMK), the Party of Civil Understanding (SOP), was a materialization of the will of 48.4 per cent of elligible voters in September 1998[3]!
As was stated by the politologist Soňa Szomolányi, Slovakia abandoned the so-called South-East Model in 1998, under which it was the support of the numerous rural population that decided on the country's political orientation, to whom authoritarian populists, such as Lukashenko, Miloshevich, and Tudjman were especially appealing. Instead, the country has approached the model implemented in the recent elections in Poland and Hungary where urban and educated population was reported to have had the highest turnout[4].
Although Vladimír Mečiar manifested affinity with the above politicians in terms of his political features, although Slovak nationalism, throughout its history, manifested some elements common with Serbian or Croatian nationalism, although, to some extent, the Slovak political culture is prone to authoritarianism, Slovak society as a whole showed to be different in the 1998 elections. The most recent parliamentary elections foreshadowed a culture and civilization move forward that testified to a progressing culture modernization. In them, enforced was the opinion of the younger, more educated, urban electorate who no longer was mentally hooked on socialist modernization.

2) The Slow Death of Democracy Did not Happen

WHAT KIND OF REGIME DID THE ELECTORATE REFUSE IN 1998?

If, back in 1995, an observer knew nothing about Slovak reality and wished to familiarize himself with it exclusively on the basis of the then available government documents, the impression he would get would be that of a reputable, standard, Central-European country that was doing relatively well in coping with its lot of a country in transition. According to the Government declaration of the government of the S.R., of January 1995, Slovakia strived to establish "a social and market space compatible with that of the industrially advanced democracies in the world[5]". The fundamental and ongoing objective of the government was "a democratic State of law based on political and economic plurality, fundamental social security, humanism, and understanding, national, ethnic, and religious tolerance". The government committed itself to respecting "the opinions of the opposition beneficial for the society", and to establish space "for the minority opinions of affinity groups that will facilitate the process of their recognition". In its memorandum enclosed to the application of the S.R. for the E.U. membership, of June 1995, the government stated that in Slovakia "democratic institutions are firmly established and despite various political changes, the constitutional system is stabilized". The broadcasting of Slovak Television only corroborated this idyllic image.
If, however, the same observer referred to foreign documents, specifically, two demarches of the E.U., followed by that of the U.S.A., in which concern was voiced about the fashion in which power was executed and democracy curtailed in Slovakia, that very person would get a rather different picture, evidencing largely the democratic deficiencies of "the young Slovak Republic", as the favourite phrase of the official representatives went when referring to their State, hoping, that it was "youth" that would pardon the child's mistakes in the "democracy operation". And, should the observer read the foreign period press between the fall of 1994 and 1995, this idyllic atmosphere would be thoroughly effaced by the headings of articles covering Slovakia: "The Clock in Slovakia Goes Backward" - New York Times; "The Most Extremist Rehabilitation of Command Control in Central Europe – Wall Street Journal; "Brutal Political Struggle in Slovakia" – Gazeta Wyborcza; "Power Sharing Reduced to Nothing" - Frankfurter Allgemeine Zeitung; "Europe Doesn't Need Semi-dictators" – Die Weltwoche; "A Heavy Shadow Over Slovakia" - Respekt; "Villainy in Slovakia" - The

Economist; "The Struggle for Power Hinders Slovakia's Accession to NATO and the EU" – Reuter; "President, Prime Minister, and a Theme for a Mediocre Detective Story" – Süddeutsche Zeitung. It was obvious that both the major political groupings, i.e. the then parliamentary majority and the then parliamentary minority, professed different ideas of democracy and constitutionalism. These differences, more pungently formulated during the memorable parliamentary night of November, 1994, when a set of unconstitutional laws was passed and anti-democratic measures were enforced, only aggravated in the four years that followed.

Although in 1994-1995, the prospects were fairly good for Slovakia, the policy of the former HZDS-ZRS-SNS government coalition caused the country to fail in its endeavours to become part of the integration processes in Europe. The Slovak Republic was not invited to join the group of states that ought to join NATO in 1999, within the framework of the "first wave" of countries; neither was it included in the group of the associated E.U. countries with whom the E.U. envisaged to commence negotiations about their full membership. As distinct from the neighbouring countries in transition (the Czech Republic, Hungary, Poland), to date, the S.R. has not become a member of the O.E.C.D., despite the fact that these were among the officially declared government policy objectives.

It should be noted that policy and economy represent communicating vessels in this case: the lagging behind of Slovakia in the European integration processes, in addition to obvious political cons, entails adverse economic impacts, both immediate and direct, as well as long-term and indirect.

If we disregard the establishment of the system of a close link between the economic and political power based on party clientelism, accompanied by the establishment of conditions facilitating the replication of this system in the future, which is elucidated in our publication, then the problematic development in the S.R. in the past election period may be summarized into twelve characteristics expanded on in the papers of local and foreign politological expert:[6]

1) Persisting conflict of the top constitutional officials (president and prime minister) that erodes the stability of the functioning of democratic institutions in the State and impedes an efficient collaboration in the process of the enforcement of State interests. To a large extent, this conflict followed from the various styles of the policy of its protagonists, and was largely related to the persistent effort of the then prime minister and HZDS chairman, V. Mečiar, to remove the legitimately elected president M. Kováč who refused to execute his office as that of a "partisan president", according to the HZDS ideas.
2) The antagonistic confrontation amongst the parties of the then government coalition (HZDS, ZRS, SNS) and the opposition political entities. The government coalition took action to weaken the opposition parties via the mechanisms of the State (legislative and executive) power, using discriminatory measures against them. In the last year of its mandate, only a few months prior to the 1998 parliamentary elections, the then ruling state power, by selectively amending the election rules, had attempted to complicate, or, thwart, a free competition of political forces that constituted the basis of a modern parliamentary democracy. It should be added that the practice of well-established democracies does not allow for too dramatic a change of election rules within such a short period of time before the elections. The power position of the parties of the former government coalition capitalized on the monopoly positions of these parties in the setup of the executive power of the State, including security structures; on their exclusive position relative to the nationwide public electronic media, notably Slovak TV; on their bonds to the economically powerful lobby groups that ensured an effective party sponsoring; on the direct representation of the officials of these parties on the supervisory boards of lucrative companies; on the establishment or promotion of a network of satellite organizations and

societies (culture, professional, trade, labor organizations, and the like), with an objective to influence public life in a fashion favouring the abovementioned political parties.

3) The preparation, adoption, and implementation of such legislative measures, whose objective was an excessive concentration of political power in the hands of the government coalition, notably, HZDS, the most powerful entity. Also, the institutions of state administration were misused for political goals, and the reform of public administration was used to solidify the influence of HZDS in particular. This was apparent from the manner in which the city managers of the local state administration were selected and appointed and their subsequent activity across the regions (some of them were, at the same time, leading officials of HZDS at the county or regional level). In addition, such procedures accounted for the weakening of the oversight function of the parliament with respect to the executive power and were an impediment for the parliament to fulfil some of its essential functions.
4) The solidification of authoritarianism in the actions of the government coalition, which was most blatantly manifested in addressing social conflicts. Rather than seeking consensus and agreement, the government coalition enforced an instrumental perception of democracy as a mechanical set of procedures, and, oftentimes, prioritized the use of the majority principle embodied in the "the winner takes it all" formula. This went hand in hand with the mistrust in the principles of autonomy and self-government in public life, with disadvantaging the local government, and a reserved attitude to decentralization and subsidiarity.
5) Persisting tension in the relations between the representatives of ruling power and the representatives of almost all the national minorities and ethnic groups, a confrontation type of nationality policy in the enforcement of minority rights. This tension resulted in the erosion of the dialogue between the governmental structures and the minority representatives and the halting of potential improvements and practical solutions in this area.
6) Juggling on the edge of the principles of constitutionality, unsatisfactory adherence to the rulings of the Constitutional Court. The government coalition expelled a legitimately elected MP from the parliament against his own will, whereby this action cast doubt upon the legitimacy of the lawmaking body, and it ignored the finding of the Constitutional Court. In 1997, the Ministry of the Interior, instructed by the government, aborted the referendum on the direct election of the country's president, thus infringing the fundamental human right of the millions of citizens of the S.R. This erosion of constitutionality increased the tension in the society and the risk of political destabilization became more patent.
7) Repeated breaking of the principles of the State of law in the interest of maintaining the power in the hands of ruling groups, the breaking of the principle of equality before the law, legal nihilism. Between the years 1995 and 1998, due to the political pressure from "the top", the investigation of grave criminal offences was thwarted. Persons who had affinity with the ruling power were suspected to have commited these offences (the abduction of Michal Kováč jr. to Austria, the murder of R. Remiáš, the Adoration of the Magi case, various privatization cases, corruption in the central state administration bodies, the abortion of the referendum on the direct election of the president).The State internal security weakened, and new, dangerous forms of criminality emerged (extortion, pay-offs, bomb assassinations).
8) Communication weakening, followed by the aggravation of misunderstandings, controversies, open conflicts between the state authorities and the various strata and institutes of civil society, starting with the representatives of the third sector (civil associations, foundations), through the representatives of the academic community, trade

unions, local governments, down to the representatives of some professional associations (medical, teacher, art, business, journalist, etc.), or the protagonists of some churches. In parallel with this trend thrived political, financial, media, and moral furtherance of the pro-governmental, or government-affiliated civil organizations and associations (of writers, culture and journalistic entities, youth and women‘s organizations, local governments, industrial groupings), state-funded institutions (some newly-founded universities), even political groupings (a new party of the members of the Hungariarn national minority). Attempts were made to initiate the establishment of alternative, parallel institutions (The Union of Civil Associations as an umbrella organization that was intended as a counterparty to the representative Association of the Third Sector, even new trade unions, etc.). This was a rather odd attempt to disrupt the civil society from within, establish "parallel polis" guaranteed, legitimized, and funded by the State.

9) Unhealthy relationship of the ruling power and mass media, efforts at direct or indirect economic and political pressures upon the independent mass media, neglecting the duties to report on the work of state authorities, an overall weakening of the communication channels with the greater portion of the journalistic community, selective approach to journalists depending on the degree of "opposition" estimated in them, a stepwise weakening of the public nature of electronic media.
10) A gradual build-up of an ideological basis of the ruling state power concealed under the pro-governmental Slovak Television; the signs of the establishment of a kind of "the state ideology" with its buttresses being the 19th century protective nationalism, isolationism, Slavophilism, the support of the regime of the military Slovak State, the rejection of the West, the defiance of the Euro-Atlantic community, and seeking political and cultural partners in countries like Russia. Although many of these elements were at variance with the official government documents, they were given significant support on the part of Matica slovenská which, with the tacit consent of HZDS and ZRS, and the political lobbying of SNS, capitalized on its unique ideological status. Proportionally to the criticism from the West, the voices of "pragmatists" were subdued, only to give way to the voices of "fundamentalists", which gradually shaped the opinions of the proponents of the ruling parties towards isolationism and anti-West orientation.
11) The endeavours of the government coalition to establish a single mass-media and propagandistic complex that would comprise some public and private mass media, advertising agencies and professional associations that collaborated with state agencies, inclusive of intelligence service. The objective of this complex was the apology of the government policy, the dissemination of the ideological concepts of the ruling parties, the discreditation of opposition politicians and the activists of civil associations.
12) The factual erosion of the country's social cohesion toward the close of the HZDS-ZRS-SNS rule was manifested, among others, by the discontinuation of the nationwide social dialogue among the government, trade unions, and employers; the government pressure upon the establishment of an alternative tripartite model; the inception of "parallel" (pro-governmental, in fact) trade union organizations along with the existing ones that were associated in the TU Confederation; the growing disparity among the employees and employers and the government that culminated into nationwide and regional protest actions (the increase of the number of strikes of the employees of individual companies dissatisfied with the present socio-economic situation, i.e. low wages, failure to meet collective agreements, unfair privatization, etc.).

As has been indicated above, this overview does not contain that which embodied the so-called Slovak Road of the transformation of the society in the government eyes, i.e. the model of economic transformation, as advocated by HZDS. By abolishing voucher privatization and replacing it by the so-called direct sale to selected privatizing entities that had affinity to the

government coalition, and other measures, this model effectively laid down the foundations of the clientelist system. There is not enough evidence at hand that it truly led to the establishment of an economically solid stratum of local (Slovak) owners who would be particularly loyal to the nation, or, the national State. However, there is every reason to believe that these owners were dedicated and loyal to the political parties that ensured their share in the redestribution of the former state-owned assets. A sweeping shaping of the "patron – client" relationships geared towards a long-term petrification of the dominant position of HZDS on the political scene affected both the state administration, particularly at the regional and local levels, as well as the economic sector.

"A more subtle and safer method of the enemies of democracy – wrote the politologist G. O'Donnel – is to curtail it slowly. This method lies in a gradual curtailing of freedoms, guarantees, and processes that are essential for democracy. There is no precise date from which democracy can be declared dead. In the retrospect, a period of a stepwise throttling can be traced down, when the chances of the protagonists of democracy to fight back, each time the loop was tightened, grew weaker, since not one step on its own was deemed important enough to fully mobilize them. The slow death of democracy is treacherous: although violence and reprisals that accompany it may be equally extensive as in the case of sudden death, slowly waning democracy may be masked under the residues of national and international legitimacy which hampers early and appropriate local and international response."[7] In the case of Slovakia, fortunately, it may be stated that although in the years 1995-1997, fear was re-ushered into the society (according to Slovak historians, one of the vital components of Slovak history), "the slow death of democracy" did not happen.

Beyond doubt, there are several reasons why this did not happen. However, one of them dominates the rest. What happened in Slovakia was culture change, our civil society matured.

3) Culture Change: The Civil Society Maturation

The HZDS-ZRS-SNS policy of power execution polarized the society and caused the indignation of the public at large. In 1995-1998, there were smaller or bigger rallies held in Bratislava and other Slovak towns, in protest of the various aspects of the government policy. The majority of these protests that outgrew into more massive demonstrations of resistance were held in a democratic setting.

Laying greater emphasis on the issues of democracy was presumably due to the fact that the topics related to the state sovereignty or national independence that were introduced into public discussions by HZDS and their adherents for several consecutive years, no longer reverberated in the society. The break-up of Czechoslovakia and the establishment of an independent state was taken as a fact of life, no matter what the citizen's original opinion was. In the years 1993-1998, no political party, no movement, no group, no initiative appeared on the scene that would deliberate the reintroduction of a one-time common state. Some welcomed the establishment of the new state, others had to get used to the new reality.[8] However, a few questions had to be answered that concerned the whole nation, namely: What are the benefits of acquired independence? What quality of life can it offer? What new opportunities does it bring? Prior to the elections, the majority of the general public were more interested in the issues of the statehood implementation rather than statehood per se.

Hence, the traditional topic of the debates of Slovak politicians and intellectuals – addressing "the Slovak issue" - was approached in a different light in the mid nineties. Obviously, it was not accidental that a few months prior to the elections, a number of historians, sociologists, men of letters, and essayists had deliberated how the period that followed November 1989 impacted the present form of the "Slovak issue".[9] In other words, only towards the close of the 20th century the Slovak issue turned out to be a truly Slovak issue in the sense that it

stopped to be primarily the Slovak-Hungarian or Slovak-Czech issue.[10] It was no longer perceived as a struggle for national sovereignty and an independent state. Ever since this state was established in 1993, the issue has been more about the nature of the state, its democratic direction.

The summary of Mečiar's rule during the existence of the independent S.R. was so negative that prior to the 1998 elections, a metaphor was spread in the Slovak intellectual circles according to which the State had "to be established anew", i.e. it had to be furnished with a new, democratic content.[11]

However, this was not an intellectuals' fabrication. According to a public opinion poll, the majority of citizens believed that the country went astray. In their opinion, several negative trends aggravated, and other vital living conditions deteriorated, namely, the citizens' security, the overall enforcement of justice in the society, the status of and opportunities for young people, the international position of Slovakia, the condition of democracy; the opportunities of citizens irrespective of their political affiliation, the adherence to consitutionality and laws, the standards of passed laws.[12] Not only intellectuals but also ordinary citizens perceived that a sweeping change was required. Above all, they were ready, more than ever, to do something to achieve the change.

Prior to the 1998 parliamentary elections, Slovakia had witnessed a phenomenon that may be referred to as "culture change". The citizen entered the pre-election period in a go-ahead manner. Tens of non-governmental organizations launched their training projects, culture events, concerts, introduced publications, films, videoclips, discussion fora with the party candidates, organized meetings with citizens, and the like. The OK '98 logo ('98 Civil Campaign associating tens of non-governmental organizations) soon made its name, and it became attractive for the majority of the population, while it was a target of frontal attack for the pro-governmental mass media. OK '98 pursued three goals, namely to: a) improve the level of information about the election process; b) increase the citizens' turnout; c) ensure civil oversight of the equitableness and fairness of the elections. Hundreds of volutneers began to work across the country, and their events were attended by thousands of people, oftentimes, young ones. Preliminary estimates indicate that the voice of civil activists reached hundreds of thousands of potential constituencies. It is generally agreed that as opposed to the previous elections, it was civil organizations that were to be given credit for a high turnout and a higher turnout of the first-time voters. The activity and enhanced vigilance of the civil society accounted for a democratic course of the elections.

The early signs of the intensification of civil mobilization were manifested in 1996-1997. Collective protest actions advocated the social rights of citizens and challenged the curtailing of the local government principle in the society (these were the protest actions of physicians and medical staff against poor remuneration, the protest of theatre professionals and the workers of culture community against the decisions of the Ministry of Culture, the protests of university educators and academic community against the government higher education bill, the protests of the personnel of privatized companies against privatization decisions, and the like).

All these protest actions raised a keen response. Over a half of the respondents took them into account and made their opinion of them. The majority of those who watched these actions, believed they were justified. This fairly wide support of civil protests indicated that a large portion of the citizens disapproved of the effort of the ruling power to concentrate power and extirpate the local government mechanisms in the society.[13]

Among the critical moments of the local political development in the recent past was an attempt to amend the criminal law (an amendment known as the so-called Republic Protection Act), which was opposed by a number of acclaimed politicians, the representatives of churches, trade unions, mass media, culture celebrities, and, last but not least, a number of

civil organizations. The amendment was not passed. However, the greatest success story was that of the mobilization of citizens for a petition in support of the direct presidential elections.
What the collective actions indicated to sociologists who conducted long-term research into political culture, was that the potential of the citizens' political activity was greater than could be expected judging by their largely passive adaptation to the government coalition policy. In the then published texts it was stated that: "The year 1996 ushered in the promise that the poorly developed culture of the political process could be improved. If the process is to continue in the period to come, enhanced by a closer collaboration among the still fragmented opposition, the chances for a democratic development could increase before the 1998 elections take place". Of the numerous empirical findings of our research work there emerged promising trends: under the pressure of an adverse political development, the people in Slovakia began to gradually free themselves from "the loss of civil conscience". They became more receptive to the problems of democracy and showed concern for them.
We assumed that the enhancement of the activist political culture in Slovakia would, most likely, lean on the individuals with a higher culture potential and progressive orientation supportive of economic transformation and a pluralist democracy. Hence, there were preconditions emerging for a more distinct mobilization of the urban population.[14]
This trend were ever-more vital, as after the 1994 elections, the development of the society was dictated by parties largely representing older, less educated and less transformation-oriented groups of the society. Despite the attempts of the government coalition to gain control over the mass media and the various areas of social life, the number of citizens who would identify themselves with the truth officially asserted by the government coalition did not grow. The majority of people, in spite of the failures of Slovak foreign policy, did not conceive hatred for the democratic West and continued to support the efforts of Slovakia to acceed to the Euro-Atlantic structures.
An unfavourable internal political development accompanied by the integration failures of Slovakia mobilized the citizens' more responsible approach to the issues of democracy and the state of law. Public opinion polls conducted longer-term indicated the citizens' higher support of the political opposition than the government coalition. The passing of the amendment of the Election Act in the spring of 1998 mobilized the democratically-oriented groups of citizens in their effort to prevent any manipulation of the elections, and by the weight of their votes, halt any further solidifaction of the authoritarian regime, and bring Slovakia back to the road of democracy and its integration in Europe.
Also, the representatives of civil organizations, the majority of bishops of the Catholic church, union leaders, academic officials, raised their voices in protest of the amendment of the Election Act. Despite that the government coalition carried it in the parliament. Within this context especially pressing was the issue of a fair course of the elections and the encouragement of the citizens to turnout at the elections. The issue was translated into the goals of the pre-election activity of several non-governmental organizations that launched the OK '98 Civil Campaign. The results of our research, of April 1998, indicated that the majority of citizens deemed these activities justified.[15]

4) The International Context of the Change

In the regional context, the elections brought hope for the strenghtening of the stability in the Central European region, hope that a wall would not be erected between Slovakia and the countries of the Vissegrad group (Poland, the Czech Republic, and Hungary), hope for our country to catch the integration train.
In the light of global processes, it should be noted that the development in Slovakia after the 1994 elections was oftentimes interpreted within the context of the growth of "illiberal

democracies" in the world. In such illiberal democracies, as referred to by Fareed Zakaria[16] in his article published in Foreign Affairs (other authors in describing the fragility, superficiality, or unconsolidated nature of new/young democracies refer to "electoral", "delegative", "formal", "procedural" democracies, or even, "semi-democracies") free elections may take place, however, they may usher autocrats to power who do not have enough respect for the rule of law, power sharing, the protection of the fundamental human rights and freedoms. They do not profess the values of liberal constitutionalism; democracy may thrive in them, however, not liberal constitutionalism. Zakaria did not see any big difference between the nature of the regimes in Slovakia and Sierra Leone, Pakistan, or the Philippines – for him, all are illiberal democracies: "Elections are an important virtue of governance, but they are not the only virtue. Despite the limited political choice they offer, countries like Singapore, Malaysia, and Thailand provide a better environment for the life, liberty and happiness of their citizens than do either dictatorships like Iraq and Libya, or illiberal democracies like Slovakia or Ghana."[17]

No doubt, the criticism of the superficiality of "electoral democracies" is justified. The Slovak example also shows that free and fair elections do have a role to play. Advocating the values of liberal constitutionalism was the vital component that coalesced "democratic alliance" that emerged in Slovakia prior to the elections, i.e. an alliance of opposition political parties, civil organizations, trade unions, independent mass media, and part of the church. A working tool of such alliance prior to the elections was the Democratic Round table.[18] It was not only about the professing of the above values, but also their implementation in the past, as could be seen from the actions of the majority of opposition politicians. The sharing and further implementation of these values could establish a basis that could bond the otherwise heterogenous conglomerate of the winning opposition parties in the future.

Hence, Slovak experience indicates that the elections can become a significant tool of the containment of illiberalism, whereby this containment has a greater chance for success provided that some preconditions are met. Among them is, above all, the fact that in Slovakia, alongside the abovementioned twelve trends, present were significant opposite trends in the 1995-1998 period. To be specific, the trend was also to maintain some elements of liberal consitutionalism (for instance, the comparatively independent judiciary, a certain degree of autonomy and local government in social life, academic setting, trade unions, local and regional local governments); the preservation of some power sharing, the functioning of the legitimate entities of power plurality (the institue of president, Constitutional Court); achieving a certain degree of the development of a market economy and the autonomy of the private sector; winning a minimal free space for independent mass media that would continuously monitor and comment on the struggle of the authoritarian and democratic political culture (in addition to the independent press in Slovakia, some private electronic media, such as TV Markiza and Radio Twist, or other mass media free from the government control - Radio Free Europe, for instance, were relatively well established); the non-existence of such vast internal differences (ethnic, for instance) that would distract the society's attention and create the foci of conflicts that would be difficult to manage; the absence of an extreme economic hardship that would thwart the citizens' political participation; the capacity of the opposition political parties to make coalitions and act jointly; some influence of the opposition over the contents of the topics of public discussion; some degree of the development of a civil society, including the existence of the mobilizable sources of citizen participation; the capacity to establish cooperating pro-democratic alliances.

5) The Need for Testimonies on Authoritarian Acts and Trends

Almost a quarter of a century shall have lapsed from the toppling of Salazar's regime in Portugal, in 1974, when a global process was triggered off, referred to by the American politologist, professor of Harvard University, Samuel Huntington, in his book entitled Third Wave: Democratization in the Late Twentieth Century[19] as "the third wave of democratic revolutions", as a transition from authoritarian regimes to more democratic ways of rule. Among the tasks facing about thirty countries in which the changes took place, was to come to terms with the past.

Coping with the country's own past was multifaceted. It entailed the rehabilitation of the rule of law, the punishment of offenders; it was about at least partial mitigation of the consequences of the one-time lawlessness, the rehabilitation of the concept of justice, the trust in the purpose of fair conduct, ethics, since the society disposed of mechanisms that would favor justice over injustice in the long run.

Also, it was about accepting the country's past, accepting the truth that "this was (also) us". "Us" being the entire, global society, the citizens making up the State or a nation; "us" being the members of various communities, the followers of different creeds and beliefs, the protagonists of different social roles; "us" being the members of smaller or branched natural social formations (families that sought their own "strategies" in establishing their statuses and living face to face with the practice of authoritarian regimes); and, last but not least, "us" being individuals, autonomous human beings, carrying an inalienable responsibility for their conduct. It was about accepting the truth that was dual by its nature: an account of the acts of defiance, disagreement, and, to a greater extent, undoubtedly, about accepting the facts of materialized concessions, false moves, and compromises. Also, it was about the political and legal, constitutional enshrining of guarantees against the recurrence of similar events in the future. And, last but not least, this coming to terms with the past, was also about the widest possible accessibility of the information to the public about what happened in the past or the more recent period; it was about making the documents, archives, testimonies, facts, statistics, and analyses widely accessible.

Oftentimes, coping with the past was particularly complex, and life showed that it was beyond the power of the newly-emerging democratic forces. Simple formulas were non-existent, and it was apparent that even those solutions that appeared the best at first sight could have adverse impacts and painful consequences. As a rule, there were efforts made to draw a "thick line" behind the past, and, as a rule, it was obvious that it could not be done quite so, and that the past which was not overcome and managed, would be back, disguised in period costumes. Simply, it was a must to learn to live with the past.

Also, if these general statements are to be transposed to Slovakia, it may be said that coping with the past of authoritarian regimes is, despite the fairly advanced historical science, an ongoing process: a more comprehensive picture of the past is still non-existent.

Therefore, testimonies, be incomplete or partial, are ever-more important. Also, the purpose of the presented publication should be viewed in this light, as by its ways and means it maps out the past, which is still strikingly fresh and alive.

6) White Papers

In recent years, various editions of "white papers" have been debated the more often, the fewer comprehensive publications of this kind have been effectively published in our country.

The idea of the White Paper was introduced into politics six years ago, which was a time when the then Prime Minister Vladimír Mečiar contemplated to familiarize the public with a list of alleged "sins" of the earlier Ján Čarnogurský's government. However, Mečiar's Cabinet never published it.[20]

After the elections, the idea to compile the White Paper evidencing the legacy of the previous rule was taken up by the new government. Some sectors, for instance, culture, have already introduced the public to their respective documents. "I'd be most unhappy", writes the publicist Marián Leško, "if new ministers don't keep their word./.../ Today, an account detailing how the constitution, law and good manners were broken in individual sectors or institutions, is no longer needed for political reasons. The majority of constituencies are clear on how the country was ruled over the past four years, therefore, they've given the new coalition everything they could, i.e. constitutional majority./.../ If there's anyone who really needs the White Paper, then it is the public at large, for the sake of the citizen's self-respect. Hence, it is vital the blank space pampered for many years are removed by making the contents of the White Paper public."[21]
Thanks to the branched family of think-tanks, small, independent analytical workplaces, the involved part of the Slovak public does not have to wait for the government to address all the issues. This publication is a proof of that, as it is an outcome of the joint efforts of a team of authors of the M.E.S.A. 10 prestigious economic think-tank.

7) The Challenges to the New Government

Election results showed that the majority of citizens welcomed the reshufflement of power. According to the research of the Institute for Public Affairs conducted in October and November 1998, the majority of citizens (62 per cent) expected that the condition of democracy in Slovakia would improve. 57 per cent of citizens found the new parliament trustworthy, while 28 per cent of citizens not; 48 per cent of citizens believed in its stability as opposed to 33 per cent who did not. 52 per cent of citizens expected that after the 1998 elections, the chances of Slovakia to acceed the E.U. would grow.
Although several observers believe that the new SDK-SDĽ-SMK-SOP government is the most professional, competent, and dynamic Cabinet ever since the establishment of the independent Slovak State, no one questions its extremely difficult position. Three quarters of Slovak citizens think that the Slovak economy, after four years of V. Mečiar's government, is in a bad shape.
Today, one can contemplate the challenges the new rule will have to face in the country stigmatized by economic, political, and moral deterioration. Among these challenges are: coping with the negative economic legacy of Mečiar's administration; the rehabilitation of the state of law; the O.E.C.D. membership; listing Slovakia in the first group of countries partaking in the process of the E.U. enlargement, NATO full membership; effective communication with the general public and mass media, the ability to convince the people of the need and meaningfulness of their sacrifice; the coexistence with the potentially anti-system, anti-democratic opposition; overcoming the egotism of the respective parties, finding mechanisms that would solve internal conflicts so that the government stability is ensured.
In simple terms, present-day Slovakia is faced with three basic areas of problems. The first group comprises civilization-related issues and challenges that affect a number of western countries, such as, population ageing and with that associated need for a change of pension schemes and the society's overall approach to old people. The second group of issues is more or less common to all the post-communist countries, and it has to do with the ongoing reforms of the society and respective economies, the changes in people's awareness and actions. The third group of problems is largely associated with the specific Slovak situation and Slovak experience with Mečiarism that has been negatively imprinted in the country's political culture. If post-communism is to be understood as a toll for forty years of "real socialism", then post- Mečiarism is an additional cost the country will have to pay especially for the past four years of "real Mečiarism".[22] In addition, there are other issues that overlap into the above

three groups, starting with corruption, through poverty and the environment, down to the national minority isses, the Romany group in the case of Slovakia.
There are no simple formulas that culd be used to address such an alarming state of the society. Presently, it is difficult to estimate for how much longer the citizens‘ patience will last, whether their trust will not be wasted. Only the expected negative impacts upon the standard of living of the many will show, whether democratic values are deeply inveterated in the majority of the general public.[23]
The partnership contract à la Mečiar in the form of "goulash nationalism" won the people's support of the idea that if economic prosperity were to be achieved, all it required was to have the Slovaks reign themselves in an independent state, whereby both these goals could be best ensured by the ruling movement and its loyal allies. By its policy, the government coalition made it clear that it believed in achieving good economic functioning without having to adhere to the principles of democracy and the state of law. It was a peculiar hybrid combination of the South American model and the model that continued the legacy of socialist modernization based on the efforts to improve social rights without observing political rights. Towards the close of the election term it was obvious that such a model was not workable – the country's economy was in a bad shape. Parallel with that emerged the question what could substitute the old partnership contract that continued the canon of Kádár's "goulash socialism".
It took the opposition a while before it got a stake in the "state co-ownerhsip" in its duel with Mečiarism. Instead of offering exclusive nationalism to the public, it ushered the principle of inclusive political participation based on the incorporation of national minorities in the framework of a political nation. After the elections, it compelled the electorate that economic prosperity could not be achieved without democracy and the observance of laws. By constituting a new government after the elections, the until then opposition made it clear that it was determined to work on its ideas. Presently, the chances for constitutional patriotism in Slovakia are greater than ever.
However, its materialization is jeopardized by a paradox – along with democracy-building the country will experience an economic decline. The publication you are holding in your hands is vital not only because it provides a comprehensive, professionally consistent, and a civilwise bitter account of the past period. It is also of substance because, in addition to a diagnosis that is not particularly encouraging, it contemplates possible therapy. Even a layman apprehends that such a curative procedure will hurt. However, the composite authors of this publication make it clear that should therapy be neglected, the outcome could be even worse.

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Despite its critical tone, the presented book is worthwile buying for a Christmas present. It explains why next Christmas or the one after it, there will be fewer presents than usual. It will take away our illusions and fairy-tales about the "Slovak Road". It shows that actually it was a private freeway for the chosen people. It will unveil the face of nouveaux riches that owe their assets to political loyalty rather than hard work. It will not spare us of the examples of an imprudent economy management. It gives an account of the consequences of circumventing, neglecting, or breaking *The Ten Commandments,* which, pitifully, was a frequent case in the past. In addition to the testimony about defeats and failures, it also brings *good news.* It also communicates that it is worthwile for both the citizens and the society as a whole to behave fairly.

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GOVERNMENT DECLARATION
(MISSION STATEMENT)

Comprehensive Analysis of the Economic Part of the Government Declaration of V. Mečiar´s Government

M.E.S.A. 10

V. Mečiar's government declaration, of January 1995, contained parts that indicated some risks, notably in the area of a non-standard intervention of the government in economic processes (for instance, in active industrial and structural policies), and favoritisim of the local business community. In principle, however, it can be said that the government declaration, notably its economic part, largely contained meaningful and much-needed plans and objectives.

However, when evaluating the implementation of the above government declaration, one is bound to come to a conclusion that the government economic policy failed, and in the light of the objectives outlined in the government declaration, not only the majority of them have never been materialized, but oftentimes, the development was just the contrary to the goals stated in the program declaration.

In the introductory part of the program declaration the government stated its effort *"to continue the process of establishing a social and market-oriented space that shall be compatible with the industrially advanced democracies in the world".*

"The government's strategic goal is to lay the foundations for achieving the standards of economic performance and the standard of living comparable to that of the advanced European countries by the turn of the millenia, however, no later than the year 2010. This shall facilitate a full integration in the European structures." ..."A stepwise integration of the S.R. in European structures assumes the solidification of the fundamental values of the European Union in economic and political systems, notably, peace, unity, freedom, equality, solidarity, economic, and social security".

However, after four years of the HZDS-ZRS-SNS government, political and economic incompatibility and disregard for the fundamental E.U. values remain a fact of life due to which the S.R. was excluded from the first group of the E.U. membership candidates, and due to which Slovakia became increasingly isolated, the interest of foreign investors to conduct business in Slovakia waned, which ultimately led to the aggravation of economic and social problems.

Instead of an economic performance and the population's standard of living comparable to that of the advanced West-European countries, the ever-increasing lagging behind these advanced and neighboring Central-European countries is the reality of our days. In the late 1997, it took 6.1 times longer to produce 1 l of milk as compared to Austria, 1.7 times longer than in the Czech Lands, 1.4 times longer than in Poland, and 1.6 times longer than in Hungary. The situation was similar in terms of the wage purchasing power related to other vital commodity groups (e.g., the production of 1 kg of bread contoured the time sequence of bread, i.e. 6 times, 1.4 times, 2.6 times, and 1.5 times).

The Macroeconomic Goals of the Government Declaration

"...to maintain and gradually dynamize economic performance so that the mean year-on-year GDP growth rate in fixed prices nears 5 per cent".

This objective, judging by the reported economic growth, was met. However, questionable was the fashion in which this was achieved and whether such a growth could be sustained, as well as the credibility of the growth reported in this manner.
With regard to the manner in which growth was achieved, of relevance is the fact that as of 1996, the country's economic growth was attained at the cost of the ever-increasing growth of external (foreign) and internal indebtedness and expanding the state deficit funding.
This fact is closely related to the issue of the sustainability of growth attained in this fashion. The ever-growing indebtedness along with the non-existence of a realistic economy restructuring (and with the competitiveness declining in real terms) has resulted in such a growth of macroeconomic pressures and imbalance which may cause the until recently reported economic growth to fail, or trigger off a new transformation recession.
"...to gradually reduce the unemployment rate below 10 per cent".
In December 1994, the unemployment rate was reported to be 14.8 per cent, by late June 1998, using a comparable methodology, it was 14.4 per cent, although the Statistics Office, by changing the methodology, reported an unemployment rate about 1 per cent lower.
"...maintain the inflation rate below 10 per cent and to gradually establish conditions for its stepwise reduction".
As regards inflation, its cap was met with some margin, however, the credit was largely to be given to the National Bank of Slovakia rather than the government, as the former achieved these goals despite the government's expansive fiscal policy. Another problem was sustaining such a low inflation, since is was achieved by monetary restriction and the postponement of the deregulation of the until then regulated prices. Production costs and costs of goods and services sold in which prices were regulated, increased, while prices per se did not, which, after their late (yet, inevitable) deregulation will result in a further price increase. The fact that low inflation was not sustainable was clear from the recent stage of the inflation development, whereby its year-on-year rate increased from 5.7 percent to 7.4 per cent between September 1997 and June 1998.
"...to maintain a positive development of the balance of payments..."
After a moderate surplus in 1995, the current account deficit was reported to be 11 per cent of the GDP in 1996, and in 1997, 6.9 per cent of the GDP, while this drop was largely due to reducing import via administrative measures (surcharge on import, the effacement of small importers due to a rather confusing introduction of import certificates). Administrative measures do not solve the problem, they merely postpone it, which is best evidenced by the fact that in the first quarter of 1998, trade deficit was by 8.5 per cent higher than in a comparable period of 1997.
"..using the IMF methodology, maintain the share of the state budget deficit in the GDP below 3 per cent, with the trend downward sloping".
The reality of 1995 was fiscal surplus amounting to 1.4 per cent of the GDP, in 1996, the deficit was 1.3 per cent of the GDP, in 1997, 1.4 % of the GDP, and in 1998, (projected) fiscal deficit of 3 per cent of the GDP. The trend is obvious, however, it is upward rather than downward sloping.
"...maintain the overall state indebtedness within a range comparable to the E.U. criteria, and gradually reduce it".
The outcome of the government policy was enormous and unsustainable indebtedness, both internal and external. In late 1997, external (foreign) indebtedness of the S.R. exceeded USD10 million USD and exceed USD 2,000 per capita. Also, the internal indebtedness of the public sector increased in all its areas (the indebtedness of the State, local governments, state funds, the National Property Fund, insurance funds).

Other Important Goals and Objectives

"The government shall base its budgetary policy on the principle of the non-increase of tax burden. This shall be reduced, step-by-step." ..."In the shortest time possible, the government shall adopt measures to remove unhealthy phenomena, such as insolvency and a poor payment discipline."..."To mobilize budgetary sources, the government shall lay emphasis on a more stringent system of paymentd to the state budget. It shall perfect the legislation, enhance professional competence, and improve audit standards." In several other places of the program declaratio,n the government made statements to limit tax avoidance.
However, reality was quite different. Tax burden continued to grow, both directly and indirectly. In 1997 alone, some commodities and services having a significant share in the consumption basket, were shifted from the 6 per cent to 23 per cent V.A.T. category.
Indirectly, tax encumbrance aggravated since tax brackets were not adjusted, meaning that even the growth of nominal income (due to inflation) caused a shift into higher tax brackets.
Instead of limiting insolvency and delinquency, the society witnessed a speedy expansion of these phenomena due to lenience in enforcing contractual obligations, favoritism, the postponement of bankruptcies, and also due to the growing interest rates (larely an outcome of the fiscal expansion of the government).
Recently, the government escalated the deterioration of payment discipline and the growth of insolvency by an absurd and confusing rehabilitation act.
In practical terms, making the payment discipline towards the State more stringent meant that in 1997, only 57.7 per cent of the corporate income tax were collected as opposed to the projected percentage. Tax avoidance and deteriorating insolvency are best evidenced by the fact that in 1997, the profit generated was by 6 per cent lower than that of 1996, however, the corporate income tax (referred to as profit tax) collected in 1997 was by 30 per cent lower than in 1996.
"The government shall insist on the consolidation of the insurance system management and guarantee assistance in the event of temporary insolvency".
Instead of consolidation, the management of insurance systems was uprooted and their surplus position reported in 1995 was replaced by losses and insolvency. The latter was largely due to a poor discipline in terms of the payments to the State and the deterioration of the payment discipline due to the post-privatization looting of companies (caused, above all, by the fashion in which privatization was conducted) and the pre-rehabilitation expectations of the payment obligations discharge (induced by the rehabilitation government project).
"The rationalization of the state budget expenditure shall lean on a more effective use of the budgetary funds, namely, in state administration, on a stepwise strenghtening of the responsibility of towns and communities for their development and increasing their own income and the elimination of the re-distribution processes between the state budget and the budgets of towns and communities..." "As part of the project of a new territorial and administrative structuring of Slovakia and in view of stimulating the economic interest of communities in establishing conditions for enterprise, the government shall usher in a law stipulating the share of towns and communities in tax income."
Instead of a more meaningful use of the funds in the budgetary area, the then government coalition embarked on an absurd reorganization of state administration and the costs associated with it amounted to tens of billions of crowns and the regional state administration was vested with powers that ought to have been assumed by local or regional local government. The income basis of towns and communities was not solidified and neither was a law in force that would stipulate the share of towns and communities in taxes.
The government also wanted to ground its attempt to rationalize the state budget expenditure in *"achieving more favourable conditions of the state debt interest payment".* However, due to a hot-headed fiscal expansion and megalomaniac state investments with dubious

effectiveness and return, interest rates sky-rocketed in 1997, for both the business entities as well as the state debt coverage.
"The government, in cooperation with the employer associations, shall establish favorable conditions for the development of enterprise based on local and foreign capital via a comprehensive system of financial and economic tools."
Presently, "favorable conditions for enterprise" are translated into the growing tax burden, confusing legislation, high interest rates, poor and deteriorating payment discipline, criminal practices proliferation (extortion, pay-offs), favouritizing groups which have affinity with the government coalition, and growing corruption.
"The government shall foster further development of the capital market, so that it becomes transparent and the standard of its services complies with that of the E.U. countries and that it boosts the recovery of the Slovak economy and stabilizes the pro-investment oriented economic environment in Slovakia for both the local and foreign investors"....
"By stabilizing the economic and political environment in the S.R., the government shall establish conditions for increasing the interest of foreign investors in the Slovak capital market and for a dramatic increase of the interest of local investors in the benefits of this form of enterprise".
In reality, the capital market is deemed the poorest functioning market in the Central European countries. It suffers from poor transparency and low liquidity. The major causes of this state are to be sought in the attacks of the government against the capital market entities (investment companies, mutual funds), inadequate protection of the rights of minority shareholders, a high number of traded junk securities, etc. Due to the above reasons, along with the manner in which assets were privatized in Slovakia, its poor image and the government assaults of mutual funds, the Slovak capital market is shunned by foreign investors.
Furthermore, the government pledged to focus *"on the organizational uniting of the organizers of public markets, and the dematerialization of securities..."*
Effectively it meant that the government embarked on an administrative effacement of one of the three organizers of the security market (Bratislava Options Exchange), and instead of the securities dematerialization, the government coalition introduced the institute of certificated securities to bearer without a central registration of shareholders. The government coalition resorted to this blatant denial of an objective spelled out in the government declaration in order to hide the true owners of privatized assets who purchased them for symbolic prices thanks to a non-transparent and uncontrollable privatization.
"The government shall foster further development of the banking infrastructure. Special attention shall be given to achieving the capital adequacy in leading banks. In coordination with the banking supervision, it shall further the restructuring of the loan portfolios of banks".
The outcome of the government policy was further deterioration of the situation of banks with the majority stake of the State (i.e. the National Property Fund of the S.R.). An example of this was the collapse of the Investment and Development Bank (IRB) that was due to the inconsistency and incompetence of the government, the National Property Fund of the S.R., (NPF) the banking supervision of the National Bank of Slovakia (NBS), and bank owners bonded with the government coalition.
As regards privatization, the following was written in the government declaration: *"the government shall guide this process to create a competitive environment, eliminate the monopoly position of companies and have the process result in the restructuring, recovery, and an all-round development of privatized companies".*
"The government shall enforce the participation of employees in the privatization of companies in which they are employed". ..."The government shall foster serviceable

involvement of foreign capital in the Slovak economy". "The government shall ensure that the second voucher privatization wave progresses without unneccesary procrastination".
In practical terms, privatization was just the opposite of what the government had promised. The competitive environment was distorted, restructuring was postponed, and instead of the recovery and comprehensive development of companies they were stripped off their assets after their privatization was over. The share of employees in privatizing was almost nil (despite their interest declared in almost each privatized company). Foreign parties were excluded from privatization (in 1995, foreign entities participated in six privatization cases, since then, no case of privatization by a foreign company has been reported). Half a year after the government declaration had been made, voucher privatization was invalidated and replaced by an indemnification in the form of government bonds.
In its declaration, the government committed itself to *"improve the solvency of the National Property Fund of the S.R."* It also made a commitment that within the National Property Fund, it would enforce *"a more consistent recovery of receivables, improvement of the payment discipline of the NPF debtors, and a more consistent audit of the shareholding companies in which the NPF has its stake. The government shall guide the privatization process so as to have it contribute to a better NPF liquidity and the generation of funds for promoting the developmental programs of the Slovak economy".*
In reality, the National Property Fund of the Slovak Republic is insolvent and does not dispose of sufficient funds to honor government bonds to citizens over 70 years of age, therefore, it had to borrow money for that purpose. No reserve has been created in the Fund to honor the bonds due after December 31, 2000, whereby the amount of necessary funds is estimated to be between SKK 30 and 35 billion. In its documentation the Fund envisaged that in the years 1996-1998, a reserve of SKK 25 billion would be created. However, not a crown of reserves has been set aside despite the fact that between 1995 and 1997, the NPF of the S.R., by implementing standard forms – mostly direct sales - sold assets in an account value of SKK 104 billion. These assets were sold dubiously for symbolic prices to people affiliated with the then government coalition, and even these symbolic prices were oftentimes not paid. Needless to say, in 1996, purchase prices including investments accounted only for 28 per cent of book prices, and in 1997, mere 18 per cent of book value.
"The government shall usher in a legal provision to comprehensively address the privatization process and make the relations with the National Property Fund more transparent."
In reality, selective amendments of the Privatization Act vested the National Property Fund of the S.R. with the power to decide on direct sales, which was declared unconstitutional by the Constitutional Court of the S.R. in 1996. Consciously and intentionally, the Fund was turned into a tool that served the government coalition to loot the national assets to its own benefit as well as allied entrepreneurial groups.
"The government realizes that only a functioning competition can ensure economic efficiency, rational fund allocation, which is ultimately to the benefit of citizens-consumers. In the process of the establishment of a competitive environment, it shall enforce an offensive approach associated with the implementation of system measures at the macroeconomic and microeconomic levels. Their objective shall be the implementation of the principles of fair competition, the elimination of obstacles that hamper its implementation, and the shaping of competitive market structures in the economy. In order to expand competitive conditions and make the licencing procedure transparent, the government shall enforce an auction system of licencing."
It is the area of competition in which all the distortions of the economic policy of the third Mečiar's government were manifested in a concentrated form. Favoritism, subjectivism, clientelism, a non-transparent percolation of political and economic power, omnipresent

corruption are the phenomena inhibiting genuine competition. Laws and their amendments were passed clearly and unambiguously favoring affinity groups (the amendment of the income tax act favoring privatizing entities, the Recovery Act, the Act on the Fund for the Promotion of Foreign Trade, import surcharge exemptions, duty discharge in the event of the import of advanced technologies, massive breaking and circumventing the public procurement act...). Subsidies, export quotas, licences were granted in a non-transparent and biassed manner, whereby the commitment to enforce the auction type of licencing remained only on the pages of the program declaration.

Industry, Trade, Tourism, and International Economic Relations

"Economic and industrial policies shall establish conditions for the recovery process, restructuring, and enhancing the competitiveness of industry".
The economic policy of the HZDS-SNS-ZRS government had an effect contrary to the above statement of the program declaration. Due to the deleteriously erroneous (and not only) economic policy, the economy's rehabilitation and restructuring lags behind, notably in the industrial sector, which is manifested in its declining competitiveness. The best evidence of this was an over 11 per cent share of the deficit of the current account balance of payments in the 1996 GDP. True, in 1997, this share was reduced to 6.9 per cent, however, only thanks to the adoption of administrative measures (surcharge on import, the introduction of import certificates) which postponed the problem solution to a later date, only to manifest itself with a greater intensity. This is clearly evidenced by the development of the balance of trade and current account in the first five months of 1998, and, again, the current account deficit exceeds the 10 per cent share in the GDP.
The effort of the government to resolve the above problem by passing the Recovery Act was a complete failure, and this coinage of a piece of law has not only proven ineffective but literally detrimental, as it has resulted in the aggravation of the anyway poor payment discipline and insolvency growth.
In industrial policy, the government set six strategic goals (increase of export and production competitiveness, reduction of energy and raw materials consumption, etc.), however, none of them was met.
Among the strategic goals stated by the government was, for instance, *"an increase in end production and its value added, and, hence, the appreciation of national labor".*
The actual figures are best evidenced by the government's own materials. In August 1997, the government of the S.R. evaluated the document Updating the Industrial Policy of the S.R. in the Years 1998-2005. It states the following: "We have not managed to implement the formulated goal that in the years 1995-1996, export, particularly of high-tech having a 30 to 40 per cent share in the overall export, shall increase, due to the fact that these sophisticated systems are especially demanding in terms of funding. The actual figure is only 15 per cent" (Updating the Industrial Policy of the S.R. in the Years 1998-2005, Bratislava). It should be noted that the above 15 per cent share of the export of sophisticated goods was also reported in 1993-1994, i.e. prior to the adoption of the ambitious goals set down in the government declaration.
"The government shall enforce a higher efficiency in the enforcment of ownership rights and obligations of the State in state-owned companies and shareholding companies with a significant stake of the National Property Fund".
In September 1997, the government of the S.R. evaluated the financial figures of state-owned companies falling under the ministries of economy, transportation, postal services and telecommunications, agriculture, and building industry. The report stated shrinking profit

before tax, increased losses in state enterprises, and the deterioration of wage profitability and increased wage costs. In all the reviewed sectors, profit before tax dropped by 7.6 per cent overall, while wage costs increased by 8.5 per cent. (Trend, October 1, 1997)
Increasing the effectiveness of the enforcement of the NPF ownership rights is a separate story. The examples of the IRB bank, Slovnaft refinery, and other companies clearly indicated that rather than advocating the interests of the NPF S.R. and the State, the representatives of the National Property Fund of the S.R. who were on the bodies of these companies advocated the interests of the private sharedholders of companies in which the NPF S.R. had a significant stake.
Also, the government stated that is would establish *"an agency for the promotion and marketing of Slovakia, with an objective to offer Slovakia as an attractive tourist region".*
The fact whether such an agency was established, remains unknown. True, in existence was the Slovak Information Agency, more known to the general public for the misuse of public funds, among others, for the benefit of the companies owned by the relatives of the ex-deputy prime minister, and less by the activites geared towards the promotion and marketing of Slovakia. The government's failure to *"offer Slovakia as an attractive tourist region"* is obvious from the fact that in 1997, the number of foreign visitors to Slovakia dropped by 4.1 per cent as opposed to 1996, whereby this decline continued in the first quarer of 1998, when it dropped by 6 per cent compared with the corresponding period of 1997.

Small and Medium-sized Enterprise

"The government measures shall be geared towards the setting up of appropriate conditions for enterprise, the furtherance of institutions delivering services to entrepreneurs, and the improvement of the availability of capital to small and medium-sized entrepreneurs."
When reading the above lines, the health condition of many tradesmen, small or medium-sized businessmae facing Slovak reality, may rapidly deteriorate. This reality is characterized by such conditions of enterprise that lead to the companies' winding-up, the ever-changing and confusing legislation, high and rising taxes and fee burden, growing bureacratization of enterprise, discriminatory certificate procedures introduced in the fall of 1997, growing insolvency, criminalization of enterprise, and the failure of the State to protect entrepreneurs against pay-off collectors and other criminal groups, etc. Particularly provocative is the program declaration statement about *"improving the availability of capital to small and medium-sized entrepreneurs"* while interest rates have been sky-rocketing for over a year and exceeding the inflation rate three to four times.
The government shall *"expedite the final drafting of the Act on the State support to small and medium-sized enterprises that is to serve as a legislative framework formulating the tasks of the State in this area".*
The government shall *"establish a separate financial institution to specifically further the development of small and medium-sized enterprise".*
Nothing of the above has been implemented, the plans have remained on paper only. In conclusion it may be said that even a knowledgeable analysist and observer of the Slovak economic life will be surprised by the number and nature of controversies found between the goals stated in the program declaration and real life. What comes into mind is the analogy with the communist time, which was notorious for the discrepancy between words and deeds, between public statements and the reality. Comparing the program declaration of Mečiar's third government in 1995 with the reality of the past four years corroborates the words of professor Lendvai who, during his lecture in Bratislava in 1996, said the following: "The present situation does not allow for the re-ushering of communism anywhere, since those, who maintained the previous regime, now want to make money and dispose of power in the

first place. It‘s a peculiar mixture of bureaucracy and cleptocracy. Whenever I’m asked in Germany or Austria, whether communism will ever be back, my answer is that it’s never left, because everybody has stayed where they’ve always been. Some may have changed masks or even conviction, but, as Lec puts it, actors leave the stage only in the theatre. In my opinion, the real threat isn’t communism, but the fact that in some countries by waiting and wasting time, opportunities, creative, and intellectural potential are wasted”.

This disheartening list can be continued (the program declaration is a comparatively extensive document), however, we are limited for space.

The above facts also testify to the failure of the government policy in terms of meeting the goals that Mečiar’s government set for itself. However, even this does not prevent V. Mečiar and his associates from claiming the opposite. After all, a new government has been ushered in, who cares for an old program declaration.

ACHIEVEMENTS
OR
ECONOMIC MIRACLE?

Economic environment

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The transparency of the economic environment is a key factor of the economic and social development. In creating favorable economic environment the key objective of the State is to provide maximum support to healthy competition and to ensure equal opportunities for every market participant.

The 1995 Meciar's Government Declaration clearly demonstrates their effort to create a transparent environment: *" The government realizes that only a functioning competition may ensure economic effectiveness, efficient allocation of resources, and at the end of the day contribute to increased benefits for the citizens – consumers. In the process of creating a competitive environment it shall take an offensive approach linked to the implementation of system measures on both macro- economic and micro-economic levels. Their objective shall be to apply principles of economic competition, to eliminate barriers of its impacts, and to establish competitive market structure in the economy.'*

Four years later it is absolutely obvious that the objectives proclaimed in the Government Declaration failed to be achieved. The outgoing government caused the worst damage in their effort to create a functioning economic competition.

