Slovakia's Threefold Transformation

Thursday 19 November 2020, by SCHMÖGNEROVÁ Brigita (Date first published: 22 October 2020).

The costly and long road to a modern state

The revolutionary political changes in the Eastern Bloc at the beginning of the 1990s brought about a threefold transformation in the Republic of Slovakia: 1. From a totalitarian regime to a liberal democratic regime; 2. From a state within a federation to a nation-state; and 3. From a centrally-planned economy to a market economy. The Slovak Republic was not prepared for any of these changes. Yet in the case of the first at least, which seemed the simplest, there were sufficiently precise, internationally-defined goals along with—in some cases—methods for implementing them. There was, in particular, support from among broad layers of the population.

Disintegration of the Czechoslovak Federation and the transition to a market economy were not the concepts which set the tone of the November 1989 mass demonstrations. Nor did the emerging political body representing Slovakia, the Public Against Violence (VPN), attempt to drive forward the breakup of the Federation. The VPN's ideas about the need for economic transformation were in any case very limited to start with, and included no more than the acceptance of private property.

The new political forces at the federal level began to prepare quite rapidly for transforming a centrally-planned into a market economy. This soon became known as the reform attributed to Václav Klaus, Leszek Barcelowicz, and, in part, Lajos Bokros. The reform programs implemented in the European post-socialist states, however—with the exception of Slovenia—were based on a single model that was more or less adapted to the conditions of each respective state. This model had been developed within the International Monetary Fund and the US Treasury, and was based on the principles of the Washington Consensus. It had been applied in the fight against hyperinflation in some Latin American states, and, although it was a success in this regard, its social consequences were devastating.

In short, the program for reform was an attempt to impose liberalization, privatization, and macroeconomic stabilization. Its ideological roots were to be found in neoliberal socioeconomic ideology. [1] The first question presenting itself then, is why were reforms based in neoliberal ideology? Secondly, it must be asked whether such a model was appropriate for states which had formerly been part of centrally-planned economies. The Austrian professor Philipp Ther, in his study Europe since 1989, writes that all of Europe was neoliberal by the 1990s. He even claims that neoliberalism's international hegemony at the turn of the millennium was more powerful than it had ever been.

Many, if not the majority, of European social democratic parties and their leaders (Tony Blair, Gerhard Schröder, Lionel Jospin, José Luis Rodríguez Zapatero) once in power were advocates of the Third Way. They wanted to "modernize the welfare state so that it does not die" (Schröder). However, they understood such modernization as a necessity for limiting the universal welfare state. This was, according to them, the inescapable answer to globalization. They did not think much at all about the necessity of "curbing" or controlling globalization. Worse still, these politicians accepted

in principle the economic policies enforced by the Right, known as TINA [2] The European institutions therefore supported the transformation model of the International Monetary Fund (IMF) and the US administration. The policy was "one size fits all". [3]

The political changes that led to the collapse of the Eastern bloc—as if it were a house of cards—took the West by surprise. Western universities housed institutes that were more or less capable of understanding the system of central planning and administration. If their officials had been approached by politicians, they could have prepared a transformation plan that would have taken into account the baseline situation of the planned economies. Characteristic of these societies, as the Hungarian economist János Kornai's analysis from 1979 indicated, was an economy of scarcity. That is, they were defined by the inability of planners to quickly identify the evolving needs of society and to ensure that they were met. Prices were artificially set, and failed to reflect costs or the relationship between supply and demand. Technical advances lagged. With the exception of military industry, the eastern states were unable to compete with the West.

All of this should have been considered when preparing the transition to the new system. Federal authorities did not respect the views of national bodies and experts in the Czech and Slovak Republics, like the chairman of the Czech government František Vlasák or Valtr Komárek, who argued against so-called shock therapy. Vlasák and Komárek supported instead a gradual transition, as did for example the Club of Economists of the Democratic Left Party SDL and the Association of Economists (NEZES) in Slovakia. Price liberalization in 1990, which was the first step in Klaus's tax reform initiated a year later, the transition to the market rate of the Czechoslovak koruna, the radical reduction of subsidies to businesses, and other such measures, all neglected to take into account the starting point of the Czech economy, much less that of Slovakia. The latter was characterized by market imbalances and a one-sided distortion of its production structure, in that it was specifically oriented toward heavy industry and exports to eastern markets.