By not enforcing the law sufficiently and by being indulgent to selected business in various ways the competitive environment in Slovakia has been fully distorted. The new age businessmen and HZDS (Movement for Democratic Slovakia) supporters were in large extent making use of their influence and contacts with government circles in order to obtain a temporary competitive advantage of some form, while this competitive advantage was discriminatory to the other market players. The government team was selective in granting exempts from certain types of tax and duties, import surcharges or fines. In the public procurement process tenders were 'won' by a predetermined bidding company whose bid was quite often much less beneficial than the other bids. In such a way companies close to HZDS, SNS and ZRS political parties (Movement for Democratic Slovakia, Slovak National Party, Association of Workers of Slovakia) were granted lucrative orders for inadequate high price. This phenomenon was spreading quickly over the country, starting at the top political offices and going down to the lowest levels of state administration. It is therefore not surprising to find some chairpersons and members of HZDS district committees as the local biggest owners of privatized companies and businessmen.

The most negative aspect of the perverted perception of a successful businessman (in the recent years a person who 'tunneled'- asset drained or looted (*transferred good assets to their own companies leaving only bad assets in the privatized companies – translator's comment*) most assets is perceived to be the most successful businessman) is the question whether the management of these purpose-built companies not directly exposed to a harsh competitive environment will be able to face the new conditions. VSZ, Eastern Slovakian steel mills, can serve as a typical example of this agony where every problem of this company has been tackled via more than standard relations with Vladimir Meciar's government more than tolerant to their megalomaniac and highly ineffective policies.

Deliberate non-compliance and ignorance of laws by the government trio and indications of highly non-transparent links of the executive power, SIS (Slovak Intelligence Agency) and the underworld contributed to the formation of favorable conditions for the activities of organized

crime groups, especially from the East. An absolute impotence (or unwillingness) of the Ministry of Interior in combating the Mafia octopus evoked a wave of fear of lives and loss of interest in business among the entrepreneurs. So called 'vypalne', contributions levied for "protection" under threat of burning down, has become a nightmare for many businessmen.
All of these negative phenomena have fully been reflected in the behavior of businesses who started to prefer short-term returns to long-term profitability. In the overall economy it has lead to the lack of interest in long-term capital investment projects and preference of business activities with short-term pay back period.
Indulgence of the state to the delivery of payments due from business, indulgence of FNM SR (Slovak Republic National Property Fund) towards its debtors, or indulgence of banks towards selected companies grew into an enormous lack of payment discipline resulting in the abnormal internal and external indebtedness of businesses. To large extent this unflattering situation was contributed to by control and audit bodies not performing their roles properly.
Another reason for the increased debt rate is the monopoly of banks as creditors providing temporarily free funds. Capital market as an alternative source of funding has completely failed to perform its primary function. Lacking transparency and liquidity, it was unable to ensure funding for capital investment projects of companies via bond and paper issuance making it possible for the banks to profit from astronomic levels of interest rates on loans. This failure was caused by a non transparent asset transfers from government to private companies resulting in not appealing and not liquid papers appearing in the market. Only minority shares were traded at the stock exchange and so the market was losing substantially on its liquidity. (In October 1998 the SAX index level was lower than its opening level – it went down below the level of 100).
Money laundering in tax paradises outside the Slovak Republic was the sore point especially the income side of the government budget paid for. The fact that in 1997 the total of income tax paid to the government budget by individuals (physical persons) was higher than the total of income tax paid by corporations (legal entities) was a direct consequence of this reality.
Macro-economic indicators have become a fetish of Vladimir Meciar's government. It must be noticed that values of some of them are really impressive. GDP growth at 5 per cent a year, 6 per cent – 7 per cent inflation rate. Despite of these positive trends in the recent period it failed to attract foreign investors in sufficient numbers. To a substantial extent his fact was caused by negative attitudes and signals sent by Slovak government abroad, as well as the political and business environment in Slovakia. Because a foreign investor is mostly interested in a stable environment for their business operations. And the outgoing government was unable to ensure that.
By its policies Vladimir Meciar's government was unable to make use of bankruptcies as an instrument for reviving and restructuring the economy. Just the opposite, by its policy of selective subsidies and so called revitalization it wanted to keep afloat loss producing companies thus preventing itself from the possibility of suitable allocation of capital and human resources. This fact become fully visible in September and October of 1998 when a large number of companies started to fire their workforce and close the gates of their production facilities. One of the alternative solutions to this problem is to initiate bankruptcy and sell the companies to strong foreign entities.
Strategic companies and companies in a monopoly position had a special position in the policy of Meciar's government. While in 1996 the companies of Slovenske elektrarne (Slovak Electricity Works) (Pre tax profit of 4.9 billion SK), Nafta Gbely (pre-tax profit of 0.9 billion SK), or VSZ Holding (Pre-tax profit of 2.2 billion SK) could be considered the flag ships of the Slovak economy, this year 'SE' and 'VSZ' will probably make a loss and 'Nafta' will generate only a minimum profit. There is a pertinent question of where the profits of these

giants disappeared. All we can do in this case is to state again in a sad voice that the so called 'Slovak way' of privatization and management was applied in these companies.
Competition has a positive influence on business relations, on a suitable allocation of resources, but mainly it restricts the possibilities for businesses to abuse market forces. Therefore the new government will have to take radical measures to make the competitive environment healthy. The key elements shall be as follows:

1. To set on the road of law enforcement and compliance
2. To be effective in ensuring competition protection
3. To watch financial discipline
4. To ensure the creditors' rights
5. To start off transparent bankruptcy proceedings for loss making and failing companies.
6. To eliminate favoritism and corruption
7. To minimize the influence of the underworld on the business activities
8. To eliminate the influence of industrial lobby on the economic policy of the government.
9. To support market mechanisms and gradually reduce the government share in the economy.
10. To develop capital market as an alternative funding.
11. To pursue protection of minority shareholders
12. To attract foreign investors.
13. To consolidate strategic companies.

Economic freedom

An interesting approach to the level of liberality of the economic environment is provided by the assessment of the so called economic freedom of individual countries. There are several renowned institutions dealing with assessment of this indicator using various indices. Because of the best availability of data we selected a list of countries arranged by the economic freedom index published every year by the Heritage Foundation in co-operation with The Wall Street Journal.
The index values are from 1 to 5, while 1 means the highest possible level of freedom and 5 means the lowest level of freedom. The resulting value allocated to a given country is arrived at as a mean, an average of ten scores measuring the level of achieved economic freedom in ten areas of economy.

Table 1
Level of economic freedom of selected countries

Comp. in 98		1995	1996	1997	1998
1	Hongkong	1.25	1.25	1.25	1.25
2	Singapur	1.25	1.3	1.3	1.3
17	Estonia	2.25	2.35	2.35	2.15
20	Čzech Rep.	2.1	2	2.05	2.2
66	Hungary	2.8	2.9	2.9	2.9
69	Poland	3.25	3.05	3.15	2.95
77	**Slovak Rep**	**2.75**	**2.95**	**3.05**	**3.05**
80	Slovenia	–	3.35	3.1	3.1
94	Romania	3.55	3.7	3.4	3.3
104	Russia	3.5	3.5	3.65	3.45
125	Ukraine	3.9	4	3.75	3.8

Source: TRANSITION, the newsletter about reforming economies

As the figures show the liberality of economic environment in Slovakia was deteriorating after the year of 1995. With the rating of 3.05 Slovak Republic was the only one from the V4 countries to get into the band of so called 'prevailing not economically free countries' (index 3.00 – 3.99). Although Poland ranked in this band until 1997, the situation improved in this country in the last year.
In the case of Slovakia lower rating for business policy, foreign investment, ownership rights protection, and regulations and corruption is worth noticing.

Table 2
Level of economic freedom in the Slovak Republic by individual areas

	1995	1997	1998
Business policy	2	2	3
Taxation	4.5	4.5	4.5
Govenrment participation	3	3	3
Monetary policy	3	3	2
Foreign investments	2	3	3
Banking policy	3	3	3
Wage and Price level	3	3	3
Ownership rights	2	3	3
Regulation, corruption	2	3	3
Black market	3	3	3

Source: TRANSITION

With the low customs and duties level the deteriorated rating for business policy is caused mainly by the efforts of V.Meciar's government to tackle the growing foreign trade deficit by introducing administrative anti-import measures (deposits, import surcharge, import certificates).
The deteriorated rating in the area of foreign investments reflects the low influx of foreign capital in the period of 1995 – 1997 as well as actual elimination of foreign investors from the privatization process.
The lowered rating for ownership right protection is substantiated by the privatization process, by the effort to limit ownership rights of the so called 'new structures' ('investment funds and managers'), by the more favorable position of debtors compared to creditors, by the not functioning bankruptcy proceedings, as well as by the efforts to introduce non standard procedures such as revitalization.
Increased corruption and favoritism was reflected in the lowered rating in the area of 'regulation and corruption'. The method of identifying the winner via direct or indirect abuse of state influence instead of the market has spread rapidly. Originally developed in the privatization process this process has gradually spread to other areas as well.
Improved rating for monetary policy was influenced mainly by the responsible policy pursued by the central bank and by a relatively low inflation rate.
As a permanent feature, Slovakia is rated low for taxation. This is a consequence of the high taxation rate imposed on businesses.
There is no need to overestimate similar ratings. But they do provide an interesting view on the development of conditions for a free and prosperous business making.
There is a generally applicable fact that countries with higher levels of economic freedom achieve also better performance in economic growth and increasing the standard of living.

Transparency in Economy of the Slovak Republic and Protection of Competition

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In economy the invisible hand of the market can be accompanied by a visible hand of the government. But this hand must be visible, transparent, with clearly determined tasks, duties, and responsibilities. The transparency then represents public sector activities open to such an extent that the entire population may actively participate in its management process. It allows the citizens to understand activities performed by public sector in accordance with the Constitution, valid legislation and regulations. It provides them with enough information to be able to assess whether individual activities are performed really in compliance with the valid legislation and regulations, whether there is a law violation, not compliance, or circumvention. At the same time, the transparent system provides them with an opportunity to claim correction of consequences of incorrectly performed activities and adoption of measures preventing future mistakes and shortcomings. Transparency therefore makes the public figures reliable, accountable for their activities, and introduction of the transparency has direct impact on creating reliable, accountable, creditworthy public sector subject to control – any tax payer is entitled to.

Introduction of transparency should result in *creating barriers* against any form of venality, illegal operations, cowardice, unqualified discrimination, preferential treatment etc. The objective of increased transparency is therefore to achieve non-economic positive effects (increased democracy, reduced crime), as well as its reflection in the improved economic parameters: Gross domestic product growth, reduced unemployment, decreased budget deficit, diminished pressure to increase tax burden, increased inflow of foreign investments, improved fair competition, more efficient use of public funds, etc. Transparency leads to strengthened principle of equal chances. The country wealth distribution depends fully on individual entities and their contribution to the wealth generation.

On the other hand, non transparent activities of public sector cause public sector lacking stability, threaten effective performance of mandated activities and development. They lead to distortion of objective and fair competition, to illegal and inadequate advantages due to public position and office abuse, to inefficient use of public funds. In addition to all of that, distorted morale of public sector has negative impact on citizens and their perception of public life fairness and objective decision making on rights and duties of individuals (natural persons) and corporate (legal entities). The most harmful invisible impact of a non transparent behavior is corruption of human soul leading to moral degeneration and possible loss of sense for values such as trust, integrity, and decency. Young people find their ideal in leaders who earned money via corruption. Such a system can only destroy a society.

One of the objectives of the vast social and economic changes started off after 1989 was to achieve in Slovakia the highest possible level of public sector transparency, information disseminated among citizens regarding public issues in the broadest sense. The long-term commitment of the state to keep its tax-payers, individuals and companies, informed has become a natural requirement of citizens. They require to be informed mainly about the non precedential transformation of ownership structures of the former state-controlled companies

and banks as possibly the most sensitive component of economic transformation, as well as about the management of funds concentrated in the state budget and state special purpose funds. The required change meant to leave the old system, it meant the disintegration of the old institutions and their gradual substitution by new institutions – the expected change was to go from close to an open system[1] based on transparency, accountability, credibility, and efficiency.

Reality was often different. It is reflected in the present status of the economy indicating an institutional fall through, failure of old institutions (not replaced by new ones) by which the government was managing the economy. At the same time this is proven by statements of local and international community expressing their concerns about transparent environment in our country.

Every year Transparency International[2] calculates a CPI (Corruption Perception Index), expressing the level of corruption in individual countries as perceived by respondents of surveys conducted by prestigious international institutions. The CPI is expressed on the scale 0 to 10, while 10 means a corruption-less economy. The lower the index and the bigger the discrepancies in ratings of individual institutions, the bigger is the threat for a country economic development. Slovak Republic entered the list of 85 countries for the first time in 1998. It shared the 47th and 48th place with Byelorussia. This only confirmed the results of surveys conducted by The Wall Street Journal, as well as the survey of the Center for Economic Development indicating that corruption in Slovakia is more spread than in the neighboring countries. From among the Central European countries the best position was held by Hungary (33), Czech Republic (37), and Poland and Italy shared 39th and 40th place.

The majority of Slovak population have similar views on corruption in Slovakia. They believe that *political corruption* run wide here. In a survey conducted by USIA in October 1997 as many as 59 per cent of respondents considered the current political corruption as bad or even worse than prior to 1989, only 32 per cent of respondents did not agree with this statement.

Citizens also believe there is a wide spread c*lientelism* in Slovakia. This is supported by results of survey conducted by the Institute for Public Issues in October 1997 when 82 per cent of respondents agreed and only 14 per cent disagreed with the statement that „without connections at the right places one cannot be sure to succeed in claiming their rights.“ As many as 75 per cent of respondents agreed and only 21 pre cent disagreed with the statement that „if someone wants to have a good life and arrange everything needed, they should find influential friends.“ All of this results in the situation in our country where the public associates the perceived wide spread corruption with embittered attitudes to democracy and market economy.

Forms and areas of non transparent and corrupted course of action in the Slovak public life

Center for Economic Development tried to describe forms and areas of non transparent and corrupted course of action in the Slovak Public life:

- Process of privatization

Privatization process started in 1989 and its course of action proved to be one of the areas of an extremely high occurrence of non transparency. The corruption potential in the privatization process carried out in a specific privatization method is a function of the amount of decision making power related to asset management in the hands of politicians and the level of control over their activities in the decision making process.

By adopting an anti-constitutional amendment of the „large scale“ privatization law in November 1994, privatization got out of control and became even less transparent compared to the previous period. The public was excluded from the privatization process controls. The bill proposing that Fund of National Property of the Slovak Republic (FNM SR) reports and gets under control of the Supreme Audit of the Slovak Republic (NKU) has been rejected for several times. Nine members of the ruling coalition, board members of the Presidium of FNM SR, acquired unlimited power to make decisions on whom and at what price the national property is sold to. No privatized assets registry was established to provide equal access to information to everybody interested in the assets subject to privatization.

At the end of 1995, Vladimír Mečiar‘s government decided to change the privatization strategy. The voucher scheme privatization was canceled and direct sales of former state-controlled companies to pre-identified new owners dominated. As stated by the government representative, the direct sale method of privatization aimed at creating „local business strata“. Critics of this method have been casting doubt on its transparency, but mainly on the effects of this strategy on the restructuring of Slovak economy.

Due to this privatization lacking transparency and control the state lost tens of billions of Crowns [3]. In the period of 1995 – 1997 the “FNM SR” Presidium decided and made 889 direct sales, and approved privatization of joint –stock company shares or state company assets of SKK 103 billion in book value. But their purchase price was SKK 48.8 billion.[4] Since 1995 the privatized assets were sold at average of 48 per cent of their book value. During the third reign of Vladimír Mečiar the real income of the National Property Fund (FNM SR) from standard method privatization represented only 28.7 per cent of the book value of the assets privatized. [5] This means that corruption and illegal activities relate mainly to the direct sale of privatized assets and to public tenders for sale of privatized assets. In selecting the buyer the principle of selecting a buyer with the best bid has not been applied frequently.

In the privatization process there was an open discrimination for the benefit of close groups, including political top representatives.[6] Political heads of the ruling coalition in Slovakia privatized via their relatives and friends. Arguments used by the ruling coalition referring to the fact that the law does not prevent relatives and friends of public figure to participate in privatization would be correct, providing the privatization process was transparent, providing equal chances for everyone, providing tenders were won by bidders offering better deals than selected „privatizers“.[7]

Providing public assistance and competitive environment

In a market economy a healthy competitive environment is considered to be the driving force of prosperity. The role of a state as a guardian of fair competitive environment is extremely challenging, especially in the period of transformation that started in late 1980s in the countries of Central and Eastern Europe. Eight year later, local and international observers express their doubts about the health of competitive environment in Slovakia.

In addition to the above described illegible privatization process the Slovak government is among other things blamed for unclear wording of the *law on company revitalization (recovery)*[8], not providing for equal chance for every entity applying for company financial recovery. Non transparent nature of this process is strengthened by Article 16 of this law reading as follows: „Commission members, commissioners, and employees of relevant Ministry are obliged to keep confidential every fact they learnt in relation to the evaluation of

the company recovery application.“ Lack of transparency, validity of criteria, and possible subjective assessment in the selection process can be documented by the fact that recovery assistance is sought out both by loss-producing and problem companies as well as by profitable companies, claiming that if assisted they may increase exports worth the support.

According to the Slovak legislature, except for rather legitimate exceptions, the government cannot *discharge* businesses from their *tax payment due.* But as of March 1995 the Ministry of Finance of the Slovak Republic posses power to grant penalty, fine, interest, increased tax and interest payment relief. In the period of January 1, 1998 – October 31, 1998 the Ministry of Finance granted to legal entities financial relief on sanction fees and interest payment in the amount of SKK 284 775 121. Information of this kind were not made available by the Ministry that refused to publish the list of defaulting tax payers. The public therefore was deprived of any possibility to have access to information on those companies that do not honor their legal duty to contribute to the state budget. This created room for speculations on potential corruption.

A non standard solution was invented by the government also in the case of granting *import surcharge relief.* This surcharge was introduced in summer of 1997 and it applied to app. 80% of Slovak imports. The Ministry of Finance of the Slovak Republic is responsible for making decisions on the import surcharge payment duty on a individual basis, while no clear rules have been published to be subject to public control. The list of companies granted import surcharge relief was not published by the Ministry of Finance, except for Volkswagen, Ltd., Bratislava, that was the first applicant granted a relief.

Ministry of Economy of the Slovak Republic with indignation only informed about *granting export licenses*, for example. There were no clear provisions on how and under what circumstances the state (as owner) may pass (sell) an exclusive deposit to a private mining company, as well clear ownership and trusteeship powers and responsibilities.

Managing public funds

In the Slovak Republic management of state assets and state budget is regulated by relevant legislation. Similarly, activities of individual institutions financed from the state budget, such as so called budgetary (fully financed from state budget) and contributional (quasi-state, partially financed by state budget) are regulated by relevant legislation. But the practical application of these laws indicates a frequent violation of individual provisions of these laws. The purpose of the Supreme Audit (NKU) is to audit management of these funds. Although the main purpose of audit is not to confine, just the opposite – to publicize findings, the “NKU” findings are published to minimum extent, as Article 16 of Act No. 39/1993 Coll. on NKU prescribes confidentiality applying to the past-employment period even. The follow up activities of the ”NKU” were frequently unclear. Cases of law violation revealed during the audit were passed to the courts and their activities frequently ended up by the enchanting phrase: „ intention not proven...“ The above state law does not allow to conduct audit and develop protocols suitable and directly applicable by courts. Š. Bajeník, President of the Supreme Audit (NKU) said that he was going to be „ the first who propose to cancel this institution, as he believes its results and findings are of no need to anybody...‘

Present status analysis of effective enforcement of *public procurement* law indicates many shortcomings and problems. The public procurement law is the most frequently violated law, based on the “NKU” – Supreme Audit findings. Audits conducted by NKU for 1996 revealed 1093 cases of law violation. Out of this public procurement law was violated 225 times. In 1997 the Supreme Audit, “NKU”, found out 2003 cases of violation of legislation, and again the above mentioned law was violated in the highest number of cases.

The Supreme Audit, the "NKU" report revealed also the unsatisfactory situation in the area of non transparent financing, management, and generation of state material reserves. In its report for 1997 the "NKU" found out shortcomings amounting to SKK 2.7 billion in *State material reserve management..*

A portion of regular tax payer payments is transferred to individual state specialized *funds*. Therefore these state funds should be utilized in a transparent way. State specialized funds, such as *International Trade Support Fund,* do not published in any newspaper or on Internet a full list of beneficiaries of this fund. Another fund – *State Fund for Housing Support (ŠFRB)* was established as a specialized fund targeted to the support of private housing development. The current shortage of funds, non transparent and not completely designed procedure of application and approval create room for various suspicions on unfair practices. Doubts and suspicions relate mainly to the preferential processing of applications made by ‚selected' persons, reasons for rejecting and repeated filing of incorrect loan applications, discrepant criteria for loan approvals, as well as inefficient operations of district offices serving as filing and registry office for the "SFRB" applications. At the same time there is no feedback and audit of the use of these public funds.[9]

The use of funds of *EXIM bank* also seems lacking transparency. EXIM bank ranks among institutions appropriated state budget funds on a regular basis.

Funds from state were directed to *local governments* mainly via shared taxes, collected centrally and via direct fund transfers. Every year the state budget determines the amount and method of redistribution. The structure of contributions or subsidies changed so that proportion of non transparent subsidies and grants was growing rapidly. Subsidies were directed via various state funds. Local government representatives consider their appropriation non transparent, as no stable economic criteria applied.

State funds are to be found also in state-controlled companies where so called asset looting was taking place. The system of *state companies asset looting* is based on a qualified, purposeful and prepared withdrawal of assets transferred on the line from state companies towards private companies – from public funds to private funds. What happens in practice is that former or current top management of state-controlled companies found their own limited liability companies. These companies make profit on activities of state companies on the basis of (unnecessary) intermediation (such as purchase of raw material not directly from a producer at a better price, but via an intermediating Limited liability company at prices higher by 12 to 17 per cent). Quite frequently the only purpose of these limited liability companies is to ensure undervalued transfer of assets from state companies into the hand of founders of these limited liability companies.

Many state-controlled companies go into *liquidation*. The Supreme Audit, the "NKÚ", elaborated a report on state companies liquidation. The report contained a lot of negative findings.

Another non transparent method in Slovakia can be found in the management of written off and out of use assets of the state, such as movable assets, vehicles, state administration offices equipment. Citizens are not informed about what is happening to the written off assets. Information on the *sale of the written off assets of the state* are not available to every citizen, for example via Internet, and no company has been established yet to be responsible for this type of activities.

Russian debt de-blocking is yet another example of a process where private capital assisted by state power used a non transparent method of gaining access to state funds and used them for private purposes.

Public servants appointments

Public servants appointments to individual positions were frequently made based on party affiliation and friendship, not on the basis of clearly stated and subject to control criteria, such as professional qualifications.

Financing political parties

Management and financing of political parties and movements is regulated by Law No. 424/1991 Coll. on association in political parties and political movements as amended later. The law has a number of loopholes, such as its provisions do not sufficiently regulate the issue of financing political entities, especially the origin of funds flowing into their treasuries. Specifically, the provision on presenting gifts not proving their source or origin is very general. In practice, the duty to present annual financial performance report (financial accounts) to the National Council of the Slovak Republic (Parliament) provided for by law is not respected. This situation created conditions for law violation and evoked legitimate lack of trust by the public in the legality of acquiring and spending funds by political parties and movements.

None of the political parties in Slovakia has published yet their method of activities financing, nor the financial amount of gifts received in order to make their funding transparent and get closer to their constituencies to win their trust..

Natural monopolies regulation[10]

In Slovakia every relevant entity was state owned. Their regulation was not transparent and was not subject to any law, so no appeal can be made against relevant 'decisions'[11] . Conditions determined by the regulatory body were highly unpredictable. One of the consequences of their non transparent activities seemed to be the control over natural monopolies and their use to achieve objectives possibly contradicting to interest of the entire society. Among other things, this meant an important opportunity for public servants representing interests of political parties to intervene not only in the economy but also in other social areas.

As an example, SPP -Slovenský plynárenský podnik (Slovak Gas Industry) bought 6-per cent share of the company "Nafta Gbely" at a price seven times higher than a price for which the Fund of National Property, FNM SR, sold a majority block of shares of the same entity to 'Druha obchodna, a.s.'. "SPP" bought 10 per cent of shares of the second issue of Slovak refinery Slovnaft at a price seven times higher than the privatization price. In this way the state was buying from itself and selling to itself via private companies – the price difference of hundreds of million of crowns was at the state expense, i.e. the expense of tax payers.

Capital market

Capital market is currently lacking liquidity, transparency, ability to perform its most important role – an optimum allocation of capital funds. There are several reasons for it, while one of the most important is *ambiguous legislation in the area of capital market*. Lack of clarity and transparency of ownership structure due to the bearer type of shares has become

a feature of Slovak capital market. This phenomenon is even supported by the operations of the Central Securities Depository, the "SCP". Non transparent policy of this monopoly institution gives no reason for satisfaction of investors or issuers concerned with the safety of their assets. Securities traders as well as many middlemen apply unfair practices, especially at the expense of small shareholders.[12] Today one can find in the market *issues of listed companies consisting of two incompatible parts.* There have been cases of companies issuing one publicly traded and one privately traded issues. Another example of rules lacking transparency is *trading securities of non existing companies*.

Reliability, earlyness and accessibility of information provided by the National Government

Right for information about decisions made by central bodies is guaranteed to Slovak citizens by the Constitution of the Slovak Republic. In the spirit of Slovak legislation citizens are not supposed to claim the right and ask for the information, it is the national government bodies (state administration bodies) who are obliged to provide information needed for citizens and their decision making. For the last four years clearly deteriorating relations between the government as the highest executive body and media as communication intermediary between citizens and the executive power can serve as a best example of ensuring this basic constitutional right.

The quality aspect of individual piece of *information provided* is yet another problem. Figures officially presented by the government were of law value. Changes in methodology for calculating such ratios as balance of trade, and unemployment rate prevent possible comparisons of individual data and cause lack of confidence in data presented.

The government was responsible not only for creating and collecting economic and statistics information of good quality, but also for ensuring the information flow towards media. From there the information has direct access to information users. Free and independent press is generally considered to be the best means of ensuring a transparent information flow towards the public. But the independent position of press is currently endangered. This is caused mainly by *lacking transparency of ownership structure in Slovak press and media.* The situation in providing information about owners of Slovak press media is intricate. It has gone so far that even the professional public cannot identify precisely who owns the majority share of large dailies or weeklies in Slovakia. There is no law providing for such an obligation to publish this information. This fact was frequently used by those who try to see the reason for "interfering with internal issues of Slovakia" in the insufficient transparency of media ownership structure. According to Ján Fülle, the President of the Slovak Syndicate of Journalist (SSN) this situation is facilitated by the fact that as of today only "Praca" daily publisher makes no secret about the fact that all its shares are owned by 43 trade unions associated in the Trade Union Confederation of the Slovak Republic.

Proposed measures to improve transparency

As the transparency of political , economic, social, cultural, and other relations is one of the basic characteristic features of a democratic society ruled by law, efforts to increase this transparency in the Slovak Republic represent a *social interest* in the solution of this problem.

In the pursue increased transparency in the area of public sector activities it is impossible to focus on legal aspect of the given problem only. Although legal means and instruments are extremely important, by themselves they do not suffice to ensure transparency and to repress

and prevent negative phenomena related to law violation. The existence of laws as such does not mean that the mechanism of public issues administration and management is transparent. Whatever high the number of existing laws may be, it never represents a real contribution unless they are enforced and implemented properly. In order to achieve this level of quality of the public sector and the entire society, an *institutional reform* is needed. *Institutions* represent rules of the game in the society. They consist of both formal and informal rules, principles (behavior standards, conventions, internal codes of conduct), and their implementation process. If institutions represent the rules of the game, then *organizations* are the players.

An institutional change aimed at improved transparency requires therefore the implementation of the following:

1. change in formal rules of operations
2. change in informal rules of public administration operations

The change in formal rules is represented by legislation changes, change in laws, standards, such as change of constitutional rules, regulatory rules, rules in the area of courts and their operations, and change of other standards creating the basic framework for operations of individual institutions.

Individual changes in legislation should be targeted to facilitate improved transparency of the institutional framework on an integrated basis via implementation of the following:

- *Reform in information access*
- *Reform in public service*
- *Reform of processes implemented by public sector*
- *Reform of audit*

Transparency may be born and may grow only in a society with high esteem of ethics and morale. Only in such a society honesty may dominate. It is therefore necessary to implement *change of informal rules*, relating mainly to change in conventions and personal standards of integrity. While formal rules may be changed "overnight", the change of informal rules represents a bigger challenge. With the objective of improved transparency via informal rules there is a need to *undertake measures of personal and educational character* as well as to *influence public opinion by exerting public pressure and raising awareness via media.*

Protection of competition in the Slovak Republic

Competition protection started in 1994 from a very good position. The basic legislation and institutional framework was created for competition protection. International contacts on bilateral and multilateral level were established (DG IV for Economic Competition for EU, OECD).

INSTITUTIONAL FRAMEWORK

Since it formation in 1992 the Anti-monopoly Office of the Slovak Republic started to build its good image and reputation both locally and internationally. In recent years the situation has changed as many international institutions use past tense when describing positive features of this institution. With local businesses the activities of this institution evoke an impression of illegal operations.

The strong position of the anti-monopoly institution was weakening mainly by too frequent President (Chairman) removals. Political criteria has been preferred to professional qualifications. As for the number of presidents of the office the Slovak Republic ranks on the first position. While in the Czech Republic there has been one and the same president in the office since the anti-monopoly institution was established, in Hungary there were 2, in Poland 2, and in the Slovak Republic there have been 6 of them – a record number. The failure to

ensure independent position[13] of this institution was abused by frequent changes in the office of its President. The purpose was to prevent initiation of investigation into sensitive cases and to prevent an active interference of the office with the privatization process via concentration control.

LEGISLATION

Competition protection is anchored in article 55 section 2 of the Constitution of the Slovak Republic. European Union Association Agreement with the Slovak Republic containing also competition rules entered into force as of February 1, 1995. The Association Council adopted enforcement guidelines regarding application of competition related provisions. In 1994 a new law No. 188/1994 Coll. was adopted on competition protection. This law represented a modern approach to legislation in this area. It created a legal framework for dealing with anti-competition practices of businesses. It was one of the first laws in the Slovak Republic compatible with EU legislation. The law assumed the issue of an ordinance to determine in details the conditions of Article 5 of the law[14] and allow the businesses to gain better orientation in the law and its application. Such a decree has not been issued yet. It was slowed down, or stopped due to the work on elaborating methodology instructions related to the interpretation of individual articles of the law. These instructions have not been made available to businesses yet.

In the past, the Anti-monopoly Office of the Slovak Republic took a number of initiatives in the area of increasing the impact of competition principles in the economy (initiation of first attempts to apply public procurement procedures, draft bill on natural monopolies and their regulation, draft bill on licensing tender). The Office has completely lost this position and it has not shown any initiative in creating and guaranteeing a competitive environment.

Not sufficient progress was made in monitoring and controlling government assistance, having substantial impact of possible distortion of competition. This area is the responsibility of the Ministry of Finance of the Slovak Republic.

LAW ENFORCEMENT

By law it is the Office responsibility to penalize anti-competitive business practices (competition limiting agreements, abuse of dominant position), to control the process of economic concentrations, and to guarantee competitive conditions. The Office undertook a number of investigations and made decisions to forbid agreements on abuse of dominant position. As a rule it did not touch any politically sensitive cases. The issue of concentration control is a difficult one. Lacking transparency the privatization process created confusing ownership and capital links capable of creating non competitive market structure. Businesses are obliged to notify concentrations above certain limit. By law the Office is entitled to require all the relevant information to assess these links and analyze their impacts on competitive environment in individual markets. In accordance with § 10 section 2 the Office is entitled to forbid concentrations creating or strengthening dominant market position, providing the participants cannot prove that this damage to competition is compensated for by national economic advantages of such a concentration. Such a ban may be introduced retro-actively asking to revert the situation into its original state. In many cases the businesses violated the notification duty, but the Office fined only few of them for the failure of notification. In most of the cases the Office agreed with concentrations, it imposed conditions in some of them. One can assume that in real terms the concentration process did not get under control of the Anti-monopoly institution. One of the reasons were the changed powers

and responsibilities of the Ministry of Finance of the Slovak Republic regarding privatization. 'PÚ SR", the Slovak Republic Anti-monopoly Office was not provided with sufficient information on privatization decisions and it did not assess them from the aspects of de-concentration of competitive market structures.

The task of the Office to oppose government decisions distorting competition was exercised passively. It did not even make a public statement to such serious measures distorting equal chances principle as law on revitalization, tax preferential treatment to "privatizers"[15], bankruptcy law exemptions granted to some entities (such as strategic, recovered companies), discharge of sanctions for tax payment default to some businesses, introduction of import restrictions, price and wage regulation.

In the Slovak Republic there is currently no „competition advocacy", i.e. pushing through such legislative changes and opposing those government decisions that limit competition and reduce consumers benefits. Although it is impossible to expect the economic policy of a government not to be lobbied, it should be counter-balanced by position and influence of institutions defending national economic interests and consumer benefits. Position of such institutions is weak and it does not allow to exert efficient counter pressure to strong and well formed business interest groups.

Public information availability

During the first years of its existence the Office introduced a practice of wide spread information dissemination to businesses and the public regarding the office activities and decisions. In the recent years press conferences were held, activities reports were published, including figures and numbers of cases, but provision of relevant information and transparency in its activities deteriorated substantially. The figures published do not represent real actions of the Office taken against the anti competitive conduct, and decisions of the Office ceased to be published. It is a common international practice to publish and issue decisions of anti-monopoly institutions accompanied by comments and interpretations so that businesses may anticipate the law applicability. This information is available also in Internet. In the Slovak Republic they seized to be published and they are neither available to the professional public (i.e. lawyers, economists) active in this area.

It may be stated here that despite good starting position competition protection has stagnated since 1994. It was related to the overall strategy of the economic policy based on selective approach, not on the principle of equal chances.

Suggestions:

- strengthen the independence of 'PÚ SR' (the Anti-monopoly Office of the Slovak Republic) by introducing a system of appointing its President, and creating a collective decision making body
- introduce a duty to publish decisions taken by the 'PÚ SR', while complying with the business secret confidentiality rules,
- strengthen competition advocacy,
- implement analysis of personal and capital links from the competitive market structure aspect,
- adopt legislation regulating specific areas of competition, such as expanding areas under competition pressure (regulatory framework for natural monopoly, licensing, making state assistance transparent),
- ensure intense involvement in the integration process in this area.

C O M M E N T S

1 Such an open system applies to both political and economic systems.
2 Transparency International (TI) is a non governmental, non profit making organization focusing on issues of transparency, corruption and bribery on international and local level. TI is the only world-wide movement with exclusive focus on the above stated issues.
3 See book value of state property sold
4 Trend, 11.2.1998, 11A
5 FINI67 – Internet daily news covering economy and capital market issuess locally and internationally, 11.8.1998
6 Peter Weiss, 'Hospodárske noviny' (Economic Daily), 3.12.1997
7 'Národná obroda' daily, 17.6.98
8 Law on company revitalization and on amendments and additions to some laws, No. 211 of July 2, 1997
9 Luboš Vagač, CPHR
10 Natural Monopolies of State Character (Prirodzené monopoly štátneho charakteru), Slovakia 1997, Institute for Public Issues (Inštitút pre verejné otázky), 1998
11 These are not decisions in the sense of decrees (legal documents), this is a mix of various forms of activities of national government (state administration), starting with legal acts down to telephone calls.
12 Trend, No.10, March, 4,1998
13 In 1994 the proposal to appoint President of the Office by the President of State for a term exceeding 4year election term failed to be approved.
14 Meeting conditions when competition restricting agreements are not subject to the ban.
15 Income tax relief following from a decree – discharge of a portion of purchase price granted by the National Property Fund of the Slovak Republic.

PRIVATIZATION

M.E.S.A. 10

The privatization process is among the most complex and controversial parts of economic transformation. In its program declaration, V. Mečiar's cabinet stated that privatization was to remain among its overriding priorities, however, the program declaration did not give any further details. No indicative schedule or assets to be privatized by the government were specified, in other words, declared objectives were not translated into concrete commitments.
The plans were directed towards the recovery of the entrepreneurial environment and the restructuring of ownership relations.
Given the fact that the investment opportunities of the local entities interested in privatization were limited, the government declared its "interest to further the development of the local business community by facilitating sales through instalments, with investments to be factored in the purchase price". Also, the government declared the use of the principle of competition "based on an accurately formulated and justified business plan that shall observe the company's specificities and the needs of its advancement". With the selection criteria formulated in this fashion the risk was that the declared competitiveness would be only perfunctory. In addition, the government made a commitment to foster "serviceable entry of foreign capital", and detail "the interest of the State in the privatization of strategic companies, especially in the energy and natural gas sectors, telecommunications, water management, military production, and banking, and the definition of the public sector". Among the then plans was also to embark on the second wave of voucher privatization "without unnecessary procrastination," alhough this procrastination did effectively take place in December 1994, when the pre-round of the second wave declared by the previous Moravčík's government was invalidated. This part of the program declaration was dramatically eroded by the government itself, as jointly with the parliamentary majority, it invalidated voucher privatization in June and July 1995, and replaced it by the government bond indemnification. The program declaration advised of "a more consistent recovery of receivables, improvement of the payment discipline of the National Property Fund debtors, and a more consistent audit of the shareholding companies in which the National Property Fund has its stake". Last but not least, the government declared "the enforcement of the participation of employees in the privatization of companies in which they are employed and the adoption of a legal provision to comprehensively address the privatization process and make the relations with the National Property Fund more transparent". However, the privatization reality contradicted the pledges the government had taken. Competitive environment was distorted, restructuring was postponed, and instead of the recovery and a sweeping advancement of privatized companies, these were oftentimes looted in privatization. The participation of employees in privatization almost did not happen. Foreign entities were eliminated from privatization, and voucher privatization was invalidated half a year after the government declaration had been adopted and replaced by a confusing indemnification in the form of government bonds. Based on a selective amendment of the Privatization Act, the authority to approve direct sales was passed over to the National Property Fund of the S.R. However, this act was declared unconstitutional by the Constitutional Court in late 1996. Consciously and wilfully, the government coalition turned the Fund into a tool for looting national property for its own benefit and that of the affinity business groups.
The most distinct feature of this very eventful process was that it took place entirely under the direction of the coalition parties without any possibility whatsoever to conduct parliamentary or any other oversight, be on the part of opposition parties (for instance, through their

representation on the NPF bodies), or independent institutions. A non-transparent, uncontrolled, and uncontrollable transfer of assets in favor of persons allied with the government coalition, under a privileged treatment and particularly favorable conditions, was increasingly taking place.
Direct sales at symbolic prices in favor of persons who had affinity with the ruling clique became practically the only privatization method. All the other interested parties, including employer companies and foreign investors, were discriminated, and their prospects to partake in the privatization were practically nil. The situation aggravated and the privatization topic dominated public discussions and political life. The political significance of privatization after 1994 was best illustrated by the fact that the opinion of several local and foreign analysts and commentators was corroborated – privatization was considered the most powerful, and, oftentimes, the only – or, at any rate, decisive – tie that coalesced the peculiar Slovak coalition composed of an ideologically amorphous, populistic Movement for a Democratic Slovakia (HZDS), leaning on its charismatic leader; the non-bolshevik, ultraleft Association of the Workers of Slovakia (ZRS), and the ultraright Slovak National Party (SNS).
The privatization process may also be characterized as an effort to privatize in a manner that facilitated the concentration of political and economic power in the hands of the ruling groups. Via privatization, an uncontrollable concentration of ownership took place, and together with the shattered position of the Antimonopoly Office, competition as the vital driving force of economic growth, was put at risk. Another negative outcome of the privatization process was the fact that the preconditions for a successful and speedy economic restructuring were not established. Privatization turned into a vital tool of the escalation of clientelism and corruption that also infiltrated other areas of socioeconomic life.

The Privatization Reality Features

Among the vital privatization features are:

- delegation of the decision-making privatization powers from the government and the Ministry of Privatization to the government-controlled National Property Fund
- speedy implementation of direct sales at symbolic prices without knowing the rules and criteria, without enforcing a transparent and competitive procedure, and without any control over the process
- direct or indirect discrimination of foreign entities (minimum number of foreign investors participating in the privatization)
- invalidation of voucher privatization, and its replacement by an unprepared and confusing government bond method
- sweeping and selective, administrative and legislative curtailing of the impact of mutual funds and investment companies in privatized companies
- the passing and adoption of unlawful and unconstitutional laws and decisions on the part of the executive power and the parliamentary coalition majority whose motif was, above all, to ensure priviledged position to groups politically and otherwise close to the coalition
- the unconstitutional nature of some fundamental privatization acts and decrees passed in 1994-1996, which was corroborated by the findings of the Constitutional Court of the S.R.
- ever-more intense favoritism of the selected privatizing entities, and, consequently, the augmentation of the NPF actual and potential losses
- the political background of the privatization process is fully manifested
- overt neglect of the concept of employee privatization
- conflicts amidst the coalition induced by privatization interests, effort at a speedy bank privatization

- clientelism in privatization infiltrates other areas of socioeconomic life
- aggravation of the liquidity crisis in the NPF S.R. and the failure of the NPF to honor the bonds at maturity, December 31, 2000 (as a consequence of the privatization inconveniencing the NPF S.R. and unilaterally favoring the acquirers of the assets), growing concerns about the capacity of the NPF to honour its future liabilities, notably to bondholders
- incompetent procedure in organizing the bond privatization and the statement of unrealistic dates for the privatization completion
- the emergence of the first significant cases of the so-called third privatization wave, i.e. the sale of shares in strategic companies by priviledged acquirers to foreign investors at real market prices
- the reluctance of the government of the S.R. to assume powers in decision-making related to direct sales, and the government's tardiness in this area after a perfunctory assumption of these powers
- a growing rate of sales unfavorable for the NPF of the S.R., and, consequently, a growing rate of sales favorable for acquirers
- the corroboration of the partisan nature of privatization and the direct involvement of the leading representatives of the ruling coalition parties and their relatives, or otherwise close persons in the biggest privatization cases
- the incidence of such cases of the privatization decision revisions whose objective was a repeated sale to the same acquirer, this time at a lower price and with the objective to involve persons close to the NPF of the S.R. and coalition parties (for instance, the NAD Trenčín case)
- the first big case of direct privatization in favor of one of the leading personalities of the NPF S.R. (Baňa Záhorie case)
- growing discontentment of the public at large with the privatization course
- confusing and inconsistent nature of the so-called bond privatization
- the growing number of concrete negative impacts of the implemented privatization in the form of the company looting, lagging restructuring, insolvency, instable and non-transparent ownership relations
- the collapse of the third biggest bank due to an irresponsible privatization policy and an incompetent and irresponsible enforcement of shareholder rights on the part of the NPF
- an ever-more massive infiltration of criminal practices into economic life also due to the fashion in which privatization was implemented.

Privatization Structure

The total value of assets suitable for privatization in the S.R was estimated to be SKK 427.6 billion in book value. By the end of 1997, of the above assets, property amounting to a book value of SKK 346.3 billion had been assumed by the NPF of the S.R. Of that amount, assets totalling SKK 223.7 billion were privatized, of which assets totalling SKK 80 billion in voucher privatization, and property amounting to SKK 143.7 billion using standard methods, largely by direct sales. By late 1997, the NPF of the S.R. had held in temporary ownership shares amounting to SKK 22.8 billion and in permanent ownership shares amounting to SKK 39.3 billion.
The above figures indicate that by late 1997, the assets owned by the founding ministries had amounted to about SKK 81.3 billion. The aggregate value of sold assets, the assets in the NPF ownership, and the assets in the possession of founding ministries is given in the Table below:

Table 3
Volume and Structure of Privatized and State-owned Assets in the S.R.

ASSETS	1995	%	1996	%	1997	%
SOLD	185,200	43.3	222,300	52.0	265,700	62.0
voucher privatization	80,000		80,000		80,000	
standard methods	72,000		101,000		143,700	
other methods*	33,200		41,000		42,000	
in npf ownership	139,400	32.6	115,500	27.0	80,600	18.8
Shares in temporary administration	68,800		63,800		22,800	
Shares in permanent administration	29,700		27,000		39,300	
Other assets**	40,900		24,700		18,500	
ASSETS OWNED BY FOUNDING MINISTRY	103,000	24.1	89,800	21.0	81,300	19.2
TOTAL	**427,600**	**100.0**	**427,600**	**100.0**	**427,600**	**100.0**

Source: M.E.S.A. 10 computations based on OECD and NPF data

* transfer of property exempt from payments, restitution fund, in the possession of co-founders, sales to insurance companies and intermediaries, reserve funds of shareholding companies with the prevalently private ownership

*** reserve funds of shareholding companies with the prevalently Fund ownership, other funds, unrealized production and price differences*

The Table indicates that by late 1997, the share of privatized assets in the total former state assets had been 62 per cent, whereby in about a half of the still State-owned assets, the State had a temporary or permanent stake and a half was in the ownership of the State under founding ministries. By late 1997, 82.6 per cent of the GDP had been generated in the private sector, which is due not only to progressing privatization but also the establishment and development of new private entrepreneurial entities. The overview of the pace of the privatization process in terms of the privatization decisions is shown in the Table below:

Table 4
Volume of Assets According to Approved Privatization Decisions and the Relationship Between Book and Purchase Prices, in million SKK

	1992	1993	1994	1995	1996	1997	TOTAL
Voucher privatization	80,000						80,000
Standard methods, book value	11,973,2	4,510,6	21,182,8	44,256,7	50,818,6	7,972,0	140,712,1
Standard methods, purchase price	12,675,1	4,811,7	17,774,9	33,046,0	14,314,5	1,436,2	74,058,4
1st instalment (% of book value)				14.12 %	8.26 %	8.00 %	
Purchase price/ book value	105.9 %	106.7 %	83.9 %	74.67 %	28.17 %	18.02 %	52.63 %

Source: M.E.S.A. 10 computations based on the NPF data, of March 1998

The Table indicates that privatization was most dynamic in 1992, when privatization projects amounting to a book value of SKK 91,973,2 were approved in voucher privatization. The

years 1992-1993 are characterized by the purchase prices in the standard privatization methods to be generally higher than the book value.
In 1994, purchase prices were lower (by over 16 per cent) than the book value of privatized assets; in 1995, this difference increased to over 25 per cent. The year 1995 was the first year of privatization implemented in the garb of the National Property Fund which was established by the former government coalition of HZDS, ZRS, and SNS, to which, in an unconstitutional manner, powers to implement direct sales were delegated.
Literally shocking is the drop of purchase prices against the book value of sold assets in 1996. Purchase prices then accounted only for 28.17 per cent of the book value of privatized assets, and in 1997, only for 18.02 per cent. The actual income of the NPF of the S.R. was reported to be even lower, as in the majority of privatization decisions, purchase prices were broken down to instalments and the first instalment constituted only part of the purchase price. Oftentimes, the representatives of the NPF of the S.R. and the representatives of the government coalition argued that purchase price was but part of true value, since the second portion of the price were investments. However, this argumentation was erroneous for at least two reasons:

1) in the majority of privatization decisions the acquirer's commitment to invest away part of the purchase price from his own funds was non-existent; in effect was only his commitment that in his capacity of a shareholder (thanks to privatization) he would enforce that the company he had privatized would invest away a certain amount of money. In the majority of cases, this was but a camouflage, as the company would carry out these investments irrespective of the fact, whether anyone privatized it or not;
2) also from the viewpoint of the investments as part of purchase price, a drop in the purchase prices between the years 1995 and 1996 was reported with the same management of the NPF of the S.R. and the same privatization methodology.

It is to be assumed that the dramatic drop of purchase prices in 1996-1997, as opposed to 1995, was a consequence of the experience from 1995, when some big sales of the shares in lucrative companies at symbolic prices did not bring about any personnel or political consequences. The sale of 39 per cent of the block of Slovnaft Inc. shares for 15 per cent of the true market price, or the sale of 15 per cent of the block of VSŽ shares for a third of the market price, serve a good example. Following the saying "the more you eat, the more you want", unbriddled privatization at symbolic prices was triggered off in 1996-1997. Cases were reported that in some companies that had been previously privatized at higher prices (for instance, in 1995), the process was arranged in such a fashion that the earlier transaction was invalidated and the company was privatized for the second consecutive time at a much lower price (via a middleman in favor of the same acquirer). Persons close to the leading representatives of the NPF or the government coalition became involved in the more recent and favorable transactions. For instance, NAD Trenčín was privatized in the above fashion in 1997, although in 1995, it was privatized for SKK 30 million. In 1997, the purchase agreement was made null and void and the company was sold for the second time via a middleman to the same person for SKK 7 million. Another significant difference, as opposed to the initial purchase, was the fact that in the second purchase among the acquirers was also brother-in-law of the Vice-president of the NPF of the S.R. and chairman of the regional board of HZDS in Trenčín, Milan Rehák.

Table 5
Privatization Through Direct Sales During the Terms of Office of the Individual S.R. Governments (million SKK)

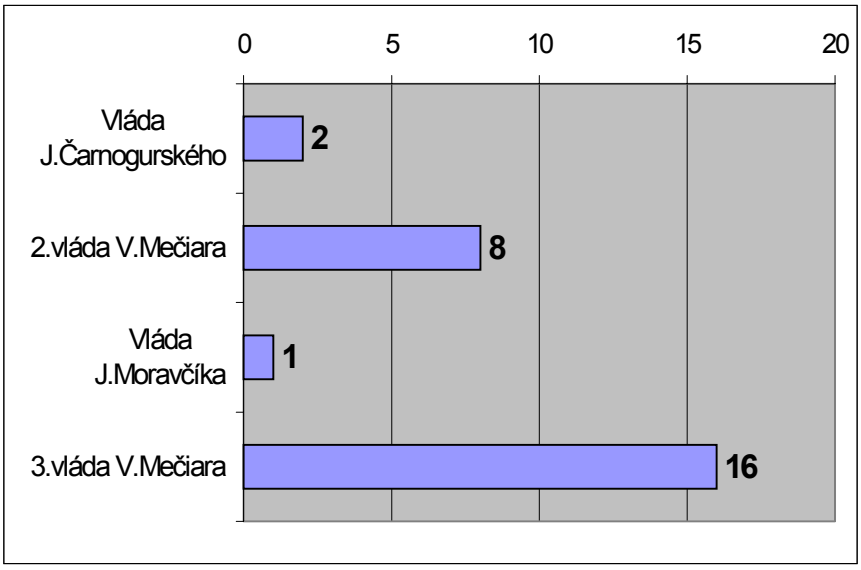
	Purchase prices	Actual NPF income	Book value	Actual income NPF/book value	Final price/book value	Final price at asset sale (mill. SKK)	Final price at sale of shares (mill. SKK)
J. Čarnogursky's government	12,675,1	11,646,7	11,973,2	97.3 %	105.9 %	9,588.58	3,086,48
2nd Mečiar's government	13,997,8	13,744,8	12,773,3	107.6%	109.6 %	8,449,01	5,548,84
J. Moravčík's government	8,578,8	7,929,5	12,920,1	61.4 %	66.4 %	5,615,52	2,963,26
3rd Mečiar's government	48,796,7	29,612,9	103,047,3	28.7 %	47.4 %	**13,593,52**	**23,557,96**
3rd Mečiar's gov. 1995	33,046,0	15,847,5	44,256,7	35.8 %	74.7 %	6,196,75	20,001,85
1996	14,314,5	12,356,6	50,818,6	24.3 %	28.2 %	6,185,36	1,752,10
1997	1,436,2	1,408,8	7,972,0	17.7 %	18.0 %	1,211,42	1,804,01

Source: M.E.S.A. 10 computations based on the data of the NPF 1991-1997 annual reports.
Note: The book value figures for share sales were not available to the authors, however, it is assumed that practically all shares had a par value of SKK 1,000.

The Table indicates an obvious decline in the dynamism of the adopted privatization decisions in 1997 as opposed to 1995 and 1996. Apparently, this fact is related to the finding of the Constitutional Court on the unconstitutional delegation of the authority in direct sales from the government to the NPF, issued in late 1996. The Fund, despite this finding, continued to privatize assets, however, at a slower pace, whereby the government did not exercise its regained powers in approving direct sales in 1997.
At the time of "Mečiar's privatization" the State lost tens of billions of crowns. In 1995-1997, the Presidium of the NPF of the S.R. approved 889 direct sales, in a book value of SKK 103 billion, sold at a purchase price of SKK 48.8 billion. From 1995 onwards, privatized assets were sold for 48 per cent of their book value on the average. Table 3 indicates that the share of the real income of the NPF of the S.R. from privatization using standard methods in prices was the lowest, i.e. 28.7 per cent of book value.

Oftentimes, the representatives of the former government coalition argued that the book value did not express the true value. In conjunction with this it is interesting to consider the "lucrativeness" of a sold asset which is shown in the Graph below. Among the 60 most profitable companies in the S.R. in 1994, the highest number (16) were privatized during Mečiar's third government.

Graph 1
The Breakdown of the Most Profitable Companies (According to TOP TREND 95) Privatized in Direct Sales During the Terms of Office of the Individual Slovak Governments



J. Čarnogurský's government

Mečiar's second government

J. Moravčík's government

Mečiar's third government

The Essential Features of Privatization Reality

THE CURTAILMENT AND INVALIDATION OF VOUCHER PRIVATIZATION, THE INTRODUCTION OF THE BOND METHOD

Part of the curtailment of voucher privatization was a deliberate restriction of the influence of mutual funds and investment companies. In late 1994, the representatives of ruling political parties and allied mass media launched a campaign against mutual funds and investment companies and undiscriminatingly accused them of an activity that contradicted the interests of minor shareholders and investors.
On the one hand, there was clearly no political will and conviction of the importance of voucher privatization. On the other hand, *the influence of state-managerial circles* grew steadily, and their privatization interests underlied the curtailment of voucher privatization right from the beginning. The fact that there was no political will was best evidenced by the above fact that J. Čarnogurský's and J. Moravčík's governments had approved the voucher privatization projects at a much faster pace and in bigger volumes.
This was fully manifested in early June 1995, when the government representatives disclosed information on the so-called new voucher privatization concept. The essence of this concept was that every citizen registered in voucher privatization was to obtain bonds in a par value of SKK 10,000 with a 5-year maturity and a discount interest rate of 8.8 per cent. Bonds were, to a limited extent, exchangeable for (practically worthless) shares of selected companies, and

could be also used for the purchase of an apartment. Selected privatizing entities could also use them for honoring their liabilities to the NPF.
Also, by invalidating voucher privatization, measures were imposed that not only *curtailed the influence of mutual funds and investment companies, but literally resulted in the liquidation of the majority of them.* Such an event with far-reaching consequnces was the information disclosed in early April 1995 that the First Slovak Investment Company, Inc., Bratislava (PSIS) had its licence suspended by the Ministry of Finance. While the decrease of the value of the voucher privatization assets incurred relative and absolute losses to the second-wave investment companies and mutual funds as distinct from the originally anticipated conditions, the new procedure in voucher privatization entailed their total elimination from the game and a loss of almost all the funds they had invested in the second privatization wave. Among these funds and companies were also foreign companies, notably Austrian.
According to a public opinion poll conducted by FOCUS agency, in the first half of June 1995, only 3.1 per cent of the citizens of the S.R. deemed the privatization implemented by the government coalition fair, 28 per cent considered it fair in some areas, while unfair in others, 56.6 per cent claimed it to be unfair, and 12.3 per cent of the respondents were unable to answer the question. The same question posed by FOCUS agency a year earlier, in the summer of 1994, reported the following results: 12.4 per cent agreed with the privatization policy of Moravčík‘s government, 45.4 per cent considered it fair in some areas and unfair in others, 29.2 per cent considered it unfair, and 13 per cent wre unable answer the question.

THE DELEGATION OF POWERS FROM THE GOVERNMENT OF THE S.R. TO THE NPF OF THE S.R.

In February 1996, 56 opposition MPs filed a motion with the Constitutional Court of the S.R., in which they challenged the unconstitutional nature of the delegation of privatization powers from the Ministry of Privatization and the government of the S.R. to the NPF of the S.R. (by virtue of the amendement of the Act No. 369/1994 Coll., of November 1994). The explanatory report stated that by delegating the decision-making powers, privatization was no longer under constitutional control and liability, it became non-transparent, and was wholly under the control of the ruling coalition parties. This was the contestation of a change crucial for privatization, which entailed the delegation of privatization powers and allowed for the evolvement of unbriddled privatization which the Slovak society witnessed in 1995-1996. Disconcerting about the motion was that it was filed more than 15 months after the amendment had been passed which facilitated the then privatization and which the former opposition parties deemed unconstitutional.
On November 21, 1996, the plenary session of the Constitutional Court of the S.R. granted the motion and declared the delegation of privatization powers from the government of the S.R. to the NPF of the S.R. unconstitutional. In its substantiation, the Constitutional Court of the S.R. stated that “the decisions on the privatization of state assets by direct sales to an interested party designated beforehand is among the fundamental measures of the government of the S.R., aimed at ensuring the economic and social policies of the S.R.”, and, as such, could not be delegated to a non-government entity which the NPF by law was (Národná obroda daily, November 15, 1996). According to the Constitutional Court of the S.R., the legal provision did not instruct the NPF to act in public interest, and legal acts of the NPF were not subject to a preliminary or subsequent approval by the state authority. According to the substantistation of the Constitutional Court, the NPF became a subject of law that decided

on public issues vital for the economy and social policy of the S.R., and, despite that, its activity was not subject to any component of state power. State authorities did not have any possibility of an effective control over the NPF (Trend, November 7, 1996).
Also, the Constitutional Court of the S.R. declared that the finding did not contest the validity of those privatization decisions that had been made at the time of the unconstitutional state, which was found confounding by several observers, as by having declared that, the Constitutional Court, in fact, corroborated the legitimacy of the decisions made on the basis of an unconstitutional law.
Štefan Gavorník, President of the Presidium of the National Property Fund, upon the disclosure of the finding of the Constitutional Court, stated that after making the ruling of the Constitutional Court public, the NPF would no longer proceed in privatization (SME daily, December 17, 1996).
On December 11, 1996, the ruling of the Constitutional Court was made public in the Collection of Laws, and thus it took legal effect. Despite that, however, the approval of direct sales by the National Property Fund has been going on. The Vice-chairman of the Executive Committee of the NPF, Ján Porvazník, made a comment that until then the NPF had been deciding on direct slaes pursuant to three provisions of the Big Privatization Act, and although two of them were declared unconstitutional by the Constitutional Court, the third provision was not, and according to it, the NPF has been authorizing direct sales since December 11, 1996. The uncontested provision was Article 26, Item 5, stipulating the disposition of the Fund assets, quote: "The Fund shall dispose of the Fund assets and its undertakings in other legal entities that could not be privatized according to the privatization decisions, in a fashion that shall be decided by the Fund Presidium on the proposal of the Fund Executive Board". According to Porvazník, these were especially cases when a shareholding company was established, but no details were provided as to how the shares were to be sold, or, such cases, when the sale of shares in voucher privatization was initially approved, however, after privatization was invalidated, the original decision could not be enforced (Práca daily, December 19, 1996).

Legislative Development, New Privatization Laws

The non-existence of the concrete plans of the government in the privatization process stipulated by the Big Privatization Act and its provisions before 1995, had resulted in the passing of numerous amendments to the fundamental legal norm and other related norms. The legislative development was also impacted by inconsistency in passing laws, or, their amendments, that was conducive to passing ever-more amendments.
Among the most significant legislative changes that impacted the privatization process most dramatically, were the amendments of the Privatization Act, the Mutual Fund and Investment Company Act, the Act on the Procurement of State Interests in the Privatization of Strategically Vital Companies, the Income Tax Act, the Bankruptcy and Composition Act, and the government ordinance on the bond disposition.
The Privatization Act amendment legally stipulated the invalidation of voucher privatization and replaced it by the the-called bond method. Also, through the amendment, the residual powers to propose direct sales were transferred from the Ministry of Privatization to the NPF (from November 1994, until the amendment became effective in July 1995, the proposals for direct sales could be submitted by the Ministry of Privatization, or the Executive Board of the NPF, whereby the decision was made by the Presidium of the NPF). According to the above amendment, proposals for direct sales were only submitted by the Executive Board of the NPF and the NPF Presidium decided on them. Also, the amendment solidified the powers of the NPF in those companies and assets that were sold on instalments. Officially, this

innovation was justified by an effort to minimize the risk of non-performance, or, asset looting without their prior payment; effectively, however, the much more relevant motif was *an effort to establish means and tools for the NPF* (the government coalition, that is) *to maintain a long-term influence* over the "privatized" assets.

The main purpose of the *amendment of the Mutual Fund and Investment Company Act was an effort to sweepingly weaken their power and influence.* According to the amendment, all the investment companies were bound to transform into companies with a registered capital of SKK 20 million minimum, which resulted in the winding-up of the majority of them. Furthermore, mutual funds were bound to reduce their share in individual shareholding companies from a maximum of 20 per cent to 10 per cent, whereby they were authorized to have their representatives on the supervisory boards, but not on the boards of directors. This significantly curtailed the influence of investment companies on the operation of shareholding companies.

In addition, the above amendment curtailed the private rights of the Fund shareholders, as all the shareholder decisions were subject to the approval of the Ministry of Finance, starting from the approval of the statutes down to the election of the Fund body members. One Article even vested the Ministry of Finance of the S.R. with the right to examine and evaluate the standard of professional competence of the investment company and the mutual fund personnel. Another discrimination was that funds were obligated to contribute fees to support the state supervision operation. Also, the amendment reduced the remuneration for the fund administration from 2 per cent to 1 per cent of the value of administered assets.

Another, equally significant, privatization act was *the Act on the Procurement of State Interests in the Privatization of Strategically Vital Companies.* This Act singled out two groups of "strategically vital companies". The first comprised 27 formula-computed companies that were to be exempt from privatization, i.e. especially state enterprises in the energy and gas industry sectors, posts, telecommunications, military production, pharmaceutical production, general engineering industry, agriculture, forestry, and water management. The second group was composed of 40 companies that could be privatized, however, the State was to retain its influence in them, either by virtue of owning a significant block of shares in those shareholding companies that had not been privatized, or, the so-called golden share (i.e. a share with special rights) in those shareholding companies in which the majority block of shares had been privatized. With these shares, the administration of the business stake of the State was to pass over from the NPF to the relevant ministry that had been the company's founder earlier on.

The leading motif of the fourteenth amendment of the Privatization Act was the inevitability to amend the confusing legal provision, of September 1995, according to which the NPF was obligated to enforce either the employee participation in the privatized assets of all the privatized companies, or the assets of the privatizing entitity. The confusion about it was that with some privatization types it was not technically feasible to enforce the provision on the mandatory employee privatization, whereby the Act did not stipulate any exceptions that would allow for the non-enforcement of employee privatization. Initially, the government proposed to have the NPF decide on the mandatory employee privatization in instances, when the founding ministry and a trade union organization requested it. Based on the proposal of a HZDS MP, this obligation of the NPF was eliminated and the enforcement of employee privatization was left fully at the discretion of the NPF.

Rejected was an opposition proposal to have the government submit information on the until then participation of employees in privatization; also, the proposal to have the government elaborate a comprehensive analysis of the privatization process for the Parliament, was declined. There was no cooperative spirit on the part of the coalition MPs, which is best evidenced by the rejection of the proposal of MP Dzurinda (Christian Democratic Movement,

KDH) to exempt from the law the obligation of communities to buy the bonds, which the Constitutional Court declared unconstitutional in 1996.
The Parliament passed another Act that enforced an unconstitutional favoritizing of the narrow groups of privatizing entities that privatized largely in direct sales and had close ties with the government coalition parties. Controversial was the amendment of the Income Tax Act that enabled entities that privatized assets in direct sales to deduct from their tax base an amount equivalent to that portion of the company price they had invested in the company.
In September 1996, the Slovak Parliament, on the government proposal, passed the Bankruptcy and Composition Act amendment, according to which exempt from this mechanism were all state enterprises and shareholding companies to which the Strategic Company Act was applicable.
The government did not hide that the overriding motif behind the passing of this marketwise non-conformist decision was the threat of adjudging the Slovak Telecommunications bankrupt in conjunction with a controversial, over a hundred billion account receivable, the SIPOX private company had with the above state shareholding company. Several opposition representatives stated that in their opinion the amendment was unconstitutional, because it established privileged conditions for selected economic entities.
In September 1996, the MPs of the Party of the Democratic Left (SDĽ) proposed to provide the retired citizens with an option of an early honoring of their bonds by late 1997. In September, the proposal was rejected by the Parliament; in October, a compromise was made, and the early honoring of bonds by June 30, 1998 at the latest, was approved for citizens over 70 years of age.
The government ordinance that detailed the conditions and forms of the bond use, was approved as late as nine months (in March 1996) and became effective as late as eleven months (May 1996) after voucher privatization had been invalidated and replaced by the so-called bond privatization method in June 1995. On May 30, 1996, a group of the MPs of the National Council of the Slovak Republic, represented by the Democratic Union MP and former Vice-president of the NPF, Viliam Vaškovič, filed a petition with the Constitutional Court of the S.R., in which it contested the above government ordinance for being at variance with the Constitution of the S.R. In their motion, PMs challenged several articles of the above ordinance, whereby the gravest was that the ordinance was in conflict with the Constitution, as it breached the principle of equality before law and the equality in rights, it curtailed the ownership right of bond holders, and that the ordinance vested the National Property Fund with powers that were at variance with the valid laws and that could be vested by law only. The Constitutional Court agreed with the majority of the arguments of opposition MPs and stated that by the given ordinance, the government of the S.R. breached several provisions of the Constitution of the S.R. and several other laws. The Constitutional Court agreed to eight of twelve items in which the opposition MPs spelled out their opinion on the conflict between the government ordinance and the Constitution of the S.R. and other laws.
The government of the S.R., at its session on April 15, 1997, approached the National Council of the S.R. with a request to pass the Big Privatization Act amendment in a summary legislative proceedings, according to which the direct sale powers were to be delegated back to the government of the S.R.
It should be noted that the Constitutional Court decided on the unconstitutional delegation of these powers to the NPF of the S.R. on November 21, 1996, whereby this ruling of the Constitutional Court of the S.R. became effective by virtue of its publishing in the Collection of Laws, on December 11, 1996. According to the Slovak rule of law, in the event the Parliament does not invalidate those articles that have been declared to be at variance with the Constitution of the S.R., invalidation shall be effectuated automatically after half a year from the date of the effect of the adjudication of the Constitutional Court of the S.R. In this

particular case, the controversial wording was to be automatically invalidated after June 11, 1997, however, the effectiveness of the delegation of the direct sale powers was invalidated on that very day the adjudication of the Constitutional Court of the S.R. took effect, i.e. on December 11, 1996.
The National Council of the S.R. eventually approved the amendment of the Act, on June 27, 1997 (i.e. more than half a year from the date of the effect of the adjudication of the Constitutional Court of the S.R.), whereby the coalition majority declined several opposition proposals that were to facilitate the Attorney General and the Supreme Audit a better control of the NPF activity, and were to assist the elucidation of the controversial Article 28, Item 5, on the basis of which the NPF of the S.R. continued its privatization activity even after the ruling of the Constitutional Court on the unconstitutional delegation of the direct sale powers to the NPF of the S.R. had taken effect.
Despite the fact that the Act amendment was passed, the government of the S.R. did not decide a single direct sale case, the Ministry was reluctant to select from among the acquirers of the assets privatized in direct sales, on the contrary, everything took place under the direction of the uncontrollable and uncontrolled NPF of the S.R., with reference made to the above Article 28, Item 5.

Affinity Groups Behind the Privatization Process

Events that had a significant impact upon Slovak privatization, of 1995-1998, and, especially those of June 1995, are rooted *in the activity of affinity groups. In fact, they were conducive to a sweeping enforcement of the interests of the state-managerial and industrial lobby affiliated with HZDS and political and economic structures of the communist regime, and, on the other hand, a total destruction of the so-called new economic structures that were the outcome of the first voucher privatization wave and were linked with the leading mutual funds and investment companies.* The Association of mutual funds and investment companies (being the representative of the second, destructed group) voiced shy protests against the government acts, while the Federation of Employer Unions and Associations (the representative of the first, favored group) openly praised the government for its privatization acts (refer to the declaration of the F.E.U.A., of April 14 and June 20). With some sarcasm it may be said that the Federation praised its own acts (as it was behind all these changes).
Right from the beginning, industrial and state-managerial circles opposed voucher privatization. From November 1989 to June 1992, this opposition was indirect and not very effective. This was due to the fact that at that time the Screening Act was passed and put into effect, and also a significant part of these groups was closely linked with the communist party during the communist era. These were also the main reasons why HZDS and SDĽ were among the leading political allies of these circle - HZDS, for its overt dislike of voucher privatization and the Screening Act, and SDĽ for its common political past and rejection of the Screening Act. A vital *part of the growing influence of the industrial-managerial lobby was the solidifaction of its economic background. This is closely related to the expansion of unbriddled privatization.* Conditions for it were established thanks to the privatization slowdown after 1992, which is apparent from the Tables in the introductory part of this paper.
A significant corroboration of the influence of the industrial-managerial lobby is the fact that since 1992, five ministers of economy have been appointed in three governments (J. Ducký twice), each time, however, the minister was the representative of industrial lobby.
The best evidence of a massive favoritism of politically and otherwise loyal persons in the privatization process is a quotation from a HZDS document, of early 1996. It is an internal material of HZDS, entitled HZDS Policy in the Government and the State Administration Bodies. The document contains the tasks geared towards the solidification of HZDS influence

in the society. From the standpoint of the object of out interest vital is the section on trade unions, in which the document authors clearly spell out the most important criterion for the selection of the acquirers of privatized assets. The given paragraph in the HZDS document is as follows: "The starting point is the establishment of new trade unions from the employee base of those companies, organizations, and institutions that have been largely transformed to date, and are managed by owners-managers and are unambiguously linked with the HZDS program; they are its adherents and base their entrepreneurial activities on the democratic nature of the State".

In 1996, the influence of HZDS continued to be manifested, narrow groups allied with the government coalition were further favoritized and discriminated were all the others, including foreign investors. A novelty, as distinct from 1995, was that more than ever, information underlying the privatization process, and conflicts within the process itself, information on the political background, family members, and the direct involvement of some MPs and other party heads, were brought to light.

The efforts of opposition MPs to have opposition representatives on the NPF bodies and their repeated action geared towards partial legislave amendments that were to make the whole process slightly more transparent, were persistently and repeatedly thwarted by the coalition majority in the Parliament. The coalition majority even rejected repeated proposals to have the NPF submit to the Parliament a report on the privatization course and the analysis of the whole privatization process.

The proposition stated in the program declaration on the furtherance of employer privatization was blatantly denied. In tens of cases, a company other than employee-privatized was favoritized in the privatization, whereby in the majority of cases price quotations and investment terms and conditions were by far less favorable. From the standpoint of the press, the privatization of Biotika Slovenská Ľupča, SCP Ružomberok, Bučina Zvolen, Hotel Bratislava, Palivá Braislava, Istrochem Bratislava, STS Trnava, Lesostav Sever Žilina, Sandrik Hanušovce, Selekt Bučany, and others, may be listed as an evidence of the above procedure. When speaking of employee companies quoting higher prices in the above and other cases, by that meant are official price quotations made to the NPF. However, with the privatization conducted in a non-transparent, uncontrollable, and uncontrolled fashion, logically, employee companies quoting higher prices did not have any chance for two major reasons. Firstly, the higher the official price quoted to the NPF, the lower the second, unofficial part of the price to HZDS (SNS, ZRS), or others, who effectively decided on the privatization in the NPF. In addition, employee companies were also inconvenienced because with a large number of shareholders (employees and managers), the unofficial part of the price could be kept hidden from them and the public only with great difficulties. The unofficial price in Slovak privatization is to be understood as the increasingly common bribes, dormant partners, contracts on future sales, concealed true owners, etc.

Even if an employee company acquitted itself in privatization, oftentimes, it was brought to light that it was but a camouflage and that employee privatization was the Trojan horse to acquire property in favor of other people (SLK Piešťany case, for instance).

The partisan nature of privatization may also be evidenced by tens of cases when its protagonists did not hide that assets were privatized only with the HZDS back-up, and even that did not always suffice. Here, too, the saying "a bigger card takes it all" holds valid. An article from the government Slovenská republika daily, of January 27, 1997, may serve a good example. The author was rightfully embittered that the state enterprise at Partizánske-Šimonovany was not given to the employee company despite the fact that it was backed-up by the local HZDS organization. The employees headed by the chairman of the HZDS club investigated into the case, to find the reasons of their failure, and what they found was that the winning bid was presented by a higher-ranking HZDS official. The HZDS club members

adopted a resolution in which they condemned the non-transparent privatization. The article is entitled Will Financial Oligarchy Rule Our Republic? (Slovenská republika, January 27, 1997).

The abuse of privatization evolved into new forms in 1997, and cases were reported of wilful tampering with the concluded sales on the part of the NPF management, in a fashion disadvantaging the NPF and favoring the acquirers having even family ties with the members of the NPF management (for instance, NAD Trenčín case). Also, public was made the first big case of open privatization at a symbolic price, with the amount remitted to the personal account of a leading NPF official, with a subsequent sale of shares at a market price, which generated a considerable profit for the NPF employee (Baňa Záhorie case).

Throughout 1997, the political background of the privatization process was also evidenced by several statements of the government coalition representatives. “If another government movement or party were in power, it would be them privatizing”, said Viliam Soboňa, owner of Sliač and Kováčová spas, the HZDS election manager in 1994 elections and Minister of Health in the second Mečiar’s government, in an interview for Radio TWIST, on December 10, 1997. It was apparent that he considered normal to privatize in favor of the government coalition individuals, which he was not hesitant to state in public.

Once again, the events of 1998 corroborated the above partisan and preconceived nature of the privatization process. The great influence of the industrial lobby associated within the Federation of Employer Unions and Associations upon the privatization policy of Mečiar’s coalition and government is generally known. In April 1998, this influence was clearly and conclusively manifested. The reporter of the private Radio TWIST obtained a copy of a fax entitled Companies Prepared for a Speedy Privatization. It is a list of six companies with a proposal to have them privatized by six concrete companies. The fax was sent on April 4, 1995, to Tomášikova Street (HZDS headquarters), and was signed by Jozef Kollár and Slavomír Hatina. The former was the former director and current owner of Duslo Šaľa, the latter was the former director and current owner of Slovnaft Bratislava. On the list of six companies were also companies which were managed by them and privatized in August 1995 in their favor, in a fashion suggested in the above fax.

In conjunction with the upcoming elections, in the spring of 1998, the statements of Ján Ľupták, chairman of ZRS (Association of the Workers of Slovakia), were heard ever-more frequently, in which he dissociated himself from privatization. Miroslav Kočnár, his former party peer and independent MP, responded as follows: “the deetatization of each company, be small or big, was decided by Vladimír Mečiar, Ján Ľupták, and Ján Slota, leaders of HZDS, ZRS, and SNS respectively, on their regular coalition meetings held on Mondays" (Pravda daily, May 2, 1998). Originally, these meetings were also attended by the vice-chairman of ZRS and president of the NPF of the SR, Štefan Gavorník. Kočnár stated that originally, these meetings were to be attended by the boards of ruling parties, however, under the pretext of a bigger flexibility, these meetings narrowed down to the attendance of the bosses of political entities. "Hence, the ZRS management does not have the moral right to dissociate itself from collusive decisions. Let Ľupták say openly what his stake in Cementárne Ladce is, and Gavorník about his stake in the Lehnice State Enterprise, Bratislava Wineries, and Stein brewery". Kočnár stated that these people privatized via their relatives or stoodges (Pravda daily, May 2, 1998).

Privatization, as seen by the Public

On the verge of January and Feburary 1997, the FOCUS agency conducted a public opinion poll which reported that only 1 per cent of the respondents considered the government privatization policy fair, 9 per cent rather fair, 27 per cent rather unfair, and 45 per cent unfair. Hence, the survey indicated that as much as 72 cent of the citizens voiced their disagreement with the government privatization policy. Only the government policy in the protection of the citizens against criminality reported a higher percentage of non-confidence, i.e. 75 per cent (Pravda, February 25, 1997).
In late October 1997, results of another survey were made public, this time, the survey was conducted by the Institute for the Public Opinion Poll Research at the Statistics Office of the S.R. According to the survey, content with the privatization were only 2 per cent of citizens, more content than discontent were 6 per cent of citizens, more discontent than content were 27 per cent of citizens, and discontent were 58 per cent of citizens. As distinct from FOCUS survey from early that year, the latter reported an overall increase of the discontent by 13 per cent, i.e. to 85 per cent.
The question, whose standard of living would be positively impacted by privatization, the respondents answered as follows: everyone's (2 per cent); of those who work in perspective areas (13 per cent); of those who privatized (40) per cent, of some wheeler-dealers (40 per cent). The above two surveys indicate the growing discontentment of the citizens with privatization.

The Remedies of Privatization Missteps

In 1997, apparently, with the looming 1998 elections, proposals and assumptions on the possibilities and limitations of remedying the privatization missteps after the elections grew in number. In April 1997, the vice-chairperson of SDĽ, Brigita Schmögnerová, stated that "the intention of SDĽ is to amend the Act No. 92 on privatization, of 1991, in such a manner that in a specific case criminal proceedings might be instituted, if it comes to light and is proven that during privatization the interests of the State have been damaged. We also have to assume some risk, or, retroactivity in the effect of the law, if we are to resolve the most blatant cases, such as Nafta Gbely and Piešťany spa, and tens of others" (Práca daily, April 11, 1997). In the same interview, B. Schmögnerová, making reference to Gavorník's statements for the press that among the privatizing entities who acquired assets in direct sales, were also leading politicians, stated that Gavorník was well aware of those people breaching the law on the conflict of interests, and, hence, was obligated to report it. "Since he hasn't done it, he'll be held responsible for it" (Práca daily, April 4, 1997).
The discussion on the issue of remedying the privatization missteps became ever-more animated in 1998, especially in conjunction with the nearing parliamentary elections. SDK, the strongest opposition grouping, repeatedly stated that it was prepared and determined to enforce a consistent inspection of the legality of the privatization process and draw consequences from breaching the laws pertaining to privatization. A vital part of the SDK program in privatization was also the setting up of a public register of privatized assets that would provide the public with information who, when, and under what terms and conditions acquired assets in privatization. Part of the SDK program in this area is also the elimination or making more transparent all the tools that are currently being utilized for the concealment of

the information on the true asset acquirers and instances of breaching the laws (bearer shares, dormant partner contracts, and the like).

Conclusion

Privatization under Mečiar‘s last cabinet was among the significant tools of the escalation of clientelism that also infiltrated other areas of socioeconomic life. The non-transparency, preconception, interlinking of political and economic power aggravated. On the one hand, the speed of the privatization process slowed down, on the other, the “quality” of the non-transparency, preconception, and unlawfulness was upward-sloping.
Despite the fact that in late 1996, the Constitutional Court of the S.R. decided on the unconstitutional nature of delegating the decision-making powers in direct sales from the government to the NPF of the S.R., throughout the whole of 1997, the Fund continued in direct sales in a fashion that breached the spirit of the adjudication of the Constitutional Court of the S.R., and in some cases (PNS case, for instance), even the substance of the ruling.
This non-transparency acquired a new dimension in the first case of share privatization at a symbolic price, with the amount remitted to the personal account of the leading NPF official (Baňa Záhorie case), whereby the gentleman subsequently sold the shares for a much higher market price and collected a profit amounting to tens of millions of crowns. Until then, the privatization in favor of insiders had taken place largely through stoodges, relatives, or via bearer shares. Apparently, in this case the motif behind “transparent” privatization with the income remitted to a natural person’s own account was that the income was tax-free.
Also, new by their quality were cases of a deliberate pre-arrangement of some sales in such a fashion that the acquirer wilfully failed to meet the sale and purchase contract conditions, and, consequently, the Fund took the company away from him only to sell it to the same acquirer for the second consecutive time (through another company, in which, however, the original assets were not held for too long) at a much lower price than in the initial case. In the second transaction at a lower price involved was another person very close to the leading Fund official (NAD Trenčín case).
New by its quality was also the manner in which the shareholder rights in shareholding companies were enforced by the NPF of the S.R.. The analysis of the collapse of the IRB bank and the activity of the bank shareholders indicates that the NPF continuously acted in favor of the shareholders associated with VSŽ (East Slovakian Steel Works), which had a detrimental effect upon the bank.
The manner in which property was privatized in Slovakia was bad not only because it was the epicenter of corruption, unlawfulness, and clientelism, and the interlinking of political and economic power. An inevitable consequence of such privatization is the lagging behind of the real economic restructuring. Among the vital reasons of the restructuring deficiency which, eventually, accounted for the building-up of macroeconomic imbalance, was the fact that privatization led to the looting of companies after they were privatized rather than their recovery. This was due to the fact that the true owners were oftentimes persons different from those who presented themselves as owners in public, and also because many true owners favored a speedy and safe short-term profit from the company-looting over a doubtful and long-term profit from the recovery and restructuring of a privatized company. Moreover, these preferences were enhanced by the apprehension that the title to assets acquired in a non-transparent and, oftentimes, unlawful manner, could be challenged.
Also, worth mention is the growth of the discontentment of the citizens with privatization: in late 1997, as much as 85 per cent of citizens stated their total or prevalent disapproval of the

privatization course, and 80 per cent of citizens stated that such a privatization would be beneficial only for those who privatized, or, for wheeler-dealers. In the pre-election period, this fact ushered in statements and opinions that were surprising, at first sight. The long-term chairman of HZDS and particularly active official in the privatization lobby, Arpád Matejka, did not run for his post at the HZDS congress, whereby he justified his leaving big politics by his discontentment with the privatization process. In late April, Mečiar, HZDS chairman and prime minister, stated that "privatization could've been implemented more fairly and more citizens should've got involved in it" (Pravda, April 30, 1998). This was said by man who concentrated a great power in his hands, man who led the government coalition, whereby several coalition representatives (for instance, Gavorník, NPF president and vice-chairman of ZRS, Ľupták, chairman of ZRS, and Slota, chairman of SNS), directly and indirectly, corroborated that it was coalition meetings in which the issues how and who would privatize, were decided.

The fax of the directors of Slovnaft Bratislava and Duslo Šaľa, of 1995, made public in April 1998, and mailed to the HZDS headquarters that contained the proposal to privatize the companies they managed in their favor, and their subsequent privatization according to this proposal, along with the statements and acts of prime minister Mečiar in conjunction with VSŽ and IRB bank, reveal a very alarming fact. The government of the S.R. has become but a puppet in the hands of influential groups that have concentrated an enormous economic and political influence through privatization.

The privatization in the Slovak Republic, due to the HZDS, ZRS, SNS government coalition, has become a trauma for the entire society, and, apparently, with long-lasting consequences.

The National Property Fund of the Slovak Republic

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Rising to Power

After the bodies of the National Property Fund of the S.R. (hereinafter the Fund), i.e. the presidium, supervisory and executive boards were revoked in early November 1994, to be replaced by the HZDS-SNS-ZRS government coalition, there followed a massive calling of the extraordinary general assemblies of shareholding companies in which the Fund had its stake, with an objective to execute changes in the companies‘ bodies. On supervisory boards appointed were coalition representatives, and, as a rule, the following key was used: three representatives of HZDS, while SNS and ZRS had one representative each. In this fashion a process of changes enforced by the new government coalition was triggered off.
By late 1994, the Fund assets had been composed largely of the Fund stakes in shareholding companies in a par value of over SKK 88 billion. Altogether, the Fund was a shareholder in 616 shareholding companies, of which in more than a 100 cases the Fund was the majority shareholder. In many other companies, the Fund also had a controlling block of shares, given the fact that in the first wave of voucher privatization, the ownership structure was still in evolution. At that time the Fund, being a majority shareholder, managed shareholding companies, such as Benzinol, Slovnaft, Doprastav, Hydrostav, Závod SNP, Chemes, Nafta Gbely, the Slovak Savings Bank, the Slovak Insurance Company, the General Credit Bank, the Slovak Electrical Company, and many others.
From the viewpoint of the use of the Fund investments in these companies and in accordance with the approved privatization projects, at stake were namely:

- residual blocks of shares from the first voucher privatization wave in a nominal value of SKK 11 billion
- according to privatization projects, shares to be used in the second voucher privatization wave, in a nominal value of SKK 25 billion
- shares left from an unsuccessful direct sale totalling SKK 5 billion
- shares from the infused registered capital amounting to SKK 7 billion
- shares whose purpose was not specified in projects amounting to SKK 10 billion
- shares in which permanent participation of the NPF of the S.R. was declared amounting to SKK 29 billion.

In addition, according to the documents of the Ministry for the Administration and Privatization of the National Property of the S.R., assets were prepared for the second privatization wave amounting to a book value of about SKK 177 billion. The value of this property was be realized as follows:

- SKK 41 billion to be sold using standard methods
- SKK 63 billion allocated for the second wave of voucher privatization
- assets in a value of SKK 67 billion to be retained in the form of the permanent participation of the NPF S.R., the remainder was to be used for other purposes.

The Fund accounts receivable at December 31, 1994, totalled SKK 23.8 billion, of which the outstanding past-due payments amounted to SKK 1.6 billion.
At December 31, 1994, the Fund was in deficit.This was due to the fact that in 1994, the projected privatization plans did not materialize. The shortage of funds towards the close of

the year which the Fund needed in order to honor the bonds to the General Credit Bank (VUB) to discharge company debt was resolved by the Fund concluding REPO deals (i.e. the sale of the Fund portfolio shares with repurchase option), amounting to SKK 3.2 billion. During 1995, all shares were repurchased.
The 1995 Fund budget assumed that the income from privatization in that year would total SKK 13.4 billion. However, the actual income from the sale of privatized property totalled only SKK 7.8 billion (without REPO deals). The same year, the Fund issued 377 desicions on direct sales, whereby sold were the majority, or, controlling blocks of shares in such solid shareholding companies as VSŽ, Doprastav, Benzinol, Slovnaft, Skloplast, Duslo, and many others.

The Government Program, a New Privatization Concept

In its government declaration, part entitled Privatization and Competition Protection, Mečiar's new government stressed a need to establish such ownership structures in which the local business community and the employees of privatized companies would be given a significant share. These objectives were to be met by combining standard methods with voucher privatization, whereby special emphasis was laid on the implementation of "competitive forms of sale and the choosing of the acquirer based on a precisely formulated and justified business plan." Furthermore, the government committed itself to the enforcement of employee participation in the company privatization and the promotion of a meaningful entry of foreign capital, whereby foreign funds were intended for modernization and the purchase of new technologies.
"The government shall ensure that the second wave of voucher privatization continues without unnecessary procrastination...By voucher privatization, the citizens shall be given an opportunity to acquire a share in the property of those shareholding companies which have a realistic chance to appreciate their assets". The government even stated that the continuation of the second wave of voucher privatization was its short-term priority.
As regards the Fund functioning, especially underscored was the need to embark on a more consistent recovery of accounts receivable, improve payment discipline, and a more consistent audit of those shareholding companies in which the Fund had its stake. Further, it was literally stated that "the government shall guide the privatization process so as to have it contribute to a better NPF liquidity and the generation of funds for the promotion of the developmental programs of the Slovak economy".

Replacing Voucher Privatization by Bond Privatization

THE INVALIDATION OF VOUCHER PRIVATIZATION

Already in the first year of the government assuming power, voucher privatization was exposed to heavy criticism and a war was waged against mutual funds. Parallel with that, a stepwise cutting down on the volume of the assets allocated for voucher privatization took place and the property value dropped below SKK 20 billion. (In the first wave of voucher privatization, investments amounting to SKK 80 billion were transferred).
By amending the Act No. 92/1991 of the Coll. (Act No. 1901/1995 of the Coll. of Laws), voucher privatization was invalidated in a hasty, unprepared fashion and contrary to the government program declaration, it was to replaced by the so-called "bond method". It should be noted that the above term was intended to create an impression that only the method was changed while privatization was to be continued and all the citizens were supposed to remain

involved. If the change is to be viewed in an objective light, a more appropriate term would be "bond compensation" for the invalidation of the citizen participation in voucher privatization.

THE BONDS OF THE NPF S.R.

The bond of the NPF S.R. – a unique type of security – whose parameters were stipulated by the law, was given free of charge to every citizen who was validly registered in the second wave of voucher privatization, and put to the asset account held with the Central Securities Depository at January 1, 1996. The bond par value equalled SKK 10,000 plus an annual interest income equivalent to the discount rate of the National Bank of Slovakia. The bond maturity was set at December 31, 2000. The number of issued bonds was identical to the number of citizens validly registered in the second voucher privatization wave, i.e. 3,329,565 pieces. The law allowed the citizen to use the bond prior to its maturity and sell it to the NPF debtor, to pay the debtor's liabilities associated with the privatization, for buying stock in a public stock market, additional pensions and health insurance, or the purchase of an apartment in private ownership.

In conjunction with the decision of the government and the Parliament of the S.R. on the issuance of bonds, several questions arise. Was the change also reviewed by experts and were their opinions taken into account? Or was it strictly a political decision and the responsibility for the bond payout was to be passed over to the following election term? The funding needs of the NPF in 2001 in view of the above reason were easily computed (without the interest income they amounted to approximately SKK 33 billion, with the interest income, almost to SKK 48 billion). The amount of NPF assets allocated for privatization was known, as well as the amount of accounts receivable and other payables. These were input figures which urged a uniform implementation of privatization in the following five years, with income maximization, or, staggering part payments over a 5-year period maximum.

However, no signs of the privatization policy were send out to indicate that the income from privatization was accumulated to pay the bonds. On the contrary: assets continued to be allocated in a fashion that increasingly disadvantaged the Fund, competitive forms of sale were ever-more disregarded, and so was the participation of the company employees in privatization.

After voucher privatization was invalidated and bonds were issued, nothing stood in the way to a confusing and uncontrollable privatization of the property using direct sale methods, conducted, as a rule, in favour of anonymous acquirers. This method was dominant in the years that followed.

BOND TRADING

The Fund commenced trading the bonds in the latter half of 1996. The early stage was accompanied by administrative measures of the government pertaining to the bond trade regulation. A minimal "market" value was set and it was equivalent to 75 per cent of the bond par value plus interest. This meant that in the first year, bonds were traded at a minimal value of SKK 7,500. The public market was characterized by a much higher offer than demand. It was soon brought to light that these deals were arranged in such a manner that the effective income for the citizen was hardly SKK 5,000. However, privatizing entities that concluded agreements with the Fund on the part payments in bonds, had SKK 10,000 factored in by the Fund for each returned bond. The difference at the citizen's expense was retained by selected securities brokers, privatizing entities, and those that enabled the whole thing happen. In each

year that followed, an interest income of SKK 880 was added to the bond par value. This is how the bond privatization, or, citizen's "compensation", was implemented.

The Impacts of "Mečiar's Privatization" on the Financial Position of the NPF S.R.

1996

The beginnings of financial difficulties of the Fund may be associated with the commencement of the process of part payments by privatizing entities in the form of bonds. In December 1996, the Fund concluded REPO deals, and although the deals amounted to only SKK 500 million, the deficit was bridged by retaining for a month SKK 1 billion remitted from a special account of the Ministry for the Administration and Privatization of the National Property of the S.R., originally allocated for the State Housing Development Fund. In December 1996, a commitment to DMD Holding Inc., Trenčín, was reported, totalling SKK 2.2 billion, which was due to the shortage of the NPF finance. *It was this commitment that was used as a pretext for one of the last Fund transactions before Durinda's government took over in 1998, i.e. transfer of 42 per cent of DMS Holding shares to its subsidiary, DMD PROGRESS, Inc.; the Fund lost its majority stake in DMD HOLDING and had no longer control over the investments in 22 machine engineering companies in which DMD had its stake.*

In 1996, which was a year of intense privatization and the Fund issued 466 decisions on direct sales (among them were investments in Nafta Gbely or Severoslovenské celulózky a papierne), the Fund cash income from privatization reached SKK 7.9 billion, while the part payments in bonds amounted to SKK 2.2 billion.

1997

In 1997, the Fund liquidity suffered from the consequences of privatization which was conducted in favour of the local business community with foreign capital almost wholly excluded. Privatization was characterized by purchase prices that were way below the book value of assets, an option to factor in the investments in privatized entities, an almost sweeping discharge of interest payments, modifications of payment schedules, and the acceptance of part payments in bonds.

During the first half of 1997, the Fund bridged the deficit by increasing the volume of REPO deals to SKK 1.3 billion. While earlier on, REPO deals served primarily as a tool that helped bridge temporary liquidity problems, towards the close of the 1997 calendar year, the financial crisis in the Fund deepened. The need for borrowed funds became ever-more urgent, and the Fund was forced to prolong several REPO agreements. The crisis culminated in late 1997 – the Fund had no finance to honor its current liabilities, and, hence, it did not have own funds to honor the bonds to the citizens over 70 years of age after December 31, 1997.

An early payment of bonds to the oldest citizens was approved by the amendment of the Act. No. 92/1991 Coll., in October, 1996. The parliament decided to honor the Fund bonds to citizens over 70 years of age at December 31, 1997. This fact incurred a cost of over SKK 3 billion to the Fund. Although in 1997, the Fund familiarized itself with the amendment of the law, it did not adopt adequate measures to maximize its money income, and the larger privatizing entities, acquirers of the most lucrative property, were granted an option to pay the instalments in bonds.

The privatization per se, after the finding of the Constitutional Court, of November, 1996, on the unconstitutional delegation of the direct sale powers from the government to the Fund, was partly subdued. In 1997, the Fund issued only 62 approvals on the direct sale of shares from its equity portfolio. In 1997, the income from the sale of privatized assets totalled SKK 6.8 billion (without REPO deals). However, of this amount, the Fund accepted only SKK 2.2 billion in monies, i.e. less than a third. The remainder (SKK 4.6 billion) was honored in bonds, whereby in the above figure included were the early payments of instalments for the years to come. *The Fund balance, at December 31, 1997, indicated that its receivables, as opposed to the end of the previous year, dropped by over SKK 10 billion (from SKK 32.9 to SKK 22.6 billion), whereby of the amount, SKK 2.3 billion were past-due unpaid instalments. The above figures deserve a more profound analysis, especially from the viewpoint of adjustments.*

1998

The 1998 Fund budget was submitted to the National Council of the S.R. as a balanced one. It assumed expenditure and income in an amount of SKK 7.1 billion. Of the total income, the income from newly-concluded contracts was estimated to be SKK 3 billion in 1998. However, reality showed that this income was exaggerated.
In early January 1998, the Fund did not have own funds to honor the bonds to citizens over 70 years over age. At that time, the Fund hastily acquired borrowed funds from abroad, totalling DEM 124 million (about SKK 2.4 billion), under unfavorable conditions, for a 6-month term. *The transaction was a bill-type transaction, whereby the cost of money was about 17 per cent p.a.* This fact was given a broad coverage in the mass media and the until then confidential information on the Fund's illiquidity were divulged.
The overriding priority of the Fund in the pre-election period was the honoring of bonds to citizens over 70 years of age. The honoring of other commitments on the part of the Fund came to a standstill. By June 30, 1998, the Fund had used almost SKK 3 billion for honoring the bonds.
The six-month period for the repayment of borrowed funds that the Fund used for honoring the bonds was way too short for the Fund to raise the money from its own sources, and it was also too short, to replace it by other, longer-term money from borrowed funds. In July 1998, the Fund had serious problems with acquiring any kind of funds whatsoever. The local banking sector did not dispose of any surplus funds and foreign countries were very cautious in the pre-election period. Eventually, the Fund made a REPO deal with the Slovak Insturance Company, *in a total value of SKK 1.6 billion. In the REPO deal, the Fund pledged lucrative shares from its portfolio (VÚB, Banka Slovakia, Restitution Investment Fund, the Slovak Navigation and Ports, DMD Holding, and Interhotel Tatry). Parallel with that, the infusion of registered capital took place in the Slovak Insurance Company, for which the Fund voted, but did not partake in the infusion. Hence, the process of hidden privatization was triggerd off in the Slovak Insurance Company, as well as VÚB (General Credit Bank), and other investments which the Fund had pledged in the REPO deal. In conjunction with honoring the bonds in July 1998, the Fund had another commitment to the Slovak Insurance Company, totalling SKK 0.8 billion.*

The Present State of NPF S.R.

ASSETS

Currently, the total par value of the Fund investments amounts to approximately SKK 58 billion, of which SKK 42.7 billion are permanent investments (in Slovak Electrical Company, Inc., Slovak Insurance Company, Inc., Slovak Savings Company, Inc.). These investments cannot be privatized pursuant to the Act 192/1995 Coll. on the procurement of State interests in the privatization of strategically vital state enterprises and shareholding companies, as amended.
For sale are allocated investments in a par value of approximately SKK 15 billion. Given the fact that these are largely minority stakes, or, investments in the companies that are being wound-up or in bankruptcy, their market value represents but a fraction of par value.

HONORING COMMITMENTS

The above clearly indicates that in late 1998, the Fund was in a totally different situation than four years earlier. In 1995, the declared proposition that "the government shall guide the privatization process so as to have it contribute to a better NPF liquidity and the generation of funds for the promotion of the developmental programs of the Slovak economy", was never met. This is also evidenced by the state after the Fund had honored its commitments to some sectors, or, creditors. At September 30, 1998, the Fund owed:

- the health sector SKK 130 million
- agriculture SKK 560 million
- housing SKK 500 million
- payment of debt of the companies in conversion SKK 240 million
- honoring bonds to towns, communities, and companies that sold apartments to citizens for bonds SKK 420 million
- engineering industry SKK 400 million

In total, at September 1998, the Fund's past-due liabilities amounted to SKK 3.1 billion. Until late 1998, the Fund is to honor its commitments totalling SKK 3.9 billion. It is assumed, however, that by the end of year, the Funds will be short of about SKK 2.4 billion.

HONORING BONDS

By September 30, 1998, 1,065,792 pieces of bonds had been prematurely withdrawn from circulation, which represents less than a third of the total issue. From the standpoint of the purpose of their use, the structure of redeemed bonds is as follows:

- honoring commitments on the part of the Fund debtors 732,881 pieces (68.8 per cent)
- honoring bonds to citizens over 70 years of age 251,887 pieces (23.6 per cent)
- honoring bonds to the rental housing owners 17,351 pieces (1.6 per cent)
- sale of shares for bonds

55,649 pieces (5.2 per cent)

- other purposes

8,024 pieces (0.8 per cent)

The main form of the bond redemption was the honoring of the commitments of the Fund debtors, and were it not for the amendment of the Act No. 92/1991 Coll. on the early honoring of bonds to citizens over 70 years of age, the above form would be clearly predominant. After the finding of the Constitutional Court pertaining to the Fund bonds, it is feasible to redeem the bonds only for the reasons of honoring bonds to the rental housing owners, citizens over 70 years of age, and for the exchange of the bond for shares from the Fund portfolio.
Given the above facts and valid legislation, it may be assumed that in the next two years, the process of the early payment of bonds will come to a standstill. The greater portion of bonds that have not been redeemed to date (at September 30, 1998, it was 2,263,773 pieces) will presumably remain unhonored until maturity. In 2001, the Fund will be in need of approx. SKK 30 billion to honor the bonds, including interest income for a 5-year period. However, based on the current financial statements of the Fund and the projection figures by the year 2002, the Fund will be short of this money.

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4) Internal documents of the National Property Fund S.R.

Natural Monopolies – Family Silver of Silver of Some Families?

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Natural monopolies (NM) are economic entities that are not exposed long-term term to a competitive environment in their respective business activities, whereby their positions reflect economic and technological conditions in which they operate. In Slovakia, the above concept is largely used in conjunction with the following companies: the Slovak Gas Industry, State Enterprise (SPP), the Slovak Electrical Company, Inc., Bratislava (SE), the West Slovakian Energy Company, State Enterprise, Žilina (SSEZ) , the Central Slovakian Energy Works, State Enterprise, Žilina (SSEZ), the East Slovakian Energy Company, State Enterprise, Košice (VSE), and Slovak Telecommunications, State Enterprise (ST).
The production of the above entities is vital for the whole Slovak economy, hence, it is only logical that their efficient functioning and healthy development are crucial for the country's economic growth. In view of the above facts, we have been witnessing an almost global reform of the NM control in the past few decades. The objective which is being mostly met, is to enhance the quality and reduce the costs of production which is manifested in consumers directly, or indirectly via reducing the costs of other entrepreneurs. The transformation of the regulatory framework takes various forms, however, it is distinct by several common features. Within the framework of the market structure reform, the de-etatization, or, de-politicization of NMs takes place, and the spinning-off of its parts which may function independently in a competitive environment. Hence, the distortions caused by partisan interventions into the NMs functioning are substantially limited, and limited is also the space for the abuse of monopoly positions in related markets. Equally significant is the transformation of revenue control, notably, price setting. In this area systems are being adopted that motivate the companies to reduce their costs and upgrade their outputs, for instance, by relating the price increase to inflation and a subsequent fixed profit sharing between the State and the company. Standard part of the reform package is also changing the control of the NMs conduct (e.g., a non-discriminatory access to networks facilitated by NMs) and the establishement of a specialized, comparatively independent regulatory office.
In Slovakia, the regulatory framework reform in the energy sector was started as late as 1998, and the first shy step[1] was the passing of the Energy Act No. 70/1998, effective as of July 1, 1998. Some reform steps are also undertaken in telecommunications, however, not to full satisfaction. After the federation break-up, the fixed telecommunication services of the C.R. in absolute figures increased twice as fast as in the S.R., which corresponds to the population ratio of the two countries. However, last year in Bohemia, where the regulatory framework had been already reformed, the number of connected subscriber stations was 3 to 3.5-times higher than in Slovakia.[2] The 1997 SE (Slovak Electrical Company) net profit was by 65 per cent lower than in 1996, an in SPP (Slovak Gas Industry), for the given period, profit dropped by 44 per cent. The great potential of natural monopolies is sacrificed in favour of political parties that strive to maintain power even at the expense of a significant deterioration of the position of hard-core companies, and hence, the entire economy. An example of such efforts was the declaration of the referendum on the non-privatization of strategic companies that took place on September 25 and 26, 1998. A clearly technical problem turned into an issue to be decided by the citizens without organizing any prior serious discussions about this step in Slovak mass media. The referendum objective was to use the opinions of the majority of S.R.

citizens to thwart the chance of the new government (for instance, by capital infusion in NMs by strategic partners) to raise funds for addressing the serious problems of the Slovak economy.

The arguments most frequently used to postpone the regulatory framework reform may be broken down as follows:

- The State cannot lose control over "family silver". There is no doubt about that. It should be noted, though, that NMs, given the Slovak conditions, are, indeed, family silver, however, it depends what family you mean. It definitely is not the State.
- The State cannot pass over its control over strategic companies, as this would result in the disappearance of their utility nature. The text below gives some examples to illustrate that natural monopolies in Slovakia are: 1) oftentimes beneficial only for part of the public; 2) under the term "utility" the State understands solution of problems that ought to be within its authority;
- The ever-less frequently used argument is that first the market value of strategic companies must increase and only then changes can be implemented.

In the text below, let us consider how natural monopolies in Slovakia fulfill their functions, how they behave to be beneficial for the entire society, whom they serve as family silver, and how their market value is increased.

To a large extent, the profits of natural monopolies are used to aid private entities. A good example of this is the purchase of 18.91 per cent of shares of the loss-making mechanical engineering company Považské strojárne, at a purchase price of SKK 400 per share, while the price per share in the given period was only SKK 90. A similar example is the 6 per cent share in Nafta Gbely purchased by the Slovak Gas Industry (SPP) at a price seven times higher than what the National Property Fund sold for its controlling block of shares of the same entity to Druhá obchodná, Inc. At a price seven times higher than the privatization price, the Slovak Gas Industry purchased 10 per cent of shares of the second issue of the Slovak refinery Slovnaft.[3] For the purchase of the Poľana Hotel shares, SPP paid SKK 110 million, whereby the previous owner purchased the hotel from the National Property Fund for SKK 50 million. In many cases, the State purchased assets from itself and sold shares to itself via private companies – the price difference amounting to hundreds of millions of crowns was at its expense, and, hence, at the expense of tax payers. When disposing of the assets of natural monopolies it should be underscored that these are companies whose production, behavior, prices, ownership, and structure are not optimized by competition pressure. Hence, public oversight is fully justified in this case. Another example illustrating the fashion in which political power was exercised via NMs, are two contrasting statements of mayors of communities published in the local press: "By 1989, the gas line had been pulled in the first half of our village. We've been struggling with the second half since 1991." The second statement on running a gas line in a community was just the contrary: "...the costs were borne by the gas company. Otherwise, it would've cost the community 14 million...I don't know, whom to thank". The Slovak Gas Industry approached the communities in a clearly discriminatory fashion. According to press information, in the community in which the costs were borne by the gas company – at Boldog – a beautiful house of Mrs. Anna Nagyová was built in the past two years. It should be noted that *assisting some communities at the expense of others* requires considerable amounts of money – the request of the Association of Towns and Communities of Slovakia to have SPP compensate the community investments in the respective infrastructure, was responded to by the SPP C.E.O. as follows: *"Presently, we're pulling gas lines in northern Slovakia. Which means that if we gave the billion to these communities unjustified, we couldn't be running the gas line where there isn't any gas line so far".* The *sponsoring* of NMs owned by the State is not problem-free, either. The SPP C.E.O. and chairman of the Board of Directors of the Slovan Bratislava football club, after being

elected to the position, confirmed to journalists that SPP would be Slovan's general sponsor. There's nothing wrong with that, if it were a private company. However, in the case of a state-owned enterprise the question is whether the citizens of Slovakia, who have no affinity for football, and the football fans of other Slovak clubs agree with such a decision. In Slovakia, all natural monopolies are under the political party control. Among others, this gives vast opportunities to narrow affinity groups to intervene in the economy and other areas. Oftentimes, decision-making in concrete cases raises suspicion that it is not motivated by the interests of the whole society.

Natural monopolies, contrary to the interests of the society, served for *"stowing away the staff loyal to the ruling political parties".* An example of that is the case of the spokesperson of the government of the S.R. who was employed with the SPP. Such a policy, if extensively used, demotivates the citizens, downgrades the standards of personnel policy in hard-core companies, etc.

The intervention into the society's democratic development and the risk of the competition distortion are better "legible" in the case of the activities of Slovak Telecommunications. ST terminated an agreement it had with its debtor, the VTV private TV company, at June 30, 1996. STV, public television, despite the fact that by late 1997, it had owed Slovak Telecommunications about a quarter of a billion of crowns[6] , had neither the agreement with ST terminated, nor its broadcasting cut off, unlike the case of the private Radio Twist. The payment for which Radio Twist broadcasting was cut off amounted to SKK 0.17 million. When justifying the action against Radio Twist, ST telecommunications stated that "...Radio Twist had an agreement by 120 per cent more favorable than other radio broadcasting companies...". According to the valid Slovak legislative, entrepreneurs in dominant, or, monopoly position shall not discriminate their clients (i.e. enforce discriminating conditions), which equally holds for ST. In view of the fact that NMs are owned by the State which is simultaneously responsible for competition protection, there is a risk of jeopardizing the fundamental precondition of economic growth, i.e. the competitive environment.

Demonopolization, vertical separation of technologically related activities, enabling the entry of new entities to the market, and a horizontal division of the entity to several competitors is clearly beneficial for the entire economy.

To date, no energetic measures have been adopted in the energy sector. The significance of demonopolization may be best illustrated by the telecommunications sector, where competition in the operation of cellular telephone networks was gradually introduced: "The first client wave in 1991 was ready to pay SKK 150,000 for a cellular phone"[7] , in February 1997, one of the two operators in the cellular telecom market launched a sale of phone sets "for as low as SKK 8,500". In March 1998, its competitor, Globtel, offered a cellular phone for one crown! The telecom services market countours the same development. In 1998, some companies from the U.S.A. entered the local market. Apparently, this is a country in which the competition in this sector has been most effective – it offers long-distance connections within the North American continent (U.S.A. and Canada) for 5 cents per minute (SKK 1,50), in case of weekend calls. For comparison, during the weekend, 1 minute of call in Slovakia is charged SKK 10,50 in comparable international tariff sections I and II.

Analogous benefits could be achieved in the case of the vertical organizational division of power generation and its transmission. Three or more newly-established distributors could purchase cheaper electricity abroad without problems. With this option non-existent, it is not feasible to elaborate a reliable study of the new capital investments efficiency, newly-built power plants. From the economic viewpoint, an organizational link of power generation and distribution is not only unprofitable for the consumer and the society due to higher prices, but also unreliable in terms of the information essential for making efficient economic decisions which may result in losses of several billions of crowns.

Among the performance parameters price is crucial. By distorting the price in hard-core production, the economy performance, the net balance of trade, and even political situation, may be negatively affected. The prices of natural gas may serve as an example of that. The C.E.O. of SPP, State Ent., gave an interview to Slovak Television as a response to the request of the Association of Slovak Towns and Communities to compensate the gas line running funded from the community budget.[8] He made the following statement: "The Slovak Gas Industry supplies the citizens with natural gas at a price that doesn't cover its acquisition costs, purchase and deliveries, that is. For instance, purchase price is SKK 3,50 per cubic meter of gas. The citizens pay only SKK 1,92". The risks for Slovakia which this seemingly appealing production sale "below price" entail, are several:

- A reliable estimate indicates that via SPP, the State *disposes of billions of crowns, the use of which is decided undemocratically,* as they do not got through the state budget. To sell natural gas for half price creates space for its use for political goals which can be met, for instance, in collaboration with those communities that urged SPP to run the gas line for them.
- The lower the price, the higher the natural gas consumption. If the price is below its optimum, which is presumably the case when the price is below production costs, the consumption is higher than its optimum. The energy demand of the Slovak economy is 4.3-times higher than the international average, whereby Slovakia imports 15 per cent of its consumption. Hence, an inefficient utilization of sources takes place, which is manifested in a reduced economic efficiency and also a negative net balance of trade with a country from which natural gas is imported (Russia), and even in an overall deficit of the balance of trade with respect to an artificially increased domestic consumption due to low energy prices. Negative balance of trade with the Russian Federation entails drastic measures geared towards the curtailing of import largely from advanced countries. To be more specific, the low price of natural gas means that SPP has decided, on behalf of the citizens, that they will opt for an overheated apartment rather than a new computer, TV set, or car.
- Oftentimes, natural monopolies solve the above problem by foreign loans to which they have a comparatively easy access. Hence, low prices of their production directly account for an increase of Slovakia's foreign indebtedness that exceeds a half of the gross domestic product.[9] The indebtedness of the Slovak Electrical Company (SE)[10] was among the reasons of lowering the company's rating by Standard and Poor's in September 1998. At stake are funds that, figuratively speaking, have been "eaten up", or, "heated away" in the energy sector.
- There is no motivation to build the relevant infrastructure. In the above-mentioned interview, the SPP C.E.O. stated that: "According to the new law, communities will have an option to manage the assets (i.e. gas branches) on their own, if they feel like it. I don't recommend it, though, as they'll lose a lot of money". This, indeed, is a true statement. Honestly, it does not pay to build an infrastructure when managing it is a loss-making business. This, however, would not be so, if the price of end production reached an economically-viable level. With current prices, the entities that build the infrastructure subsidize the entities that utilize the already built branches. In other words, housing construction lags behind, because young families who wish to build themselves apartments, subsidize the citizens that already dwell in their apartments.

The above risks are largely associated with the presence of low prices. In a non-transparent and inefficient regulatory environment just the opposite effect may take place. For the past several years, there have been proposals made to gradually increase telephone tariffs depending on the officially reported inflation rate. Despite that the obsolete system of price control largely exposed to political pressures persists: due to shifting telecommunication

services into the 23 per cent V.A.T. category, as of January 1, 1998, their prices have increased by 16.7 to 133.3 per cent. This is a clearly one-time, destabilizing measure. Such a price-setting complicates strategic planning not only of ST but also their commercial clients. Oftentimes, the public insists on the guarantee of stability on the part of the government and the latter tries to respond positively. Unfortunately, it does so largely by postponing solutions, not realizing, that it is the change (of prices, too) that has always been stable. Postponing solutions only results in problem accumulation and subsequent shocks.

Another significant area of control within the behavior control is *the system of public procurement of goods, services, and works.* As distinct from the European Union (E.U.), presently in Slovakia, the relevant act does not cover the activities of natural monopolies, and it concerns only orders partly or wholly funded from the state budget. The relevant legal norms are not been harmonized with the E.U. regulations. Of no lesser significance is that vast amounts of money that belong to the entire society are disposed of without appropriate control. The companies are not exposed to competitive pressures and are managed by the government which, indeed, represents the majority, but that majority is only part of the society. There is a risk that via the purchase of investments, advertising services in TV, the press, or billboards, via funding construction work, and the like, the so-called asset looting of companies may take place, an unwatned transfer of their assets in favor of those entities that do not represent the interests of the society as a whole. Another problem related to the behavior of natural monopolies are agreements that are signed by their representatives largely with foreign partners. Oftentimes, despite a strong pressure on the part of the mass media, their contents are kept away from the public.[11] Such agreements, too, may work against the interests of Slovakia.[12]

Traditionally, natural monopolies are the object of the interest of politicians worldwide. Unfortunately, this is largely so because via power and energy complexes, gas companies, telecommunications, potable water distribution, etc. the entire economy (hence, the entire society) can be controlled, and this is so even in a country that appears to be democratic at first sight. These companies may be a source of a significant state budget income and serve as an avenue via which foreign capital flows into an otherwise problem country; they may even serve as a tool for the extortion of foreign countries. The governments also use these entities to solve social problems, for instance, by exerting pressure on these entities to artificially absorb part of the unemployed. From the medium-term and long-term perspectives of a country's successful development, all the above goals are incorrectly formulated. Natural monopolies ought to be understood as entities whose conduct should come as close as possible to the functioning of companies that operate in a competitive environment. Just like with all the other companies, their task is to operate as efficiently as possible, and thus contribute to the country's assets creation in the most cost-effective way. The State should solve political, social, macroeconomic, and other problems by employing means other than natural monopolies.

REFERENCES

1 The law does not stipulate the obligation to facilitate the so-called third-party access to the network.

2 An interview at a press conference with the C.E.O. of the Telecommunications Sections of the Ministry of Transportation, Postal Services, and Telecommunications of the S.R., Peter Haluš, May 19, 1998.

3 Pravda, January 15, 1998.

4 Pravda, February 16, 1998. An interview with the mayor of Koniarovce.

5 An interview with the mayor of Boldog published in Plus 7 dní.

6 Národná obroda, November 13, 1998.

7 An interview with Artur Bobovnický, EuroTel C.E.O., Trend, November 19, 1998,

8 According to the relevant legislation, entities that implemented infrastructure projects at their own costs, were obligated to hand them over to NM administration, in the given case, to SPP, without compensation.

9 Due to the inaccessibility of aggregate data, given is an example of the syndicated loan of the Central Slovakian Energy Works, State Ent., Žilina, totalling USD 20 million, at a LIBOR interest rate plus 1.1 per cent. According to the company‘s C.E.O., two more loans should follow, totalling “billions of crowns”.

10 In 1997, SE profit dropped by 65 per cent as opposed to 1996. According to the SE representative, the profit should be approx. SKK 6 billion. In the first half of 1998, borrowed funds accounted for 50.1 per cent of the company’s liablities, while a year earlier, it was only 40.6 per cent.

11 For instance, the agreement on the establishment of a joint venture between SPP and the Russian gas company Gazprom.

12 When describing the link between Polish companies and Russian affinity groups, professor Kaminski stated at the seminar organized by the Center for Economic Development that “among the major tools of Russian penetration in the countries of Central and Eastern Europe mention is made of the Gazprom gigantic oil concern” (Olszanski, 1996)”.

Public Administration

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M.E.S.A. 10

A draft of the reform of national councils and the local state administration that was on the agenda of the government of the S.R. on June 6, 1990, formulated a need for a sweeping qualitative reform of the state power execution in communities and the state administration enforcement that would lead to an extensive functioning of the community local government and a rational and efficient arrangement of the local state administration. This plan called for the establishment of economic and legal conditions for the local government of communities, the separation of state power from state administration at all levels, the establishment of a new two-tier organization of state administration, changing the territorial structuring of the S.R., and the rearrangement of the state administration central management and control.
By invalidating the original structure of national councils and by passing the Act. No. 369/90 of Coll. on Municipalities, separating the State activities from the activities of communities, and direct elections into the local government bodies, the so-called dual system of public administration was launched in Slovakia. Its logical continuation would have been the establishment of the regional local government; its role being the implementation of those public tasks whose administration would be inefficient at the local level. The work on the reform had continued in this spirit until 1993. The initial plan (by the way, furthered by several protagonists of V. Mečiar's 1994-1998 government) envisaged the transfer of powers onto self-governing institutions, which was to happen in parallel with the changes in funding and the new territorial and administrative structuring of Slovakia. Such a sweeping solution would not only bring public administration closer to the citizens (2,870 towns and communities plus 77 county offices), but also reduce the state administration staff by approx. 4,230, i.e. in 1992, it was a drop by 18 per cent.
In its program declaration, of January 1995, V. Mečiar's government declared to:

- further a rational institutional arrangement and an efficient functioning of public administration, in line with the political and economic transformation
- enhance the powers of local governments powers simultaneously with a stepwise improvement of their funding
- continue the public administration reform with an objective to establish such a system of administration that would better serve the needs of citizens, be less complex and less costly
- implement a gradual functional decentralization of the executive power
- reduce direct financial transfers withing the public budget framework
- review the obligation of communities to transfer part of their income from the lease and sale of property to the state budget
- restrict the establishment of state funds, review the justification and functioning of the existing funds
- set new criteria for the subsidy allocation
- introduce a new territorial and administrative structuring of the S.R.

Meeting Election Pledges

Of the government pledges in the area of the public administration reform, only two were met. One was the horizontal integration of state administration, by which the number of the offices of the local state administration was cut down, the other one was the new territorial and

administative structuring with 8 regions and 79 counties. However, the final impact of meeting these commitments was not satisfactory. It soon turned out that the integration of state administration did not bring about its rationalization, on the contrary, the number of offices, the number of staff and the state bureaucracy expenditure continued to grow. Regional and county offices established their field workplaces, since the politically motivated establishment of counties caused problems with delivering services to citizens. New networks of the sectoral state institutions emerged, such as the National Labour Office with eight regional and seventy-nine county offices, regional culture and civic centres, The Central Revenue Directorate with eight regional and seventy-nine county tax offices, various regional consulting and developmental agencies funded from the state budget. Indeed, the government coalition cut the number of the local state administration from 21,300 to less than 20,000, but it was not too keen on mentioning the number of the staff that worked in the offices of the local state administration and other specialized networks. Based on the analyses of local government institutions, this figure was between 35,000 and 40,000 employees of state administration.

Hand in hand with the running costs grew the capital expenditure which was needed to operate the state administration. On the one hand, the construction and conversion of buildings to serve the needs of central institutions, country and regional offices, tax offices, new interior appointment, new furniture cost the tax payers billions of crowns. On the other hand, pressure was exerted especially on towns, to make available buildings and premises that could otherwise be run much more effectively by letting them to the private sector at lucrative prices. And, much more effectively could have been utilized the buildings and premises owned by the State which until the reform had been leased to the private sector, and gradually "were sacrificed" to the proliferating state bureaucracy.

Although among the major objectives of the public administration reform was its rationalization, just the opposite was true. In 1995, added to the number of the central bodies of state administration was the Bureau for the Strategy of the Development of the Society, Science, and Technology (in 1998, it had a staff of 181), and the Ministry of Construction and Public Works, in 1996 (in 1998, a headcount of 186).

By passing the laws on territorial and administrative structuring of the S.R. and on the organization of the local state administration in 1996, a large portion of the powers of central state authorities was transferred to regional and county offices. These, for instance, were founders of over 8,000 quasi-governmental and subsidized organizations (of which 7,500 were incepted in the education system), with a staff of over 135,000. However, the funding of the State tasks via regional and county offices turned out to be costlier by approx. 25 per cent as opposed to the until then funding via central offices.

Another, in principle, logical, consequence of setting up regional and county offices, was that rther than cutting-down the number of the central state administration staff, their number increased and so did their running costs.

Table 6
The Development of the Headcount of the State Administration Central Authorities and the State Budget Expenditure

Year	Central Authorities Headcount	State Administration Expenditure (in bill.)	State Administration Running Costs (billion SKK)
1993	4.735	171.18	93.1
1994	-	160.92	92.6
1995	5.692	170.25	91.3
1996	**7.125**	**173.91**	**85.4**
1997	**7.685**	**178.47**	**88.6**
1998	**7.951**	**181.50**	**92.5**

Source: 1993-1997 state finance accounts, 1998 state budget

A negative consequence of the implemented state administration reform was also an unfavourable distribution of state institutions, for instance, in police, forest management, customs administration, tax offices, fire protection, and others, i.e. those institutions which did not have to contour the country's territorial and administrative structuring. Hence, not only the revenues dropped but also the costs increased due to excessive decentralization.
The basic problem of the hitherto reform was that it lacked comprehensiveness and an "intermediate step" was made with an objective to first establish a strong state administration and a gradual transfer of powers to self-governing institutions was to follow. Enforcing this approach which could be partly excused by the establishment of the Slovak Republic, was naturally reflected in the increase of the state bureaucracy expenditure. Furthermore, this approach will cause an increased demand for public funds which are needed for the implementation of the genuine decentralization of the public administration in Slovakia, therefore, it is better to wait with the reform until the economic environment of the S.R. shall have stablilized.
After 1996, it was clear that the reluctance of the government coalition to listen to the arguments of the opposition and professional self-governing institutions was motivated politically. The fashion in which regional and county districts were staffed, the managerial staff of specialized departments appointed, and the staff urged to become members of the government coalition parties, showed that it was particularly in the interest of HZDS to solidify and build its political structures from the tax payers' money, appoint its adherents to the positions in the local state administration, employment agencies, tax offices, and the regional culture centres.
It should be noted that of the many commitments made in public administration, V. Mečiar's government met only those that could be used to materialize its political and power ambitions. Interestingly enough, ever since the county and regional offices were first established, the prices of the privatized property of the State have declined dramatically, and the privatization of the "minor" state property picked up (for instance, in the economic and agricultural sectors). The 1997 report of the Supreme Audit states, for instance, that in the sector falling under the Ministry of Economy, state enterprises were wound up at 5.6 per cent of their book value, and in the agricultural sector, at 3 per cent of their book value. The assets privatized in this fashion were subsequently financed from the state earmarked funds. It was the

representatives of the local state administration establishing the regional structures of the political parties of the government coalition that played a significant role in this process.
The activities of tax offices serve as a good example of the inefficiency of the new structure of state administration. Despite establishing a new network comprising eight regional and seventy-nine county tax offices, the amount of tax arrears was upwards sloping, whereby the annual tax avoidance figures in the Slovak economy are estimated to be between SKK 10 and 30 billion. The question is whether it would not be more meaningful to stress the quality of the activity rather than the number of jobs in state administration.

Table 7
Tax Arrear Figures

Million SKK	1995	1996	1997	Dec. 1998
Tax arrears	19,491.3	23,405.1	29,405.7	38,458.0

Source: Supreme Audit reports

The Public Administration Cost Efficiency

Several reasons underly the inefficiency of the public administration costs, the growth of the state bureaucracy expenditure at the expense of the citizens' public consumption expenditure. Among them are such issues as the overall system of the state financial administration, the relations between the individual public budgets, and the manner in which public funds are disposed of.
During V. Mečiar's government, a better coordination of public funds did not happen. As was stated in the draft of the feasibility study of the state treasury of the Slovak Republic, the non-transparency and complicated nature of the public funding flows not only accounted for the growth of the public sector indebtedness, but also prevented the coordination of the state budget, local budgets, state earmarked funds, insurance funds, but also established were the conditions for an inefficient use of public funds, or, their misuse. Annually, the quasi-governmental running of the state budget resulted in its overall deficit. The budget was enforced via a high number of independent quasi-governmental organizations that made individual decisions irrespective of the availability of funds on their bank accounts, which the central budget covered by borrowings in the capital market under ever-less favourable conditions. It was common practice for the quasi-governmental organizations, and even towns and communities, to assume liabilities throughout the year that exceeded available funds, which caused the budget to blow up at the end of the year. This could not be halted even by the Ministry of Finance of the S.R. annually earmarking these funds.
There are several reasons why the public administration was run inneficiently. An objective reason is the ongoing process of the transformation of the society and to that related institutional relations and links that are tentatively non-transparent and unclear. Another reason is the rather poor ethical standard of the representatives of public administration which mirrors the overall situation in the country after the decades of the totalitarian regime and the persisting slogan: "He who doesn't steal, rips off his own family".
V. Mečiar's government accounts for a significant rise in the inefficiency of the public funds use, as it did not meet its government program in the area of the public administration reform and exposed the reform steps to its power and political interests.

The Proliferation of Clientelism and Corruption

While the former coalition was in power, the preconceived decision-making of the state bureaucracy was favoured over an objective utilization of the public funds with the citizens, or, their elected representatives, increasingly conducting the oversight of the public funds and their use. Not only the stated number of state funds was not reduced – on the contrary, it went up – but also increasing was the amount of public funds the use of which was determined by fund committees which were largely made up of the representatives of the state executive power. While in 1994, the expenditure of the state earmarked funds totalled SKK 5,758 billion, in 1998, it was SKK 31,289 billion.
An example illustrating the manner in which the state executive can curtail the local government independence, or, affect its operation by using the "fund" financing of public projects, is the development of the share of grants and general subsidies allocated to local governments. While the general subsidies are allocated to the local government budget based on the State Budget Act, grants flow into the budgets of selected towns and communities on the basis of the recommendations of civil servants and grant committees, which, naturally, increases the risk of preconception and corruption.

Table 8
The Development of General Subsidies and Grants Allocated to Local Governments from the State Budget

	1994	**1995**	**1996**	**1997**
General subsidies (million SKK)	216.1	218.3	250.0	350.0
%	19.9	11.1	7.3	6.9
Grants (million SKK)	870.9	1.758.9	3.200.0	4.676.3
%	80.1	88.9	92.7	93.1

Source: 1994-1997 state finance accounts

To get grant funding, towns, communities, NGOs, and the private sector submitted their applications with the county and regional offices, or, directly with the state funds that referred them to the central decision-making level. In 1994-1998, it was a public secret that public funds were not allocated from the individual state funds on the basis of efficiency criteria and project profitability, but based on personal contacts. From the viewpoint of the assistance to the private sector this was a definite loss, and allocating subsidies to other public institutions in this fashion (to local government, for instance) resulted in an ever-increasing unfinished construction and a drop in the investment profitability. This clientelist approach on the part of bureaucracy rather than rendering assistance in the elaboration of an appropriate project is deemed one of the reasons why the Slovak Republic failed to utilize foreign assistance (e.g. the PHARE project) in the years 1994-1998. For instance, in early 1997, only 74 per cent of the funds allocated in 1993 were used, 41 per cent of the funds allocated in 1994, and 30.9 per cent of the funds allocated in 1995.

Among the many examples is the manner in which the subsidies promoting regional development were allocated by the Office for the Strategy of the Development of the Society, Science, and Technology of the S.R., based on the recommendations of the intersectoral committee. The latter evaluates the projects according to approved criteria, which, however, are conceived in such a fashion that practically any project can fit into them. For instance, subsidies were allocated for the rehabilitation of a shepherd‘s cottage, enhancement of the hotel optional services, the completion of a hotel or restaurant construction, the construction of cottages, boarding-houses, and excursion restaurants, and the like, i.e. facilities in which their profitability should be obvious based on their marketing studies, and granting subsidies is not justified in these cases.
The allocation of subsidies to several counties according to the adopted criteria, i.e. the subsidy limit for them was nil, was not a point of discussion, and still, they were allocated the subsidies (e.g., Žilina, Trnava, Nitra, Trenčín regions). The number of projects allocated a subsidy increased in a similar fashion. Also, the number of natural and juridical persons went up, however, the number of the projects allocated to the institutions of the local public administration and the average amount of funds allocated per project dropped. In 1998, given the inflation rate, funds equivalent to 47 per cent of the 1996 amount were allocated per project. The above development, the project selection, the election year, the efforts to change the selection procedure of the projects approved by the committee in June 1998 – all these facts account for the proliferation of clientelism and corruption.

Table 9
An Overview of Subsidies Allocated on the Basis of the Decision of the Committee by the Office for the Strategy of the Development of the Society:

	1996	**1997**	**1998**
Allocated subsidies (million SKK)	99.40	99.84	70.60
No. of subsidized counties	9	28	45
No. of projects	69	81	92
Of which: Natural persons	5	9	23
Legal entities	21	49	45
Public administration	19	13	4
Average SKK/project (million SKK)	1.441	1.233	0.767

Source: Reports of the Intersectoral Committee of the Office for the Strategy of the Development of the Society, Science, and Technology of the S.R.

Slovak Republic Economy Rating

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Rating as an analyst opinion on the obligor's capacity to meet its financial commitments on obligations resulting the issued securities was used for the first time by John Moody in 1909. Approximately since then one- or three-letter abbreviations for ratings started to be used by American rating agencies Moody's Investors Service (Moody's) and Standard & Poor's (S&P). The biggest rating agency in Europe is IBCA headquartered in London who recently merged with Fitch agency to form Fitch IBCA.
Rating measures one of the main financial criteria, called credit risk. There is a specific rating category called sovereign rating, or country risk rating. In a country rating, several categories of factors are taken into account by rating agencies. These are: political risks, revenue structure and economy of the country, economic growth prospects, public finance status, internal and external debt developments, price stability, and balance of payments and its development.
Slovak Republic was given its first rating by S&P agency on February 15,1994. This was the well known 'BB-' rating for public bonds issued by 'NBS' (Central Bank).'BB-' with stable prospects means a lesser predisposition to short-term default and it indicates the existence of uncertainties and risks in business, economic and financial conditions. The former CSFR and Hungary were rated 'BB+', the Czech Republic was rated 'BBB."

Table 10
International Long-term Credit Ratings categories by Moody's, S&P, and Fitch IBCA agencies

Moody´s	S&P	Fitch IBCA	Definition
Investment grade			
Aaa Aa1 Aa2 Aa3	AAA AA+ AA AA-	AAA AA+ AA AA-	Highest credit quality – the obligors´ exceptionally strong capacity to meet its financial commitments
A1 A2 A3	A+ A A-	A+ A A-	Obligors´ strong capacity to meet their commitments,. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions.
Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-	Adequate capacity for timely payment of financial commitments, but adverse cahnges in circumstances and in economic conditions are more likely to impair this capacity.
Speculative grade (not investment grade)			
Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-	This category contains speculative elements, however, business or financial alternatives may be available to allow financial commitments to be met.
B1 B2 B3	B+ B B-	B+ B B	
Caa1 Caa2 Caa3	CCC+ CCC CCC-	CCC+ CCC CCC-	A highly speculative grade. Imminent default risk. Obligation is vulnerable to nonpayment.
CC	CC	CCC	High default risk grade
C	C	-	Extremely speculative grade, the obligor´s capacity for timely and full payment of financial commitments is highly vulnerable.

Table 11
Development of Slovak Republic ratings in the period of 1995 –1998

	1995			1996			1997			1998		
Agency	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**
SR	BB+	Baa3	–	BBB-	Baa3	BBB-	BBB-	Baa3	BBB-	BB+	Ba1	BBB-

1995

In April 1995 the S&P agency improved the National Bank of Slovakia (NBS) long-term foreign currency credit rating from BB- to BB+ with stable prospects. Having done so, Slovakia was given the highest possible non-investment (speculative) rating of the agency. For the comparison purposes – Czech Republic (CR) was rated by three grades higher at BBB+ and it belonged to a different, so called investment grade.
A month later, Moody's rated Slovak Republic represented by NBS – its central bank foreign currency credit at *Baa3* investment grade. Such a rating of this agency had been granted only to the Czech Republic from among Central and East-European countries. Representatives of the company appreciated, among other things, mainly the low state debt to export and GDP ratio.

1996

In 1996 for the first time Slovakia appeared also at the classification list of Fitch IBCA agency. Its first rating for the Slovak Republic was at the level of 'triple B', BBB-. This rating is generally given to countries with adequate capacity for timely payment of financial commitments, but adverse changes in circumstances and in business, financial and economic conditions are more likely to impair this capacity for timely payment of their commitments. The improved foreign currency credit rating at *BBB- with stable prospects* was announced by S&P agency on April, 11. Although in this case the foreign credit rating has improved by one grade only, (Slovak Republic improved last year by two grades, from BB- to BB+), *the new Slovak Republic rating moved the country up from a speculative into an investment band*, to the lowest investment grade, i.e. into the level of rational investments. According to the NBS Governor, V.Masar this :'created room for improved rating for other Slovak companies as well and it is reflected in a better negotiating position for Slovak entities negotiating for funding in foreign capital markets.' S&P stated that their rating reflected 'progress achieved in maintaining prudent economic management despite the often destructive political development.' V.Masar stated that what was appreciated most were good macroeconomic results, especially the combination of fast growth (6.9%) and the lowest inflation rate (7.2%) in the post-communist countries. In his opinion an important role was played by positive results of state budget management in 1995. S&P saw main problems in the political area and they criticized directly the prime-minister Meciar and his policies.
Despite the improved S&P rating the Slovak Republic remains four grades below the Czech Republic rating increased in last year November by two grades to "A". At the same time Poland improved by two grades and by its "BBB-" rating it gets to the same level as Slovakia.
According to Peter Balaz, head of foreign currency liabilities management department of the NBS, the shift into the investment band was of a decisive importance. The most important group of institutional investors has in their internal rules a limitation preventing them from investing in securities with speculative rating. Investment ratings from two most important world agencies, i.e. Standard & Poor's and Moody's are a pre-requisition for their investments. The Slovak Republic has already got the lowest possible investment rating *Baa3*

by *Moody's* last year and in the ratings of this agency the Slovak Republic was falling behind the Czech Republic by two grades only.
This completed all the positive news on the Slovak Republic ratings, although the fact that some Slovak companies active in international markets got rating at the level of SR rating can be considered a positive phenomenon. In a short period of time, in November 1996 and in January 1997 there were news published on Moody's review of SR rating and its possible degrading. In its January statement Moody's indicated some negative development trends in the Slovak Republic. The Agency was concerned with the high current account deficit of balance of payments and state budget deficit. Measures taken to support non-performing companies and efforts to limit NBS independence were perceived as negative.

1997

In June 1997 S&P confirmed the same rating as in the previous year – investment grade credit rating of BBB-. According to the agency the 'ongoing political discords' represented the main obstacle preventing them from improving their credit rating. The agency stated that strong interest groups prevent political reforms and slow down westward integration of the country. According to the agency another problem is seen in industry restructuring and company owners management where both direct and indirect influence of the state should be reduced. It continued to be concerned with the weak banking sector and low external liquidity, mainly high reliance on foreign loans in funding the high current account deficit. All these were factors making Slovak economy more prone to external shocks.
Moody's agency also confirmed its previous year rating for the Slovak Republic at the level of *Baa3* but in October they announced their degraded forecasts for economic credibility of Slovakia. It was argued mainly by deepening budget deficit and sinking balance of trade with goods and services. The image of Slovakia as a safe harbor for foreign capital was damaged mainly by the fact that investors do not believe in the effectiveness of government revitalizing measures including budget cuts, wage regulation in loss making companies and 7% import surcharge.
Slovak Republic could see also the previous year BBB- rating confirmed by Fitch IBCA. IBCA noticed that macroeconomic results of Slovakia ranked among the best in the region since the independence of Slovakia in 1993. The central bank policy provided a guarantee of a stable currency and decreasing inflation rate, while in the period of 1994 - 1996 the public sector accounts were rather balanced. The current account deficit in 1996 revealed the external vulnerability of Slovakia and doubts were cast on the sustainability of the economic performance achievements. They also stated that the governing political situation caused concerns about the future economic development of Slovakia. Prime-minister Meciar's government was characterized as confronting in relation to other state institutions such as the office of President and Constitutional Court.
For the comparison purposes the best rating of A category was granted by S&P to the Czech Republic and Slovenia from among the countries of Central and Eastern Europe. Slovakia, Poland and Hungary were rated at the lowest investment grade.

Table 12
Comparison of ratings for Slovak Republic and V4 (Vysegrad 4) countries in the period of 1995 –1998

	95			96			97			98		
Agency	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**	**S&P**	**Moody´s**	**IBCA**
SR	BB+	Baa3	–	BBB-	Baa3	BBB-	BBB-	Baa3	BBB-	BB+	Ba1	BBB-
ČR	BBB+	Baa1	A-	A	Baa1	A-	A	Baa1	A	A	Baa1	BBB+
PL	BB	Baa3	*	BBB-	Baa3	BBB	BBB-	Baa3	BBB-	BBB-	Baa1	BBB
H	BB+	*	*	BB+	Ba1	BBB-	BBB-	Baa3	BBB-	BBB-	Baa3	BBB

** Data not availablei*

1998

Bad news came as early as the first quarter of this year. March 30, 1998 *Moody's* agency announced Slovak Republic rating degrading from *Baa3* investment grade down to *Ba1* speculative grade. Substantial increase in government budget deficit and balance of payment current account deficit caused the SR degraded rating. The agency reminded that these deficits were funded by foreign loans mainly. Slovak Republic external debt grew up to more than 11 billion USD and it was estimated to increase to app. 12 billion USD by the end of the year.

On April 7, 1998 *Standard & Poor's* confirmed their previous rating of SR foreign currency credit at *BBB-,*, the lowest possible investment grade. But S&P also changed their SR forecast from stable down to negative. This change was caused by the substantial growth of external debt of the Slovak Republic, deteriorated level of macroeconomic management and repeated efforts of the Slovak government to limit the independence of NBS. Slovak Republic ratings were negatively influenced also by the ongoing political disputes – strong party allegiance slowed down political reforms and integration of the Slovak Republic into the western structures. On *September 17, 1998* this agency reviewed the rating of the Slovak Republic capacity to repay long-term foreign currency debt from *BBB- grade down to BB+*. This rating means a speculative grade where the obligor´s capacity to meet its financial commitments is ensured, providing a stable boom environment exists. This was already the second of most prestigious rating agencies shifting Slovak Republic rating from investment into speculative band.

On October 5, 1998 Fitch IBCA issued so called Rating Alert as a consequence of recent economic and political development. This agency considers the possibility to reduce SR foreign currency and local currency credit rating. It is the last of the important world agnecies to maintain the SR credit rating in its investment band at the level of *BBB-*, although with negative forecasts. The agency issued its Rating Alert also to local currency credit rating currently at the level of *A-*. According to the agency opinion, despite its weakened external liquidity position, the Slovak Republic could find rather acceptable ways out. The debt rate is still on a controllable level, despite its ongoing increase since 1995. According to Fitch IBCA during the latest government reign the financial discipline was substantially weakened while the banking system restructuring stagnated. It is therefore important for Slovakia to focus on these issues immediately if it wants to maintain its economic growth. Next assessment is to be expected in the middle of December.

Conclusions

The rating development curve set on the right track as early as the beginning of 1995 where S&P agency improved Slovakia's rating from BB- to BB+ with stable prospects. In 1996 the positive development continues, achieving the BBB level, thus moving the Slovak Republic from speculative into the investment grades. In the following year Slovakia still maintained the same level of rating, i.e. the lower investment grade. The decreasing trends started towards the end of 1997 and beginning of 1998 when results of the government policies started to emerge causing volatility in Slovak Republic rating as well. Still optimistic about the development in Slovakia Sergej Kozlik, Deputy Prime-minister and former minister of finance stated that if there was to be any change in SR rating then the change was to be only positive. The opposite became true. At the beginning of the year Moody's agency moved Slovakia in its rating into a speculative band. It was followed by S&P rating agency in September, and the move was completed by Fitch IBCA agency publishing it Rating Alert on October 5 and considering possible degrading of SR foreign currency and local currency credit rating. Sergej Kozlik does not consider the Slovakia's degraded ratings to be substantiated and states that agencies decision making is based mainly on other then economic development factors. But he does not state the causes of the worse rating. In his opinion Moody's agency is wrong in stating that in the Slovak Republic there is a permanent deficit of balance of payment current account and high financial deficit of the government budget.

In the conclusion, it is important to stress that deteriorating rating of the Slovak Republic reduces realistic chances of getting foreign debt funding resulting in increased interest rates, reduced credit terms and decreasing number of potential creditors.

Table 13

Horizontal comparison of rating development in selected countries

INVESTMENT GRADE	AAA		◆	◆	◆	◆
	AA+					
	AA					
	AA-					
	A+					
	A			●	●	●
	A-					
	BBB+		●			
	BBB	●				
	BBB-			π◗	▲π◗	▲◗
	BB+	▲	π▲	▲		π
SPECULATIVE GRADE	BB		◗			
	BB-	π		✸		
	B+					✸
	B					
	B-					✸
	CCC+					
	CCC					✸
	CCC-					✸
	CC					
	C					
	D					
		94	95	96	97	98

Slovakia π *Hungary* ▲ *Russia* ✸
Austria ◆ *Czech Rep.* ● *Poland* ◗

Economic Growth

Marek Jakoby
M.E.S.A.10

In the former Czechoslovakia the beginning of 1990s was marked by a substantial economic drop. It was an inevitable accompanying phenomenon of the beginning of economic transformation.
Slovakia entered its growth track in 1994 when the real value of gross domestic product was increased by 4.8 per cent. Economic growth expressed as a real GDP growth continued in the following years.
GDP growth and its demand side structure is shown in Figure 16.
While in 1994 and 1995 the growth was driven by foreign demand mainly, in 1996 domestic demand, especially State spending and fixed capital investments were becoming more and more the driving force of the growth.
GDP growth in 1997 was one of the highest in the countries in transition. But still its real value level represented only 95 per cent of 1989 GDP growth.

Table 14
GDP in fixed prices in 1995

	1994		1995		1996		1997		1/2 1998	
	Proportion	Growth	Proportion	Growth	Proportion	Growth	Proportion	Growth	Podiel	Rast
GDP		4.9		6.9		6.6		6.5		6.1
FHC	50.5	0	48.9	3.4	49.1	6.9	48.9	6.3	50.7	3.2
FSC	21.7	-11.2	20.9	3	23.6	20.3	22.2	0.1	18.7	-0.5
GFCG	27.8	-4.6	27.4	5.3	35.9	39.8	38.6	14.5		10.6
CHiI	-5.7		1.0		1.6		-5.1			
NE*	5.6	**14.2**/-3.6	1.8	3.1/**9.6**	-10.1	–0.3/**20.3**	-4.6	**6.1**/-2.3		**16**/15.3
	99.9		100.0		100.1		100.0		69.4	

GDP – Gross domestic product
FHC – Final Household consuption
FSC – Final State Consuption
** growth/proportion of export,or import*
Source: Statistical Office
GFCG – Gross Fixed Caputal Generation
CHiI –Change in Inventory
NE –net exports (export of goods and services – import of goods and services)

A rather high GDP growth rate in 1997 was followed by economic growth in the first six months of 1998. According to the latest data of the Statistics Office, in the first six months of 1998 the real GDP increased by 6.2 per cent on a year-on-year basis. While in the first quarter of the year the growth rate represented 6.2 per cent, it was slightly slowed down in the second quarter to 6.1 per cent only. The government projected annual growth was 5 per cent.
Overall volume of generated GDP represented 347.8 billion SK, while 82 per cent of it was generated by private sector.
Domestic demand continues to be the driving force of the growth. Similar to the 1997, in the first half of 1998 the important role on the demand side was played by the growth of gross fixed capital (gross investments), although to the lesser extend compared to 1997 (10.6 per cent compared to 14.5 per cent). According to the Statistics Office decisive component of investments was represented by government investments in large scale projects of infrastructure reconstruction and development. This type of projects is characterized by a long

pay back period and it is not directed to export oriented production. Current investment boom therefore does not create preconditions for improved export performance of the economy and sustainable economic growth. While in 1997 the government sector counted for 12.7 per cent of investments, in the first half of 1998 the state cut off almost 40 per cent of resources that could be used for investments. Private sector share in overall investments was 61 per cent.
Final household consumption was increased by 3.2 per cent in the first half of the year, government spending (consumption) was reduced by 0.5 per cent.
On the supply side the growth supported increased production in construction and development (6 per cent on the annual basis), in industry (4.5 per cent), as well as in market and non-market services.
Despite the remarkable results it must be stated that the growth extended the capacity of the economy and the substantial increase in foreign debt was the price paid for it. This follows from the fact that domestic savings rate does not correspond to the investment rate. In 1996, for example, with the investment rate of 35.9 per cent the domestic savings represented only 26.9 per cent. For the year of 1997 with the investment rate of 35 per cent the savings rate of only 28 per cent (estimated) (1) was achieved. The problem is more complex due to the questionable repayment of some loans.
Economic growth continues to be adversely impacted by the growing balance of payment deficit. The growing domestic demand does not meet with adequate domestic supply causing the deepening of external imbalance.
In the recent period the lack of credibility of official statistics data is a serious problem. Stefan Condik, Chairman of the Statistics Office himself cast doubt on the credibility of officially reported data. Due to the wrong foreign trade reporting in 1997 the real amount of net export deficit shall be reviewed and increased, in his opinion, with a consequent effect on the reduction of officially reported GDP growth.
Economic growth structure in comparison with other economies in transition is worth noticing. In countries such as Poland, Hungary, and Czech Republic the economic growth in the period of 1996 – 1997 was driven by the growth in industry, agriculture and construction and development sectors mainly, while in the case of Slovak economy it was driven mainly by the contribution of market services (trade, transport, telecommunications, trade services) and non-market services (education, health-care, defense and safety, implicit rent) with minimum contributions of industry, construction and development, and agriculture.
Comparison of economic growth and unemployment development in the Slovak Republic and Poland is also striking. While both the countries reported similar GDP growth rate in the period of 1994 – 1997, in Poland this was reflected in the reduced unemployment rate from 16.4 per cent in 1993 down to 10.5 per cent in 1997 (a 36 per cent reduction), but the unemployment rate in Slovakia starting at 14.4 per cent in 1993 dropped to 13.4 per cent only (a 7 per cent reduction) towards the end of 1997, and in the middle of 1998 it even grew up to the 1993 level, despite the 6.1 per cent GDP growth.
The above stated facts cast doubts on the credibility and reliability of the official statistics, articulated by a prestigious American company, Plan-Econ in its report on the economic development in Slovakia in October 1997.
Although the economic growth rate achieved by the Slovak Republic in the previous years wase higher than stated in the Government declaration of V. Meciar's third government (5 per cent a year), the structure of the growth was not favorable (domestic demand growth, high proportion of investments - mainly in infrastructure projects with long pay-back period, insufficient industry restructuring and lack of adequate domestic supply), and it did not lay the basis for its sustainability. This can be proved by the increasing deficit of the balance of payment current account. The reported favorable ratios are paid for by foreign debt approaching the level of 60 per cent of GDP as well as growing internal debt level.

COMMENT

(1) Progress report on meeting deadlines and accomplishing tasks following from the updated Slovak Republic Industrial Policy, Ministry of Economy of the Slovak Republic, March 1998

Efficiency and Competitiveness of Industry

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Industry of the Slovak Republic is a very important sector from the aspect of its production, employment, but mainly Slovak exports. In 1997 industry contributed to GDP by 28.1 per cent and industry employed 30 per cent of the total number of population working in the national economy.

Metallurgical, chemical, machine engineering, food processing, and energy industries have a great bearing capacity in the Slovak industry.

In its section dealing with industry the 1995 government declaration reads among other things as follows:„Economic and industrial policies shall create conditions for the processes of revitalization, restructuring, and increasing competitiveness of industry.“

The government considered the following strategic objectives of industrial development:

– stabilizing industrial sectors and increasing their efficiency while complying with the conditions of the sustainable development program,
– increasing exports and production competitiveness,
– increasing the utilization of local raw material, achieving higher level of finished production, increasing added value of the production and higher added value of national labor, increasing labor productivity.

Towards the end of 1995 the Government of the Slovak Republic and the National Council of the Slovak Republic (parliament) acknowledged the document entitled Industrial Policy of the Slovak Republic. Although this document claimed to combine sector and liberal approaches to the industrial policy development, its characteristic feature is a sectoral, state-activist approach to the formation of industrial structure of Slovakia[1]. Material intentions dominate, while system and institutional aspects of economic development are underestimated or even abstracted from..

Development of key industrial indicators in the period of 1994–1998

Table 15
Production of goods (industrial companies of 20+ employees), year –on-year per cent changes

	1994	1995	1996	1997	1/2 1998
Raw material mining	-4.6	-0.3	5.6	7.5	-11.5
Industrial production	1.7	9.6	2.2	2.2	8.0
Generation and distribution of electricity, gas, and water.	15.9	-2.0	5.0	-4.0	-15.2
Industry – Total	3.0	7.4	2.6	1.7	4.9

Source: ŠÚ SR (Statistics Office of the Slovak Republic)

After a rather considerable growth of industrial production in 1995 the growth dynamics slowed down in the following years. Although the development in the first six months of 1998

is slightly more positive, due to the difficult situation in a number of industrial companies the development of last months of the year and the annual growth figures are questionable.

The very low growth dynamics of the industrial production is indicated by figures presented in the following table. Especially important is the development of labor productivity and real wages ratio, as this ratio influence the competitiveness of the industry in foreign markets (as a consequence of the fact that majority of Slovak industrial export is based on price competitiveness of unsophisticated products).

Table 16

Selected indicators of Slovak Republic industry and their year –on- year change (organizations with 20+ employees)

	1993	1994	1995	1996	1997	1/2 1998
Employees	-9.3	-4.9	0.7	-0.9	-1.3	-3.7
Productivity of labor in goods production	-2.4	8.0	6.7	3.9	4.8	9.0
Real wages			5.2	8.4	5.6	1.3

Source: ŠÚ SR (Statistics Office of the Slovak Republic)

As indicated by the figures, in the period of 1995 – 1997 there was a permanent lead of real wage growth over labor productivity growth. Compared to 1996, in 1997 the advanced growth of real wage compared to labor productivity was substantially moderated. In the first six months of 1998 the labor productivity growth was higher. It is too early to evaluate to what extent this was caused by the introduced wage regulation in the second half of 1997 and to what extent this was due to the stricter monetary policy followed by lack of lending funds. It could also be caused by progress made in company management, but taking into account the privatization methods and low inflow of foreign investments, this was not probably the case of Slovak industry.

Data presented in the Figure document that in 1996 the industry responded to the increased aggregate demand by increasing pressure to utilize even the less efficient production capacities (from the aspect of their added value). This resulted in narrowed room for effectiveness improving structural changes, the production structure was preserved at the level of overemployment and productivity increase was reduced to the level of production increase (2.5 per cent). In 1997 the aggregate (overall) demand reduced and so did the pressure to utilize these less efficient capacities. This meant reduced overemployment (by 2.9 per cent) and labor productivity growth faster than production growth. This development leads to important and negative conclusion that the economy is unable to respond to increased aggregate demand by flexible creation of new, modern production capacities, but only by utilizing inefficient old ones[2] . It was shown that in 1996 and 1997 we experienced the growth of aggregate demand thanks to mass government expenditures covered in the industry by extensive increase in capacity with rather small change of its efficiency.

Relevant data providing an overview of development of industry performance

Table 17
Industry performance (end of year P&L)
(organizations with 20+ employees, current price, in SKK million)

Year	*1993*	*1994*	*1995*	*1996*	*1997*	*1/2 1998*
P&L	*26365*	*25493*	*33017*	*20078*	*15427*	*9317*
Year to year per cent change		*-3.3*	*29.5*	*-39.2*	*-23.2*	

Table 18
Profit or loss generated by key sectors of industry

	1994	*1995*	*1996*	*1997*
Industrial production	*1 298*	*8 037*	*-320*	*-637*
Raw material mining	*810*	*1 105*	*759*	*369*
Generation and distribution of electricity, water, steam	*23 385*	*23 875*	*19 638*	*15 696*

The economic performance improved in 1995, and in the following years it was reduced substantially. The most important issue is that industrial production also generated an overall loss.

Development of expense, income, P&L and added value of industrial production (processing industry) (year-on-year per cent change)

Table 19
Development of some industry indicators

	1994	*1995*	*1996*	*1997*
Expense	*12.6*	*19.6*	*11*	*9.8*
Income	*13.1*	*17.9*	*9*	*9.7*
Added value	*17.7*	*19.3*	*-1*	*7.7*

Since 1995 the industrial production shows a negative trend of expense growing faster than income.

The increasing overall loss generated by the processing industry is predominantly contributed by performance of such sectors as machinery and instrument manufacturing, production of other non metal mineral products, production of radio, television and telecommunication equipment. There was also a substantial decrease in profit made by ‚flag ships“ of Slovak industry (VSŽ Holding –1.1 billion, or 52 per cent; Nafta Gbely: -286 million, or 32 per cent).

Reducing income of energy sector companies is related mainly by opening scissors between cost incurred by so called natural monopolies and regulated price of energy. (e.g. Slovenské elektrárne (Slovak Electricity) – profit drop by SKK 2.5 billion, or 51 per cent). Despite that companies in this sector generated almost the entire volume of profit in the industry.

In September 1997 the government of the Slovak Republic evaluated performance of state-controlled companies reporting to Ministry of Economy, Ministry of Transport, Post, and Telecommunications, Ministry of Land Management, and Ministry of Construction. The report stated a reduced amount of pre-tax profit, increasing loss generation by state-controlled companies, and increased payroll cost (wages) causing reduced wage profitability. Every resort under review showed pre-tax profit reduced in total by 7.6 per cent, while payroll cost increased by 8.5 per cent. (Trend, October 1,1997)

A rather slow pace of production growth and deteriorating P&L do not present the one and only negative feature of industry and its latest years development. Another critical issue is the development of past due payables of industrial companies. After a drop in 1995 it shows an increasing trend. Compared to 1995, the amount of past due payables was by ¼ higher on June 30, 1998. It is worth noticing that the biggest nominal increase of past due payables occurs within processing industry.

Table 20
Development of past due payables (SKK million)

	1994	*1995*	*1996*	*1997*	*½ 1998*
Industry total	*60428*	*54133*	*57199*	*64916*	*67476*
Economy of the Slovak Republic	*73181*	*65721*	*72249*	*83698*	*88329*

Source: Information bulletin of the Ministry of Economy, 4/1994, 4/1995, 4/1996, 4/1997,

Increased amount of past due payables by app. SKK billion 15 since 1994 sufficiently documents the inability to solve this lingering problem and it indicates a low legal awareness of business community in Slovakia. Last but not least, this is yet another proof of ineffective, so called „system“ measures taken by the previous government.

A more substantial increase of past due payables in 1997 can be related to the adopted ‚revitalization‘ law resulting in deteriorated payment discipline of a number of companies due to their revitalization expectations. The ‚revitalization“ point was that a revitalization committee was entitled to grant to a selected group of companies deferment or discharge of liabilities due to state, insurance funds, banks or other companies. It is a paradox that by the end of Meciar government term, no project has been approved.

Along with the development of payables, development of debt burden of companies is worth noticing. The level of borrowed funds (loans) in industry is shown in Figure 21.

Table 21
SKK loans for Slovak Republic industry in SKK billion

	1993	**1994**	**1995**	**1996**	**1997**
Raw material mining	9.5	8.9	2.6	2.6	2.6
Processing industry	68.9	67.2	103.3	113.3	115.1
– food processing	9.7	10.4	17.5	20.6	22.0
– chemical and pharmaceutical	8.8	8.4	10.2	9.7	8.1
– metallurgy and machine engineering	30.4	27.6	43.3	45.7	47.1
– electronic and electrical	5.5	5.7	7.5	8.5	8.4
– textile. clothing, and tanning	4.3	4.3	6.1	7.5	7.1
– others	10.3	10.8	18.6	21.2	22.4
Generation and distribution of electricity, gas, and water	18.4	17.4	18.2	21.9	22.1

Source: NBS

Due to the interest differential (as a consequence of high interest rate level in local money market) and due to the international financial markets situation the increase of foreign currency loans was higher than SKK loans. (this applies to large companies, such as VSŽ, Slovnaft, Nafta Gbely...having no difficulties with raising foreign funds at relatively beneficial terms). 13.3 per cent of the total of loans in 1997 was represented by foreign funds. Majority of them (SKK 5.3 billion) was used for generation and distribution of electric energy, hot water and steam, while only SKK 4.4 billion was used in processing industry.

Real cost of foreign currency loans shall be higher at the end of the day due to SKK devaluation in FX markets. At that time businesses had few choices to raise funds, as government was using major portion of liquidity for its mass expenditures and in a systemic way it was reducing the capital market function as an alternative source of funds. All of that resulted in undercapitalized industry.

The loan structure represents another negative phenomenon, as short- and medium-term loans prevail over long-term loans. This means that majority of borrowed funds is used for operations, and only small portion is used for investments into long-term development of industrial companies. The report on monetary development in the Slovak Republic for the first six months of 1998 states that only 5 per cent of the total amount of loans drown was used for development programs. This represents less than SKK 9 billion.

The increase of loans results in increased debt to total assets ratio. According to Trend TOP 100 list, in 1997 debt to total assets ratio was 45.3 per cent. In 1995 it was only 36.2 per cent. The total debt was SKK 338 billion, while 62 per cent of this amount was represented by ten most indebted companies.

Inadequate increase of debt financing of companies cannot continue in long run. The companies experience more and more limited access to bank funds and other forms of financing become inevitable. Taking into account the decreasing profitability of majority of companies and in practice non functioning capital market, this will be more than difficult. Foreign direct investment represent another possible source of long-term capital. Their amount is far from adequate to the needs.

Foreign capital in industry

FOREIGN DIRECT INVESTMENTS (FDI)

Towards the end of the first quarter of 1998 the amount of foreign direct investments in industrial production (SKK 27.1 billion) represented 59.1 per cent of the total FDI.

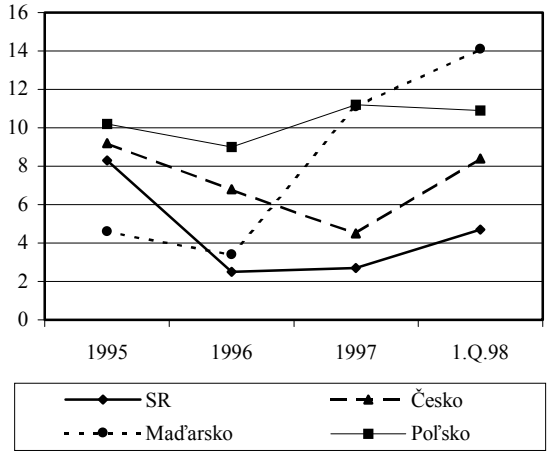
Table 22
Foreign direct investment influx in ‚V4‘ countries (USD million)

	1995	*1996*	*1997*	*1998**
Slovakia	*153*	*206*	*297*	*300*
Czech Republic	*2559*	*1428*	*1000*	*1200*
Poland	*2500*	*5200*	*5700*	*8000*
Hungary	*4453*	*1983*	*2085*	*1100*

Source: CA–IB Securities. a.s.. Bratislava
* *estimate*

The figures show a substantial deficit of foreign direct investment in Slovakia compared to other ‘V4’ (Vysegrad 4) countries, both in absolute figures and in per capita presentation. To large extent this fact contributed to the insufficient structural change in industry of the Slovak Republic. The examples of Hungary or Poland show a principle change in industrial structure and growth dynamics due to foreign direct investment. In these countries an increasing market share of. industry with high level of final processing and competitiveness can be observed. This was one of the key objectives of our industrial policy, but the results achieved do not confirm it.

Graph 2
Industrial production growth in ‚V4“ countries (per cent)



SR – SLovak Republic
Cesko – Czech Republic
Madarsko – Hungary
Polsko - Poland

Source: CESTAT

On the other hand, it is true that high proportion of foreign direct investment in the neighboring countries went to the so called natural monopolies owned by the State in Slovakia. Making it possible to purchase at least minority shares of these companies would lead to a change in this indicator for the benefit of Slovakia, as in the neighboring countries these capital inputs have been made already.

According to the estimates of the Ministry of Economy of the Slovak Republic the restructuring process of Slovak industry in the period of 1998–2005 would require estimated SKK 980 billion, while 18 per cent of this amount should come from foreign direct investments and 25 per cent of the required amount should be covered by foreign loans. This would mean an annual inflow of foreign direct investments of minimum SKK 22 billion (or USD 630 million) needed by the Slovak industry.

Another example of schizophrenia and lack of concept in government documents on industrial policy can be presented here. The document entitled „Industrial Policy Update...“ precisely and correctly states that „since 1996 the development clearly proved that industry of the Slovak Republic is unable to ensure a dashing investment in the restructuring process using its own funds only“ (Industrial Policy Update for the Period of 1998–2005. Bratislava. Government of the Slovak Republic, 1997, p. 4). On the other hand, the document does not even try to identify causes of inadequate use of foreign funds, not speaking about proposing measures to eliminate these causes. Political and economic excesses in the policy of the previous government are the main causes of insufficient influx of foreign investment as well as of high cost of local borrowed funds and insufficient functioning of capital market.

Export in industry

The government documents (Industrial policy, Industrial Policy Update....) indicate as the key problem that „highest comparative advantages of the Slovak Republic industry are with commodity groups 6 and 8 of the SITC international classification, i.e. in semi-finished goods and simple final products. In 1996 they represented 50 per cent of the total export (Industrial Policy Update for the Period of 1998 –2005, Bratislava, Government of the Slovak Republic,

1997, p. 3). In the attachment to the above mentioned government document statement is made that the previous development is strongly contributed by industrial sectors with low processing level and high raw material, energy and transport intensiveness. The product structure is dominated by subcontracts, semi-finished goods and simple consumption products, while final production processing is legging behind.“ (Update ....attachment No. 2,. p. 3).

The following statement can also be found in the document: „We failed to fulfill our statements made in the period of 1995 –1996 regarding ensuring export of mainly high-tech to the level of 30-40 per cent, as these are sophisticated systems with high financial cost. The reality (i.e. proportion of sophisticated production in the total export – authors comment) represent only 15 per cent“ (Industrial Policy Update for the Period of 1998–2005. Bratislava. Government of the Slovak Republic, 1997, p. 7). All that needs to be said is that the above stated 15 per cent share of sophisticated export was here also in the period of 1993 –1994, i.e. prior to the adoption of the ambitious industrial policy.

It seems that despite remarkable plans of the third government of V. Mečiar in the industrial policy since the beginning of 1995, this sector in reality failed to achieve any marked results. Possibly the biggest shortcoming of the government documents in the area of industrial policy was the missing link to government financial policy. This made the industrial policy a mere declaration without real economic basis. This is truthfully documented even by the document of the Ministry of Economy of the Slovak Republic „Progress Report on material and time compliance with tasks following from the Industrial Policy Update“ of March 1998, where the following statement is made in relation to the above mentioned documents: „Fictitious support of industry is presented within these documents“....“we state that except for small and medium size businesses, industrial support was insufficient.“ „ No funding was appropriated for the proposed programs‘. It seems that non-conceptual government approach to industrial policy substantially contributed to the recent crisis situation in a number of companies. (ZTS TEES Martin. Mostáreň Brezno ...)

INDIRECT INFLUENCES ON EFFICIENCY AND COMPETITIVENESS OF INDUSTRY

Privatization methods lacking transparency and low purchase price made it possible for ‚privatizers‘ to survive in short run without changing production structure. As majority of new owners transferred the purchase cost to the privatized company, in most of the companies increased financial cost or debt burden and reduction of investments could be observed. This fact is expected to result in reduced competitiveness of these companies followed by forced mergers with supranational companies.

In this way the privatization process delayed transfer of majority of the companies into the hands of their final owners by 2-3 years, while in this period these companies experience deteriorated financial situation and they are fully exposed to the business cycle development in a given period.

Non transparent management methods in strategic state-controlled companies that were frequently managed for the benefit of closed interest groups at the expense of state interests. Taking these steps, quite frequently companies and even entire industry sectors were recovered making survival possible for entities that would otherwise have to solve their situation via market conformed means. It also lead to above standard profits made by ‘friendly’ companies.

Following examples may be used for illustration:

- capitalization of SPP (Slovak Gas Industry), state company, payments due from machine engineering companies
- SPP, state company (Slovak Gas Industry) was granted a SKK 1.1 billion loan in the form of SPP drafts deal for the benefit of machine engineering companies at the time when loans were not granted at all
- business activities of companies, such as CORINEX, Tatry-Sympatia Insurance Company (both in SPP and SE – Slovak Gas Industry and Slovak Electricity)
- Capitalization of SE, a.s. (Slovak Electricity) payments due from machine engineering companies

Clientelistic approach to selected business entities, 'friendly' related to the political power. They were supported by the government, either via tax relief, state orders, or some protection measures against foreign competitors. These facts were criticized by some EU bodies as well.

Based on these statements we can say that despite priorities of industrial policy declared by the government, particular interests within political power were preferred and they distorted the entire environment not responding efficiently to the changed conditions and thus increasing the disproportion even more.

C O M M E N T S

1 The dominating philosophy of the government in their economic management is clearly demonstrated by the fact that the Government of the Slovak Republic at its meeting in June 1997 approved the requirement for the EU Association Council and Slovak Republic to prolong the period during which the state assistance in Slovakia would not be subject to EU Directives. This is an exemption from strict rules applied in EU countries in order to prevent limitation and interference with competition via state power and state interference in the economy.. When signing EU Association Agreements the associated countries agreed not to be bound by these restrictions for the period of five years. (1992 – 1997). The Government of Slovak Republic requested to prolong this period till the end of 2001.

2 For more information see Kárász. P. – Renčko. J.. 1998. Employment and basic labor market trends in the economy of the Slovak Republic in 1998.. Národná obroda, March 25, 1998, April 1, 1998.

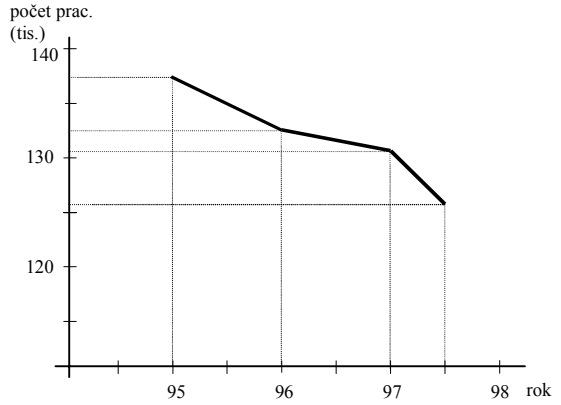
Engineering Industry

Juraj Borgula
INSTORE GROUP

By its 19.2 per cent share in the goods production, the Slovak engineering industry is the third strongest industry. As distinct from chemical or heavy industry, it is engineering industry having a higher added value of its production.
The following segments of industry fall under the engineering sector (according to the sectoral classification of economic activities):
28 - manufacture of metal structures, except machinery production
29 - manufacture of machinery and instruments
33 - manufacture of medical, precision, and optic instruments
34 - manufacture of trailers and double-track motor vehicles
35 - manufacture of other transportation means.

Currently, the sector comprises 575 enterprises with over 20 employees each, and employs a total of 126,025 workers. The engineering industry accounts for 23.3 per cent of the total industrial production, and within the processing industry, it accounts for 26 per cent. The sector employs 25.8 per cent of the total number of industrial workers (and 28.8 per cent of the workers of processing industry, ref. to Graph 3). For comparison, in late 1995, engineering industry employed a staff of 137,678 and its share in the number of industrial staff was 26.6 per cent (in processing industry – industrial production – it was 37.9 per cent).
During 1990-1994, the engineering industry of Slovakia underwent a slump, which was more dramatic than the overall economic slump. This was largely due to fact that engineering industry in the S.R., more than any other industrial sector, was dependent on eastern markets, and their sudden collapse accounted for a dramatic recession. The depression of 1994 was ever-more disturbing due to a depression in the West-European markets.

Graph 3
Headcount
(headcount, thousands)

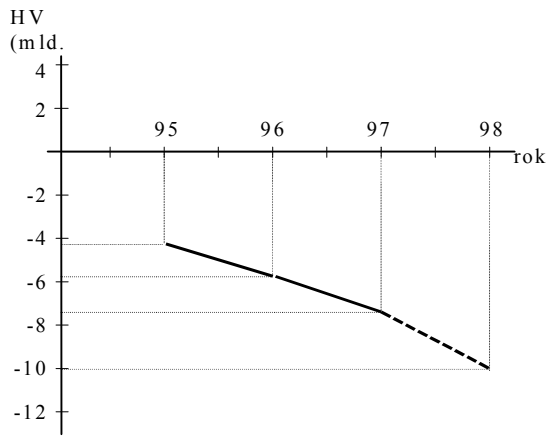


year

In 1995-1997, engineering industry recovered slightly, however, a relative slump was reported in the first half of 1997. Dynamic growth was reported only in the manufacture and export of motor cars, largely thanks to the growth of manufacture and export of Volkswagen Inc., Bratislava. In 1996, as opposed to 1995, the manufacture of goods in the engineering industry as a whole increased by an index of 113.8, export by an index of 109.6, whereby the number of workers dropped moderately, to 96.6 per cent.
As far as the indices like goods manufacture, income, production, and value added are concerned, the sector has been reporting a 10 to 35 per cent (!) annual growth over the past three years, or, between 5 and 17 per cent in value added.
However, costs tend to grow faster – in the first half of 1998, costs increased by 43.2 per cent, and the gross profit margin was permanently negative. In 1995, the negative figure was SKK 4.3 billion, in 1997, - 7.6 billion, and in the first half of 1998, the reported negative figure was SKK 5.3 billion, which accounted for 76.7 per cent of the total loss in industry. Judging by the rate of the loss growth, it is assumed that by late 1998, this loss shall have exceeded SKK 10 billion (ref. to Graph 4)

Graph 4
Gross Profit Margin

Gross profit margin
(billions)



Year

A serious setback of Slovak engineering companies is their undercapitalization and a high wear and tear of the machine stock. Their actual wear and tear is over 50 per cent, whereby their depreciable life percentage is even higher. The prospects of this sector are not optimistic, which is largely due to the deficiency of direct foreign investments, high prices, and the inaccessibility of the local credit funding, and the non-existence of a developed capital market.

A more detailed analysis of the engineering industry by twenty-six groups of production branches summarizes the most important findings as follows:

- according to the RCA (revealed comparative advantages) coefficient, of the twenty-six engineering production branches, only 5 production branches are competitive in the discriminating markets in the following order of priority: shippbuilding, ship and boat repair; bearings manufacture, transmission and control elements, motor car parts and accessories and motor engines; train locomotives and carriages, engineering metallurgy);
- the worst competitiveness using the RCA coefficient is reported in the following production branches: machinery for food industry, general-purpose machinery and equipment, energy equipment, agricultural and forest machinery, cooling machinery, air technology, air conditioning equipment, pumps and compressors;
- only 9 of the 26 groups report the depreciation of their machinery and equipment to be below 50 per cent, of which only the production of household gadgets has depreciated its equipment and machinery less than 40 per cent (this is useful life percentage, whereby depreciable life percentage is much higher);
- the R&D base of the engineering industry is also in a bad condition, which is also true of the whole industry and economy (in 1996, only 1.01 per cent of the GDP was allocated for R&D, while in the O.E.C.D. countries, it was 2.24 per cent of the GDP on the average).

Presently, the engineering industry in the S.R. accounts only for 16 per cent of the GDP of the whole processing industry, while in small, economically advanced European countries, this indicator ranges between 22 and 28 per cent (for instance, it is 28 per cent in Germany).

The end production of the engineering industry is also below its capacity, and the Slovak engineering industry is more geared towards intermediate consumption. In addition, the

Slovak engineering industry, compared to the engineering industry of the advanced European countries, is much more focused on productions dependent on less sophisticated technologies, productions with a less sophisticated processing, with a lower value added, lower rate of skilled manpower, and the use of scientific and technological knowledge. According to some analyses, as much as 70 per cent of the Slovak engineering export is dependent on the products of such manufacturing branches.
The financial position of the engineering companies is truthfully reflected in the development of accounts receivable, which increased from SKK 28 billion in 1995 to SKK 34.5 billion in late 1997, whereby this figure accounted for 85 per cent of the equity of engineering companies.
To make the picture complete, some balance data need to be added: while in 1996, the value of tangible and intangible fixed assets (in purchase prices) was SKK 94.8 billion, at June 30, 1998, it was only SKK 86.4 billion, which is a drop by 9.3 per cent. The equity of engineering companies dropped from SKK 38.3 billion in late 1996, to SKK 34.8 billion (i.e. by 9.1 per cent) in mid 1998. On the other hand, borrowed funds (bank loans and payables) grew from SKK 87.2 billion to Skk 99.7 billion. The indebtendess (debt-to-worth ratio) of engineering companies increased from 2.15:1 to 2.87:1. In the manufacture of machinery and instruments, it was is even higher, over 6 to 1. In reality, the situation is even worse, as it is necessary to deduct bad debt from equity, whereby it is estimated that bad debt totalls SKK 15 billion.

The Consequences of the Present State

- Even if a company gets a contract (largely for export), it is not capable of funding it, because:

1) local funding is costly (last year, the interest rate as the cost of loan exeeded 10 per cent p.a.), and, hence, cannot be repaid from the company‘s average profitability (between 3 and 8 per cent)
2) foreign financial institutions do not trust industrial companies which have their equity way below 50 per cent of assets.

- Companies do not ensure their development by developing new products or at least monitoring the latest trends.
- Companies become suppliers of wage labor – an extreme case is the delivery of skilled manpower to foreign companies, refer to the ZTS Dubnica case. An ever-increasing share of wages in the value added, whereby the original 40 per cent has increased to the current 50 – 55 per cent, which testifies to the fact that the profit of engineering industry has been downward sloping and very little is invested.
- Companies generate a large portion of their income by selling redundant machinery, equipment, and buildings. Given the fact that supply is higher than demand, prices are very low. There was a positive development due to a high demand for office buildings associated with the state administration reorganization in 1996, however, lasting effect is dubious due to the persisting state budget deficit and a need to cut-down the state administration expenditure.
- 15 per cent of the productivity growth is due to dismissals, which would be fine, if the unemployment did not grow in the State.
- The sum of effective investments in the engineering industry does not suffice to cover the capital maintenance needs, i.e. production equipment is not modernized, not even replaced.
- The ever-dropping prices in stock exchanges (although the economic condition of engineering companies is not the only cause of the slump in stock prices) has caused that

the ownership of companies increasingly becomes the subject of dubious deals, ref. to Považské strojárne, Vagónka Poprad, and others.

- The inception of subsidiaries using unencumbered equity has become a solution for many managements and owners (mind you, a logical one). The commitments left with the parent company are "resolved" by winding them up or filing a bankruptcy.
- An excessive growth of collusive practices linked with seizures and bankruptcies. The interests of creditors are not a priority. The overriding priority of the administrators of the bankruptcy estate is to get cash which at least covers their costs.

Seeking the Reasons

In 1996 and 1997, a drop in the export dynamism was reported. Several reasons underly this fact, and in the macroeconomic area, it was largely because the 1994-1995 growth was due to several unique opportunities that were not utilized sufficiently to implement such system and factual changes in the economy that would contribute to the growth of the competitiveness of our economy, and, hence, the sustainability of the positive trends of the 1994-1995 period.
At the macroeconomic level, the reasons accounting for a drop in the performance of the Slovak engineering industry ought to be seen in the factors as follows:

- The greater portion of the offered Slovak production is unable to compete with the rapidly advancing technological and quality standards of foreign competitors;
- Slovak companies are characterized by low standards of their technological and production base which constraints the enhancement of the production quality and parameters, cost reduction, and the capacity to promptly respond to market needs;
- The standard of business services markedly lags behind the foreign competitors, notably, marketing, advertising, service, documentation, packaging, in-warranty and out-of-warranty service, etc.
- The non-existence of a capital link with foreign partners limits the opportunities to sell local commodities in foreign markets and accounts for less favourable financial terms and conditions offered by the local exporters to foreign buyers. The hitherto operation of the Eximbank has proven inefficient in this respect.
- The greater portion of export is conducted largely thanks to the so-called price competitiveness, that is, very low price of local products, whereby the prices are maintained low in many areas only at the cost of disregarding or not appreciating actual costs associated with extended reproduction, not to mention capital maintenance. This largely involves:
  - low depreciation charges, nearing roughly 25 to 35 per cent of the real depreciation charges (especially in buildings and structures)
  - costs associated with the repayment of debt are not factored in
  - low costs related to the technological development
  - insufficient marketing-related costs
  - comparatively low costs related to training and quality enhancement.

The outcome of such developmet is the waning of the engineering industry dynamics. For instance, in the most vital part of engineering industry, the manufacture of machinery and equipment, the former half of 1997 reported a slump in the labor production growth as opposed to the corresponding period of 1996, whereby in 1996, this indicator continued to rise. An accompanying phenomenon of such a development is also a slump in the value added and an increase in the production wage-intensiveness.

A considerable part of the indicated problems of the Slovak engineering industry is rooted in the early stages of the transformation of a planned economy to a market one. Listed among the problems may clearly be the collapse of Eastern markets, the discontinuation of military production, naive opening up to the import of consumer goods, illusions kindled by politicians about a rapid integration in the global (European) economy and becoming rich. The outcome of these decisions was also manifested in the Czech economy after 1994-1995. The only difference between the Czech and Slovak economies was that in the Czech Republic, actions to solve these problems were taken in parallel with that. Among the basic factors that account for the present unfavourable situation are:

- Long-term discrepancy between the inflation rate, commercial interest rate, and profit rate distracted investments, and accounted for an increase of receivables and payables. The current indebtedness ratio is 2.87:1 (i.e. debt-to-worth ratio) and this practically does not give any chance for the improvement of the company‘s situation by employing its own potential. If we assume that indebtedness does not change, to achieve at least a balanced ratio of 1:1, capital amounting to approx. SKK 65 billion (!) is required. After all, the situation is not any better in the entire processing industry, at June 1, 1998, the debt-to-worth ratio was reported to be 1.6:1, the industry indebtedness as a whole was 0.98:1, and the overall situation was alleviated by monopolies (power, water, natural gas), and extractive industry.
- Production capacities are left idle long-term – if a price index of 3 is used for the sake of comparing the 1989 and 1997 production figures, the capacity utilization is no higher than 40 per cent. It is obvious that even the break-even point is not achieved, and the sector as a whole reports a loss (ref. to Graph 4).
- The inefficiency in the economy is also due to the approach of owners who, to honor their liabilities associated with the company acquisition, use the company‘s own funds excessively. Among the popular methods are:
  - the sale of bonds to banks, whereby the funds generated are used to purchase stock
  - outsourcing of works and services to third parties (for instance, software, rehabilitation of office buildings, computers) at exorbitant prices
  - the sale of products to the commercial houses of owners at prices that are below production prices.

Such a behavior, referred to as the rent-seeking behavior in Anglo-Saxon professional literature, is also being tolerated by Slovak legislation, by not rendering adequate protection to minority owners, and also the politically-motivated destruction of the capital market.

- Insufficient support of small and medium-sized enterprise as a dynamizing component of the economy (in 1997, over 60 per cent of the employed worked with small and medium-sized enterprises and generated over two thirds of the total profit in industry). Annually, small and medium-sized enterprises create some 25,000 jobs. If about SKK 1 million is required to create a job, then for the newly-created jobs in small and medium-sized enterprises, about SKK 25 billion are needed annually, whereby the annual funding in the form of loans hardly amounts to SKK 1 billion!
- A targeted policy of the state support of some sectors and branches is non-existent. The previous government declared its support to the industry several times and even a list of prioritized sectors was made public. Apparently the most important step was the establishment of DMD Holding Inc., the objective of which was to act as a spark plug and prompt the recovery of heavy engineering. However, it is a fact that the situation in the factories of former ZTS is worse than in 1995. The fundamental mistake of the up until now adopted development trends, strategies, concepts, and the like is that they are not associated with any specific tangible assistance. For instance:

- if the government policy of the assistance to the engineering production of ZTS Tees Martin is in place, it cannot happen that the subsidies of the Ministry of Agriculture are allocated for imported tractors and preferential loans are granted for their purchase;
- if there exists a feasibility study for the manufacture of automobiles in Slovakia, a feasibility study for parts manufacture must also be in place;
- if the government furthers the construction of freeways, it cannot happen that the building equipment, similar to that manufactured by ZTS Dubnica, CSM Tisovec, or ZTS Krupina, is imported.

▪ The recovery of the economy the Slovak way, referred to as "asset-looting", accounts for an increase in the volume of non-performing loans. The essence of this method lies in the parent company (holding co.) investing assets in its subsidiaries, while liabilites are maintained with the parent company. The highest incidence of the use of this method was reported in 1997 (ZŤS Dubnica, ZŤS Tees Martin, PPS Detva, Vzduchotechnika, TAZ Trnava, VAB Sipox Bánovce, Mostáreň Brezno, and others), whereby this procedure may be ethically justified in a number of cases, as it was motivated by the company's management effort to save at least the viable part of the company from indebtedness and avoid the seizure of its assets, once the State did not care. Of course, cases motivated by personal benefit cannot be justified. Asset-looting as a method of salvaging at least part of the receivables was also accepted by banks, for instance, in the Calex Zlaté Moravce case.

▪ Foreign capital shows no interest for investing in Slovakia. A positive impact of the foreign investor may be seen in the following cases:
  - Volkswagen Bratislava which accounts for a fifth of the production of the entire Slovak engineering industry and has a significant and ever-growing share in export;
  - VUMA Nove Mesto, owned by Emerson, the U.S.A. Investments (including the company buyout) totalled about SKK 350 million, and the 1998 production totalled SKK 1 billion – it is largely exported-oriented and has a staff of about 800 (originally, VUMA had a headcount between 500 and 600).

Of course, negative examples can also be given, such as, Samsung Calex, however, the overall impact is definitely a positive one. The connection with foreign capital in various forms is the driving force of the prosperity (or just a mere existence) of companies, such as TOS Trenčín, Lodenice Komárno, CSM Tisovec, KINEX Bytča, and others. An advantage of these companies is, above all, a better access to foreign markets and cheaper funding.

Of course, the reasons of the negative situation can be analyzed indepth. The current situation has been impacted by the last privatization wave, the low efficiency of the banking system, the use (or, more precisely, the non-use) of direct debit financial instruments, such as bills, warehouse receipts, L/C, and the like. These, however, have a wider action range and do not affect just the engineering industry.

A certain positive feature is the fact that social cohesion has been maintained over the past few years and also wages have been maintained at an appropriate level, despite the "very good" macroeconomic indicators.

SEEKING NEW STARTING-POINTS

It seems that there is no other way out than drawing a new starting line for those who want and know how to deal in industry and this also holds for the inflow of foreign capital. This solution (unfortunately) entails inflation, however, it is believed that the mechanisms should reflect the fact that two thirds of Slovak industry are not functional, the only exception being

natural and state monopolies. Inflation will depreciate currency which, in turn, will result in the loss of both receivables and payables, and, simultaneously, it will appreciate tangible assets and increase the nominal value of revenues. This will impact, first and foremost, the citizens (consumption and savings will be cut), and only after several years it will have a positive effect on the industry in terms of the growing volume of investments. Bankruptcies in their present form cannot resolve the indebtedness issue, as they relate to 90 per cent of the processing industry. This calls for a system solution rather than the elimination of deviations via bankruptcy proceedings which, when enforced in advanced economies, is a system solution, there's no doubt about that. The new starting line could be a massive capitalization of receivables by using a method proposed by the Slovak Chamber of Commerce and Industry (SOPK).

The essence of this method is to prevent the depreciation of national savings (investments) by uselessly waiting for the outcome of a conventional solution through bankruptcy. Bankruptcy is a legally valid method that brings to a standstill the operations of a company that has been reporting a loss over an extended period of time. The first step is the suspension of ownership rights, followed by the sale of assets and discharge (be only a part) of the company's undertakings. However, the economy should be able to cope with these losses and also there must be demand for the redundand assets. However, the Slovak economy and engineering industry are far from meeting these preconditions, and the outcome is either tedious waiting or a sale at minimal prices. If, within the bankruptcy proceedings, rather than wasting time and waiting for the buyers paying cash, the company disposes of its redundant assets, and creditors (proportionally to their receivables) become owners, one would be faced with a company whose advantage is a complete discharge of debt. It is up to the owners to decide whether to:

- continue the original program
- find a strategic partner
- sell the business.

In the event they are not interested in the ownership of shares, the latter are purchased by an institution incepted by the State (The National Rehabilitation Fund) for bonds with a longer maturity (10 years), with a yield equivalent to the discount rate.

True, this does not bring in new funding, but at least it means the acquisition of companies that are not encumbered (are discharged of their debt), i.e. to put if figuratively, the table is cleaned up and set for the inflow of foreign capital or the re-start of viable companies with new owners. The inflationary effect of this method cannot be overlooked, but it will be solely used to recover the industry (investment), not consumption. The following measures can be implemented in near future:

- Significant support to small and medium-sized enterprises, with the foreign funds back-up, and also the disposal of the idle tangible assets in industry. One of such projects was approved by the former government. Included here is also the simplification of the loan extension and guarantee mechanism.
- Expanding the use of direct debit funding instruments, such as bills and warehouse receipts. The present legal provision of the warehouse receipt use was meant well, as a means of support to agriculture, at the same time, however, it prevented their use in other areas of the economy and vested the Ministry of Finance with above-standard powers. With an appropriate functioning of these instruments, current assets exceeding the volume of the State-controlled money in circulation (M2) are acquired, and also an opportunity to trade goods without the obligation to pay the value added tax each time the goods change their owner (intermediation takes place).

Crisis timing appears to be a particularly pressing problem for the engineering industry, and, in fact, of the entire processing industry. The practical effect of the measures geared towards

the improvement of the present condition can hardly be expected before January 1999, and the hardest hit can be expected during the second quarter of 1999. In the event the social partners (employers and trade unions) lose control over the situation, the starting-point may deteriorate. These concerns are justified, which is corroborated by the events of October and November 1998 (ZŤS TEES Martin, Mostáreň Brezno, SAM Myjava) - it seems that in these companies the initiative came from the grass-roots and the action of OZ Kovo officials was rather diffident. Certain solution (purely political) could be employee participation in the capitalization (or, rather privatization?) process of the companies that employ them. True, the well-established mistrust due to the fashion in which the first wave of voucher privatization was handled, followed by the bond method, will be very difficult to break.

Foreign trade

Marek Jakoby
M.E.S.A. 10
Inez Krautmannová
M.E.S.A. 10

As for its economic capacity the Slovak Republic ranks among countries where key role is played by foreign trade. The economic reform started in 1990 and inevitably effected the area of foreign trade. Unsuitable commodity structure and unilateral orientation to "soft" Eastern markets represented the basic problem.

In the period when the third government of V. Mečiar entered the office, Slovak export was facing a number of serious problems.

Due to the high industrial capacity of the Slovak Republic industry played the key role in exports. Despite a quick re-focus of Slovak exporters to solvent western markets, Slovakia remained dependant on Russia in the area of strategic row material imports. In addition to that, the outdated technology and production caused high row material consumption and continuing shortcomings in the export commodity structure, i.e. products of low level of processing, with low added value and low proportion of human intellectual contribution.

After three years (1991 – 1993) of foreign trade deficit, in 1994 the balance of trade was SKK 2.6 billion. This was a result of the following factors:

- positive international market situation,
- devaluation of 1993 (10 per cent),
- introduction of import surcharge (10 per cent),
- multilateral and bilateral co-operation,
- other instruments of customs policy (preferential duties, preferential treatment clause).

Excerpt from V. Mečiar's Government Declaration of January 1995

The Government considers the following strategic objectives of industrial development:

- increase of export and competitiveness of production
- reduction of energy, row material and material consumption

The Government shall adopt an export supporting policy focusing mainly at the following :

- support of collaboration with the Czech Republic within the Customs Union
- gradual elimination of barriers in mutual trade with industrial and agricultural products among CEFTA member states,
- support of every form of international trade and economic activities with the Russian Federation and other countries of the Commonwealth of Independent States with the objective to achieve a balanced trade balance,
- application of economic instruments and measures to increase export performance of business entities,
- support of export of capital investment units and equipment, high technology and other export activities,
- building an effective international representations network in co-operation with foreign trade entities.

According to its Declaration the third government of V. Mečiar considered ‚increasing exports and competitiveness of industry" to be one of its strategic objectives.

Let us have a look at the development of foreign trade basic indicators in the past years.

Table 23
Development of Foreign Trade Basic Indicators

	1993	1994	1995	1996	1997	1/2.1998*
Export (SKK billion)	168.11	214.37	255.1	270.63	295.6	179.275
Year to year change		27.5 %	19 %	6.1 %	9.2 %	
Import (SKK billion)	195.03	211.81	260.79	340.90	360.1	217.687
Year to year change		8.6 %	23.1 %	30.7 %	1.2 %	
Net Balance of Trade (SKK billion)	-26.9	2.564	-5.695	-70.26	-64.5	-38.412
GDP (b. c., SKK billion)	369.1	440.5	515.1	581.3	653.9	347.8
Balance of Trade/ GDP (%)	-7.3 %	0.6 %	-1.1 %	-12.2 %	-9.8 %	-11 %

Source: ŠÚ SR
** corrected data as of November 1998*

According to the official statistics data in 1995 the export was increased by 19 per cent, while in 1996 only by 6 per cent and in 1997 by 2.5 per cent. On the other hand, in the same period the imports increased by 23.1 per cent, 30.7 per cent, and by 1.2 per cent in 1997. It is worth noticing that in 1997 the export was higher than import due to the anti-import measures adopted, not due to an improved export performance.

According to the originally reported data published by the Statistics Office the trade deficit was SKK 49.5 billion in 1997. This figure presented by the former ruling coalition as improved results of foreign trade compared to 1996 was doubted by Stefan Condik, the President of the Statistics Office who admitted some incorrect reporting of exports and imports in 1997, in particular the reported trade of so called refining mode. The corrected figures of balance of foreign trade (published by the Statistics Office in November) show almost no improvement despite the introduction of a number of anti-import measures.

In evaluating the overall development of foreign trade it is important to assess the development of export performance and import performance. To assess export performance the most common and simple ratio of export of goods and services to GDP is used. The following Figure 24 shows the development of export performance and import performance (import of goods and services to GDP ratio).

The figures indicate that since 1995 the export performance was decreasing, while imports were increasing (figure for 1997 is based on the published, not yet corrected data). Certain positive development of export performance can be observed in the first six months of 1998.

Table 24
Development of export and import performance

	1994	1995	1996	1997	1/2 1998
Export Performance (%)	65.8	62.9	57.5	56.4	61.7
Import Performance (%)	59.8	61.1	68.5	63.5	73.8

Source: MESA 10 calculations based on data of ŠÚ SR and NBS (Statistics Office and Central Bank)

Increased import is given by insufficient levels of local supply, and last but not least, by the outstaying high row material and material consumption of local production.

COMMODITY AND TERRITORIAL STRUCTURE OF FOREIGN TRADE

Evaluation of basic figures does not provide a comprehensive picture of the development of foreign trade. It is important to review the quality aspect, i.e. commodity and territorial structure of Slovak exports.

In principle the commodity structure of export (with some exceptions such as machinery and vehicles) has not changed in the last four years. To a substantial extent, Slovak export still relies on the same products as prior to 1989. The biggest problem is posed by the fact that these are mainly simple, not sophisticated products of low processing level and low added value. Export competitive advantage of these products is based on price factors mainly, while their position is shaky due to a possible input price increase and export reliance on boom situation in target markets. Price competitiveness was given mainly by the low cost of labor and devaluation effects.

A substantial progress in the area of economic restructuring, in particular new machinery, technology, know-how, and new managerial and marketing procedures are required for a transition to a more sophisticated production. Institutional conditions, especially effective ownership structure and abundance of investments and funds are preconditions of a sophisticated production. The basis of price competitiveness, i.e. effects of devaluation of 1990 and 1993 gradually evaporated. Despite of it the government did not create necessary institutional and material preconditions for the transition towards a production based on other than price competitiveness. With the fixed exchange rate and inflation higher than in western countries so called hidden evaluation of currency followed by reduced price competitiveness was taking place since 1995. The cheap cost of labor and its effects started to disappear since 1996 when for the first time a marked real wage increase was higher than work productivity growth. The year of 1996 ended up with a record trade deficit of SKK 70.2 billion.

Table 25
Commodity structure of Slovak Republic export (%)

	1993	1994	1995	1996	1997	1/21998
Iron and steel	14.50	16.20	16.30	13.80	12.24	11.8
Machinery, instruments and nuclear reactor components	7.76	7.80	7.80	8.20	8.19	7.6
Vehicles, tractors, motorcycles and accessories	4.80	5.80	4.90	8.10	10.84	15.4
Audio and video equipment	Na	Na	4.60	5.00	6.30	8.0
Mineral fuel, mineral oil, wax	4.40	4.70	4.20	4.90	5.05	Na
Plastics and plastic products	3.90	5.00	5.40	4.90	4.78	Na
Iron and steel products	3.90	4.10	4.40	4.40	4.03	Na

Source: Information Bulletin Ministry of Economy of the Slovak Republic No. 4/97

The table shows that in the last four years the proportion of individual commodity groups has not substantially changed in the Slovak export. The item of vehicles is worth noticing. Their export contribution in 1996 doubled compared to 1995. This substantial change was caused by one of the biggest investors in Slovakia – Volkswagen Bratislava (in 1996 it increased export by SKK 4.2 billion , or by 31 per cent), and also by the increased production of subcontractors to this company.

To assess the competitiveness of Slovak export the approach introduced by K. Aiginger (WIFO Institute, Vienna – 1995) can be used. This approach is based on identifying the sensitivity level of types of products on price competition, while the quality categories ranks from 1 to 166. Products of grade 1 are those with highest quality grade and the lowest price-sensitivity (with regard to competition), while products in grade 166 are those of lowest

quality and highest price- sensitivity. From the Slovak export basket 50 most important export items were identified, representing in 1995 67.1 per cent of export of goods. They were broken into three groups by price - sensitivity factor:

1. quality grade 1–55 (low price and high non-price competitiveness)
2. quality grade 56–110 (medium price and non-prices competitiveness)
3. quality grade 111–166 (high price competitiveness and low non- price (other than price) competitiveness)

Table 26
Structure of quality grades of Slovak export (%)

	High quality grade/1	Medium quality grade/2	Low quality grade/3	Total
1995	**11.6**	**16.3**	**39.3**	**67.3**
	17.2	24.3	58.5	100.0
1996	**13.1**	**15.9**	**36.0**	**65.0**
	20.1	24.4	55.4	100.0
1997*	**12.4**	**15.0**	**34.8**	**62.2**
	20.0	24.2	55.9	100.0

Source: Calculations are based on statistics data on commodity structure of Slovak export by the SITC-rev. 3 classification, at the level of three digit code
** preliminary data*

Data in the table show that if items representing 62 to 67 per cent of Slovak export were taken as a representative of the entire export, conclusions can be made that more than a half of export is almost completely dependant on price level, and only one fifth represents products with higher added value, the competitiveness of which is given by quality parameters mainly.

Taking into account the insufficient progress achieved in industry restructuring (as industry is a substantial contributor to export) that could have positive affect on non-price competitiveness, the higher pace of import growth than export and the increasing deficit of trade are only natural results.

This export – import discrepancy started as early as in 1993, but since 1994 during Meciar‘s third government it has become more intense.

So called *transformation effect* is another factor indicating the progress achieved in the area of restructuring. This is a ratio of finished product export (SITC international classification grades of 5,6,7,8) to row material and material import (SITC grades 2,3) – Fig. 23.

Table 27
Transformation effect (coefficient)

	Slovak Republic	Czech Republic
1991	1.58	2.85
1992	2.31	3.13
1993	2.64	4.95
1994	3.44	5.2
1995	3.62	5.4
1996	3.18	5.44
1997	3.28	5.81
1/2 1998	4.35	7.21

Sources: MESA 10 calculations based on: Štatistický bulletin SR a ČR (Statistics Bulletin of Slovak Republic and Czech Republic)

In 1996, for the first time since the transformation was launched in the Slovak Republic, there was a decrease in transformation effect, in other words, in 1996 the row material import was increasing faster than the export of finished production. In 1997 the value of this ratio was still below its value in 1994.

Certain improvement can be observed in the first six months of 1998 when the transformation effect reached 4.35 points. This development was positively influenced by export of machinery and equipment representing a year-on-year increase by SKK 20 billion. Its share of total export increased from 26.9 per cent to 33.2 per cent. Compared to the Czech Republic and its transformation effect, Slovakia still shows substantially lower effect.

Due to the fact that in the Slovak economy restructuring is not taking place and the non-price competitiveness stagnates, during the previous years the government dealt with the deficit of trade issue by limiting import..

The first measure was Slovak Crown devaluation against convertible currencies by 10 per cent in July 1993. In the beginning of 1994 the government adopted substitutional anti-import measures. In March a 10 per cent import surcharge was introduced and mandatory import certificates for food import from the Czech Republic, despite the Customs Union of the Slovak Republic and Czech Republic agreed in 1993. These measures resulted in reduced imports, while at the same time increased export was achieved. In 1994 this resulted in a slightly surplus balance of trade of SKK 2.6 billion.

In the following period the government was gradually reducing the import surcharge level and by December 1996 it was reduced to zero. On July 21, 1997 due to the deteriorated external payment position of the Slovak Republic and due to the risk of reduced foreign currency reserve of NBS (Central Bank) below the level of three month import of goods and services cover, the government of the Slovak Republic re-introduced a 7 per cent import surcharge applying to imports from any country and to more than 75 per cent of the total import.

As a result of WTO committee consultation regarding the introduced import surcharge by the Slovak Republic, the import surcharge rate was reduced to 5 per cent as of January 1, 1998 and to 3 per cent as of September 30, 1998. The import surcharge was reduced to zero rate as of October 1, 1998.

Of a clearly administrative anti-import nature were new rules for goods import certification introduced by the government in September 1997. The rules were extremely strict, requiring certificates also for goods already having international certificates. As a paradox, a confirmation was required for goods not subject to certification. The main problem was the fact that government introduced this new system in a chaotic manner with no preparation. Neither material nor institutional preconditions existed for entities to adjust to the new rules. Above all the importers were not given time to adjust to the new conditions. It is fair enough to say that Slovak testing institutions need for certification one to six or more months in average and it is obvious that majority of importers simply could not comply with the new rules in time, regardless of their flexible response. Needless to say, there was absolutely inadequate information dissemination regarding the new rules. In addition to all of this adjustment to the new rules brought along high direct cost. Importers had to pay for certificates and for notary confirmation of certificate copies to be presented at any single import. It seems that government introduced this liquidating method of certificates purposefully, with an objective to reduce import and stop the increasing deficit of the balance of trade. Obviously this was related to the all possible effort of the government to avoid Slovak Crown devaluation at any cost.

The same objective was pursued by three legal anti-import measures of the Slovak Republic in 1997, the law on antidumping protection with goods import, the law on protective measures relating to import, and the law on subsidies and equalizing measures. These pieces

of law are in compliance with World Trade Organization (WTO) standards and various international agreements. Especially the law on anti dumping protection in relation to goods import is worth noticing.

a) The law on anti dumping protection entered into force on February 6, 1997. Several experts agreed that after some period of time the government developed a standard legal norm. In their opinion it come into existence too late. The government decision to draft this law was adopted on November 29, 1994, i.e. during Jozef Moravčík‘s government. In this case there is a legitimate question why it took more than two years to develop this law. A need to draft such a law in anchored in the EU Association Agreement for Slovakia. Out of the countries in transition such a law has been adopted in Hungary, Poland and a similar law is just to be approved in the Czech Republic.

Antidumping procedure is rather complex and lengthy. The law prescribed up to nine months period to take a final decision, there is also a risk of law abuse. The law says that during the above stated nine months period the relevant Ministry is entitled to commit the foreign exporter to adjust the price immediately, or to ban the export of the given goods to the Slovak Republic.

b) The second piece of legislation was the law on import protection measures entering into force in May 1997.

According to the law access import is such an amount of goods causing damage or threatening production, conditions of sale, market position, or in any other way deteriorating economic indicators of local production sector. The government bill of this law in its reasoned statement referred to the Protection Measures Agreement adopted in April 1994 by that time ministers of GATT (Currently WTO) in Marrakech.

In 1997 the government adopted new measures to support export: Foreign Trade Support Fund (FPZO) was established as well as Eximbank.

The main operations of Eximbank fall into the area of financing and insuring export-import activities via providing credits and insuring export operations against commercial and political risks. Eximbank has registered capital of SKK 2 billion provided by the government based on the credit granted by Japan Eximbank. Other funds consist of mandatory contributions of exporters and importers representing 0.05 per cent of the value of export and import, then funds taken over from the former ‚SPE“ Export Credit Insurance Company, and in the future borrowed funds should be acquired. By the end of September 1998 it failed to raise foreign funds in the budgeted amount of SKK 2 billion.

It needs to be stressed that Eximbank is not subject to the Bank Law, nor to the banking supervision of the NBS (Central Bank). This means that it does not follow the B.I.S. regulations and rules and its activities may contradict to the interest and objectives of NBS monetary policy. In addition, the Eximbank law does not provide for transparent procedures, criteria or conditions of direct financing. By law the Eximbank is not held responsible nor obliged to follow standard banking practices and the law does not specify criteria for allocation of bank funds that are tax payers money and borrowings from foreign investors guaranteed by the state.

Another instrument created to support export was supposed to be the Foreign Trade Support Fund (FPZO). Its funds consist again of mandatory contributions paid by exporters and importers in the amount of 0.1 per cent of export and import. The Fund provides support mainly for presentation of Slovak producers and products abroad. Within ‚FPZO“ trade representations of the Slovak Republic in selected foreign countries have been strengthened.

Based on the previous experience the existence of the ‚FZPO‘ Fund still appears to be an additional tax only to burden any exporter and importer. It is not correct that this tax is to be paid by exporters as well. Although the Fund offers opportunity to receive funds to expand foreign trade, lobby is very strong here as decisions on funds allocations are made by Fund

administrative staff members and interest groups. The basic problem of the „FPZO“ Fund is the redistribution of funds namely, as it is very difficult to find objective criteria for how and whom the funds to be appropriated.

Having compared the system and instruments of export support in CEFTA member countries the following statements can be made:

- in most of the countries the state is in maximum possible way involved in the financial support of export – unlike in the Slovak Republic,
- Eximbank in the Slovak Republic has absolutely insufficient capital base to provide a wider scope support of export, or import of modern technologies and investment units to support Slovak export at the end of the day,
- as for the state budget of the Slovak Republic, instead of providing support it collects duties, VAT, and possibly import surcharge in the past, from exporters for import of machinery or technology. It should instead discharge them from paying these taxes and support a fast restructuring of national economy for which the state budget does not have enough funds,
- importing raw material , material, semi-finished goods, and spare parts exporters must pay duties , VAT, or import surcharge, although these are subject to further processing in production. There were only few cases of import surcharge refunds,
- Banking institutions in the Slovak Republic are lacking long-term funds and therefore cannot support exporters by granting long-term credits at discounted rates,
- As for the Foreign Trade Support Fund, on one hand it collects mandatory contributions from every exporting and importing entity, on the other hand it provides funds to selected entities only. Questions may be raised as to the selection process of these entities, assessment of the purpose of the use of allocated funds, and evaluation of the effective utilization of the funds,
- it is useless for foreign trade entities to contribute both to the FPZO Fund and to Eximbank. Being a financial institution the bank should operate without the contributions and its operations should be supported by the state mainly.

While assessing the development of Slovak foreign trade, its territorial structure should also be mentioned.

Table 28
Individual territories and their share in the total of Slovak exports (%)

	1993	1994	1995	1996	1997	1/2 1998
Russia	4.71	4.12	3.85	3.48	3.7	2.5
Czech Republic	42.48	37.19	35.24	31.0	26.7	21.0
EU	24.18	28.64	37.39	41.26	45.0	54.1
CEFTA	49.96	45.47	44.28	42.06	38.7	32.5
OECD	32.73	38.79	40.63	84.94	85.5	88.6

Source: Statistics bulletins of the Statistics Office of the Slovak Republic
* *Austria, Sweden, and Finland entering EU*
** *Czech Republic, Poland, Hungary entering OECD*

While in 1993 the export from Slovakia into EU countries represented approximately one forth, in 1998 more than 50 per cent of Slovak export was placed in this market (partially due to the new countries joining EU in 1995). On one hand, the fast change in orientation of Slovak exporters focusing on more solvent western markets, and the outlasting reliance of Slovak economy on raw material supplies from Russia on the other hand resulted in increasing Slovak-Russian trade deficit. In 1997 the mutual trade deficit was SKK 42 billion (!).

Table 29
Individual territories and their share in the total of Slovak imports (%)

	1993	1994	1995*	1996**	1997	1/2 1998
Russia	19.5	18	16.6	17.4	15.6	11.2
ČR	35.9	29.6	27.8	24.3	23	18.8
EU	20.5	26	34.8	37.3	39.5	48.6
CEFTA	39.3	34.1	33.1	29.7	28.9	24.9
OECD	33	39.7	41.4	74.6	75.3	79.6

Source: Statistics bulletins of the Statistics Office of the Slovak Republic
* *Austria, Sweden, and Finland entering EU*
** *Czech Republic, Poland, Hungary entering OECD*

The high negative balance of trade was the main argument used by government representatives and economist supporting their efforts to establish closer co-operation between the Slovak Republic and Russia, including the form of increased export by Slovak party. These efforts were strongly criticized, claiming that re-focus of Slovak export to eastern markets is not dictated by business needs but by government decisions. The government was not able to support real restructuring and stop the gradual reduction of competitiveness in western markets. Consequently it was not able to compensate for the trade deficit with Russia by increased export to western markets.

Experts presented an opinion that Slovakia may pay tribute for its economic growth to non standard relations of some Slovak companies and Russian mining factories. Till April 1996, strongly interfered by the state these companies allowed Slovak processing companies to buy key raw material at substantially lower prices compared to international markets.

Bratislava – Moscow economic relations are of key importance mainly for the structure of the economy inherited from the previous socialist style of management. Despite skeptical forecasts about the strength of Slovak economy after the split of the Federation, Slovakia was doing rather well. There is nobody capable explaining reasons for this positive development. The level of foreign investments to Slovakia, for example, represents roughly ten to fifteen times lower amount than in other CEFTA countries. In addition, the amount of local capital needed for restructuring is far from sufficient. And finally, having realized that the economic reform was restricted to privatization, we ask a legitimate question what is the driving force of the Slovak economic growth.

It is the reality that according to the official statistics, export of the Slovak Republic contributes by 50 per cent to the GDP of the country. Two thirds of Slovak export go to solvent markets of Western Europe, including the Czech Republic. But it is also reality, that Slovak export is substantially produced by companies having to do with raw material sources in the East. For illustration purposes, one of these companies is the monopoly crude oil refinery Slovnaft, a.s. living on Russian crude oil for 100 per cent, and placing 40 per cent of its production on western markets. Another example is ‚VSŽ, a.s., Košice‘ (Eastern Slovakian Steel Mills in Kosice), importing iron ore from the Ukraine, or ‚Slovenský plynárenský priemysel, š.p.‘ (Slovak Gas Industry, state company), depending on Russian gas and transiting Russian gas through Slovakia to western Europe. In addition to that, as illustrated above, only 24 per cent of Slovak export is based on quality, while as much as 55 per cent is based on cheap price. According to some opinions up to 60 per cent of Slovak-Russian trade is represented on the Russian side by state organized trade. In addition to that by spring 1996 volumes and prices for crude oil imported to Slovakia were subject to intergovernmental agreement. This fact on its own reveals the above standard relations in this case.

Towards the end of 1995 the public was surprised to hear a consideration of the Ministry of Finance,S. Kozlík returning from Moscow, on a possible creation of customs union between the Slovak Republic and Russia. Later on these ambitions of the government were corrected and the topic was changed into a free trade zone agreement. The above mentioned agreement was supposed to reduce high customs barriers on the Russian side, at the average level of 30 per cent to 40 per cent. None of these agreements was signed

The fact that Slovakia was the only former Comecon country proposing customs union with Russia on the government level only proves the purposeful bet of the government on the above standard relations with Russia. At the same time the EU Association Agreement commits the Slovak party to consult steps of this nature in Brussels. It did not happen. It must be stated here that the idea of a customs union with EU countries and free trade zone with Russia at the same time was, is and shall be inconceivable as Moscow does not even consider its membership in this prestigious club of the most economically developed countries of the world. Another ‚black point' Slovakia scored in the eyes of the West was the participation of Slovakia as the only non post-soviet country since summer 1993 in the negotiations of so called Surgutsk Agreement with the observer statute. This agreement, covered by the veil of secrecy, probably sets for its signatories special mode of setting price of crude oil and other energy raw material bought mainly in Russia. According to non verified information the agreement itself lost its effect some time at the turn of 1996/1997.

If Slovakia was participating in such non transparent agreements of international importance, it only indicates certain style of politics making speculations on foreign political orientation of the state legitimate. This was felt in 1998 when Slovakia was not included in the first round of EU entry negotiations.

Foreign Investment

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M.E.S.A. 10

In transforming economies foreign direct investment represent an important source of real capital, new technologies, markets, know-how, and business culture.

As for Slovakia, real influx of Foreign Direct Investment can be observed since 1990. By the end of 1994 the total of SKK 22 billion of Foreign Direct Investment in corporate sector was generally considered as too low.

Table 30
Corporate foreign investment in SKK million at the end of the period

	1994	1995	1996	1997	6/1998
Foreign Direct Investment	21 954	28 961	36 957	41 854	49 545
GDP in current prices	440 500	515 100	581 300	653 900	347 800
Foreign Direct Investment as proportion of GDP	5.0 %	5.6 %	6.4 %	6.4 %	14.2 %

Source: NBS, ŠÚ SR

Aware of the situation, the third government of Vladimír Mečiar entered its four year term of office with commitment to increase the amount of Foreign Direct Investment declaring this goal in its mission statement in January 1995: „*The Government shall support targeted entry of foreign capital in Slovak economy. It shall facilitate formation of joint ventures with foreign investors so that foreign funds are used mainly for upgrading and purchase of new technologies, or for financial recovery of these companies. Similar criteria shall be preferred in selling companies to foreign investors.*“ The Government committed itself to instigate interest of foreign investors in doing business in Slovakia and it promised to create an environment making Slovak capital market attractive for foreigners.

In reality, Foreign Direct Investment into corporate sector amounted for SKK 50 billion in June 1998. It is 10 times less than in the Czech Republic and 15 times lower than in Hungary..

Table 31
Net increase of corporate foreign investment in SKK million

	1994	1995	1996	1997	1998
Net increase	8 033	6 000	7 747	5 155	7 589
GDP in current prices	440 500	515 100	581 300	653 900	347 800
Net change/GDP	1.8 %	1.2 %	1.3 %	0.8 %	2.2 %

Source: NBS, ŠÚ SR

The ratio of Foreign Direct Investment to GDP was showing a decreasing trend since 1994 and a slight improvement could be observed in 1998 only. But 2.2 per cent ratio of foreign direct investments to GDP cannot be considered an economic miracle. In the last four years Mečiar's Cabinet „managed" to increase the amount of Foreign Direct Investment into corporate sector up to SKK 27 591 million, equalling an increment of 125 per cent. Lack of stable political environment and legal framework, non transparent privatization, exuberant bureaucracy, capital market failure, degrading rating, special tax exemptions, ineffective infrastructure, and inadequate statements made by HZDS representatives addressed to foreign personalities, all of that can be considered the most important barriers causing the low influx of foreign investments to Slovakia. It is extremely important that despite these difficult and complex conditions the Slovak National Agency for Foreign Investments and Development (SNAZIR) was able to represent respectably the Slovak Republic abroad and contribute substantially to the influx of foreign investments to the Slovak Republic.

Political stability

Political and economic stability is the highest priority for foreign investors deciding the destination – target territory for their investments. Market size is their second priority. Interest in tax relief ranks very low in their priorities list. Therefore the government commitment was right as presented in its declaration: „*to create legislative framework ensuring compatibility with capital markets of European Union member countries. By stabilizing the economic and political environment in the Slovak Republic the government shall create conditions to stimulate foreign investors and their interest in Slovak capital market and to increase substantially the interest of local investors in utilizing advantages of this form of doing business.*"

Pompous statements of January 1995 were taken down a peg in spring of 1998 by an important Austrian Banking house Bank Austria considering political stability a dominant factor in attracting foreign investors. They commented the Slovak Republic situation as follows: „*Until there is substantial change in overall political style, in Slovakia the lack of foreign investments continues to block the influx of know-how, managerial and marketing skills and experience, and new work approaches. In long run this will undermine the competitiveness of the Slovak Republic.*."

The artificially supported vision of Slovak economic miracle finally started to dwindle away in 1996 when the positive macro-economic balance as a key attraction for foreign investors lost its charm too soon to be able to evoke the desired influx of foreign investments. The causes are very clearly named in the International Monetary Fund Report acknowledged

by the Slovak Republic Government in January 1997: „*Haziness of the privatization process discourages potential foreign investors and Slovakia looses the adequate influx of foreign know-how and capital* .“

Political and economic stability are the factors foreign investors miss most in Slovakia.. Foreign investors considering investments in a country with more than 7 per cent GDP growth at 7.2 per cent inflation rate and exchange rate stability in 1995 could only be astonished in 1996. After the legislative chaos, inadequate statements towards international community, corrupted privatization, absence of bankruptcy proceedings and sales of high quality companies deep below the market price, even the more venturous investors withdrew from the market when they started to feel the indicators of non transparency..

Legislative support of foreign investment influx

The outgoing government strongly proclaimed their pro-investment oriented legislation.. Mečiar‘s Cabinet exerted minimum effort in this area. This can be proved by only a few amendment related to foreign investment support.. These amendments related mainly to selective import surcharge exempts, and liberalization of foreign securities trading in Slovak capital market via Securities Law amendment caused by the effort to meet one of the criteria for Slovakian membership in OECD, etc. More substantial changes have taken place only recently when two conflicting laws regarding foreign investors entry came into effect.

Income tax law amendment in effect as of July 1, 1998 introduces a new § 35a regarding the so called 5year tax holidays (tax relief) for large investment activities on the territory of Slovakia financed by foreign funds other than loans.

The substance of the tax relief provision is that corporations (legal entities) submitting their tax returns for the first time may reduce their tax due by 75 per cent a year in five consequent taxation periods (calendar years) They may use this clause providing they invest funds generated abroad (except for credits and loans) during each calendar year in the minimum amount of SKK 200 million to purchase fixed assets located in the territory of Slovakia. In order to qualify for this tax relief tax payers must comply with other conditions specified in the tax income amended law. One of the conditions is to increase production by at least SKK 100 million in the first year of applied tax reduction. In the following four years of reduced tax duty in addition to the above stated criterion the tax payer must achieve at least 10 per cent increase of production on the year to year basis. These conditions need not be met by tax relief applicant providing they achieve increased production of at least SKK 1 billion in total during the five calendar years of applied reduced tax. Another legal requirement is that during the five years following the first year of applied tax relief the tax payer must not transfer to another person or entity assets gained on the basis of tax exempted large investment activities. In addition to that every year the tax payer must sign a contract with tax authority establishing lien on the assets to secure possible future tax payable in the amount of the tax reduction applied.

The background of the amended income tax law (offering five year tax relief) was the government interest in a specific investment, i.e. attracting more investments of Volkswagen already established in Slovakia. This was confirmed also by very specific and strictly limited conditions of the relief as presented in the government proposed law amendment. While negotiated in the parliament these conditions of the amended law were lifted to some extent and according to analysts they can be utilized also by other foreign businesses.

The exceptional 10 year tax exempt can be used only by a joint-stock company providing it was (or still will be) registered in 1998 and its sole and only founder is a foreign individual. In the period from creation of the company to the end of the year previous to taxation period when the tax is due for the first time (and the tax exempt applies) the tax-payer must use at least SKK 300 million of foreign funds other than credits or loans to increase the equity of the company.

In the same period of time the tax-payer applying for 10year tax holidays must invest at least SKK 1 billion of foreign or local funds to purchase fixed assets utilized for production in the territory of the Slovak Republic. It means that during tax holiday period they have to invest an average of other SKK 300 million a year. The dominant area of business of the company must be production of goods. The company must increase the production by average 5 per cent every year during the exempt period. At least 90 per cent of company own production of goods must be exported. Company enjoying tax holidays must issue its shares on name. During the tax exempt period the company must not issue bonds.

An extremely detail characteristics of this measure evokes certain assumptions of bias or discrimination as it is highly probable that this regulation is tailor-made for one specific investor – American company Motorola. The conditions are so specific that only one investor can meet them.

After the purpose-made law amendments that were to bring benefits to narrow groups of businesses related to the government coalition a new trend was invented – adopting laws and government regulations aimed at solving specific investment actions. The formula used was: „two investment projects = two regulations“. Even entering into effect at the same date.

Third, in the last week of June the government approved its „declaration to support Foreign Direct Investment“. It is full of buoyant statements about government good will and commitment to create positive conditions for foreign investments and to make up advances to foreign investors to gain their trust. Some of the statements are worth quoting: „*The Government is committed to evoke participation of foreign investors in the privatization process and to ensure that foreign investors have access to privatization programs on the basis of predictable and transparent rules and regulations ...*“ All that needs to be said here is that out of more than 500 privatization decisions in the period of 1996 – 1997 none was a sale to an important foreign entity. Speaking about commitment, it is therefore not clear what government has the Meciar‘s government in mind.

On one hand, one could be pleased by the changed attitude of the government towards foreign investors, on the other hand it shows that it was too early for the joy. The main problem is that Meciar‘s government was neither willing nor capable of eliminating real barriers to foreign investment influx as the method of governance was the main obstacle.

SNAZIR

„Slovenská národná agentúra pre zahraničné investície a rozvoj“ (SNAZIR) = Slovak National Agency for Foreign Investment and Development was created in 1992 as an agency at the Ministry of International Relations and Ministry of Privatization. It was subsidized from the state budget by up to SKK 10 million a year. In the beginning of 1994 „SNAZIR“ was transformed into a joint-stock company with the Fund of National Property of the Slovak Republic being its 100 per cent owner, or shareholder. Since 1994 the state has not supported it in any form and in order to finance its activities SNAZIR has to raise funds by its own business activities.

Intensified entry of foreign capital to Slovakia is the main objective of „SNAZIR“. It focuses mainly on attracting direct investments, i.e. creating joint-ventures, projects starting „from the scratch“, etc. The agency develops activities in two areas. The first one is

networking, representatives of the agency establish direct contacts with potential foreign investors and try to bring them to Slovakia. The second area of activities deals with publishing, information dissemination or marketing.

In the last four years „SNAZIR“ exerted maximum effort to attract foreign investors to Slovakia. The biggest barriers for foreign investments are reported to be the lack of interest in foreign capital by government representatives and overall political and economic climate in Slovakia. During its short period of existence it substantially contributed to foreign capital inflowy to Slovakia. In the last three years it ensured via its activities almost 40 per cent of all Foreign Direct Investment entering Slovakia.

Table 32
Foreign Direct Investment ensured via SNAZIR, Inc.

Year	1994	1995	1996	1997
Foreign Direct Investment in million USD	15.2	63.0	66.0	27.3
Jobs created	550	1 525	3 990	5 230
% of total Foreign Direct Investment	8%	35%	43%	38%

Source: SNAZIR

Since 1995 by its activities „SNAZIR“ created more than 10 000 jobs and by its sensitive marketing in prestigious periodicals contributed to positive image of Slovakia abroad. Its survey showed that as many as 87 per cent of established foreign investors want to continue investing in Slovakia in the future. This is a very important information.

Foreign Direct Investment and Capital Market

To attract foreign investors to a transparent capital market was one of the highest priorities of the Government Declaration announced by Mečiar’s ruling party caucus. Their objective was to ensure sufficient influx of portfolio investors focusing mainly on gaining equity shares in companies. Their volume has been drastically reduced in the last four years. It is caused by shallow, illiquid, and not very transparent capital market in Slovakia.

Majority of portfolio investors in Slovakia has chosen the strategy of leaving the market, selling their shares in Slovak companies even at a loss. This can be proven by information provided by several top securities traders (CREDITANSTALT, ING,...). They were not selective in selling their shares, in principle they were getting rid of their positions and abandoning the market. In short-term, they cannot be expected to return, and their hesitation was influenced also by the political situation in the country. The most frequently stated reason for their leaving was the status of the capital market in the Slovak Republic. .

Investors were looking mainly for investment opportunities for growth. They did not prefer safe equities only, they prefer mainly yield, while price increase, not dividends, was considered important. 1995 and 1996 were the best years for investments. Roughly from among 40 to 50 international investment funds half of them were investing in Slovakia considering a 5 year time horizon. Outstaying illiquidity and lack of transparency of the market made many of these investors leave.

The presence is more than just bitter. Interest of foreign investors has shrunk to shares of approximately five Slovak companies. After four years the ruling trio not only failed to attract portfolio investors, by their irresponsible policies they drove away those few having some interest in the Slovak capital market. It resulted in a sad statement that Slovak market is of little interest to foreign investors both by its scope and offer. A number of investors consider it a non standard feature that most of the transactions at the Stock Exchange are direct sales.

Benefits of foreign investment influx

Know-how and better corporate culture are the biggest benefits of foreign investment influx. A company with experienced foreign management has better chance to establish itself and it is capable of developing qualified experts. Higher nominal wage and productivity represent a component part of foreign companies and their influence. According to data available an employee of a foreign company earns in average by SKK 1500 more a month than an employee of a private company with Slovak owners.

Foreign investment influx results in higher employment, increased export, improved balance of trade, and inevitably in foreign currency inflow. This can be proved by a comparison of one hour work production. While in Slovak companies the one hour work production represents SKK 400 in private companies and SKK 492 in state controlled companies, it is SKK 1056 in a foreign company operating in Slovakia (TREND, 6/97).

It was extremely irresponsible that the former government simply got rid of all these advantages and preferred personal interest to state interest.

Foreign Direct Investment Structure

During the last four years the amount of Foreign Direct Investment did not grow substantially compared to the period of 1990 – 1994. The biggest increase was experienced in the banking sector with the inflow of Austrian and German capital.

Table 33
Foreign Direct Investment by sector, in SKK million

	Corporate sector		Banking sector		Total	
Year	**1995**	**1998**	**1995**	**1998**	**1995**	**1998**
Foreign Direct Investment	28 961	49 545	2 459	11 575	31 420	61 120

Source: NBS

Compared to 1995 the foreign investment structure has changed substantially. Percentage share of trade was evidently reduced for the benefit of industry and financial institutions. Entry of German and Austrian banks and billions of investments by Volkswagen in recent years rank among the main causes of this shift.

Table 34
Structure of Foreign Direct Investment in corporate sector in %

Sector	1995	1998
Industrial production	43.4	47.6
Finance and insurance	15.7	22.1
Trade	32.4	18.5
Other	8.5	11.8

Source: NBS

For comparison, in Hungary as many as 75 per cent of all foreign investments go to industry (TREND 17/98), having an extremely positive effect on the balance of trade and changed export structure for the benefit of sophisticated products. The highest proportion of foreign investments come to Slovakia from Germany (SKK 12.1 billion) and Austria (SKK 11.9 billion), while the 5 billion level was exceeded by United Kingdom (SKK 7.7 billion), USA (SKK 6.7 billion), and the Czech Republic (SKK 5.9 billion).

Table 35
Territorial structure of Foreign Direct Investment in corporate sector, in%

Investors home country	1995	1998
Germany	22.2	19.8
Austria	20.9	19.5
United Kingdom	2.6	12.6
USA	14.4	11.0
Czech Republic	15.2	9.7
Netherlands	5.1	8.0
France	6.8	6.7
Other	12.8	12.7

Source: NBS

The German car producer Volkswagen investing app. SKK 15 billion into BAZ Bratislava is undoubtedly one of the biggest foreign investment company. In the area of trade it was retail chain TESCO establishing itself on Slovak market by buying the chain of former PRIOR stores from K-MART company. Another important investment is represented by Swedish concern Assi-Domän, buying 93 per cent of shares of 'JCP Štúrovo' (Pulp and Paper company). In the brewery sector in Slovakia Heineken owning 'Zlatý Bažant" brewery (SKK 800 million) and 'Corgoň' (SKK 200 million) compete with SAB South Africa investing in 'Šariš' brewery (SKK 1 400 million). During the last four years important investments were made by France Telecom entering "Globtel", a mobile telephone network operator (35 per cent), and by SONY building a new plant in Trnava. Important proportion of foreign investments was directed to car manufacturing industry dominated mainly by investors focusing on car component assembly (ZVL Auto Prešov, Pal-Inalfa Vráble, SACHS Trnava, etc...).

Foreign investor activities in Slovakia have considerable impact on their relevant regions, although most of the investments were made in the area of Bratislava attracting more than half of the total of investments made. Reasons for that are good location, developed infrastructure, qualified workforce and proximity of important authorities and institutions.

Comparison of Foreign Direct Investment in the Slovak Republic and other countries

Slovakia has a 1.5 per cent share in the total amount of investments made to the countries of Central and Eastern Europe and former CIS countries since the beginning of the transformation process. Hungarians are most successful, attracting more than ¼ (25.5 per cent) of Foreign Direct Investment heading to the „East"!!! It is alarming that Slovakia placed only thirteenth, when more than twice as much investments went to Romania, the Ukraine, and even to Azerbaijan.

Table 36
Individual countries and their share in Foreign Direct Investment targeted to Central and Eastern Europe and former CIS countries

Order	Country	Investment share in %
1.	Hungary	25.2
2.	Russia	15.9
3.	Poland	13.8
4.	Czech Republic	12.2
5.	Kazakhstan	7.0
6.	Romania	3.9
7.	Ukraine	3.4
8.	Azerbaijan	3.3
9.	Croatia	2.1
10.	Lithuania	2.1
11.	Slovenia	1.8
12.	Bulgaria	1.6
13.	Slovakia	1.5
	Other	6.2
	Total	100.0

Source: Financial Times, 1998

Direct foreign capital investment into Hungarian economy has reached the level of USD 17 billion and it substantially decides on the development of the Hungarian economy. It generates 60 per cent of the total company revenues and it contributes by 70 per cent to the exports. The impact of Foreign Direct Investment helped our southern neighbors to restructure their economy and to increase substantially exports of high level of value added products.

The low level of Foreign Direct Investment to Slovakia cannot be argued by the insignificant size of our country. When comparing direct foreign investment per capita of different countries, Slovakia falls behind Hungary and Czech Republic by many times. The above stated fact show that Slovakia considerably legs behind its biggest competitors in attracting foreign investors.

Table 37
Cumulative Foreign Direct Investment in V4 countries as of Dec.31, 1997 in USD per capita

Order	Country	USD
1.	Hungary	1 667
2.	Czech Republic	796
3.	Poland	534
4.	Slovakia	222

Source: Cestat, 1998

Conclusions

Slovakia possessed all the preconditions to become an Eden for foreign investors, especially by its geo-political location, rather cheap and available workforce, highly diversified industrial base, access to energy and utilities, as well as possibilities to utilize comparative advantage in the area of wage and energy inputs.

Despite all these advantages foreign capital flows in Slovakia only in small amounts. This adverse phenomenon must be explained by investors motivation stimulating their investments. Majority of investors state stable political and economic environment as their priority. The third government of V. Mečiar succeeded in destabilizing it and making it non transparent..

Another entry barrier is represented by high legislative risk when many laws were amended several time a year. This was another bad signal for investors willing to make a long-term investment and presence in Slovakia. Add to it privatization lacking transparency and deviant understanding of a successful business where the common *profit-seeking behavior* (company owners focusing on profitability and long-term growth of their company) was gradually replaced by *rent-seeking behavior* (company owners focusing on their personal rent and short-term asset drainage for their own benefit). As a result of that an exceptional new social strata was created, so called „milionarios“, very badly perceived especially by portfolio investors withdrawing from the market concerned with the possible asset draining of companies in their equity portfolio.

Non standard procedures applied in privatizing national assets reflected in full on the foreign investor participation in this process. In 1995 only three foreign entities of some importance participated in the privatization. In the period of 1996 to 1998 no foreign investor participated in the privatization as Mečiar and his team preferred so called “Slovak Way”. The principle was to cut off several foreign investors interested in privatization and to sell assets for symbolic price to the supporters of the ruling political movement. It is therefore even more striking to call it a third wave of privatization when Slovak entities are selling the assets bought so cheap to foreign investors at market price. Building “national economy” is fully revealed, when proceeds from the sale of state assets are appropriated for the own use of some privatizers instead of the “FNM” (National Property Fund) the treasury of which is empty.

By its policies the new government must now ensure a sufficient influx of foreign capital in the present need of ten times as much as before. It is amusing to read the statement of Vladimír Mečiar pronounced in his speech in May 1998 in Vienna for the audience of several hundreds of politicians, businessmen and bankers with regard to the amount of Foreign Direct Investment in the country: „We are in the position when offers (of foreign investors) in principle saturate the needs of Slovakia. There are coming from all over the world.“ And later on he emphasized: „Slovakia can therefore make its choices.“ It is the irony of fate that on the same day the original agenda of Government session contained the negotiation of the Slovak

Republic Government declaration of the support of Foreign Direct Investment. This item of the agenda was cut out.....

Being objective one must admit that improved preconditions for foreign investment influx are expected from the new government in Slovakia. In addition to the proclaimed political stability and stable legal framework we still posses comparative advantage of input costs. It is obvious that majority of investors plan to export their production, and so the weakening of Slovak Crown in October could be considered a positive phenomenon. Starting off the bankruptcy proceedings would mean a rather cheap offer of land and production faciltiies. It is therefore highly probable that foreign investors are interested in these companies. After four years of fasting in the area of foreign investments caused by the ignorant government of Vladimír Mečiar, there are some indications of realistic chance for better days in Slovakia. Everything depends on the measures to be taken and signals to be sent by the incoming government.

Small and Medium Size Businesses

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Present status and development of SMEs

The following two types of business entities qualify as small and medium size enterprise: 1. Small and Medium size businesses – individuals, or "natural persons" (self-employed and free-lancers), and corporates, or 'legal entities" (registered in the business register). The development of their numbers since 1991 is shown in Figure 38.

Table 38
Development of number of ,natural persons" - individuals

	1991	1992	1993	1994	1995	1996	1997
Self-employed	200817	286 284	264 090	263 733	248 204	241 199	244 419
Free-lance	–	–	1 172	2 480	7 307	10 486	12 212
Total of self-employed and free-lance	200 817	286 284	265 262	266 213	255 511	251 685	256 631

Source: NAMSP[1] ,Report on the development and status of SMEs in 1997

To present a full picture „natural persons" or individuals need to be joined by individual farmers of 20 571 in 1997. Thus the total number of „natural persons" was 277 202.

The second group is represented by „legal entities" up to maximum 500 employees.

Table 39
Development of number of „legal entities"

	1991	1992	1993	1994	1995	1996	1997
Small	8 095	16 973	23 828	30 997	37 868	46 953	47 784
Medium	1 743	2 344	2 847	4 337	4 977	5 997	5 732
SMEs	9 838	19 317	26 675	35 334	42 845	52 950	53 516

Source: NAMSP, Report of the development and status of SMEs in 1997, SMEs status in

** small – up to 24, medium size – 25 – 499, large – more than 500*

Table 40
Structure of selected legal forms of SMEs

	Limited Liability Company	Self-employed registered in business register	Joint-Stock (Inc.)Company	Co-operatives	Public Corporations	State company
1994 [1]	8 038	655	669	236	218	143
1995	30 952	4 026	2 456	533	1 154	–
1996	39 378	4 086	3 425	2 233	1 265	–
1997	40 228	3 708	3 297	1 923	1 077	–

Source: Report on the status and development of SMEs in 1997, NARMSP, SMEs status in 1994

Figure 40 shows a gradual growth of small and medium size enterprises (SMEs). In 1995 – 1996 there was a decrease in the numbers of individuals – „natural persons“. The latest data of the Statistics Office of the Slovak Republic (after the statistics register was reviewed and economics of active units in 1997 was specified) give the total of business entities of 331 021 in 1997, out of this 330 199 being SMEs, i.e. 99 per cent. Number of ‚natural persons‘, including individual farmers was 277 202. There were 53 516 ‚legal entities‘, predominantly in the form of limited liability companies (75 per cent) falling into the category of SMEs.

Table 41
„Natural persons“ and „legal entities“ by regions, in 1997

Region	Bratislava	Trnava	Trenčín	Nitra	Žilina	B. Bystrica	Prešov	Košice
„natural persons‘	49 709	31 234	27 442	37 981	33 749	31 050	31 858	34 179
% share	18	11	10	14	12	11	12	12
Index 97/96	0.93	0.89	1.10	1.05	1.11	1.05	1.05	1.05
Legal entities	15 159	4 299	5 008	4 881	5 715	6 213	5 171	7 373
% share	28	8	9	8	11	12	10	14
Index 97/96	0.89	0.97	1.09	0.97	1.10	1.10	1.12	1.10

Source: Development and status of SMEs in 1997

Figure 41 shows regional distribution of SMEs.

Based on the statistics of 1993 – 1997 the following assumptions can be made:

– micro-companies (up to 10 employees) experienced the fastest pace of growth,
– number of large companies was falling down,
– there are regional differences in numbers and growth of SMEs.

Despite the above stated, large companies still play an important role in the economy as for employment, investment, and added value.

In 1997 SMEs, including self-employed, had 59,4 per cent[3] share of employment.

The following figure shows SMEs broken down by size groups:

[1] SMEs status in 1994, p. 32

Table 42
SMEs break down by size

Size of company	the Average No. Of employees	Index 97/96	% share of the total employment
0–9	215 104	120.3	10.6
10–19	44 424	95.0	2.2
20–49	112 764	117.5	5.5
50–249	395 698	99.0	19.5
250 and more	823 657	88.2	40.6
Self-employed (estimate)	437 500	114.7	21.6
Total	2 029 147	99.6	100.0

Source. Status and Development of SMEs in 1997, NAMPS

In 1997 SMEs generated *added value of* SKK 340.3 billion in current prices, representing 58 per cent of the total added value in the national economy.[4]

Conditions for developing small and medium size enterprises

V.Mečiar‘s government in its Declaration devoted the entire chapter to the SMEs issues. Among other things, it committed itself to „establish a specialized financial institution with a priority of supporting the development of small and medium size businesses.‘ In another place it states: , We shall assist starting off and venture capital investments to newly established and developing small and medium size companies“, or „we shall speed up the work on finalizing the law on government support of small and medium size enterprises as a legal framework defining state duties in this respect.“

No „specialized financial institution“ was established. Just the opposite, for a number of reasons Slovak companies have less and more difficult access to funds. Expansive fiscal policy requires NBS (Central bank) to adopt restrictive monetary policy leading to the surplus of loan demand and high interest rates. Cost of funds have both direct (expensive debt financing) and indirect impact on companies as more expensive debt service reduces equity of the companies. Public sector was drawing substantial share of the increased debt finance available to fund infrastructure projects, thus reducing the availability of funds for companies. A very limited number of companies, especially large companies, so called public utilities (natural monopolies) and foreign equity companies had the possibility of borrowing. These companies may take loans at better terms and conditions, both locally and internationally.

Based on the data of „BZC“ – Banking Clearing Center on the distribution of debt to asset ratio a statement can be made that majority of Slovak companies have minimum availability to get loans. For the majority of companies the debt to asset ratio in minimum, the lowest figures are observed with small companies. Both long-term and short-term bank loans are available to 10 per cent of companies only, usually the big ones.[5]

Equity raising is complicated by the trend of deteriorating profit generation. There is a trend of decreasing profitability, high proportion of loss making companies, defaulting companies causing financial flow break-downs. All of that has stronger impact on SMEs with limited capabilities to overcome these break-downs.

In 1997 non-financial organization generated profit totaling SKK 52.2 billion. The following chart shows the distribution of profit and investments by company size in 1997:

Table 43
Profit and Loss, and Investments by Company Size

Company Size	Profit and Loss		Investments	
	KK billion	%	Sk billion	%
0–9 employees	16.2	31	15.9	8.6
10–19	3.7	7	4.2	2.3
20–49	6.0	11	8.1	4.4
50–249	8.8	17	42.3	23.0
250 and more	17.5	34	114.1	61.7
Total	52.2	100	184.6	100

Source. Statistical Office of the Slovak Republic

Data in the table indicates that businesses employing less than 10 people contribute substantially to the generated profits and consequently to the government budget income. On the other hand, investments concentrate to large companies mainly. Despite the declared support to SMEs, reality has just an opposite impact.

Except for special programs (such as the so called Lending Support Program participated by PHARE, state budget, and commercial banks) SMEs have a very limited access to lending. As presented by some bankers, there is no access to funds for them available at all

With SMEs banks require collateral to secure the loans in the form of movable and fixed assets. As the customer – loan applicant does not possess assets in sufficient amount, they can apply for the guarantee provided by the Slovak Guarantee Bank.(Slovenska záručna banka). This applies only to a limited number of companies. The required loan security is again an advantage for companies with more assets. In the same way businessmen acquiring assets in the privatization process (as they can use the assets as a guarantee) are preferred to new and starting businesses perceived by banks as risky customers (no history, no assets). Loans are required to be secured up to 200 – 300 %. Smaller companies have only one possibility to obtain guarantees via the SZB – Slovak Guarantee Bank and its guarantee scheme. And currently it is causing problems both for the businesses and for the lending banks.

Interest rate level is high requiring high profitability to allow for the repayment of loans. Cheaper foreign funds are available for larger companies only, or for companies with foreign equity partners. Large companies also have better possibilities to raise funds by issuing shares, attracting foreign partners, etc.

According to „TREND 100 1998“ publication the biggest increase of debt (in the form of loans) was observed mainly with the so called public utilities, or biggest companies (Železnice SR, Slovenské Telekomunikácie, SPP, VSŽ Holding, Slovnaft – Railways, Telecommunications, Gas industry, Steel mills, Refinery).

In the decision making process of loan granting developed contacts are an important factor. Generally, larger companies have better contacts than small businesses, except for situations when the new owner used to be in an important position in a large company. Businessmen indicate the increasing corruption. For small businessmen, so called the self-employed mainly, Mafia practices of „vypalne“, or contributions levied for “protection” by Mafia under thread of burning down the business represent a serious problem as police is powerless in this respect. .

LEGAL AND REGULATORY FRAMEWORK

Business environment for small and medium size companies is not motivating and it does not provide incentive to create new jobs. This slows down the restructuring process as it does not provide job opportunities for workforce released from large companies. Especially in regions with rather low purchase power the room for small businesses is limited.

Frequent legislation changes (new laws, numerous direct and indirect amendments, regulations, government decrees) create a system difficult to orient in even for professional lawyers. Changes are difficult to predict, preventing businesses from taking strategic decisions and planning.

The tax legislation set on its own has been amended more than 70-times. Some pieces of legislation (e.g. income tax law) had been amended several times during one year. Laws on establishing the National Insurance and on financing health, welfare and old-age pension insurance have been amended 14-times. Some pieces of legislation are ambiguous, there is no binding interpretation, e.g. there are differences between tax authorities and customs authorities, or among individual tax offices and their interpretations of the laws.

Some laws (e.g. Law No. 376/1996 on International Trade Support Fund, Law No. .80/1997 on Eximbank) are perceived by the SMEs as additional taxation, while the redistribution of these centralized funds is not sufficiently transparent (support beneficiaries have not been published, funds are used to cover foreign trips of representatives of various associations, etc.)

Laws introducing regulation (price law, wage regulation law No. 1/1992) allow for regulatory interference with the market environment. The minimum wage and the system of fund contribution payments slow down or prevent the small companies from hiring new employees, for example.

A number of laws allow for selective procedure, discrimination, such as discharge of import surcharge and penalties for past due tax duty, export licensing, winning public procurement contracts), no transparency is ensured. Large infrastructure projects implemented currently by the government are contracted to large companies mainly. Businessmen believe that public procurement law application allows for preferential treatment of some entities.

A number of laws and their enforcement represent an administrative challenge, and have created a number of technical equivocations (e.g. Law No. 376/1996 on Foreign Trade Support Fund, Law No.80/1997 on Eximbank, import deposits, import surcharge, certificates). All of that represent an extreme burden especially for small businesses. Law No. 273/1994 Coll. on Health Insurance, Law No. 274/1994 Coll. on Social Insurance, Law No. 387/1996 on Employment – by splitting the National Insurance into a health-care insurance and a social insurance, and by separating Employment Fund payments, the administration of these payments have become more demanding.. Businessmen also point out at the lacking uniformity of forms and complex administrative procedures. The SMEs have problems to comply with the duty of submitting tax return reports, insurance and license declarations to the increasing number of authorities. It is mainly SMEs who do not employ specialist in individual areas. Their transaction costs are therefore much higher due to the changing laws and rules.

Application of a number of other laws is time consuming (businessmen complain about the slow registration process in the business register, there is no central register, lengthy court proceedings, such as bankruptcy).

Businessmen also voice their reservations on tax legislation:

– V.A.T. law – the law needs to be simplified, the advance payment system needs to be eliminated as it effectively represents businesses lending to the state, and increased amount of frozen funds, an extremely sensitive issue with smaller businesses,

- Income tax law,
- since the original law was adopted in 1992 the tax rate bands have not been cost of living adjusted, and so even the below average income falls into higher tax rate band,
- SMEs require to be equalized with "privatizers" who can reduce their tax basis by investments made,
- Self-employed and employees should be equal in respects of tax deductible expense items,
- Businessmen demand a change in the system of tax deductible items, more realistic depreciation period, etc.

The total of tax and contribution load is rather high (tax band I and II) and it does not create a business motivating environment.

In developing the legislation, government seemed to take into consideration the interests of better formed lobby of large companies. The SMEs support has been different in different time horizons. At the beginning, influenced by the federative policy of Slovakia the government considered the SME and their support an important element of creating market economy. This goal was originally supported by Meciar's government and short-term coalition government in 1994. But after Mečiar regained the power in 1994 the support was increasingly provided to large companies (the policy of support to "flag ship" companies) with the objective of maintaining the employment and profitability. Being former managers of large companies, representatives of the Ministry of Economy and Ministry of Finance tried to support the needs of large companies, underestimating the SMEs and their potential. Their political interests were reflected more in their support to regional and local employment of the existing companies than to smaller businesses.

SMEs lobby can be characterized as inconsistent, uncoordinated and insufficiently targeted in comparison with large companies and their lobby.

Limited access to funds, high taxation and contribution load, and business environment lacking transparency, parameters, and motivating factors can be considered the key barriers to SMEs development.

3. Proposals

- Eliminate legal, and organizational barriers for SMEs development.
- SMEs growth conditions to be coupled with the extinction of no prospects activities to allow the transfer of workforce.
- Simplify legislation, publish full versions of laws with multiple amendments, produce law interpretation.
- Create motivating business environment – by enforcing tax and contribution due payments by any business entity in order to stabilize and increase possibilities of the state budget to reduce the overall tax burden.
- In granting contracts and appropriating centralized funds follow transparent procedures, respect equal chances.
- Government assistance and possible foreign funds target mainly to the support of starting small businesses (developing business plans, legal and financial counselling). In respect to providing discounted lending schemes ensure efficient control over their utilisation.

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2 Stav MSP 1994, str. 32 – (Status of SMEs in 1994 – p. 32)
3 Správa o stave a rozvoji MSP a jeho podpore v roku 1997, NAMSP – (Report on the Status and Development of SMEs and their support in 1997, NAMSP)
4 Správa o stave a rozvoji MSP a jeho podpore v roku 1997 – (Report on the Status and Development of SMEs and their support in 1997)
5 Zdroj: Bankové zúčtovacie centrum – (Source: Banking Clearing Center)

Unemployment

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„*Unemployment rate in Slovakia is not decreasing, in the coming months it will be increasing, and it should culminate in summer next year*." This inconvenient title in the daily ‚Národná obroda' of November 13, 1998 describes the labor market situation. By the end of September the labor offices in the Slovak Republic had registered more than 385 000 unemployed persons. Due to the present existential problems of a number of Slovak companies, in the nearest future these figures will increase substantially, reaching the level of 400 000 unemployed. When Vladimír Mečiar entered his third Government term, there were some more than 366 000 unemployed.

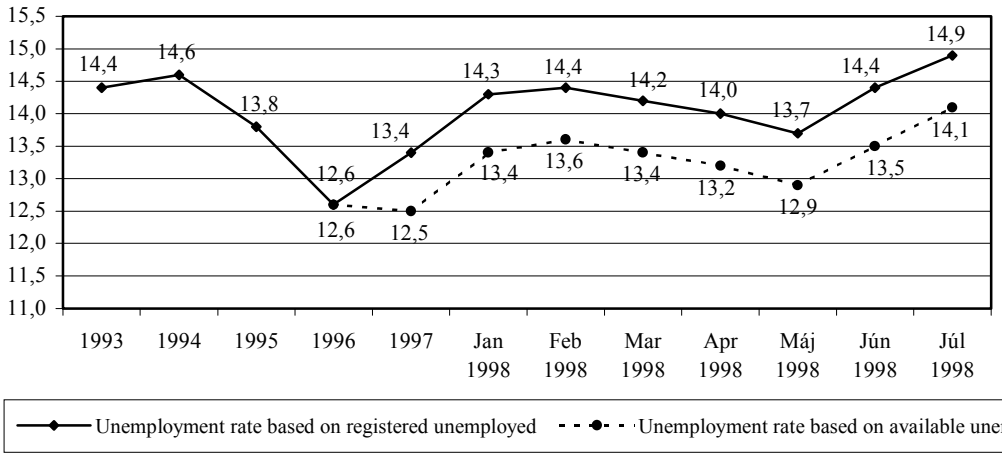
Let us go back four years and read the Government Declaration section dealing with macro-economic measures. A rather courageous commitment can be found there: „*During its term the Government shall pursue policies to achieve a gradual reduction of umeployment rate below 10 per cent.*." Rather a high-minded objective, but not achieved at all. In 1998 unemployment rate can be booked at approximately the same level as in 1994 (using a compatible methodology).

In 1994 the unemployment rate was at 14.6 per cent, the highest rate in the history of the Slovak Republic. In 1995 it dropped to 13.8 per cent, and in 1996 to 12.6 per cent, but then the critical year of 1997 came to see a drastic increase of the unemployment rate getting close to the 1995 level and attacking the 13.4 per cent level. By then the ruling coalition fully realized that in 1998 it was not possible to cut the unemployment rate down below 10 per cent. When the Government failed to increase employment it made up a new system of unemployment reporting to mitigate the menacing labor market situation at least at a sight. Since December 1997 the unemployment rate reported by the Statistics Office is not calculated from the total number of registered unemployed. Instead they use so called available unemployed, i.e. those able to fill in a job vacancy immediately when offered. The difference between registered and available unemployed was 7.1 per cent at the end of 1997.

Due to the changes in methodology the unemployment rate reported by the Statistics Office for 1997 was 12.5 per cent, instead of 13.4 per cent, providing the old reporting system was used. Unfortunately, this is not the only case of purposeful interference of the governing caucus with macro-economic figures reporting. There are substantiated doubts that GDP calculation methodology was also changed or adjusted so that the figures reported corresponded to the Government wish. The last case of statistics data review was the correction of net balance of payment figure by unbelievable SKK 15 billion a year, carried out as late as in the middle of 1998.

Vladimír Mečiar's Government „achieved" almost one per cent reduction of unemployment rate by applying a well thought change in methodology. The development of real and reported unemployment rate is shown in the following graph.

Graph 5
Unemployment rate development in the Slovak Republic



In reality the unemployment rate achieved the level of four years ago when in June 1998 it was almost 15 per cent. Interesting comparison can be made by comparing GDP development and unemployment rate development in Poland and Slovakia. It is a paradox that unemployment rate grows with a rather high GDP growth. While in both countries the GDP was growing at approximately similar pace since 1994, in Poland the unemployment rate of 16.4 per cent in 1993 dropped to 10.5 per cent in 1997. In Slovakia the GDP growth also experienced an increasing trend, but unemployment rate of 14.4 per cent in 1993 was not reduced and in 1998 it even grew up above this level. This devastating situation is caused mainly by Meciar‘s Government lacking abilities to develop qualified economic policy to solve the labor market situation.

In the period of 1994 - 1997 not only the number of registered unemployed increased, the number of unemployment benefit receivers increased as well. This phenomenon had negative impact on the expenditure side of the state budget.

Table 44
Development of registered unemployed, unemployment rate, and benefits and allowances receivers

Year	1994	1995	1996	1997	1998*
Average number of registered unemployed	336 168	349 821	324 278	336 661	367 000
Average registered unemployment rate	14.6 %	13.8 %	12.6 %	13.4 %	14.4 %
Average number of unemployment benefit receivers	91 143	76 590	85 241	83 939	108 400

Source: ŠÚ SR, KOZ
**first six months of 1998*

Main problems cumulated during the last four years are as follows:

- high regional differentiation of employment
- high job applicant to job vacancy ratio
- high and increasing proportion of long-term unemployed
- high share of school leavers and socially repellent groups (Romanies) as unemployed
- low mobility of workforce

Regional Differentiation of Employment

Regional differences in unemployment represent a serious problem for Slovakia. There are currently eight regions in Slovakia. At the end of July 1998 in four of them the regional unemployment rate was higher than the national average.

Table 45
Regions with the highest unemployment rate calculated from the data on available unemployed as of June 1998 (%)

Region	Unemployment rate
Prešov region	19.4
Košice region	19.2
Banska Bystrica region	16.3
Nitra region	15.2

Source: ŠÚ SR

In July 1998, 38 districts reported unemployment rate higher than 15 per cent, and 18 districts reported unemployment rate below 10 per cent. The highest unemployment rate was recorded in the districts of Rimavská Sobota (30.1 per cent), Revúca (28.7 per cent), Veľký Krtíš (26.2 per cent), Michalovce (25.6 per cent), Vranov nad Topľou (25.3 per cent), Trebišov (25.2 per cent), and Rožňava (24.8 per cent). Th situation is most critical in border districts in the south of central and eastern Slovakia. The lowest unemployment rate continues to be recorded in Bratislava districts , in the band of 3.4-4.8 per cent, and districts of Trenčín and Senec, 5 per cent each.

With the increasing unemployment the regional differences in unemployment rate level were becoming deeper and deeper. When Meciar‘s Government entered the office the biggest regional difference of 23.4 points was reported in December 1994 (Bratislava 5.01 per cent – Rimavská Sobota 28.41 per cent), while at the end of his term the maximum regional imbalance among districts was increased to 26.7 points (Bratislava 3.4 per cent – Rimavská Sobota 30.1 per cent).

Slovak Republic development after 1989 shows that different pace and intensity of increasing employment in individual regions depend on the intensity of economic reforms and their impact on the regional economic development. Big differences were observed in the capabilities to adapt to new economic conditions.

Table 46
Social and economic characteristics of regions of the Slovak Republic according to OECD typology

Indicator	Predominantly rural regions	Significantly rural regions	Predominantly urban regions	SR total
Number of districts	33	37	9	79
Population	1 943 619	2 731 203	692 968	5 367 790
Population (%)	36.21	50.81	12.91	100.00
Average unemployment rate (%)	16.52	12.07	12.91	12.95
Unemployed school-leavers (%)	7.52	9.55	11.97	8.76
Unemployed women (%)	51.58	52.78	56.36	52.46
Long-term unemployed (%)	39.92	35.61	27.43	38.4
Average wage (SKK) of employed – in organizations of 25 and more	7 286	7 821	10 232	8 769
Retail monthly sale per capita (current prices) (SKK)	2 964	3 413	10 799	4 204
Retail sale (%)	25.50	41.30	33.20	100.00
Commuters to regions (territorial workforce mobility) (%)	8.70	11.20	34.10	13.00
Employed in agriculture (%)	6.28	4.15	1.27	5.31
Population per one self-employed	22.80	21.80	13.50	20.50
Pre-productive population (%)	23.35	22.04	20.13	22.27
Productive population (%)	58.97	60.29	63.22	6.19
Post-productive population (%)	17.68	63.22	16.65	17.54

Source: ŠÚ SR, TREND 8/1998

Regional differentiation is evidenced not only by the average unemployment rate, but also by the proportion of long-term unemployed, the ratio of retail sale per capita in SKK, and population per one self-employed. These ratios indicate the better situation in urban regions (Bratislava, Košice), characterized by high number of vacancies. It is not a coincidence that predominantly rural regions correspond to economically weaker regions.

In most of the case the previous economic development has not had any positive impact on the standard of living of population of these economically weakest regions of the Slovak Republic and these regions on their own have not been able to reverse the unfavorable situation in the numbers of unemployed. Funds received by the highest unemployment rate districts from the Employment Fund of the Slovak Republic have not been sufficient either.

High ratio of job applicants per vacant job

The absence of new jobs is one of the main causes of high unemployment rate. In the period of 1994 – 1998 the number of job applicants per vacancy has stabilized at the average of 20 job-seekers per one vacant job. This gloomy situation is caused by the lacking support of small and medium size businesses and the heritage of the centrally planned economy. Mečiar‘s Government was unable to restructure and recover industry, while at the same time it spent a lot of money on maintaining employment in large loss-producing companies instead of opening bankruptcy proceedings, supporting small and medium size companies, and creating suitable business environment for starting small businesses and self-employment.

So called „substitution effect“ may present a big risk in creating new jobs. This means that the existence of a new job may cause a need for someone to be fired from the existing job.

High and increasing share of long-term unemployed

Term structure of unemployment is considered to be one of the critical factors of labor market. It depends on the dynamics and production structure of the economy. Short-term unemployment represents a minority share in the overall unemployment. The persistent high share of long-term unemployment (longer than one year) represents currently a serious social problem of Slovakia.

At the end of 1996 the long-term unemployed represented more than 50 per cent of the total number of unemployed in Slovakia and the situation did not changed substantially by the end of 1997. The average longest unemployment period is registered in districts with highest unemployment rate. At the same time the lowest number of days of unemployment per one registered unemployed person can be observed in districts with the lowest unemployment rate.. Specific problem is presented by the unemployment of Romany population representing 19.2 per cent of all job seekers. Their average registered unemployment period is 2.5 years.

Long-term unemployment has not only become wide-spread recently, it has also become a challenging social and political problem with multiplying effect of the unemployment period length. A general statement applies here: the longer the people are without job the lower is their hope to find job again. Long-term unemployment is also caused by the lack of interest in finding job, secured delivery of social allowances, insurance paid – all of that being sufficient reason for many to stay unemployed artificially and make best use of legislation loop-holes allowing them to remain in the social safety nest. The long-term unemployment problem also lays in their unreadiness for permanent and effective job performance. This is related to the insufficient education, loss or absence of work habits, making their labor market placement more difficult. In seeking suitable job their biggest barrier is the lack of interest of employers in these people because the society has already developed negative stereotypes about long-term unemployed.

Especially with long-term unemployed, one of the main reasons for their lacking interest in job seeking is in most of the cases a rather high unemployment benefit payment. The current maximum unemployment benefit (1.8 multiple of the minimum wage, i.e. SKK 5 400!!!) does not differ much from the net, close to average, wage.

The Project of Public work services provided by job seekers was one of legal instruments meant to create better conditions for placement of long-term unemployed. Public work services were contracted for limited time period of maximum 12 months. According to data published by the Employment Fund of the Slovak Republic the project resulted in the unemployment reduction by less than 5 600 registered job seekers. Up to 80 per cent of job seekers contracted for public work in winter period return to the Labor Office registers. Although beneficial for the society and for the unemployed, this project did not meet the expectations with regard to long-term unemployment solution. Predominantly short- and medium-term unemployment issues are tackled by this project, not the long-term unemployment.

On February 1, 1996 the Slovak Republic Government adopted its Employment policy concept. Among other measures in the area of labor market policy it also reads:‘ to propose a set of instruments motivating the long-term unemployed to get employed“, and later on „ in co-operation with district labor offices, based on the labor market situation to perform a regular exercise of identifying target groups of citizens, and the long-term unemployed among them, and to propose and implement special programs to support their job placement.“. Unfortunately, except for the public work program, no legal instrument in the area of labor market policy or taxation policy has been identified to provide incentives for employers to hire long-term registered job seekers.

Low workforce mobility

Two types of housing prevail in market economies. Ownership type and renting type. Countries with higher proportion of ownership housing tend to have higher unemployment rates. On the other hand, citizens of countries preferring rented housing achieve rather low and stable unemployment rate. In Slovakia the mobility of workforce and people in general is rather low.

There is a direct relationship between employment, mobility, and housing development. Mečiar‘s Government completely failed in housing development, especially rented housing. Trying to be objective we must admit that it tried and in a way succeeded to complete long-term infrastructure projects such as highways. Though at the expense of inadequate growth of foreign debt. Therefore towns and cities with low unemployment rate and developed infrastructure should become centers of housing development recovery.

Conclusions

According to the survey conducted by the Statistics Office, 64 per cent of the population consider unemployment to be a serious social problem. The outgoing Government failed to achieve its ambitious unemployment rate reduction below 10 per cent, despite a substantial assistance provided by citizen of the Slovak Republic working in the Czech Republic. The present estimated number is 80 000 of them. Compared to 1994 this is a 100 per cent increase. In fact, this reduces the unemployment rate by app. 1.5 per cent.

The Government did not tackle this social problem by conceptual instruments of economic policy (lending policy, restructuring of large companies, revival and recovery of industry, support to small and medium size businesses....), instead, it tried to solve the situation using complementary forms of labor market active policy, especially by creating socially useful jobs, by initiating public work jobs, or by retraining programs. These measures solved only short-term unemployment and only by a few percentage points.

Public work projects were introduced mainly with the aim of reducing long-term unemployment. Their success rate is below 20 per cent. Long-term unemployed represent app. 40 per cent of the total number of registered unemployed. Retraining program success is similar – only about one third of the retrained are able to find job.

Internal economic problems of the Slovak Republic, especially the inability of the economy to create jobs have fully been reflected in the menacing unemployment situation. This increase is caused by the reduced performance of the Slovak economy and by the generous unemployment benefits scheme having demotivating effects.

The new Government cannot concentrate on interim solutions of public work, socially useful jobs, or retraining in its recovery process. These instruments are capable of reducing unemployment by 2 per cent maximum. A substantial reduction of unemployment can only be achieved by a targeted qualified economic policy with measures supporting mainly the following:

- new jobs creation
- industry restructuring
- tax and financial motivation of businesses to create new jobs
- increased investment into undercapitalized economy of the Slovak Republic
- developing employment policy of the state
- mobility of workforce via housing development
- creating conditions for the self-employed
- facilitate access to funds – conceptual lending policy

Inflation

Marek Jakoby
M.E.S.A.10

Inflation as a general increase of price level in the economy is perceived as a negative phenomenon as it reduces the real value of a monetary unit. In this respect years of 1991 and 1993 were the most painful as the average annual Inflation rate (measured as a consumer price index change) was 61.2, or 23,2 per cent. In 1994 there was a substantial Inflation rate drop when consumer price increase averaged 13,4 per cent.

In its January 1995 Declaration the Government states to do its best, not to exceed the year-on-year Inflation rate of 10 per cent, and to create preconditions for its gradual decrease".

Table 47
1991–1997 Inflation development

	1991	1992	1993	1994	1995	1996	1997
Average annual inflation rate	61.2	10.0	23.2	13.4	9.9	5.8	6.1
Year to year inflation rate (as of Dec. 31)	58.3	9.1	25.1	11.7	7.2	5.4	6.4

In 1995 the inflation rate achieved a two-digit level for the first time. In the following years it managed to stabilize at 6-7 per cent, especially due to the "NBS" (Central bank) restrictive monetary policy.

A rather low inflation rate level was maintained also in 1997. When compared to 1996 there was a relative increase though, both on the year to year basis and on the average annual inflation rate basis. This development corresponded to government forecasts and forecasts of the Statistics Office. This increase may have been influenced by the increased money supply (measured as money aggregate M2) in 1996, although it was slowed down during 1997. Towards the end of 1996 there was a slight increase in regulated prices (heat, telecommunications).

For 1998 the Ministry of Finance projected inflation rate of 6 per cent, the NBS forecasts assumed consumer price index (CPI) increase by 5,6–5,9 per cent.

The actual CPI development during the majority of the year pushed the inflation high, above the 7 per cent level.

Table 48
Year–on-year inflation rate in 1998 (%)

Jan	Feb	March	April	May	June	July	Aug
7.2	7.5	7.2	7	7.6	7.4	7	5.7

The highest monthly price increase was registered in January (1,9 per cent). This was caused mainly by adjustment of certain types of taxes, including increased excise duty on tobacco and tobacco products, and shifting certain types of products and services from the lower 6% VAT category into the 23% VAT category. This applied to post and telecommunication services mainly.

A marked price increase in May was caused by the introduction of minimum guaranteed price of sugar on a higher level, followed by increased price of sugar-based food products. During July and August consumer price level was reduced mainly due to the reduced price of food and transport.

In comparison with other economies in transition the Slovak inflation rate is rather low. Compared to EU, it is 3 to 4 times higher.

At first sight the price increase figures may indicate that goals declared by the Government were achieved. On the other hand, the cost of it need to be mentioned as well.

The NBS (National Bank of Slovakia - Central bank) managed to maintain currency stability only at the expense of a long-term freezing of liquidity and substantial increase in interest rate levels. This was reflected in reduced funds availability felt in the business sector as well as in state budget financing.

Along with the GDP growth, the low increase of consumer prices was another important argument used by the third Mečiar‘s government in proving the success of their own economic policy.

In addition to the above indicated cost of the currency stability in the form of high interest rates we consider it fair to mention that inflation was not increased mainly due to the postponement of the inevitable deregulation of some prices, including rent, gas, electricity, and transport.

The postponement of the inevitable deregulation brought about two main negative effects:

– future price leap shall be bigger and more painful,
– due to the widening of price scissors between the cost and revenues performance of price regulated goods producers deteriorates. On one hand, cost of natural monopolies may increase for objective reasons (increased cost of imported material inputs etc.), on the other hand, they may increase due to various forms of ‚asset drainage‘ (e.g. ‚SPP‘ – Slovak Gas Industry, , Slovenské elektrárne‘ – Slovak Electricity cases).

Price regulation also does not allow to measure production or service rendering efficiency. The current dreary situation in housing development and actual absence of so called rented lodgings is also a specific consequence of the postponement of rent deregulation.

According to the PlanEcon report of October 1997 in the case of full deregulation of regulated prices the overall consumer price level would increase by 20-25 per cent, at least.

Banking sector

Eduard Žitňanský
DUEL

There are twenty-five banks and three foreign banks' branches operating in Slovakia, focusing on universal banking mainly. 'Konsolidačná banka' (Consolidation bank) and 'Slovenská záručná banka' (Slovak Guarantee Bank) are state controlled financial institutions. Fond národného majetku SR, (Slovak Republic National Property Fund) is also an important owner in the banking sector, owning 97 per cent share of 'Slovenska sporiteľna, a.s.' (Slovak Savings Bank). Important share of 'Všeobecna úverova banka' (General Credit Bank), and 'Investična a rozvojova banka' (Investment and Development Bank) are also owned by the Fund.

As of the end of 1997 foreign capital interest in banking sector in Slovakia represented 38.6 per cent of registered capital. In 1997 foreign investments in banking and financial sector represented 25.7 per cent of overall foreign investment in the Slovak Republic. Approximately 40 per cent of assets in banking sector in the Slovak Republic are owned by the State. The state-owned companies own 6 per cent of the total registered capital in banking sector in the Slovak Republic, branch networks including. 60 per cent of bank registered capital is in private hands. Out of this 38.6 per cent is owned by foreign capital and the rest is shared by some private companies ('VSZ' – East Slovakian Steel Mills, 'Slovakofarma' – pharmaceutical company) and small shareholders.

Recovery forgotten

The issue of Slovak banking sector recovery was raised by Vladimír Mečiar government in its Government Declaration (or mission statement). In March, 1995 the government adopted its Resolution No. 170 identifying steps to be taken in order to restructure commercial banks. Banks were to be allowed to create reserves and provisions for all 'classified debt' (non-performing and defaulting loans), while these reserves and provisions were tax exempted. Interest due but not paid to banks by debtors were not to be booked as income and banks were to be exempted from paying tax on this fictitious money. Principal solutions for non payment of tax on provisions and bad debt reserves and for not including unpaid interest to income were not adopted at the end of the day. The Government initiated adoption of a bill on deposit guarantee and protection and on formation of loans and guarantees register. In 1996 the government adopted three more resolutions regarding banking sector restructuring but non of them was implemented either. According to the amended Law on Banks (§44a) the state supported loan portfolio restructuring was to take place in banks that inherited risk loans from the past. Government was to issue a resolution on this provision. It did not.

Unsubstantiated optimism

For a long period of time Slovakia was ruled by optimism based on the assumption only that everything is O.K. in the banking sector, because the banks are not failing or bankrupt as in the Czech Republic. The case of 'Investična a rozvojova banka, a.s., Bratislava (Investment and Development Bank, Bratislava) brought about disillusionment. In the middle of December, 1997 the bank failed to honor its commitments (and to pay out deposits). The

National Bank of Slovakia (NBS) imposed trusteeship, stating unfavorable development of performance and management and unfavorable liquidity situation of IRB (Investment and Development Bank) as reasons.
The 'IRB' bank is the forth biggest Slovak bank, having more than 4 per cent share of deposit market, and even higher, 11 per cent share of banking sector lending. Recovery project for this bank assumed writing off bad debt and creating loan loss reserves. In 1996 the bank generated a controlled loss of more than SKK 1.3 billion.

Supported by the 'FNM' (National Property Fund) and owning more than 40 per cent shares of the bank, 'VSŽ, a.s., Košice' group (East Slovakian Steel Mill Group) replaced top management of the bank in January 1997. The lack of continuity in the top management and lacking experience of the Kosice management, as indicated by several bankers, led to substantial delays in meeting the restructuring project objectives during the year. The IRB was generating more and more loss, not only due to the creation of bad debt reserves and loan loss provisions but also from regular banking operations.

The planned loss was generated as early as the end of summer period. The loss only accelerated in the fall, getting close to two billion Slovak Crowns. At the same time the credibility of the bank was impaired by major shareholders hesitating to increase the equity of the bank. In the second half of November depositors started to take out their deposits. In approving 1998 budget the MPs in the National Council of the Slovak Republic (Parliament) refused to compensate the bank for revenue losses caused by low interest rate bearing social loans the bank granted. Bank placements of funds by other bank, the IRB relied on, started to be taken out as well.

For a long time the 'NBS' (Central bank) was awaiting IRB shareholders to take some action. Negotiations of Vladimír Mečiar, the prime-minister, Sergej Kozlík, the deputy price-minister, Vladimír Masár, the NBS Governor, Alexander Rezes, President of the Supervisory Board of VSŽ, a.s., Košice, representatives of 'FNM' (National Property Fund) and some other financial institutions did not come up with any solution. Only when IRB had to close its doors, being unable to pay out the deposits and only after an extraordinary General Assembly meeting was held (December 19, 1997) the 'NBS' took its trusteeship decision.

Before Christmas, V. Mečiar blamed Central bank for bringing the IRB issue to a head. „If you are looking for people accountable for this, look for them in the NBS. They are sitting there and they are satisfied,' he said.

V. Masár, the NBS Governor responded by a statement that the role of banking supervision is to protect the banking system and depositors, not investors – bank shareholders. „Investors not taking care of their investment, may loose the money in any sector, including banking sector," said V. Masár and he noted that losses generated by IRB should be consumed by its shareholders. It is known that 'NBS' 'poured' approximately SKK 11 billion into 'IRB', while 'VSZ' and its satellites were only standing by idly.

Ownership as irresponsibility

The 'IRB' problem possibly indicates a more serious problem of Slovak banking sector, that is owners' and shareholders' behavior.

Companies facing shortage of funds often want to be shareholders of banks. Many of them believe this to be the way of ensuring funds available to them. According to analysis in TREND weekly (24/1998) some of them are even successful, usually at the detriment of the bank..

„While in the world it is usually strong companies who are majority shareholders in banks investing their available funds, it is different in Slovakia. 'Slovnaft, a.s., Bratislava', for example, does not show any interest in becoming a bank shareholder. They could afford it but

they reject the offers. The others are very active, though. Those who do not rank among the best credible debtors and have more or less difficulties in getting loans. In this case their main objective is to help themselves, not to help the bank," reads the comment in TREND.

The case of silent privatization of 'Poštova banka, a.s., Bratislava' (Post Bank) was in the shadow of the IRB case. In 1997 the state as a majority shareholder (via 'Slovenske telekomunikacie, a.s.' – Slovak Telecommunications and 'Slovenska posta' – Slovak Post) ignored twice the bank new equity share issues and let not very strong private companies to obtain more than 50 per cent share of the bank. Individual shares of these companies were less than 15 per cent of the bank equity. This is exactly the maximum level of shareholding not requiring a pre-approval by NBS when increasing the share. It is very difficult to speak about transparency and financial strength of owners in the cases of AG Bank, a.s., Banská Bystrica, Devín bank, a.s., Bratislava, and Slovenska kreditna banka, a.s., Bratislava (Slovak Credit Bank).

Management of Všeobecna úverova banka (General Credit Bank), (VÚB), a.s., Bratislava used their grand daughter company, subsidiaries – limited liability companies, and other companies and bought a rather big block of shares in VÚB (there was an article devoted to this topic in the weekly TREND 36/1998). Transfers were made so that none of the shareholders (except for FNM SR (National Property Fund) and 'Slovenska poisťovna, a.s.' (Slovak Insurance Company)) had or still has more than 5 per cent share on their accounts. This 5 per cent limit ensures that no names of shareholders are registered in the statement of the Slovak Republic Central Securities Depository (Stredisko cennych papierov SR) listing more than 5 per cent shareholders in companies.

For 'NBS' (Central Bank) to prevent these actions it must know the links between companies acting as shareholders of banks. In many cases shareholders are hidden behind various unknown companies. 'NBS' may have suspicions but there is no chance of proving anything. This is also a form of the power of business secret. In this respect the weekly TREND quoted Jozef Mudrík, the Vice Governor of NBS, saying that in Central and East European countries in transition the relevant legislation framework is a compromise of banking supervision and various lobbies. „This is a combat of groups, each representing their own interests. Businesses like a lot of freedom with as few limitations as possible." But he considers it suitable to reduce business limitations in other areas. „Banking is a specific sector, as it is based on debt (funds of other people)." As a rule shareholders equity represents less than one tenth of the total of bank funds. Therefore shareholders „with a rather small capital investment make decisions on the fate of billions deposited by the others," said the Vice-Governor for TREND. It seems inevitable to amend the Bank Law so that powers of banking supervision are substantially increased.

Lending

So called bad debt (bad loans) is the problem of this sector. The NBS sees objective shortcomings in the fact that banking sector restructuring process, including restructuring of loan portfolio of the three largest banks, and privatization do not progress in the expected and desired pace. „If we speak about one third of loans being bad, we are actually saying that one third of corporate and individual savings lost in value. A negative impact of this on the entire economy is more than obvious," states in his analysis *Restructuring of banks in Slovak Republic* Anton Marcinčin, an analyst from the Center for Economic Development (CPHR) .

Reported data on the total amount of bad debt in the Slovak economy vary. This is caused by the lack of will of some banks to provide information about their bad debt, by rough estimates, and sometimes by using different terminology (bad debt, non-performing loans). According to NBS survey on banks prudential business (compliance with B.I.S.rules)

conducted on June 30, 1997 the problems persisted mainly in 'Všeobecna úverova banka' (VÚB), 'Slovenska sporiteľna' (SSp), 'Investična a rozvojova banka' (IRB), and 'Konsolidačna banka' (KBB).

The author of the analysis believes the existence of bad debt in Slovak economy is caused among other things by the fact that companies were borrowing not only from banks but they also supplied goods to non paying customers. From the management and trade union point of view producing and delivering to bad customers promised a better position in future negotiations with state administration than not producing at all. On the other hand, banks sometimes did not charge fees for not repaying loans, they instead were providing new loans to bad debtors to repayr their previous loans. Doing so they were temporarily improving their capital adequacy ratio and situation of their "friendly' companies.

„Slovak government simply did not pay attention to the issue of bad debt. They probably counted on NBS to resolve the situation, and on the large banks not daring to take any extreme steps. As a matter of fact, until 1996 the banks were reporting profits and helped the income side of the state budget. 1996 was the turning point when NBS started to restructure VÚB, SSp and IRB," states the analysis. According to A. Marcinčin the restructuring process started in 1996 only because of probable conflict between NBS and state controlled banks on one hand and government and parliament on the other.

According to the analysis, three domestic, in principle state controlled banks - VÚB, SSp and IRB- dominated the market of borrowing and lending (deposits and loans), despite the entry of many other banks. Their share was diminishing: the above stated three banks and their deposit market shares developed as follows: in 1993 it was as much as 94 per cent, a year later only 86 per cent, in 1996 72 per cent only, and in June 1997 69 per cent. This development indicates that other banks started to raise funds from individuals and corporate customers directly, not relying on the interbank market only, where these three banks held a monopoly position. On the lending side, the market share of the three banks - VÚB, SSp and IRB- developed as follows: 71 per cent in 1993, 67 per cent in 1994, 61 per cent in 1996, and 60 per cent in June 1997. Restructured banks were gradually reducing their share in borrowing and lending markets without any substantial changes towards the end of the year.

Term structure of loans was also changing gradually in favor of short-term (less risky) loans. This reflects the term structure of funding where high risk related to Slovak Crown instability (despite a stable decreasing inflation rate and exchange rate there are strong devaluation expectations) and possible expectations of other investment opportunities make long-term fixed deposits unattractive.

The longer it takes to tackle bad debt the worse it is going to be for Slovak banks and Slovak companies according to the 'CPHR' analysis. Banks will have to limit the amount of loans and increase their cost. This will lead to increased cost of funds for companies and individuals. The companies will more and more frequently try to avoid banks as financial mediators. The National Bank could immediately impose trusteeship to a number of large Slovak banks having dwindling capital adequacy ratios. Not having done so yet, it is only hiding problems that may fire back in a long run. Especially when the Slovak government needs a clear signal that money is not for free and the bad debt problem exists here burdening all the companies and individuals – with the possible exception of those politically 'friendly' ones.

Recovery revived

In the middle of October 1998 the outgoing government of Vladimír Mečiar at its last but one meeting dealt with the proposed recovery program for selected banks. The situation of the largest Slovak banks can be characterized also buy the fact that as of December 31, 1997

the following banks - Slovenská sporiteľňa, a.s., Banská Bystrica, Všeobecná úverová banka, a.s., Bratislava, Investičná a rozvojová banka, a.s., Bratislava, and Konsolidačná banka, š.p.ú., Bratislava reported a total amount of SKK 57,2 billion in so called classified (past due) receivables on loans made prior to January 1, 1990. According to the Bank Law the recovery of this portion of loan portfolio of banks under restructuring process should not be done by state exclusively, i.e. via state budget subsidies, or reduced income tax. The outgoing government expected for 1999 and 2000 a direct state involvement at the level of app. SKK 4 billion. In addition to that the government proposal assumes that in the following two years the state budget will loose app. SKK 6 billion in the form of exemptions granted in respect to legally required creation of loan loss reserves and provisions and income tax exempts. In the following two years the state budget must create SKK 1-1.5 billion reserve for government guarantees to liabilities of Konsolidačna banka, š.p.ú., Bratislava.

The restructuring will therefore cost the state budget SKK 12-13 billion in 1999 and 2000. „The biggest share in the loan portfolio recovery in the form of writing off bad debt (loss generating unpaid loan principal and interest repayment) on loans granted not only prior to January 1, 1990 but also in the later period, will be taken by banks themselves absorbing loan loss reserves and provisions created" reads in the government proposal.

The government also recommended to create more favorable economic environment for banking business and for bank debtors to honor their commitments. Certain proportion of "classified debt", including funds for their cover should be transferred to the Consolidation bank "Konsolidačna banka'. The government expressed their expectation that banks having majority share in deposit taking and loan making business shall facilitate lowered interest rate levels and make business loans more affordable.

Until the end of December 1998 the Slovak Republic National Property Fund "FNM SR" was to "co-operate effectively" in the privatization of 'Všeobecna úverova banka' (VÚB), 'Investična a rozvojova banka' (IRB), and other state controlled banks. The 'FNM' was to propose its own financial participation in the restructuring of loan portfolio of the transforming banks. It was the government decision that by the end of the year Minister of Finance submits a government proposal of a bill dealing with rules and procedures for selected banks and their restructuring. This law was to specify or amend exemptions from valid legislation for selected banks during the restructuring process. At the same time, Ministry of Finance was to propose in 1999 and 2000 state budgets a special purpose reserve of SKK 2 billion each year for restructuring the loan portfolio of these banks. For the next year the state budget should create a reserve to refund loss of profit to Slovenska sporitelna and Investicna a rozvojova banka in the amount of SKK 2.6 billion.

In the proposed recovery program for selected banks the state agreed to guarantee liabilities of state controlled financial institutions in the "Agreement on method, terms and conditions of honoring the commitments on behalf of the state controlled financial institution" to be signed between the Ministry of Finance and 'Konsolidacna banka'. The government guarantees for liabilities of state controlled financial institution were to be covered by budget reserve created in the Slovak Republic budget. The government recommended to transfer SKK 7.6 billion from reserves and provisions of central bank to the state budget to be used for recovery of 'Všeobecna úverova banka' (SKK 3.6 billion), 'Slovenska sporiteľna (SKK 1.0 billion), and 'Konsolidačna banka' (SKK 2.0 billion).

In principle, the entire professional public was amused and disappointed by the government actions dealing with the banks problem in a dashing manner two weeks before resigning. „The proposed recovery program for selected banks can serve as a starting point in the future but in its present form it is not acceptable," said Brigita Schmögnerová, an expert economist and Vice-Chairperson of SDĽ (Party of Democratic Left) for the SITA press agency, expressing her surprise over the date of program approval, when the government was not

dealing with financial institutions restructuring for four years. „This time delay is even more critical, because while in 1995 there was a state fiscal budget surplus and funds could have been made available for the restructuring, the new government inherits this year the highest budget deficit since the existence of the country," said B. Schmögnerová. She also stressed that the new government would support the recovery and restructuring of banks within the existing possibilities of the state budget. But central bank and bank shareholders would have to take an active part in the process. Being diplomatic Vladimír Masár, the Governor of NBS (Central bank) characterized the government proposal as a debatable effort to correct the present status. Central bank has its own ideas on banking sector and its functioning.

Several specialists claim the government approach shortcoming is in its one-sided focus on financial institutions. Corporate sector and its restructuring needs were left unnoticed.. „These are the two sides of one and the same coin that cannot be separated," said B. Schmögnerová in this respect. In other words: in the unhealthy economy it is impossible for healthy banks to operate in isolation.

The banking sector restructuring problems have been discussed since 1990. Out of a number of projects the most promising and best developed was the procedure assuming World Bank and International Monetary Fund loans. In 1993 and 1994 experts of these two international institutions paid a number of visits to Slovakia, followed by further negotiations in the U.S. EFSAL type of loan was to be used for a linked solution of difficulties with corporate and banking sector restructuring. In 1994, B.Schmögnerová, the Deputy Prime-Minister of the Slovak Republic underlined the inter-related problems of banks and companies more than once. „The fact that weak companies have not failed yet reflects the position of their creditors, i.e. banks. It reveals their unsuitable structure of their capital and loan portfolio: by forcing defaulting companies into liquidation the banks would get into trouble as well," said B. Schmögnerová after her meeting with World Bank experts and experts from other reforming countries of Eastern Europe. When asked the question of when the banks are restructured to such an extend that they themselves would be interested in corporate sector recovery, B. Schmögnerová answered that if this process was to be implemented and funded by the banks equity only, it would take too long, and on the other hand, the banks would probably again try to widen the spread between the cost of funds borrowed from central bank and their lending interest rate. Banks margins are too big, making corporate loans hardly affordable. In 1994 B. Schmögnerová presented her opinion that certain proportion of banking sector restructuring cost must be consumed by state budget – via issuing securities to solve impacts of defaulting loans. Four years ago possibilities for banks to transfer portions of bad debt to the Consolidation bank (Konsolidačna banka) were considered. At that time the Deputy Prime-Minister assumed the results of banking portfolio recovery to be felt within 6 month, in some cases within one year or 18 months. This could have been the beginning of practical implementation of corporate sector reform where the key role was to be taken by banking sector and the State.

Resuming the power, Vladimír Mečiar's government immediately rejected this project claiming to use their own specific way. This unique way resulted in piles of problems and critical situation in the entire banking sector. The four banks dealt with in the government proposal "produced" a loss of SKK 5.031 billion in 1997.

Capital market

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Slovak capital market in 1994

Real capital market come into existence in the Slovak Republic in 1993, while it was substantially influenced by the voucher method of privatization. There is no doubt it contributed to the accelerated building of institutional basis achieving a rather high technical and organizational level in several respects comparable to the developed markets. Securities market makers, some financial mediators and securities traders, as well as investment fund managers have become able to provide services at the level close to the international standards. The Central Securities Depository of the Slovak Republic (Stredisko cenných papierov SR („SCP SR“) was established to perform the role of a central depository of booked securities. Capital market supervision was vested to the Ministry of Finance of the Slovak Republic.

In the introductory period the above listed Slovak capital market entities were predominantly responsible for creating room for trading of a substantial number of equity share issues distributed within the voucher scheme privatization. Due to the presence of foreign investors, both portfolio and strategic investors, and due to the banks entering capital market the equity trading was intensified in a relatively short period of time. Foreign investors and local banks provided the missing liquidity in a cash form as the privatizing investment funds – the most important market players were missing it in the introductory period. Although the capital market trading was dominated by the concentration of disintegrated ownership of joint-stock companies, including investment funds, elements typical of standard capital markets started to be observed. Worth mentioning are namely the new issues of equity shares a number of Slovak companies used successfully to increase their registered capital. As an illustration, four largest issues in 1994 (Slovnaft, VÚB, Slovenská poisťovňa, and IRB – Slovnaft refinery, VUB – general credit bank, Slovenska poistovna – Insurence company, IRB – Investment and Development Bank) represented the amount of more than SKK 6 billion.

The undercapitalized Slovak economy benefited also from the developing bond market, including not only Treasury bills, government bonds, but also commercial papers of companies, banks and municipalities. In 1994, for example, the amount of bonds issued represented SKK 9.3 billion. So basic conditions were created for financial investors, including privatization investment funds, to create standard portfolios with diversified risk. Collective investment activities also developed. These were mainly investment fund managers who unlike investment funds, were able to raise not only investment voucher but real cash from individual citizens mainly. The yield levels achieved by the most important unit funds were highly attractive in comparison to bank interest rate level, thus creating preconditions for the transition towards a more leveled distribution of population savings between the banking sector and capital market. By the end of 1994 the assets concentrated rather quickly by the unit funds represented more than SKK 2.3 billion.

The marked boom of share prices at the beginning of 1994 was followed by share price drop causing reduced interest of foreign investors in the entire Central European region

(Hungary, Poland, Czech Republic). The situation stabilized in the second half of the year, to great extent thanks to the increased interest of investors after the second wave of voucher scheme privatization was announced.

During 1994 first negative signals started to appear caused mainly by the insufficient regulation of the Slovak capital market. Problems manifested themselves in the most swelling form in the market low level of transparency mainly. Liberal approach to regulation, or lack of experience manifested by the regulatory body and its staff allowed market players to execute operations applying rules incompatible with developed markets. This resulted in first cases of damages made to investment fund shareholders by fund managers mismanaging assets of the funds, and damages and limitation of rights of minority shareholders in privatized companies, abuse of citizens lacking information in a doubtful sales of their shares obtained by citizens in the voucher scheme privatization, etc. Negative signals were to challenge the competent government bodies to take urgent steps and effective measures focusing on the capital market legislation improvement and increased efficiency of supervision. But the further development was influenced by the early parliamentary elections held in the fall of 1994 followed by the new government installation.

Declared objectives and reality of V. Mečiar‘s government

Below stated examples of implementation of specific items listed in the Government declaration of Vladimir Mečiar provide the best illustration of its practical approach to the government declared objectives in the area of capital markets. Before doing so, let us remind us that Slovak Republic Capital Market Development Policy specifying rather general theses proclaimed in the Government mission statement were approved by the government rather late, two and a half year after it was installed, i.e. in March 1997. The most important goals specified in the Policy to be implemented in the rest of the government term, i.e. for 1997 and 1998, have not been achieved. But let us return to the Government Declaration.

In 1994 V. Mečiar‘s Government committed itself in its Declaration to „support further development of capital market so that it becomes transparent, and its service quality corresponds to the European Union standards, and it is the accelerator and driving force of the recovery of the Slovak economy, and at the same time it is a stabilizing factor of the investment oriented economic environment in Slovakia both for local and foreign investors.“ In order to achieve this objective the government wanted „to take gradual steps to create legislative framework to ensure its compatibility with capital markets of European Union countries“ and „by stabilizing economic and political environment in the Slovak Republic to create conditions for increased interest of foreign investors in the Slovak capital market“. The government also declared its interest in „creating conditions for further growth and development of capital market by the ongoing privatization“ and at the same time „to create preconditions for making the capital market activities of investment funds and investment fund managers transparent and for improving the legal framework for the protection of small shareholders and their rights.“ The government also promised „to ensure efficient and effective performance of regulatory function of the state in the capital market by creating relevant organizational and material preconditions“; to focus on „urgent achievement of securities trading concentration in organized markets, organizational unification of public market makers, securities dematerializing, improved quality of service provided by market makers, the Central Securities Depository, ... “.

The above stated objectives are commented as follows:

Preparing legal framework compatible with the EU capital markets. Capital market laws and their wording valid at the end of 1998 is a result of numerous and frequently purposeful amendments in many cases turning the original laws adopted at the beginning of the

transformation process into inconsistent scrap. The backbone of the new capital market legislation, collective investment law in specific, recodified Securities law, and Securities Commission law were to be drafted in 1997 or in 1998 according to the approved Slovak Republic Capital Market Development Policy. As of the end of October 1998 the above listed legislation did not come into existence, or it was in a shape unsuitable for submission to the legislative Council of the Government. The current capital market legislation does not meet the requirements presented in the EU Directives. Frequent inaccurate and ambiguous formulations and insufficient legal determination of procedures in many areas represent a swelling shortcoming of the laws. This shortcoming created a nursery of consequent purposeful law interpretations and law circumvention by both market players and government bodies or institutions.

Creating conditions for increased interest of foreign investors in Slovak capital market. After four years of V. Mečiar‘s government a statement can be made that foreign investors (portfolio investors in this case) lost almost all their interest in Slovak capital market. During this period of time many of them pursued the strategy of a complete market leaving and selling the total Slovak issued securities portfolio. Unfortunately, exact statistics of foreign portfolio investments are not available. For foreign fund managers Slovak capital market has become one of the least preferred markets in Central and Eastern Europe. The main reasons were as follows::

- unfavorable image of direction and political stability of Slovakia;
- low level market transparency – unavailability of important information, absence of price-setting market, and low information value of official rates;
- absolutely inadequate system of investor rights protection, especially for minority shareholders;
- market regulation lacking credibility and effectiveness;
- extremely low liquidity resulting in limited opportunities for portfolio investments;
- non transparent privatization followed by market price distortion.

Creating conditions for further growth and development of capital market by the ongoing privatization. In this respect an unambiguous statement can be made that the government succeeded in achieving just the opposite to the objective presented in its Declaration. Especially foreign investors and their trust was shattered by the annulment of the second wave of voucher scheme privatization at the time they had already invested substantial amounts of money into it.. Conditions of the following privatization had even worse consequences. Majority of serious investors were discouraged from investing in Slovak capital market witnessing national assets (equity shares) being sold at price representing fractions of current market price. According to data published by M.E.S.A. 10 real income of the National Property Fund „ FNM SR‘ in the period of 1995 - 1997 represented only 28.7 % of the book value of assets privatized, equity shares including. Prior to 1995 this ratio was several time higher – from 61 per cent to 107 per cent.

Improving transparency of activities of investment funds and investment fund managers. After V. Meciar‘s government came to power in 1994 majority of investment fund managers and investment funds of voucher scheme privatization in particular became inconvenient. They represented a strong segment of the Slovak economy, but outside the control of the ruling power. The government tackled the situation and instead of making their activities transparent, it decided to eliminate their influence. In some cases it even undertook liquidation measures later proved to be illegal. The most famous case were measures of the state power represented by Jozef Magula, State Secretary of the Ministry of Finance of the Slovak Republic, taken against the fund managed by „ Prva slovenska investična, a.s.“ (First Slovak Investment Joint Stock Company). In 1995 a purposeful measure was taken to amend conditions for investment funds and their operations in order to limit their role in managing

privatized companies. Harmonizing collective investment conditions to the developed market standard where investment funds are of portfolio investor nature was taken as an excuse. It resulted in an unregulated mass transformation of investment funds into standard business companies not subject to the relevant provisions as well as liquidation of several funds. As of the end of October 1998, out of the original 165 investment funds established for the first wave of voucher scheme privatization, only 36 remained in operation. The overall climate caused by the open fight of the ruling power against the funds and by privatization practices accelerated mass transfers of investment fund assets for the benefit of majority shareholders and managers. And so in practice the shares of majority investment funds held in the hands of small investors lost their value.

Improving legal framework for the protection of small shareholders and their rights. The government interest in securing protection of small shareholders and their rights in the context of activities (or better to say lack of activities) of the Ministry of Finance of the Slovak Republic remained at the level of a cliché . The devaluation of shares acquired by citizens in the voucher scheme privatization is the best proof of it. It can be documented by the development of price of Slovak Stock indices. The best known of them – SAX index level dropped from 201.4 on October 31, 1994 down to 89.4 on October 30, 1998, loosing 56 per cent of its value and it continues to reach its new historic minimum values. Shares of many companies are simply untradable. Shareholders of the transformed investment funds are even worse off as they are left with "equities" of non existing companies on their accounts, having no possibility to do anything about it.

Ensuring efficient and effective performance of capital market regulatory function of the state. Until 1998 the State was unable to ensure the necessary protection to capital market players, neither was it able to create pre-conditions for healthy functioning of the market as such. Passive attitude of state bodies allowed for mass enforcement of individual economic interests of individual institutions and entities at the expense of the overall market development. Lack of professionalism, lack of experience, and unsuitably allocated powers caused the failure of state in performing its capital market supervision role. There is also a question of the extent to which there was a political will to take effective measures to eliminate negative phenomena in this area. On the other hand, inaccurate and vague formulations of basic capital market laws and their provisions and voluntaristic (high-handed, subjective) procedures in applying the provisions made it possible for the State supervision to take selective interference measures with entities becoming inconvenient for the ruling power. At the same time the state supervision body tolerated companies and individuals and passed their illegal actions unnoticed. Frequent cases of clientelism, willfulness, as well as lengthy bureaucratic practices of the Ministry of Finance department in granting licenses (often literally useless) for performing certain activities or operations discouraged issuers, mediators, and investors from their capital market activities. There was also a lack of will to create legislative framework for effective market players self regulation. Just the opposite, there was a visible trend to concentrate maximum of decision making powers to the hands of state supervision body causing in several cases market distortion and invalidating in part market mechanisms.. Granting license to issue commercial papers or municipal bonds was just one example.

Achieving securities trading concentration in organized markets. Before 1995 the substantial majority of securities trading was made and settled outside the organized markets. In the given year securities law amendment forbade trading securities outside organized markets. „BCPS" – Bratislava Stock Exchange and „RM-System" – OTC trading institution were given monopoly for transfers of any securities in booked form. Market players were forced to pay fees not only to the „SCP" – Central Securities Depository but also to market makers (organizers) regardless of their needs of their service. The only benefit of the above mentioned amendment was certain transparency of the market. Any transaction including its

reported price started to appear in Exchange quotations. Transactions from non organized market transformed in most of the cases into so called direct trades that are only reported to the Exchange without having any impact on pricing or liquidity of the organized market. The fictitious success of the above stated solution of the issue of unorganized market is best documented by the fact that according to the analysis provided by the Association of Securities Traders in the first six months of 1998 BCPB financially settled deals represented less than 9% of the total volume traded. This resulted in the situation where in most of the cases securities public market makers (organizers) perform the role of the Central Securities Depository terminal only.

Dematerializing of Securities. After V. Meciar gained the power the original concept where the form of securities was decided by the issuer was replaced by the concept of absolute power of a booked form. The purpose of it was, among other things, to ensure that ruling power has control over the owners of equity shares in all the privatized companies via the state controlled Central Securities Depository. The mandatory booked form of securities started to be resisted by the newly created privatization groups losing opportunity of using the bearer type of securities to conceal persons – the real owners of doubtfully privatized assets. And therefore towards the end of 1996 by the purpose-made initiative of HZDS (Movement for Democratic Slovakia) MPs successfully amended the law so that the mandatory booked form of securities does not apply to shares not subject to public trading.

Organizational unification of public market maker failed to be achieved. The only thing achieved by the state power in 1995 was the forced termination of operations of the Bratislava Options Exchange, the representatives of which fell into disfavor. Officially stated reason was the untimely early existence of derivative market in the Slovak Republic. But this did not prevent the representatives of the Ministry of Finance of the Slovak Republic in rendering license for organizing derivatives market to the BCPB and RM-system at the same time. Before October 1998 none of them managed to start off the derivatives market.

Consequences and present status

Present status of Slovak capital market can be characterized by deep stagnation and failure of its basic functions in the Slovak economy. Capital market in the Slovak Republic in practice does not perform effective funds distribution causing justified doubts cast on its meaningfulness. Ministry of Finance by its numerous issues of Treasury bonds yielding in some cases more than 30% p.a. pushed the other issuers out of the market. Secondary trading intensity has been substantially reduced. Average daily movements dropped by almost 64 per cent in the first half of 1998 compared to the 1997 average. “BCPB” still reports rather high volumes of trade, but most of them are reported direct transactions of very specific nature in many cases. Anonymous market has disastrous liquidity. In vast majority of published quotes their information value is almost zero and their purpose is only to make artificial impression of representing market price of relevant securities. State supervision over the capital market is in most of the cases unable to ensure protection of rights of individual market players. Market players do not possess access to information common in the developed markets. If the present unfavorable development is not reversed in the near future the established institutional bases may fall apart. Their re-building would require high costs. In addition, time factor plays an important role. Due to the progressing internationalization small and mainly inefficient capital markets may not survive the competition and they may disappear. Their role may be taken over by strong regional international associations.

Public Sector Debt

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According to the public finance analysis, public sector consists of state budget, local government budgets, insurance funds, state purpose-made funds, and Fund of National Property of the Slovak Republic. The latter one is dealt with in a separate chapter on "Privatization".

State budget

In 1994 the budgetary management development was influenced by impacts of clearing settlements with the Czech Republic and separation of National Insurance from the state budget reducing both the income and expense sides of the budget by almost one third. During the year periods of relative stabilizing of budget deficit took turns with periods of increasing the budget deficit. A substantial drop was experienced in December (from SKK 16.7 billion to SKK 22.8 billion).

In 1995 the budgetary management was done in two different modes. During the first three months budgetary provisional arrangement was made with state budget expenses set at the level of SKK 37.9 billion. Only the most inevitable needs in chapters of investment and non investment expenses, contributions and subsidies to production and non production sectors were met. Income was specified for so called "budgetary" and "contributional", i.e. quasi-state organizations only.

State budget was approved by the National Council of the Slovak Republic (Parliament) by the Act No.58/1995 Coll. of March 7, 1995. Total state budget income was set at SKK 146.4 billion and total expense at SKK 167.4 billion. State budget deficit was set at SKK 21 billion.

In reality budget income for 1995 was SKK 163.1 billion, i.e. by 16.7 billion higher than budgeted. The determining contribution to income was made by tax revenues (84 per cent), especially higher than expected value added tax revenue (+9.1 billion SKK). Income tax revenue was also higher than expected. On the other hand, excise duty revenue was by 5 billion SKK lower than expected.

State budget expense amounted to SKK 171.4 billion, i.e. by 4 billion more than expected. The excessive spending was covered by income from repayment of credit in clearing settlement of balance of payments with the Czech Republic after the termination of payments agreement and by additional sources of the state budget.

Changes were made in the method of covering state budget deficit for 1993. Treasury (government) bonds in two issues, no. 010 and 014, were sold in the total amount of SKK 15.1 billion, replacing direct loan from the National Bank of Slovakia (Central bank). Debt structure was positively impacted also by converting Treasury bills meant to cover 1994 state budget deficit into Treasury bonds (SKK 23,1 billion).

In the beginning of the year the government debt was funded by the National Bank of Slovakia (53.9 per cent), funding mainly state budget deficit of previous years. Taking

gradual steps during the year the burden was shifted to commercial banks mainly, sharing almost 80 per cent of the total government sector debt funding by the end of 1995.

For *1996* the state budget law specified income of SKK 162.4 billion and total expense of SKK 189.4 billion, the state budget deficit of SKK 27.0 billion. In relation to the state administration (national government) reorganization (establishing regional and district offices of national government) and in accordance with the fiscal policy the Ministry of Finance adjusted the state budget reflecting revenues of Treasury bond issues in the amount of SKK 3.0 billion for highway construction. After these adjustments the income was budgeted at SKK 165.7 billion and expense at SKK 190.7 billion, while the deficit was budgeted for SKK 25.0 billion. In 1996 the real income amounted to 166.3 billion, expense to 191.9 billion and the budget deficit was SKK 25.6 billion.

Fiscal deficit (deficit including repayment of loan principal and Treasury bonds, management of local government, state funds, state financial assets and liabilities, insurance funds, other lending and borrowing, non budgetary projects) amounted to SKK 5.0 billion (0.9 per cent of GDP).

During the year another purpose-made fund was created, Housing Development State Fund to finance state support of housing development – apartments, temporary housing facilities, additional insulation of apartment blocks, etc.

1997 state budget law no. 386/1996 of the National Council of the Slovak Republic approved the budget deficit of SKK 36.9 billion. State budget income was SKK 180.8 billion, and budget expense of 217.8 billion. The budget deficit amounted to SKK 36,999 billion.

The revenues were higher by SKK 9.7 billion than budgeted. Budget was not met in the area of tax income (SKK - 9.1 billion) caused mainly by the drop out of corporate income tax (SKK - 17,1 billion) and excise duties (SKK - 2,1 billion). On the other hand, individual income tax revenue was higher (SKK + 3.2 billion) as well as tax on international trade and transactions. But this was related to increased import surcharge (SKK + 7.5 billion).

Compared to the plan budgeted expense was shifted to capital expenditures, especially in relation to highway construction.

According to the NBS (Central bank) calculations in line with the IMF methodology, public sector fiscal deficit was approximately at the level of SKK 29.0 billion, i.e. 4.4 per cent of GDP.

Deficit management of state budget during the entire year was caused by debt servicing achieving SKK 25.2 billion by the end of 1997 (68.1 per cent of the budget deficit for 1997). The state budget deficit was fully covered by the issue of Treasury bills, considerably supported by revolving funding provided by the National Bank of Slovakia. In September only, the NBS made 10 special 7days issues filling its portfolio at the legally binding level of SKK 8.3 billion (e.g. in July there were 15 and in October 13 issues).

For *1998* the approved state budget assumed income of SKK 179.8 billion, expense of 184.8 billion, and budget deficit of SKK 5.0 billion.

According to the Ministry of Finance internal methodology, the planned state budget deficit should not exceed SKK 8.0 billion. Using the methodology of previous years (including principal payments) the state budget deficit exceeds SKK 50 billion. In accordance with Ministry of Finance methodology , in September the deficit was of SKK 8.4 billion. By the end of the year the state budget deficit is estimated to reach SKK 16-20 billion. In November the newly elected National Council approved increased state budget deficit of SKK 19 billion.

Local Government budgets

For the entire period, fiscal management of local governments is reported to be in surplus. This was frequently used by the central government as an argument for imposing restrictive approach to local government budgets.

Table 49
Development of local governments budgetary income and expense (in SKK billion) :

	1994	1995	1996	1997
Income	20.073	22.236	25.424	28.786
Expense	19.097	18.853	23.154	26.625
Balance	+0.976	+3.383	+2.270	+2.461

Source: 1994–1997state final financial accounts

Effective fiscal management at the local government level was complicated by substantial restrictions imposed by the state in 1994 and 1995 when tax income of municipalities could hardly cover public service municipalities are legally obliged to provide. Another problem was posed by the fact that during the entire election term the state increasingly did not perform its public duties and municipalities had to subsidize it from their financial sources. This applies mainly to state duties in the area of schools, public transport, health service, social issues, as well as municipal capital investments in technical infrastructure subsequently submitted to the assets of state monopoly companies („SPP“ (Slovak Gas Industry), „Energetické závody“ (Energy Works),...). On the other hand, it needs to be stated that municipalities implemented numerous so called development programs above the limit of their financial capacity. This was felt in the second half of the election term, when in 1997 capital expenditures increased to 37.6 per cent of local government budgeted expense (within state budget capital expenditures represented 15.7 per cent).

Another problem is posed by the system of redistribution of tax revenues to individual municipalities regardless of the variety of amount of public service provided, increased cost of service related to the size of the municipality, but especially, not corresponding to the link between the location of tax revenue generation and its utilization. Added to wrong decisions made by municipal councillors, this system contributed to the increased debt of larger towns especially (Košice, B. Bystrica...).

State restriction, bad redistribution system, and wrong decisions taken by local councillors caused permanent increase of local budget deficit since 1994, and municipal debt for 1998 is estimated at app. SKK 10.0 billion.

Insurance funds

In Slovakia there are three different systems of social insurance in place. Social insurance is responsible for providing pensions and sickness payments. Employment Fund provides unemployment benefits and organizes pro-active labor market programs. There are 12 insurance companies providing health insurance services.

In the period of 1994–1998 budgeted funds of all three systems have almost doubled (in billion SKK):

Table 50
Income and Expense of Insurance systems

	Income		Expense	
	1994	1998	1994	1998
Health Insurance	20.0	42.1	19.3	42.0
Social Insurance	44.7	78.0	41.9	67.2
Employment Fund	4.9	10.3	4.6	8.9
Total	69.6	130.4	65.8	118.6

Source: Ministry of Finance of the Slovak Republic

In the period of 1994–1998 problems were growing mainly in the system of *health service financing* shared by health insurance companies, state budget, and citizens. The bad system failed to be reformed and thanks to various regulations (wage, medicaments...) the deficit was only growing in this resort, and in the public sector as such. Health insurance companies, health service providers, pharmacies, medicament distributors,.... all of them have gradually become insolvent.

By the end of 1997 the Slovak health system debt amounted for SKK 8.0 billion. By the end of 1998 it is preliminary estimated to SKK 12 – 19 billion. The main causes of this situation are as follows: wrong system of medical performance rating, premium payment defaults (up to SKK 4.0 billion of debt), high operational cost inherited from the previous decades, as well as low state payments for „its“ insurance beneficiaries, currently 3.1 million of them (children, pensioners....).

In the period of 1994–1998 the situation in the area of *social insurance* also deteriorated. The accumulated capital to support the needs of old-age pensions scheme is gradually used up and in 1998 the cost of old-age pension scheme payments shall be higher than income of the Social Insurance by SKK 2.2 billion. The Insurance company will have to take these funds from revenues generated in previous years. One of the most urgent problems is again state payments due to the old-age pension scheme on behalf of „its“ beneficiaries. These are reduced year by year, in 1994 it was 5.675 billion, while in 1998 it will be SKK 0.872 billion only.

State purpose-made funds

In 1994 they did not play any important role within the overall public expenditure. Their importance was growing though. At present there are 12 state purpose-made funds. While in 1994 the total fund income was SKK 6.62 billion, in 1998 the total funds income is assumed to be SKK 32.94 billion, out of which app. SKK 12.5 billion represent transfers from state budget, SKK 11.3 billion are loans, and the rest are tax and non tax income of the funds (SKK 9.14 billion)

Table 51
State purpose-made funds in 1994 and 1998 (budgeted balance) in SKK billion.

State fund	Income		Expense		Loans taken
	1994	1998	1994	1998	1994–1998
Decommissioning of nuclear power facilities	0	3.376	0	1.312	
Housing development	0	4.160	0	4.160	
Health care development	0.047	0.130	0.047	0.130	
Physical culture development	0.128	0.242	0.122	0.242	
Environment	1.049	0.835	1.006	0.835	
Road management	2.154	17.141	2.066	17.141	14.185
Land management and food processing	0.807	1.537	0.048	1.537	0.200
Pro Slovakia	0.085	0.100	0.131	0.100	
Protection and improvement of agricultural lands	0.257	0.803	0.183	0.803	0.090
Protection and improvement of forest lands	0.209	0.542	0.196	0.539	
Market regulation	1.886	3.876	1.933	3.876	4.952
Water management	0.003	0.200	0.026	0.614	
Total	6.625	32.942	5.758	31.289	19.427

Source:State final financial account for 1994, state budget for 1998

Towards the end of 1998 the estimated debt within the state purpose-made funds is SKK 11.3 billion.

Overall evaluation

In the period of 1994–1998 deficit management of the entire public sector was rather expanding, despite the economic boom. Public sector continued to interfere more and more into the economy of areas belonging to the private sector. This created distortions in the private-public sector relations, and the public sector debt was increasing.

While at the beginning of 1994 the domestic debt was app. SKK 87 billion, at the end of 1998 it is estimated at the total of SKK 104 billion. Government foreign debt increased from SKK 43 billion at the end of 1994 to app. SKK 70 billion in the middle of 1998, i.e. the total state debt was increased from SKK 130 billion (29.6 per cent of GDP) at the beginning of 1995 to SKK 174 billion (25 per cent of estimated GDP) in 1998.

Since 1996 refinancing of public sector debt become increasingly difficult, mainly because of increased interest rates of local capital market (average interest rate – yield on treasury bonds and treasury bills was 20-30 per cent) , but also due to deteriorated conditions for repayment of foreign loans and interest. State debt repayment increased from SKK 18 billion in 1996 to app. SKK 46 billion in 1998 (including debt service of local governments, it is more than SKK 50 billion).

Latent debt of potential exchange rate losses (estimated at SKK 3.0 billion), debt of insurance companies (health insurance companies app. SKK 12-19 billion), debt of the National Property Fund (SKK 2.2 billion in 1998, and SKK 30 billion as of 2001), debt owed to banks (CSOB, Konsolidačná banka, IRB...), local government debt (SKK 11 billion), defaulted payments to insurance funds, debt of state purpose-made funds (SKK 11 billion), invoices past due...., but also guarantees given to business entities in the amount of several tens of billion mainly within foreign currency loan agreements and therefore bringing along further exchange rate risk and potential loss – all of that is just another „heritage“ of Slovakia from V. Mečiar‘s government. The total gross estimate of this already existing debt may be around SKK 100 billion for the period of the coming four years.

Foreign Debt

Marek Jakoby
M.E.S.A.10

With the shortage of local funds foreign financial sources represent a usefull and frequently also inevitable means for ensuring development of local economy. Foreign funds may flow into local economy in two basic forms. The first form is the so called „foreign direct investment“, or portfolio investment. Foreign loans represent the second form. It is obvious that especially for Slovak type of economy the direct foreign investment is more advantageous as they bring in new technologies, know-how, and they open new markets, they are cheaper and they do not exert strong pressure for repayment.

The biggest weak point of foreign loans is the fact that they must be repaid. Important role is played here by factors such as the purpose of the loan, repayment calendar, interest terms and conditions, as well as currency in which the loan is denominated.

An entity may borrow foreign funds either directly by taking credit or by issuing bonds.

From the above listed statements follows that borrowed funds bring about the desired effect, providing they are directed in areas expecting increased exports, the repayment calendar is spread over a time period long enough for the loan to be repaid from the achieved profitability. Stable exchange rates play also an important role.

Let‘s have a look now on the Slovak Republic foreign debt and its development.

When established in 1993 Slovakia ranked among countries with rather low amount of foreign debt. Towards the end of 1993 the total foreign debt of the Slovak Republic amounted to USD 3.4 billion. Towards the end of 1994, i.e. at the beginning of the term of V.Mečiar‘s third government it was increased to 4.7. The 1995–1998 period brought about a substantially higher growth. According to the NBS (Central bank) data, the Slovak Republic foreign debt amounted for USD 11.3 billion as of June 30, 1998. This means that compared to the starting point level in 1995 it increased by 140 per cent. When calculated per capita, towards the end of 1994 every citizen of the Slovak Republic owed to abroad app. USD 900, while in the middle of 1998 it was as much as USD 2100 .

Figure 52 and Graph 6 show the development of this period.

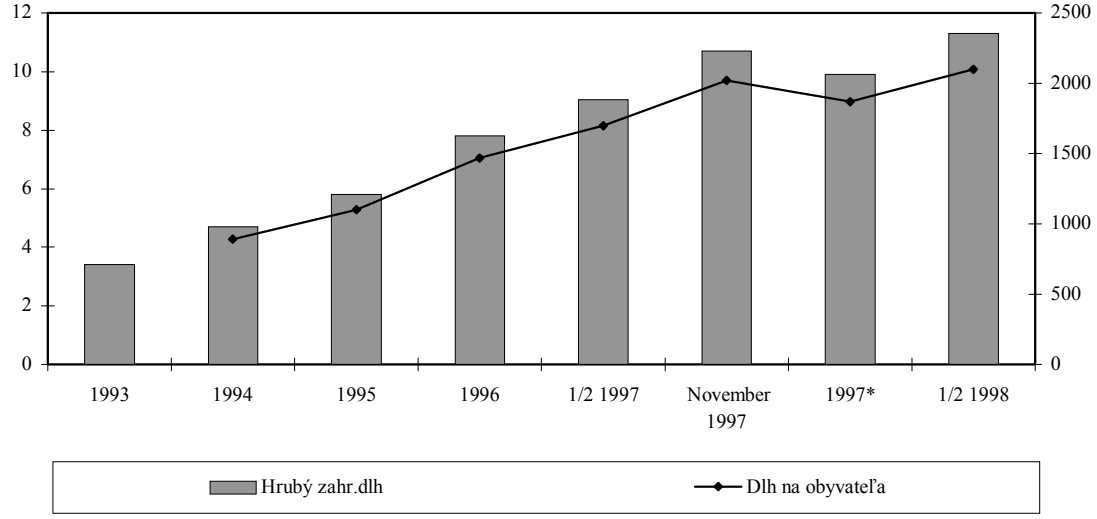
Table 52
Slovak Republic Foreign Debt Development

	1994	1995	1996	1/2 1997	11. 1997	1997	1/2 1998
Foreign debt (billion USD)	4.7	5.8	7.8	9.04	10.7	9.9*	11.3
Debt per capita	890	1100	1470	1700	2020	1870	2100

Source: NBS

** according to NBS the reduced foreign debt was reported due to accounting procedure of one foreign bank in the Slovak Republic*

Graph 6
Development of gross foreign debt (billion USD) and per capita debt (USD)



hruby zahr. Dlh = gross foreign debt *dlh na obyvatela = per capita debt*

Source: NBS
** the reduced foreign debt was reported due to accounting procedure of one foreign bank*

Compared to the neighboring economies in transition the Slovak debt is still considerably low. But it is interesting to compare the trend development since 1995: From among the ‚V4' (Vysegrad 4) countries since 1994 the foreign debt increased only in the Czech Republic (10.7 billion; 100 per cent) and in Slovakia (6 billion.; 127 per cent). It was reduced in Poland (-4,1 billion.; 9,7 per cent) and in Hungary (-4,8 billion.; 16,8 per cent).

Table 53
Comparison of foreign debt development in V4 countries

	Poland			***Hungary***			***Czech Republic***			***Slovakia***		
	Debt (billion$)	*Debt per capita ($)*	*%GDP*	*Debt (billion$)*	*Debt per capita ($)*	*%GDP*	*Debt (billion$)*	*Debt per capita ($)*	*%GDP*	***Debt (billion$)***	***Debt per capita ($)***	***%GDP***
1994	*42,2*	*1100*	*45,5*	*28,5*	*2800*	*68,7*	*10,7*	*1040*	*26,9*	***4,7***	***906***	***34***
1997	*38,1*	*990*	*28,1*	*23,7*	*2300*	*53,2*	*21,4*	*2080*	*41,1*	***10,7***	***2020***	***55***

Source: own calculations based on NBS data and CREDITANSTALT Central European Quarterly, II/1998

The steep increase of foreign debt in 1997 continued in the first half of 1998. The total gross foreign debt increased by USD 1.5 billion, reaching USD 11.3 billion. Debt per capita ratio also increased to USD 2 100.

This figure does not represent the factual status of government foreign liabilities, because the debt of corporate sector includes debt of state controlled companies and certain portion of corporate liabilties is guaranteed by the state. According to the NBS[1] estimates more than 50 per cent of medium-term and long-term foreign debt of corporate entities represent

a government guaranteed debt in amount of app. USD 2 billion. The most complicated and problem posing guarantees are those to loans taken by state controlled company ‚Vodohospodárska výstavba Bratislava' (Water Management Development) to finish the construction of dams in Gabčíkovo and Žilina in the amount of USD 500 million. These guarantees were given by the state in 1995, 1996, and 1998.

Less favorable interest rate and repayment terms and conditions for raising new funds for Slovak companies represent one of the negative aspects of increased debt of Slovak entities. This is directly related to the deteriorated sovereign rating of Slovakia by reknown rating agencies.

Slovak Republic Eurobond issue of May 1998 in the total amount of USD 750 Million may serve as a good illustration. When placed on the primary market the yield (i.e. interest) averaged 3.5 per cent above LIBOR, i.e. level corresponding to government bonds of countries of the denomination currencies (In this case DEM – German Government bonds, JPY – Japaneese bonds, USD – American bonds). The so called risk margin (coupon yield above LIBOR) was at the level of foreign bonds of Romania or Kazachstan. At the same time the yield of foreign bonds of Poland, Hungary of Czech Republic was app. 0.7 – 1 per cent above LIBOR.

In February 1998 , Slovenské elektrárne' (Slovak Electricity) was granted a syndicated loan of USD 20 million at LIBOR + 1.1 per cent , and ‚Slovenská pošta' (Slovak Post) was granted a loan of DEM 13,6 million at FIBOR (Frankfurt Borse reference rate) + 0.5 per cent.

The term structure of foreign loans is worth noticing. It is relevant that short-term debt of USD 1.6 billion in November 1995 increased to almost USD 4.7 billion in June 1998. The short-term debt contributed to the total debt by 41 per cent , compared to previous 30 per cent. This portion of the debt is represented by short-term trade creditors as well as bank liabilities due to their obligation to create foreign currency reserves for monetary purposes.

As stated in the daily ‚*Národná obroda*[2], as many as 66 per cent of foreign investment loans have maturity of maximum 3 years, while the average payback period of investment projects is 3-4 years. The existing structure of investment projects cover by foreign loans creates a risk of default or a necessity to take more loans to repay the previous ones.

Even more critical is the fact that the so called net debt of Slovakia is increasing. Net debt is the difference between gross foreign debt and value of foreign currency assets (foreign currency reserves of central bank and commercial banks). Since the middle of 1995 the gross foreign debt has grown faster than foreign currency assets, increasing the net foreign debt amount from USD 0 to 2.4 billion and putting Slovakia in the position of a so called net borrower.

R E F E R E N C E S

1 Ing. Pavol Kyjac: Zahraničná zadlženosť Slovenskej republiky v 1. polroku 1998, BIATEC 11/98, s.9 (Foreign Debt of the Slovak Republic in the 1st half of 1998)

2 4. 8. 1998

Housing Policy

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In its program declaration, of early 1995, the now resigning government furthered *housing development* as *a task of nationwide significance.* In addition to elaborating a public investment program, the project entailed the incentivization of the use of as wide a range of private funds as possible and the establishment of conditions for a long-term loan granting and an effective lien perfection. Among the housing development tasks were:

- redrafting the approved housing policy of 1994
- increase housing construction by providing concrete support to new housing construction geared towards the lower income groups, the disabled, homeless, single elderly people, and also
- the improvement of the current housing stock condition and the completion of the work-in-progress of the former comprehensive housing construction
- establishing conditions for mortgage loans with an appropriate maturity (20 years), whereby the State was to cover part of the interest payments from the state budget
- establishing an autonomous system supporting housing construction for the lower income groups
- fomenting accelerated privatization of the housing stock
- fostering the implementation of the utilities savings program in buildings.

In its program declaration, the government corroborated the fact that at the given stage, it did not consider prudent to fullly liberalize the rent.

The redrafted concept of the state housing policy by the year 2000 was approved by the government of the S.R., by the resolution No. 867, of *November 1995.* It spelled out the government tasks and categorized them by provisions to be yet adopted:

- ensure the housing construction development so as to have about 97,000 apartments built by the year 2000
- establish legislative and organizational conditions for the ownership rights protection and transfer
- implement inevitable changes in ownership relations and the infrastructure economy
- liberalize rent and other prices associated with housing
- introduce housing allowance to protect the lower income level groups within the social policy framework
- enforce economic instruments that would promote housing development – these instruments should act in a coordinated fashion in three areas, notably, subsidies, loans, and tax policy.

THE STATUS ON THE TASKS SPELLED OUT IN THE PROGRAM DECLARATION

Based on the evaluation of the present state it may be said that *the hitherto progress of the housing policy transformation is unsatisfactory. The government did not fully meet any of the envisaged tasks, and protectionist measures* leaning on the principles of the *socialist order and a centrally-managed economic system persist* (sweeping subsidy policy, some tax provisions, price control, protectionist measures, etc.).

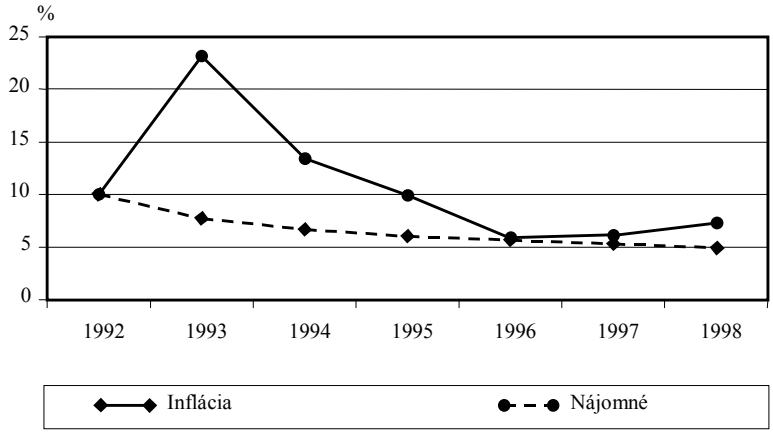
LEGISLATIVE INSTRUMENTS IN HOUSING POLICY

As regards legislative changes, the hitherto procedure has not been coordinated from the viewpoint of the material and time impact of individual instruments; in legislation, an analysis of the currently effective rules and a subsequent invalidation of those which are unacceptable for further development (including statutes) is called for, along with the implementation of the necessary amendements of the existing provisions, particularly in the area of apartment ownership and technical infrastructure.
To date, in the ownership area, the impediments to the protection and transfer of private ownership have not been satisfactorily eliminated.
The Act No. 182/93 of Coll., as amended, establishes a fundamental legislative framework for *the transfer of the ownership of apartments and business premises to the ownership of citizens.* A non-systemic stipulation of the sale price regulation as laid down in the Act favoring the citizen-tenant, will have to be limited timewise, as this stipulation is a serious non-systemic measure acting against the management of the assets of municipalities and other housing stock owners, and it impedes any opportunity whatsoever to conduct any long-term planning in housing development at the municipal and regional levels.
In *the real property registration*, the executive activity of cadastral offices is not satisfactorily coordinated with the obligations spelled out in the Cadaster Act without the option to enforce recourse on the part of natural and juridical persons. The housing market is also dependent on the improvement of work in this area as it is envisaged that the volume of this activity will continue to grow steadily. In conjunction with the need to enforce market price maps that will lean on the land and real estate market values, it is also recommended to keep the price value of the last real estate transfer on cadaster records (these are indicative values found useful in bank loans, mortgage loans included).
Housing development is closely linked with the *development of technological infrastructure. To date, the conditions of this development have not been addressed due to an unresolved transformation of the ownership issues* (privatization) pertaining to these assets. A clearly spelled out ownership is linked with investment obligations which, in any country, are associated with ownership or other legal relations, such as lease or franchise. The present technological condition of infrastructure clearly calls for rehabilitation investments, which state enterprises have no chance to acquire locally, not to mention foreign funding. The government replaced investments by support programs of housing construction that were largely funded from off-budget sources which will be elaborated on below.
In civil relations, the necessary apartment rent stipulation that would place the tenant and the owner on equal footing *has not taken place* to date; a new rent stipulation ought to also cover the inevitable rent change for a definite period of time with a possibility to adjust the rent depending on inflation in certain intervals and the demand impact, if any, at the local level.
The government did not address the issue of *formulating the tasks of individual parties* and the implementation of individual instruments in their mutual correlations. Within the framework of housing development, the role and tasks of the participating third sector in housing, especially with regard to specific citizen groups, were not elucidated, and equally unclear is the role and significance of non-profit organizations in the housing stock construction and operation, including rental houses (essential philosophy that would underly housing policy, as well as the forms and tasks of individual instruments are non-existent).

Tax and Price Instruments

In housing policy, *the required transformation steps pertaining to tax and price policies were not implemented*. Non-systemic price adjustments of utilities and the rent which the resigning government did not address comprehensively, although these issues were incorporated in its program declaration, call for an ever-increasing state budget funding at the expense of the social needs coverage. The solving of these burning problems was completely passed over by the former government onto the new election period.
In price policy, the necessary system changes that would usher a stepwise rent liberalization have not taken place to date. Non-systemic measures, such as rent control, account for the deterioration of the apartment house maintenance for reasons of the funds shortage. The present rent has not been adjusted since 1992, neither relative to the inflation growth, nor to the return of the housing construction investment. The construction of rental housing in the public or private sector cannot happen without price deregulation. The real rent dropped to 49 per cent of the 1992 rent.

Graph 7
Inflation and the Real Rent Curve



INFLATION RENT

The current *subsidy policy associated with the price of utilities* is among the reasons of high utility consumption. Heat that is distributed to the population via a system of central heat supplies accounts for 39 per cent of the total heat consumption. (Based on the available 1995 comparative data, energy-intensiveness per gdp unit was four times higher as opposed to an overall world consumption, and 6.25 times higher than energy-intensiveness per unit of the GDP in West-European countries), whereby the heat producers in Slovakia consume a total of 5 per cent of the total fuel consumption as distinct from 2 per cent in Western Europe. These differences affect the housing stock as a whole and to a large extent reflect the mix of the total technological conditions of buildings (more stringent prescriptive conditions were introduced too late) and the inefficiency of heat generation and distribution. In this area, the government did not address the hard-core issue, that is, the introduction of the deregulated prices of utilities with a parallel protection of the lower income groups of population. Instead, it introduced a non-systemic measure of cutting sweeping subsidies while regulating the prices of utilities for residential users without addressing the differential across the individual counties.

Within the framework of price and tax policy, in conflict with the housing policy statements, other *non-systemic instruments persist, notably:*

- *The decree of the Ministry of Finance of the S.R. No. 465/91 of Coll. on Building, Land, and Stand Prices* that accounts for two kinds of real property prices, i.e. market and official, *which results in an extensive tax avoidance and the distortion of the development of the housing market prices.*
- An option to transfer the rights of the use of cooperative apartments, which, effectively, entail the payment of full market prices without any taxation whatsoever (income tax and real estate transfer tax).

The government, despite the declared objective, did not introduce other housing development instruments, among which are *tax motivators*. These are extensively used in all advanced countries in a variety of combinations. This largely entails motivators in the construction of new rental housing (associated with the setting of accelerated depreciation), and the purchase of private property. Within the framework of tax incentives*, the status of non-profit organizations* is not stipulated; in many countries, non-profit organizations are not only active *in the new housing construction, but also in its running* (especially of housing built from public funds, or, built with a view to meet certain public and social goals, such as rental housing for the low income groups of population), including various specific forms of housing (for the homeless, asylum-seekers, old citizens, etc.).

The Housing Policy Financial Instruments

In financial instruments for the promotion of housing construction and the rehabilitation of apartments with all types of title, the government furthered two types of instruments entailing a direct use of public funding (subsidies), disregarding the user's social situation, i.e. the building savings scheme, and the state system of housing support (within the framework of the State Housing Development Fund), and on the basis of legal norms pertaining to banks, legislative conditions for mortagage loans were put in place. Parallel with that, banks continued to be allocated subsidies from the state budget, to compensate them for economic damage incurred due to extending loans to citizens for the housing construction prior to 1991, at 1 per cent, or, 2.7 per cent interest.

The building savings scheme, stipulated in the Act 310/92 of Coll., as amended (incorporating German and Austrian experiences) *mobilizes private funding and motivates the citizens* to saving. The State partakes in this system by allocating funds from the state budget in the form of the State premium; the participation principle entailing the individual's 40 per cent share, up to a maximum of SKK 6,000 was changed to 30 per cent and the category of friendly savers was invalidated in 1997. Two banking institutions provide for the building savings scheme, Prvá stavebná sporiteľňa (the First Building Savings Bank, as of November 16, 1992), and VÚB Wüstenrot (since 1993).

Table 54
The Building Savings Scheme of Prvá stavebná sporiteľňa, Inc., (PSS) has reported the following figures (million SKK):

Year	No. of new contracts	Target amount	No. of building loans and bridging facilities	Volume of building loans and bridging facilities	Volume of disbursed deposited funds	Earmark- ed funds total*	State pre- mium from State Budget	Savers' deposits
1992	55,932	7,509,2						410,3
1993	151,322	17,629,1			19,9	1,9	797,2	1,417,1
1994	183,519	23,070,6	8,0	1,7	252,8	254,5	1,002,9	2,796,6
1995	229,678	30,878,5	511,0	61,3	861,7	923,0	1,500,0	4,412,4
1996	267,376	35,796,7	2,535,0	302,3	2,261,8	2,964,1	2,300,0	6,677,9
1997	129,803	22,536,7	14,924,0	3,139,7	2,839,9	7,430,5	2,327,8	7,172,0
X/1998	114,856	17,183,0	23,077,0	6,278,3	3,160,4	9,818,3	1,040,7	4,485,3
total	1,132,486	154,603,8	41,055,0	9,783,3	9,396,6	21,410,3	8,968,6	27,371,7

** Total funds allocated for housing also include SKK 1,030,5 mill. for big construction projects (1997 and 1998), skk 400 million for PKB (First Municipal Bank) bonds intended for housing construction (1996), and skk 800 million in government bonds for the State Housing Development Fund (1997).*

Table 55
Breakdown of Approved Building Loans and Bridging facilities

Year	No. of approved bridging facilities	Volume of approved bridging facilities (mill. SKK)	No. of approved building loans	Volume of approved building loans (mill. SKK)
1994	8	1,7		
1995	365	54,8	146	5,5
1996	1,869	260,7	666	41,6
1997	13,415	3,037,6	1,059	102,1
X/1998	20,520	6,084,9	2,557	193,4
total	36,177	9,439,7	4,878	343,6

Source: PSS Inc., amounts in SKK millions.

Currently, SKK 25.6 billion deposited with pss Inc. (Prvá stavebná sporiteľňa, a.s.) allows to allocate to the new housing construction and the housing stock rehabilitation SKK 12.9 billion in 1998, SKK 13.9 billion in 1999, and over SKK 20 billion p.a. by the year 2000.

In conjunction with the building savings scheme, it should be noted that 30 per cent of the clients that concluded the contracts were citizens under 30 years of age, whose primary objective was to resolve their housing issue. In late 1996, pss opened a department for the large project financing, which capitalized on the idea to provide savers with their own dwellings as soon as possible. By late February, loans totalling SKK 651 million had been approved, for the construction of family houses and 177 apartments in Bratislava. Other loans totalling about SKK 3 billion were also under way.

Another financial loan instrument is mortgage loan. Legislative conditions were established by the amendment of the Banking Act No. 58/1996 of Coll. (Chapter 8 of the Act), that amended and supplemented the Act No. 21/1992 of Coll. on banks, as amended. Subsequently, in the first half of 1997, the National Bank of Slovakia granted a licence to VÚB Inc. (the General Credit Bank), to conduct mortgage deals, and VÚB began to extend mortgage loans on October 27, 1997. Currently, it is the only bank in Slovakia that deals in this business. The commencement of this business was adversely impacted by the imperfect legislative setting and the overall economic conditions, notably, the problematic money and idle capital markets. A separate problem of mortgage banking in the S.R. is the non-existence of the State support. Anywhere else mortgage loans are among the fundamental tools of the housing construction development and enhancement, with various forms of direct (interest rate support) or indirect support (tax incentives, for instance, tax-deductible interest rate, or, their portion from the income tax, tax-free municipal bonds, etc.).

During 1998, a working committee was set up (at the Ministry of Finance of the S.R.) which, in accordance with the government-approved Legislative Plan, drafted the amendment of the Banking Act, among others, of its Mortgage Banking part as well, and the amendement was interconnected with other legal norms stipulating and impacting the housing sector and mortgage deals.

To ensure an efficient development of mortgage banking in the S.R., it is inevitable to comprehensively resolve and perfect all the above areas, so that this support instrument becomes a fundamental component of the housing construction funding, just like in any advanced country, and so that it operates the way it had in our country prior to 1948.

Based on the Act No. 124/96 of Coll., the State Housing Development Fund was established with a purpose to operate as an independent, autonomous system in the interest of housing construction (originally, it was to attend to the housing needs of the lower income groups).

The passed Act did not establish conditions for the system autonomy, as it did not stipulate the obligation of a regular, annual funding from the stage budget, and neither did it spell out the conditions to whom (related to the beneficiary category, the applicant's social background), for what category (standard) of housing, and at what (engineering) costs the funds were to be allocated, which caused the non-existence of the relationship between the allocated public funds and the applicant's social background.

Hence, the Fund became a general support instrument void of the originally contemplated idea to act as an instrument targeted towards the lower income groups, and its enforcement was narrowed down merely to the construction of privately-owned apartments.

Under the supplier pressure, the Act was amended in 1997, and also legal entities could apply for funding. The loan conditions were also changed, the applicants were broken down to categories under 35 years of age and 35 years and over, disabled persons, the original credit amount of SKK 300,000 at a uniform interest rate of 3 per cent went up to an amount between SKK 300,000 and 500,000, with varying interest rates (1 per cent, 3 per cent, and 6 per cent), and a possibility to get a block grant of SKK 150,000, i.e. 30 per cent of the extended loan according to the stipulated conditions was made available.. By combining loan granting with a subsidy from a single source, the transparency of the State Housing Development Fund deteriorated, and its autonomy was ever-more curtailed.

Among the financial sources of the State Housing Development Fund are subsidies from the National Property Fund of the S.R., government bonds, and the state budget.
Due to the fact that through the State Housing Development Fund public funds began to be also allocated to legal entities, although the criteria and control mechanisms optimizing the funds use were not sufficiently prepared for this step, the role of the future owner – end debtor – was subdued (i.e. the possibility to impact the price of the apartment in the preparatory stage based on engineering computations, deficiencies in building contracts, unclear title to lots, etc.).
Last but not least, for reasons of the setbacks in public bidding, the S.H.D.F. funds caused a number of problems (among others, uncontrollable corruption). True, the introduction of the above form of the S.H.D.F. resulted in a higher number of built apartments, but on the other hand, it triggered off an uncontrollable price growth per enclosed dwelling unit, either per sq.m or cu.m, whereby the price of construction in apartment buildings went up disproportionately to the building material prices. In addition to the above reasons, the price policy related to apartment construction is also impacted by the ruling of the Ministry of Finance of the S.R. No. 1/95 that introduced price adjustments in the building industry based on the indexing of the Statistics Office of the S.R., which accounted for further distortion of prices in the housing market. Furthermore, this caused the tension between the capital costs per dwelling unit and the effective investment payback in the form of rent to increase (in the first deregulation step, price adjustment to the basic cost-covering rent is envisaged).
In 1996, 1,705 applications were filed, of which 1,249 applications (i.e. 73.2 per cent) were favorably assessed based on pre-set criteria and allocated SKK 446,539 thousand from the S.H.D.F. funds. By late March 1998, another 5,463 applicants had been allocated funding amounting to SKK 2,656,5 million.
Based on the S.H.D.F. funding, building saving schemes, and other private and public funds, following trends were reported in housing construction as distinct from the previous period of the municipal housing construction:

Table 56
Housing Construction Development and Its Structure

Year	Completed appts.	Municipal housing %	Cooperative housing %	Corporate housing %	Private housing %
1981-85	*183,947*	*18.30*	*49.0*	*2.60*	*30.10*
1986	*31,579*	*19.94*	*47.10*	*2.88*	*29.78*
1987	*30,626*	*23.80*	*43.91*	*2.52*	*29.77*
1988	*32,210*	*21.24*	*48.19*	*0.53*	*30.04*
1989	*33,437*	*21.58*	*46.48*	*0.41*	*31.52*
1990	*24,705*	*16.81*	*40.61*	*0.62*	*41.96*
1991	*20,816*	*17.72*	*52.26*	*0.35*	*29.67*
1992	*16,372*	*11.03*	*32.08*	*1.36*	*55.53*
1993	*14,146*	*15.67*	*24.56*	*1.07*	*58.70*
1994	*6,709*	*9.15*	*32.63*	*5.20*	*53.02*
1995	*6,157*	*25.14*	*23.34*	*1.28*	*50.24*
1996	*6,257*	*22.82*	*20.87*	*0.27*	*56.10*
1997	*7,172*	*30.35*	*13.29*	*0.00*	*56.33*
1998/2	*3,506*	*21.71*	*8.16*	*0.00*	*70.08*

In addition to the S.H.D.F., another component of the State housing development system, were also housing development programs launched by the Ministry of Construction and

Public Works of the S.R. Within these programs, block grants, i.e. subsidies, were allocated to communities largely geared towards:
the construction of municipal rental housing
technical infrastructure construction
housing construction for the Romany ethnic minority and for citizens in need
repair, modernization, and rehabilitation of heritage buildings entered in the unesco heritage list.
The allocation of these grants was contingent on the use of own funds in a stipulated amount, and compliance with other conditions (building permit, construction supplier documentation, etc.).
The National Property Fund of the S.R. allocated funding for the housing development program in the individual years as follows:
in 1996, SKK1,000 million
in 1997, SKK 2,000 million of which SKK 170 million were used to solidify the S.H.D.F.
in 1998, SKK 1,000 million.
In addition, the Ministry for the Administration and Privatization of National Property allocated SKK 500 million in 1998.
Hence, housing development was allocated additional off-budget sources from the National Property Fund of the S.R. amounting to SKK 4,330 million, which were not subject to public oversight due to the fact that the economy of the National Property Fund of the S.R. was exempt from the government and parliament control. In this case, at stake was a significant amount compared to the state budget contribution.
In addition to the above budget and off-budget sources, local governments allocated SKK 5,232,4 million for housing development from their respective budgets.

Social Policy in Housing

Within the framework of the approved State housing policy, the relationship of social protection and other related support instruments was not satisfactorily transparent. The objective and forms of social protection in housing, the stipulation of the population categories, to whom a certain form of housing assistance is rendered, remains unclear. Neither has this problem been addressed comprehensively, therefore, the role of the State is also unclear, whether it shall further the construction and running of social housing, or, rather promote the construction for low- and moderate-income groups of citizens, and assist the socially weak groups by earmarked housing allowances, with an option to live in the above type of rental housing. Housing policy was unilaterally focused on housing allowances, although the combinations of all the instruments available provide for a much greater variability of solutions.
In the social area, the government, at variance with the State housing policy, did not present the parliament with the housing allowance bill which was drafted by the Ministry of Labor, Social Affairs, and the Family of the S.R. in accordance with the Legislative Plan for 1997, which resulted in the granting of sweeping subsidies in heat and warm service water irrespective of the consumer social situation. With this is closely linked a populist justification of the hitherto rent regulation, which currently affects only some 12 to 15 per cent of the tenants of municipal housing across various income groups who are given preferential treatment at the expense of other tenants in other ownership forms who are liable to fully cover housing costs, whereby their social situation is disregarded. The ever-growing non-systemic requirements for sweeping subsidy systems are in conflict with the need to render social assistance selectively, in the form of a concrete “per head” assistance that eliminates the “grievances” of social assistance and eases off the pressure on the state budget.

Recommendations

The State housing policy concept ought to be a fundamental document clearly formulating the inevitable concrete tasks in the transformation of housing to market conditions, including a clear stipulation of the form and fashion of the protection of lower income groups.
Based on the above objective, it is essential to:

- clarify the roles of the individual potential partners that follow from the housing policy transformation needs (the State, community, citizen, private, public, and third sectors), with an objective to make the process transparent and maximize the opportunities of the public-private partnership in the preparation, implementation, and operating of the housing stock based on the conditions of the housing market (i.e. real supply and demand), and stipulate protective rules related to the social aspect of housing;
- incorporate the above tasks in the relevant legislative provisions and the stipulation of support financial, tax, and subsidy instruments and social policy (review the conditions of the building savings schemes, the S.H.D.F., formulate the support system of mortgage loans – tax instruments, interest rate subsidies, start a state insurance system of mortgage loans, activate the secondary capital market, mortgage guarantees, etc., especially in conjunction with the foreign funding of housing construction, support grants for the housing stock rehabilitation, etc.);
- optimize the conditions of the use of state funds in the whole housing process (construction and running);
- remove the obstacles of the housing market development, whereby the process is to be coordinated materially and timewise (protection and transfer of the private ownerhsip of apartments, price control, legislative provisions pertaining to rent and the deregulation of rent and prices of services associated with housing, tax conditions, loan instruments, the selectivity of subsidies, address the issue of sharing, among all the partners, the risk associated with the real estate market, notably, in loans, etc.);
- prompt the developmental policy of communities and regions in mutual economic and social relations (including housing development) and a stepwise elimination of obstacles (property record-keeping, property tax, land policy, investment policy, tax policy, technical infrastructure, upgrading the services associated with housing, the issues of the position of local and state monopolies, price deregulation, energy savings, etc.);
- enhance the legal awareness of citizens and their personal liability through active participation in addressing the housing needs (new housing construction and running of the existing housing stock);
- fine-tune and enforce a record-keeping system of all the data that are essential for decision-making and correctional ammendments of the housing policy instruments while in effect;
- The above fundamental conditions of transformation call for a speedy setting up of a working group composed of the representatives of relevant ministries, MPs of the parliamentary committees which it concerns, experts on the individual issues, the representatives of towns and communities, the banking sector, building housing cooperatives, the association of apartment owners (condomenia), etc., which shall be instrumental in:
- the fine-tuning of the State housing policy
- assigning individual tasks and coordination of their schedule in collaboration with the relevant institutions;
- monitoring the meeting of assigned tasks with a view to elimiminate the obstacles that are bound to emerge in the process;

- ensuring the start-up of citizen public education, the objective being the understanding of the implementation of transformation steps (public discussions, involving mass media, conference, workshops, etc.).

Standard of Living

Peter Pažitný
M.E.S.A.10

The overriding priority of a market economy is the enhancement of the standard of living of citizens. The socioeconomic impacts of the transformation of economy have negatively affected the quality of life. Statistical data and public opinion polls are an evidence of the failure to meet social objectives of the society's development. To date, the expectations of citizens that by the transition to a market economy their standard of living will rise, after a short period inevitable for the adaptation of the Slovak economy, have not been met. The disproportion between needs and consumption persists, and a significant portion of needs is either neglected or met unsatisfactorily. The changes in the society have loosened up and distorted morale in all areas. An ever-greater number of citizens learns from their experiences what the concerns about the financial well-being of their families entail, not to mention the fear for the lives of their relatives.
The program declaration of the third V. Mečiar's government, of January 1995, states that: *"A conceptual and comprehensive approach of the government shall be, first and foremost, directed towards the establishment of balance in the development of the economic, social, and culture potential of the society on the one hand, and the status of citizens on the other. This entails a speedy solution of the topical social problems of people, a social policy that shall eliminate and observe the social consequences of the inevitable structural changes of the society, and the establishment of long-lasting fundaments in the social area for decades to come, in line with the standards attained in international and European social and legal cultures."*
A truthful comment on the present-day situation in the standard of living is found in *Hospodárske noviny,* of October 6, 1998: *"The former coalition-members (meaning Mečiar's cabinet) assert that the Slovak economy is stabilized, ignoring the fact that an ever-growing number of companies reports a loss, the unemployment rate hits a record notch of 14 per cent, there have been numerous lay-offs in the Slovak engineering plants in recent weeks, the non-payment of wages, and that 55 per cent of the citizens of Slovakia live on the poverty line..."*
For four years, marcoeconomic indicators served as a fetish for the ruling trio, concealing innumerable cases of diplomatic stumbles and political missteps, not to mention economic distortions. From among the reform Central-European countries, consumer prices increased in the most moderate fashion, the nominal wage growth reported two-digit increments. Statistically, the standard of living went up. However, the standard of living cannot be reflected in some perked-up macroeconomic indicators, whose glitter took a heavy toll in the form of enormous indebtedness, especially towards foreign countries.

The Quality of Life

Although the data on social development are generally known, let us mention at least the most important ones. The most significant indicator of the standard of living is personal consumption. From the economic standpoint, its amount and quality are vitally affected by the population's income. The family budget statistics that monitors income and expenditure, while taking the development of consumer prices and costs of living into account, reports a steady drop in real income. The 1997 real income per capita for all the households was reported to be only 79.1 per cent of the 1989 income. Compared to 1989, the government

social policy in wager-earner households accounted for a 37.5 per cent drop in the 1997 social income. The fact that the growth of money income did not cover the growth of the costs of living resulted in a purchase slump, undesirable restructuring, and an overall deterioration in meeting the basic living needs.
The social situation, notably of the young people starting their own families, is adversely affected by the deficiency of affordable apartments. In 1990-1997, only about 100,000 apartments were built, whereby the demand was more than a double (refer to Housing Policy).

Wages, Income, Savings, and Tax Burden

In conjunction with the household income development, it is important to state several facts related to wage-earning income, which represents about 82 per cent of the total income in the wage-earner families. Wages are the fundamental social security for wager-earner families. The average nominal monthly earnings of a wage-earner in the national economy was reported to be SKK 9,226 in 1997, and its real value was by 10.6 per cent lower than in 1989.

Table 57
Nominal Average Monthly Earnings

	1994	1995	1996	1997	6/1998*
Industry	6,501	7,489	8,583	9,533	10,745
Building ind.	6,530	**7,**503	8,737	9,953	10,425
Trade	5,007	5,668	6,911	8,051	8,153
Transport	6,561	7,735	8,865	10,032	9,728

Source: Statistics Office of the S.R.

The average monthly earnings are among the lowest in the countries in transition. Compared to the V4 countries, the situation in Slovakia is not particularly encouraging, as both Poland and the Czech Lands managed to exceed the USD 300 limit of monthly earnings in 1997, while the average monthly earnings of the Slovak citizen were reported to be USD 286. Given the hitherto development of the Slovak economy, the risk is that the S.R. becomes a repository of cheap labor, not only relative to the strong capitalist economies but also the most advanced countries of former Yugoslavia and the V4 countries.

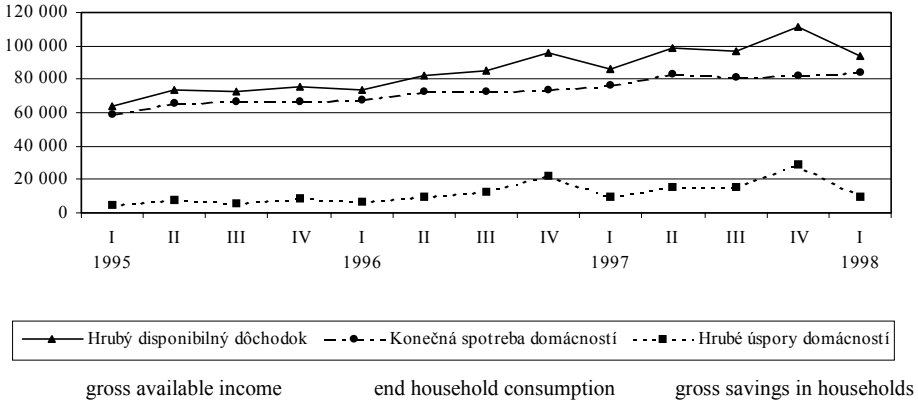
Table 58
Average Monthly Earnings in USD

	1996	1997	1998
Slovenia	605.6	569.8	637.9
Poland	341.9	331.8	328.2
Czech Republic	356.3	336.7	355.5
Slovakia	**265.5**	**275.2**	**256.0**
Hungary	198.3	203.7	247.5
Russia	157.2	166.8	166.3
Rumania	103.8	86.9	96.8

Source: Standard & Poor's, 1998

The net income from a wage-earning activity is adversely affected by the ever-growing tax encumbrance of the wage-earning revenues. Since 1994, the non-taxable income, tax-deductible items, and tax brackets have remained unchanged, although the inflation rate and average wage have been steadily growing, which aggravates the tax burden of wage-earners and reduces their net wage-earning income. In wage-earner families with children, this "social" tax policy reflects a rather poor interest of the government in the family. Since 1994, the nominal wage growth has been roughly 60 per cent, the tax encumbrance of citizens, due to unchanged tax brackets and growing nominal wages, increased by about 80 per cent.

Graph 8
Income, Consumption, and Savings Curves



Hence, if the government gears its policy towards macroeconomic indicators and is reluctant to improve the conditions for enterprise, this will be reflected in the standard of living of citizens, which is bound to deteriorate due to the ever-growing tax encumbrance and price increase. Nominal income is closely linked with consumption and savings figures. During 1995-1997, the consumption curve did not contour the income curve and the latter reported a markedly lower dynamism of growth.
In 1995-1997, a significant propensity to savings was reported, and savings accounted for almost a sixth of the household income in 1996 and 1997. In the given period, a dramatic increase of nominal earnings was reported in Slovakia, a relatively stable price increase around 6 per cent, and especially a marked increase of interest rates, which the majority of families appreciated as a deposit-making signal. However, this phenomenon changed in 1998, when families, apprehending changes, prioritized consumption and used their savings to purchase tangibles.

Table 59
Propensity to Consumption and Propensity to Savings (%)

	1996	1995	1997	I/1998
Propensity to consumption	85	90	84	89
Propensity to savings	15	10	16	11

Source: Statistics Office of the S.R.

Table 60
Year-on-year Growth of the Average Nominal Monthly Earnings (%)

	95/94	96/95	97/96	98*/97
Industry	15.2	14.6	11.1	8.7
Building ind.	14.9	16.4	13.9	9.6
Trade	13.2	21.9	16.5	15.8
Transport	17.9	14.6	13.2	7.4

Source: Statistics Office of the S.R.
** 6/98*

Table 61
Year-on-year Growth of the Average Real Monthly Earnings (%)

	95/94	96/95	97/96	98*/97
Industry	5.2	8.4	5.6	1.3
Building ind.	4.9	10.1	7.9	2.1
Trade	3.4	15.3	9.8	7.9
Transport	7.7	8.5	6.1	0.1

Source: Statistics Office of the S.R.
** 6/98*

A slow-down in the growth of nominal and real earnings (refer to the Table), growing unemployment, ever-increasing tax encumbrance, and the consumer price increase encourage the propensity to consumption. This phenomenon was also corroborated by a public opinion poll conducted by Názory Inc. (Opinions) agency, conducted in July, which focused on the topical income situation of the citizens of the S.R., and their expectations in terms of their own standard of living. The question "Can you possibly save anything from your monthly earnings?" was answered negatively by almost a half of Slovak citizens (48 per cent), a third (32 per cent) managed to save sporadically. Only the smallest portion, 20 per cent, was able to save a certain amount on a monthly basis. A fifth of the respondents stated that it had happened to them that year, their income did not suffice to purchase staple groceries and pay monthly bills. As much as 38 per cent could not afford to buy other goods of daily need.

Table 62
Household Expenditures in %

Year	1989	1995	1996	1997
Foodstuffs, beverages, board	38.6	40.3	40.0	40.7
Non-foodstuff products	43.1	35.3	36.2	36.4
Services	18.3	24.4	23.8	22.9

Source: The Ministry of Labor, Social Affairs, and the Family of the S.R.

Since 1989, the population's consumption habits have been impacted by the consumption basket restructuring, whereby meeting nutrition and housing needs was given a priority. This trend did not change during Mečiar's government, on the contrary, it deteriorated, and people increasingly live from one payroll to another, or, from hand to mouth.
According to the government program declaration *"The measures of economic and social policies as part of the overall government policy shall be directed towards the starting of a lasting trend of cutting the share of the population's grocery expenditures which currently account for 38 per cent of the overall consumption expenditures, by at least 1 per cent annually, on a long-term basis"*. Judging by this statement, food expenditures in 1998 were then expected to account for 34 per cent of the total expenditures (given the envisaged expenditure cut in groceries by 1 per cent annually was maintained). The real 1998 situation was far worse, as grocery expenditures exceeded 41 per cent. The commitment made to the citizen in January 1995 was not met, on the contrary, the citizens were bound to spent more money on groceries than in 1995.

Table 63
Net Monthly Income per Capita

Year	1989	1993	1994	1995	1996	1997	1998*
Net monthly earnings per capita	1,792	2,822	3,178	3,454	3,937	4,652	4,990

Source: Source: Ministry of Labor, Social Affairs, and the Family of the S.R
**Second quarter of 1998*

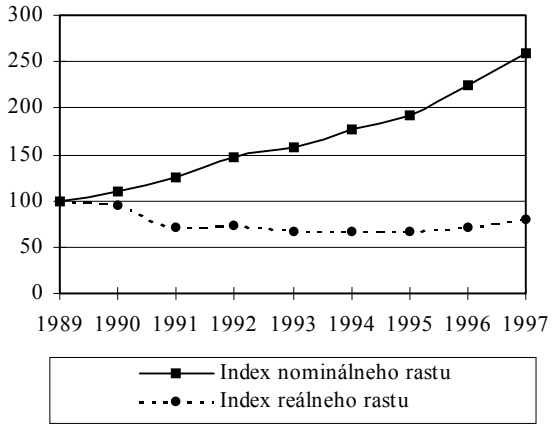
Table 64
Nominal and Real Earnings Growth Index

Year	1989	1993	1994	1995	1996	1997
Nominal growth index	100.0	157.5	177.2	192.7	223.4	259.6
Real growth index	100.0	67.0	66.4	65.9	72.2	79.1

Source: Source: Ministry of Labor, Social Affairs, and the Family of the S.R.

The net monthly income has been growing ever since 1989, although in 1994-1998, its increment reported a slump in dynamism. A breakthrough in the real earnings development was reported in 1996, when, for the first time since 1989, the year-on-year index of real wages reported a positive increment.
It is obvious that the increase of the real net monthly income per capita does not contour the dynamism of the nominal net monthly income curve. Nominal income reports a regular increment which is induced by the increase of hourly earnings, the latter, in turn, contouring the consumer price increase. This could create a false impression that the standard of living in Slovakia has gone up dramatically.

Graph 9
Nominal and Real Net Monthly Income



Nominal growth index
Real growth index

However, the situation is different. A significant indicator of the growth of the standard of living is the real net monthly household income curve. Until 1995, the curve had been steadily declining. However, since 1995, it has been reporting a very moderate increase, although the society is far from reaching the 1989 standard of living.

Unemployment

Mečiar's government addressed the grave problem of unemployment with its typical enthusiasm, and in its program declaration, it stated the following goals: *"We shall upgrade the current, and especially, new instruments of an active labor market policy, so that the 1995 unemployment rate does not exceed 15 per cent on the average, and in the years to come, it shall be gradually reduced below 10 per cent".* Only a fraction of the above bold pledge came true. Indeed, Mečiar's government managed to partly reduce unemployment, however, at the expense of changing the methodology of the unemployment rate computation, and currently, unemployment rate reports alarming figures just below 15 per cent.
High unemployment is a grave nationwide, socioeconomic problem of the Slovak economy. The unemployment rate in the independent S.R. is about 14.5 per cent. High regional unemployment is a specific problem, and in places, it exceeds 30 per cent.
A long-term unemployment and the unemployment of young people is especially worrying. Long-term unemployment puts the individual and his/her surrounding at risk and induces socially undesirable phenomena, such as detachment from work and the society, poverty, and moral risk.

Income Differentiation

Prior to taking up office, even Mečiar's cabinet realized that the standard of living declined steadily, and in conjunction with social relations, the following is stated in the program declaration: *"The hitherto development of the social standard of people has largely entailed negative impacts upon the standard of living, social assistance to citizens, risk to families, and social injustice in the funds generation and distribution has deterioraed".*
The availability of funds and liberal income, notably the wage policy of the State in the entrepreneurial area, accounted for a disorderly transition from income egalitarianism to an

unhealthy income differentiation. Wage policy which did not utilize the State instruments to guide individual remuneration (minimal wage, minimal salary scales), introduced an unjustified and unfair wage differentiation. The rapid wage growth of top and middle management and other persons in the company's management contradicts the low company performance and is among the forms of the company asset-looting. Income differentiation per se is not a negative phenomenon in a market economy. Rather than the fact that it exists, the unfairness of this differentiation lies with the fashion in which it originated, when a certain group of people has an opportunity to acquire a great deal of assets practically for free (refer to the Privatization Chapter).

Table 65
Income Differentiation

Cumulative % of Households	Cumulative % of income		
	Ideal	1992	1996
0 %	0 %	0 %	0 %
20 %	20 %	12 %	10 %
40 %	40 %	28 %	26 %
60 %	60 %	46 %	44 %
80 %	80 %	68 %	66 %
100 %	100 %	100 %	100 %

Source: Ministry of Labor, Social Affairs, and the Family of the S.R.

The differentiation of the income in Slovakia is quite dramatic; in 1996, as opposed to 1992, it even worsened. This income differentiation is obvious from the following example. The poorest 20 per cent of households dispose of 10 per cent of income. The richest 20 per cent dispose of over a third of income, i.e. 34 per cent. It may be assumed that this trend also continued in 1998, when the government, through its policy, consciously established a group of multimillionaires and a large group of the poor. Obviously, no one ever thought of such a socially-conscious policy, not to mention the population of the socially vulnerable regions, such as Revúca, Rimavská Sobota, Veľký Krtíš, Rožňava, or Sabinov.
A hypothetical case of absolute egalitarianism is when all the income is distributed evenly amongst all the households, and a hypotetical case of total unequality is when one group of households claims all the income.
The fact that this differentiation grows is evidenced by an ever-growing share of the income of the households with the highest income in the income of the households with the lowest income. While in 1992, this ratio was only 2.6, in 1996, it was 3.4. As distinct from 1992, the share of all the groups in the low-income level went up. In 1992, about 80 per cent of all the households were at the middle-income level. In 1996, the figure was only 26.5 per cent, which is three times less. This trend was especially obvious in the last two years of Vladimír Mečiar's government – the unemployment rate sky-rocketed and several companies, especially engineering ones, were forced to dismiss their employees.

Consumer Prices

The development of annual inflation expressed in the mean annual consumer price indices in the years 1994-1998 may be positively evaluated, as through restrictive measures, the

government managed to gradually decrease the two-digit inflation below 6 per cent. The secret of this success is largely in an excessive control of heat, fuels, transportation, and rent. Since 1994, compared to 1989, the consumer price dynamism has markedly weakened. In 1994, consumer prices increased by 170 per cent as opposed to 1989, while in 1997, the reported price increase was 240 per cent as opposed to 1989.
The increase of consumer, goods, and service prices markedly impacted the increase of the costs of living of households. Since 1989, costs of living have more than doubled.

Table 66
Costs of Living Index (previous period = 100)

Parameter	1993	1994	1995	1996	1997	1998
Costs of living index	123.2	113.4	109.9	106.1	107.3	107.3

Source: Ministry of Labor, Social Affairs, and the Family of the S.R.

Since 1993, the increment of the costs of living index has been downward sloping, which is caused largely by a low increment of consumer prices.

Purchasing Power

The growth of nominal earnings, consumption and consumer prices growth do not give a true picture of the purchasing power issue. Purchasing power is best comprehended from the comparison of the time period required to purchase a product or service among the V4 countries.
The Slovak has to work 196 hours to get the same consumption basket as the Czech who needs to work 181 hours, the Hungarian 158 hours, and the Pole only 93 hours. The evaluation of purchasing power reflects the mutual income-price effect, i.e. what the citizen can afford to effectively purchase for his money. Using this comparison, the situation is far from what the comparison of macroeconomic indicators offers. The Slovak must work twice as much as the Pole to buy the same assets.
This order test places our country last, and the Slovak citizen will buy cheaper only those products that are subsidized by the State, or whose prices are controlled by the State, such as power, city transport tickets, railway tickets, and fitter work. The Slovak must work longest to buy groceries, clothing, and gas. The bold words of Vladimír Mečiar about Slovakia becoming second Switzerland have been invalidated, since in terms of purchasing power, Slovakia can hardly compete with its neighbors, such as Hungary or Poland.

Regional Differentiation

The low productivity of regions is closely related to their unfavourable situation in the regional wage differentiation. The persisting overall drop in real wages, compared to 1989, not only indicates an economic deterioration of regions, but also a crisis of their production performance.

Table 67
Working time necessary for the purchase of products or services, by countries (in minutes)

Product, service	Czech Lands	Slovakia	Croatia	Poland	Hungary	Austria
Milk (1l)	11.85	19.52	10.43	13.10	12.90	3.30
Bread (1 kg)	16.30	22.02	14.72	8.70	15.42	3.12
Bun (1 pc)	1.76	3.47	5.35	1.58	1.43	0.70
Potatos (1 kg)	6.78	10.42	10 .70	2.88	6.22	1.88
Butter (25 dag)	24.70	40.50	30.80	18.78	28.03	6.45
Coffee (25 dag)	43.48	98.00	66.00	46.96	69.00	7.65
Leg of beef (1 kg)	131.00	177.00	96.00	100.00	119.00	30.60
Pork chop (1 kg)	139.00	196.00	104.00	105.00	129.00	23.25
Meal in restaurant	148.00	208.00	214.00	216.00	115.00	67.00
Marlboro (pack)	45.00	55.00	34.00	28.00	38.00	12.00
Cheapest local cig.	35.00	32.00	22.00	18.00	22.00	10.00
Local beer (0.5 l)	9.86	13.32	10.70	15.90	10.47	2.75
Ladies' dress	3,428.00	3,869.00	2,678.00	1,450.00	2,954.00	547.00
Men's suit	4,744.00	5,260.00	4,285.00	2,529.00	3,932.00	1,094.00
Men's shoes	1,482.00	1,112.00	939.00	578.00	1,284.00	244.00
Electricity (1 kWh)	2.36	1.13	2.67	5.20	2.57	0.52
Natural gas (1 cu. m)	2.95	3.47	4.17	1.65	4.62	1.67
Brick (1 pc)	5.90	7.07	7.65	1.83	3.93	1.67
Cement (1 bag)	247.00	224.00	134.00	115.00	145.00	43.47
Natural gasoline (1 l)	22.03	25.47	11.50	13.58	23.15	3.47
Local post stamp	4.53	4.63	3.47	2.88	4.13	2.13
Local phone call (3min)	2.22	3.82	0.67	1.36	4.13	0.73
Local municipal transport ticket	11.18	8.03	13.67	7.22	8.77	5.20
Drycleaning – suit	69.00	138.00	242.00	122.00	132.00	42.00
Railway ticket (100 km)	52.00	50.92	72.00	96.00	76.00	39.00
Fitter work (1 hr)	168.00	173.00	243.00	216.00	298.00	245.00
Total in minutes	10,853.90	11,755,79	9,255.50	5.714.00	9,438.00	2,438.56
Total in hours	**180.9**	**195.9**	**154.3**	**95.2**	**157.3**	**40.6**

Source: Selekt, Cestat

Table 68
Average Monthly Earnings, 1st Half of 1998

Region	Average monthly earnings for 1st half of 1998 in SKK	Percentage share against S.R. average in %
S.R. total	9,677	100.0
Bratislava region	12,331	127.4
Košice region	9,663	99.9
Trnava region	9,001	93.0
Banská Bystrica region	8,813	91.1
Trenčín region	8,738	90.3
Nitra region	8,357	86.3
Žilina region	8,578	88.6
Prešov region	7,932	82.0

Source: The Trade Unions Confederation of the S.R.

In the first half of 1998, of the eight regions, seven reported an average wage lower than the nationwide average!!! From the viewpoint of average earnings, a crisis situation was reported in the majority of counties of Prešov, Banská Bystrica, Žilina, and Košice regions. Needless to say, the above regions have held long-term records in unemployment.

Conclusion

An objective measure of the country's prosperity, and in our case, of the success of the transformation process, is the living standard of its citizens. The development of some of the living standard parameters in Slovakia indicates that the preconditions for its growth are gradually being established. However, these positive trends cannot be overestimated. Among the gravest problems in the living standard of Slovakia are clearly a high unemployment rate, a low purchasing power parity, income differentiation in the income area, the quality of housing, and regional differences.

The statistical growth of the standard of living promoted by macroeconomic indicators used by Mečiar's "experts" is humorous, compared to the daily struggle of citizens for survival. Humour, in most cases, is hidden behind tears. A high regional unemployment, unclear future of many companies, and the non-payment of wages for several consecutive months, increasingly calls for radical measures in the form of strikes and protests on the part of trade unions.

Under Mečiar's government, economic differences among Slovak regions became even more apparent, which, naturally, impacted the living standard. Only several regions back-up the Slovak economy. In addition to Bratislava, it is Banská Bystrica to which a great portion of financial services has been transferred, Trenčín, largely the city of food industry and engineering industry, or Trnava county with the Jaslovské Bohunice nuclear power plant and pharmaceutical plant at Hlohovec, the only thriving region of East Slovakia is Košice. Disregarding the above regions with comparatively high nominal wages and a low unemployment rate; literally hunger valleys begin to emerge in Slovakia, with both the adults in the family being unemployed and their future looking anything but optimistic.

In terms of the expectations of the living standard development by the year 2000, the expectations of citizens are not optimistic. The greatest percentage of citizens (33 per cent) assumes that their standard of living has remained unchanged. 28 per cent expects deterioration of their living standard, while only 23 per cent expects improvement.

The Trade Unions Confederation of the S.R. persistently and repeatedly pointed out the existing problems and causes of the serious economic and social crises. It pinpointed the non-existence of microeconomic policy fostering the competitiveness of Slovak products, the non-workable privatization, and a low inflow of foreign capital in direct investments (highly productive technologies). However, the government of the S.R. disregarded the opinions and recommendations made by the trade unions. The procedural and material injustice lead to narrowing down the tripartite negotiations to perfunctory bargaining which discontinued the social dialogue in the Council of Economic and Social Contract of the S.R. (a stimulus to that was the approval of wage control without prior negotiations with the trade unions).

Increasing the standard of living is a long-term and painful process which may also entail unpopular measures. These may be mitigated by various compensatory measures for the socially most vulnerable groups of citizens. It is necessary to implement several reform steps that shall be especially directed towards:

- increase of real wages
- decrease of unemployment
- recovery of housing construction
- changing the system of continuous funding of pension schemes to the fund scheme
- easing off tax burden
- reform of the social and health systems
- increase of the purchasing power parity
- elimination of regional disproportions.

CONCLUSION

Starting Points and Outline of Recovery Program

M.E.S.A.10

The Slovak economy in the period of 1995–1998 can be characterized in two ways. One is political and it was chosen by the previous government coalition emphasizing short-term success and macro-economic achievements compared to other countries of the former ‚soviet bloc‘. The other one is professional discussed by a number of groups of independent economists and institutions warning that the methods of achieving „economic miracle“ in Slovakia is not sustainable, that the economic growth of Slovakia is lacking quality and it is achieved at the expense of increased internal and external debt and at the expense of quality of public services. The period of V. Mečiar‘s third government was also marked by deteriorating foreign balance of trade.

The biggest problem of Slovak economy is the fact that business community failed to adjust to external conditions, also „thank to“ framework conditions in Slovakia, mainly of legal and institutional character, not supporting the development of market forces. Just the opposite, business environment was distorted. The privatization method and preference of short-term yields to long-term development resulted in the failure to create a suitable ownership structure. By excluding foreign capital from the process, privatization contributed neither to the change of structure of the Slovak economy, nor to the increase of its competitiveness. This was reflected in the unchanged production and export structures still dominated by goods with lower added value.

The period of 1995–1998 was noted for a high level of investment, especially by the State. The investment was targeted mainly to infrastructure projects with long-term payback period. But these projects did not bring the promised short-term effect of jobs creation either. The unemployment rate was increasing throughout the entire last year. Arguments claiming that highway construction creates conditions for capital entry are correct only to certain extent, as due to the construction concept and required links with European routes they will only bring along increasing regional disparities.

Economic policy of V. Mečiar‘s government did not create conditions for healthy business environment as it was focusing on strengthening state influence over private sector. Privatization, political and economic power links, subsidy schemes, support programs, all of that resulted in the growth of „clientelism“ and corruption. Support and privileged treatment of large companies at the expense of creating conditions for development of small and medium size business resulted in increased unemployment, increased regional disparities, and it did not bring about production restructuring, job diversification or conditions for better use of human and natural potential of Slovakia.

Expansive budget policy contributed to elimination of private investment and limited access to business loans.

V. Mečiar‘s government actually liquidated capital market and distorted basic legal framework of the society and economy. It did not create an environment facilitating growth of competition and continuous growth of Slovak economy. On one hand, it failed to provide citizens with constitution guaranteed public services (schools, health care, social issues, transport, ..), on the other hand, it interfered more and more with private services and

liquidated third sector (NGOs) initiatives. By centralizing the state administration, supporting subsidy schemes and growing state bureaucracy, it supported the growth of corruption and preferential treatment of political supporters. To the objective of linking economic and political powers the government adjusted even the first steps of public administration reform. By creating regional and district offices and other specialized networks it created a system that is by 25 per cent more expensive for tax payers than the original public service provision by individual ministries.

Competition protection and transparency in economy were weakened substantially, there was neither a clear definition nor any efficient regulation of natural monopolies.

V. Mečiar‘s government was unable to ensure optimum functioning of the economic system and to maximize its effects. In other words, the ruling coalition was unable to utilize production, human, and natural potential. Just the opposite, it managed to devastate it in a way reminding the socialist period. The increasing differentiation of population income caused by the growth of „clientelizm“ and corruption, and the perverted redistribution of revenues resulted in increasing growth of risks in economic, social, and moral areas, fully oppressing the conditions of a successful society, such as justice and morale. Injustice and inefficiency of the redistribution system could be felt more and more in the areas of income and social insurance, or financing of schools and health care.

Responding to the fact that Slovakia was left out from the first group of countries, V. Mečiar‘s government argued by excellent economic results achieved and by blaming opposition for the drop out of Slovakia caused by their ‚destructive“ policies. This book proved the truth to be somewhere else. It seems that elimination of barriers in political area is going to be much easier than correction of economic distortions left behind by V. Mečiar‘s government and its full four year term in power.

Authors of a number of chapters in this book indicated measures to be taken by the current government in order for Slovakia to set on the road leading to prosperity. The following section offers a summary of proposals made by individual authors in their relevant chapters. In the conclusion we tried to outline broader context. It is our opinion that only within this context it is possible to stabilize and create framework conditions for economic development of the country and for improved standard of living of its citizens.

A summary of measures supporting recovery of Slovak economy

RECOVERY OF DISTORTED COMPETITIVE ENVIRONMENT

- To introduce and apply law compliance, including law enforcement instruments
- To strengthen payment discipline compliance controls
- To ensure creditors’ rights
- To create conditions to start off transparent bankruptcy proceedings for loss making and failing companies.
- To eliminate conditions allowing for growing favoritism and corruption, and to conduct analysis of personal and capital links among businesses in respect of market competition structures
- To minimize the influence of the underworld on the business activities
- To eliminate the influence of industrial lobby on the economic policy of the government.
- To pursue protection of minority shareholders
- To consolidate situation in strategic companies
- To support market mechanism by minimizing the government share in the economy.

- To attract foreign investors.

COMPETITION PROTECTION

- To strengthen the independence of 'PÚ SR' (Anti-monopoly Office) by establishing a collective decision making body
- To introduce a duty to publish decisions taken by 'PÚ SR', while complying with the business confidentiality rules,
- To strengthen competition advocacy,
- To adopt legislation regulating specific areas of competition, or expanding areas under competition pressure, i.e. creating regulatory framework for natural monopoly, licensing, making state assistance transparent,
- To make the Slovak Republic involved in the integration process in the area of competition protection.

CORRECTING DISTORTIONS OF PRIVATIZATION PROCESS

- To review legitimacy of individual privatization cases, to assess the appliance of public interest, and to impose sanctions in the case of law violation found ,
- To continue in privatization under public supervision with the option of reviewing privatization decisions by courts,
- To adopt legislation amendments to ensure reporting lines and exercise of ownership rights of the State among all the institutional elements of the privatization process,
- To elaborate and publish a registry of privatized assets,
- To abandon bearer type of shares,
- To review the definition of strategic interest of the State and State interest in the sectors of energy, telecommunications, machine engineering, transport, road infrastructure, schools, spas, water management, as well as state ownership of agricultural and forest lands, and to review the participation of local and regional self-government and private sector in these industries,
- To create preconditions for the entry of foreign investors, especially strategic investors, in the process of de-etatization or privatization,
- To ensure that privatization is under control of the Supreme Audit and of prosecutors office.

INDUSTRY

- To create institutional preconditions for the launch of real restructuring of industry in the direction of increasing the share of sophisticated productions with high added value,
- To restructure, stabilize, and solve industry crises, to increase export, to reduce energy intensiveness, to improve labor productivity and increase added value ,
- To speed up restructuring of machine engineering mainly, to review the defense system in accordance with the State safety policy, mainly via support programs recommended by EU and OECD,
- Having considered the crisis of engineering and in other industries, it is inevitable to develop and start implementing conversion programs in all the regions hit by the crisis, on three parallel levels: conversion of companies, conversion of people – employees, and

conversion of the territory . All this on the basis of regional concept policies with targeted and co-ordinated support of European Commission programs,

- To support creation of environment favorable for entrepreneurial initiatives, and to utilize comparative advantages of Slovak industry with the objective of increasing real growth of industrial production,
- To develop models and assisted by foreign capital to establish industrial zones, scientific and technology parks with the objective to create suitable conditions for the implementation of structural changes and economic development policies,
- To adopt legislation and economic support for energy savings and use of reusable energy sources with the objective to reduce real consumption and reliance of imports of the above mentioned sources.

MACHINE ENGINEERING

- To prepare a new starting line for businesses in engineering and for foreign capital entry, via measures such as capitalization of receivables and launch of bankruptcy proceedings,
- To support small and medium size businesses using foreign funds and making unused fixed assets available, and by simplifying the lending mechanism,
- To spread the use of cashless instruments of financing such as bills of exchange, drafts, and warehouse papers.

SMALL AND MEDIUM SIZE BUSINESSES

- To eliminate legal, and organizational barriers for SMEs development.
- SMEs growth conditions to be coupled with the extinction of no prospects activities to allow the transfer of workforce.
- To simplify legislation, publish full versions of laws with multiple amendments, produce law interpretation.
- To create motivating business environment by reducing tax and contribution payments burden
- In granting contracts and appropriating centralized funds follow transparent procedures, respect equal chances.
- To target Government assistance and possible foreign funds mainly to the support of starting small businesses (developing business plans, legal and financial counseling). In respect to providing discounted lending schemes ensure efficient control over their utilization.

BANKING SECTOR

- To tighten banking supervision in order to stop the unfavorable development in some banks,
- To speed up the restructuring process in banks,
- To develop special rules for lending, securities trading, dividend payments, purchase of real estate, and provision of sponsorship for banks included in the restructuring process,
- To consider the option of State participation in selected restructured banks with the objective to recover their loan portfolio,
- To contribute to capitalization of banking sector via foreign investors,

- To increase accountability and responsibility of Directors (Board members), Supervisory Board members, and executive management for business performance and executed transactions,
- To make owners of the banks visible in order to prevent the abuse of their exclusive position in executing bank financial operations,
- To create legislation and institutional framework for the existence of a more efficient financial sector regulation.

CAPITAL MARKET

- To develop and adopt capital market legislation compatible with EU legislation,
- To re-codify Securities law, to draft a new law on collective investment, and legislation needed to establish an independent regulatory body to supervise the entire financial market,
- To create legal and institutional framework for the development of collective investment, mainly for investment, unit, and pension funds, and thus eliminate the existing distortions in collective investment,
- To introduce measures motivating population to invest on capital market via collective investment bodies or individually,
- To improve information flows mainly from issuers of publicly traded securities,
- To undertake steps to improve the level of desired market liquidity and to eliminate de-motivating tax regulations,
- To abandon bearer type of shares in order to make the ownership of privatized assets transparent and to prevent conflict of interest.

UNEMPLOYMENT

It is not enough to concentrate on an interim solution in the form of public works, socially purposeful jobs, or retraining. These instruments are capable of reducing unemployment rate by two per cent at maximum. A more substantial decrease can be achieved only by a targeted economic and regional policy with measures supporting mainly the following:

- new jobs creation
- industry restructuring
- diversification of regional industrial bases
- tax and financial motivation of businesses to create new jobs
- increased investment into undercapitalized economy
- employment policy solutions should be shared by the State, regions, and municipalities
- mobility of workforce via rental housing development
- creating tax and legal conditions for the self-employed
- simplify and facilitate access to funds via conceptual lending policy

FOREIGN TRADE AND FOREIGN INVESTMENT

- To create legal framework to increase interest in the entry of Foreign Direct Investment via bilateral agreements on support and protection of investments, preferably with OECD and EU countries and countries with intense foreign trade with Slovakia,

- To make better use of raw material and material from local sources, using protection measures in compliance with WTO provisions,
- To make transparent, to review and to abandon laws and regulations allowing for preferential treatment of narrow groups at the expense of the majority of the others (law on revitalization, Foreign Trade Support Fund, discharges of tax, interest, duties, and sanctions)
- To make transparent and to publish granting of licenses, import and export quotas via public tenders and auctions,
- To develop a comprehensive program of export focusing on transparent application of economic instruments to increase export performance and information dissemination to businesses, especially SMEs with the objective to improve conditions for new markets penetration,
- To review the powers and responsibilities of state administration (national government) to improve co-ordination and effective use of instruments and means of EXIM bank, Foreign Trade Support Fund, and other institutions with the objective to improve export performance of the Slovak Republic,
- To support the project of incorporating Slovak businesses in the international network of Trade points, as well as formation of World Trade Center (WTC) in Bratislava.

HOUSING POLICY

- To clarify roles of potential partners (the State, citizens, private sector, public sector, non-profit making sector)- this follows from the need to transform housing policy with the objective to make the entire process transparent and to maximize the possibilities of public-private partnership in the stage of developing, implementing and operating the houses based on the conditions of housing market (real demand and supply
- To determine protection rules related to the social aspect of housing,
- To reflect the above stated tasks in the legislation and support financial, taxation, and subvention instruments and in the social policy (review of the existing housing saving scheme, State fund for housing development, support system for mortgage lending, support grants for housing reconstruction, etc.),
- To optimize conditions of the use of government funds in the overall housing process (construction and operation),
- To eliminate barriers of housing market development in material and time co-ordination (protection and options for transfer of private ownership of houses and apartments, price regulations, legislation on renting, deregulation of rental and price for services related to housing, activating private and non-profit making sector,....)
- To activate development policy of municipalities and regions by eliminating barriers (registry of assets, property tax, land-use policy, investment policy, taxation policy, development and operation of technical infrastructure, elimination of state and local monopolies,....)
- To increase legal awareness of citizens to increase their personal responsibility for active involvement in dealing with housing needs.

PUBLIC SECTOR DEBT

- In principle, to change the system of public sector funding (social system, health-care funding, and school system funding) and to improve efficiency of all the public expenditure both on the level of national government and the level of local governments,

- To define clearly a prioritizing method of the use of tax revenues in providing public services, and within them to prefer public consumption of the population to the consumption of the bureaucracy,
- To review the purposefulness and legitimacy of so called budgetary and contribution quasi-state organizations (the same applies to quasi-municipal organization)
- Within the national government (state administration) to introduce a system of Treasury in order to tighten financial discipline, and public funds management control
- To reduce substantially the scope of re-distribution of public funds from the state budget via a principal decentralization of public finance and via changes in the taxation system,
- To reduce tax load of businesses, as well as income tax for citizens, taking into account the tax burden of the low income groups of population,
- To eliminate the subsidy system lacking transparency,
- To make transparent and simplify financial flows from foreign support programs (EU) and to co-ordinate their use with the use of local funds,
- To reduce tax evasions and tax arrears via legislation, but mainly via legislation enforcement,
- To improve effectiveness and efficiency of public spending and to review the system f financing large infrastructure units
- To reduce substantially guarantees for private sector loans,
- To deregulate prices
- To abandon preferential treatment of individual economic industries,
- To limit administrative protection measures and quotas, to reduce customs duties in gradual steps,
- To simplify the licensing process for banks or small financial institutions (loans co-operatives...),
- To create conditions for foreign capital entry.

Conclusions

BROADER CONTEXT OF THE RECOVERY PROCESS

The recovery program for Slovak economy must be sought in broader context. For the economy a completely new framework conditions must be created, compatible with conditions of successful countries of the world. Successful countries of the world are countries where standard of living is several time higher than standard of living of citizens of Slovakia, where citizens of such a country do not have to toil to earn for basic vital necessities. These successful countries preferred a democratic system to an autocratic system, they preferred substantial reduction of central government position and they decentralized most of the central power and they empowered regions. Successful countries respect constitution, prefer competition of several political parties and above all they respect owners rights and individual freedom. Most of successful countries limit strong government social programs as they reduce motivation and make efficient utilization of funds available for municipalities (towns and villages) and regions difficult. Successful countries do not distort price system by government measures and they do not try to interfere with production processes from a position of one and the only ‘savior‘.

Only an environment with minimum level of centralization, bureaucracy, with minimum interference of public sector into private sector and with maximum involvement of the third sector (NGOs) in providing public services can facilitate a substantial reduction of

‚clientelizm“, corruption, it can increase transparency in the economy of Slovakia needed to improve its competitiveness and co-operation within the world economy.

Speaking about starting points for the economy of Slovakia, first of all framework conditions of its operations must be changed. This means that first of all institutional reform must take place requiring changes in both formal and informal rules of operation for public administration.. Principal changes are necessary in the area of legislation, starting from the highest level, i.e. Constitution of the Slovak Republic providing for certain rules incompatible with the rules of ‚successful countries‘. This applies both to the area of power distribution in the country, and to issues like various social rights. Equally important is the change of a high number of legislation related to information access, controls, processes implemented by public sector, public service provisioning. Of extreme importance is the adoption of so called informal measures of personal and educational nature, such as influencing public opinion, exerting public pressure via media with the objective to increase transparency of political, economic, social, cultural, and other relations.

Speaking about starting points for the development of economy of the Slovak Republic, it is necessary to eliminate communist regime inherited basic distortion of relations between private, public, and non-profit making sectors. It is inevitable to eliminate public sector interference in areas where it is not beneficial or efficient and where private or non-profit making sectors are much more effective. There is a need to eliminate distortions within the private sector for the benefit of small and medium size businesses, it is inevitable to eliminate too many powers and responsibilities undertaken by state sector of public administration (national government) at the expense of local government. Unclear relations of public, private, and „third“ sector are reflected in the increased cost of public administration, meaning a reduction of funds available for public spending. Monopoly position of public administration entities is detrimental to improving quality and eliminates any possibility to reduce prices via competitive environment. The not yet completed transformation of ownership and insufficient transfer of responsibilities from public sector to private sector, and within the public sector from state (national government) to local and regional self-governments does not allow for funds mobilization, does not support citizen activities, and it does not allow for efficient utilization of country potential. All the time it requires various government support programs, it prevents production restructuring and job diversification. All of that results in more and more new „hunger valleys“.

It shall also be inevitable to take different view on the role of central government – state level and the role of local and regional governments. The role of the state should be to support, audit, and organize, while local and regional governments should be responsible for ensuring every public service for citizens. Respecting current and predicted European and international trends of society development is inevitable for Slovakia with respect to its future membership in international structures. It seems to be much more reasonable, efficient, controllable, and therefore acceptable for citizens to make public services provided on local and regional level the responsibility of self-government on local and interest basis. Therefore one of the preconditions of a stable growth of the Slovak economy is a comprehensive reform of public administration as a basis and precondition of economic and political stabilizing of the country. This reform must consist of the following steps: segregation of support instruments and public administration, introduction of a principle of non interference between private and public sectors, review of the scope of services provided by public sector, and reorientation of the public sector from budget income side preference to budget expenditure control.

Unless the new framework is established, no positive change in the development of the Slovak economy can be expected.

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TREND, currently he is an editor of monthly DUEL and weekly TREND, as well as a co-operator with the daily SME. He was a founding member of F.A.Hayek Club ('Klub F. A. Hayeka') focusing on dissemination of ideas on liberal economics.

In the period of 1995-1998 M.E.S.A.10 issued the following publications:

- Privatization in Slovakia
- Development possibilities and restrains of the region of South-West Slovakia
- Economic conditions of local governments since 1990
- New system of local government financing in Slovakia
- New system of public administration financing in Slovakia
- Municipal financing