The disintegration of the Council for Mutual Economic Assistance (CMEA) caused the collapse of the Czech and Slovakian export markets. The Slovakian economy was more focused on the east and therefore felt the consequences even more profoundly. Slovakian military industry accounted for 80 percent of Czechoslovakian military output; the swift, unprecedented, and regrettably unsuccessful transformation entailed the loss of 100,000 jobs at its outset.

The decision of the federal authorities led to the liberalization of foreign trade, in addition to the liberalization of most prices. Customs rates fell to a level that would have been appropriate for advanced market economies—just over 5 percent. Protection of the internal market, which was not exactly highly developed, broke down as a result of this decision and meant that domestic production was often displaced by products subsidized from the West, as was the case with foodstuffs.

The year 1990 and the first two years of the transformation model's implementation caused a deep economic slump in the Slovakian economy. The transformation recession, as it is known, was characterized by a collapse in foreign trade, a leap in prices with which wage increases could not keep pace at all, and high unemployment. These were factors that led some Slovakian politicians such as Vladimír Mečiar and the public at large to demand that the country pursue its own path of transition. However, such an approach would have only been possible through acceptance of the disintegration of the Czechoslovak Federation.

On the Czech side, there had traditionally been politicians who argued that the Czech economy was compelled to "pay extra" for Slovakia, and that therefore the "money line" to it must be cut. The minister of finance and later chairman of the Czech government, Klaus, probably likewise thought that the Czech economy would be better off without the burden of the Slovakian economy. This is

how the pair of prime ministers Mečiar in Slovakia and Klaus in the Czech Republic emerged: they decided on the demise of the Federation. The possibility of making a decision of such moment democratically, through a referendum, was rejected outright. Pressure from the public, which was not at all accustomed to democratic decision-making, was in fact non-existent. The West praised the quiet separation, the so-called Velvet Revolution, and presented it as exemplary. But the manner in which decisions were made was hardly worthy of emulation. The disintegration of the Federation did at least transpire without violence, and the task then became one of shaping the subsequent relationship between the two successor repu

Establishment of the Independent Slovak Republic and Division of the Assets of the Czechoslovak Federal Republic (ČSFR)

The newly formed state entities assumed the responsibilities of international treaties, state debts, claims against foreign creditors and debtors, and became themselves members of international organizations. In other words, they extinguished the identity of ČSFR, and the latter passed into two independent successor states, even if only one of them, the Czech Republic, inherited the symbols of the defunct entity—in violation of the original agreement (Constitutional Act No. 542/1992).

At the international level, however, the two states were *de facto* not equally accepted. The Czech Republic had its president, the humanist Václav Havel, who was an export sensation and revered abroad. The Slovak Republic had only the authoritarian prime minister Mečiar, whose international reputation deteriorated even further during his rule. The former main body for international affairs, the Ministry of Foreign Affairs, had its seat in Prague and most professional diplomats were of Czech origin. The Slovak Republic had to rebuild its own diplomatic corps and make itself known to the world.

Some initial difficulties arose, for example, in the distribution of the IMF quota between the Czech Republic and the Slovak Republic. The Association Agreement between the Czech and Slovak Federal Republic (ČSFR) and the European Community (EC) had furthermore not been ratified, and had to be taken up separately and anew in a fast-track procedure involving both successor states.

The division of ČSFR also had serious socio-economic consequences. From 1990 to 1993, the Slovak Republic's foreign trade relations were characterized by the disintegration of the hitherto dominant ties with the CEMR states on the one hand, and the initiation of new ties with the states of the European Community on the other. The disintegration of the ČSFR contributed to a rapid decline in trade between the two republics. However, the collapse was less severe than originally predicted. There is no doubt that the established customs union between the Slovak Republic and the Czech Republic, as well as the clearing transactions taken shortly after the failure of the weeks-long attempt to establish a monetary union of both states, did prevent a major collapse of trade between the Czech Republic and Slovakia. Slovakia, which was still more dependent on exports to the Czech Republic, was from the beginning left with the shorter end of the stick. According to the Clearing Agreement, its deficit with the Czech Republic had to be balanced several times by remittances of foreign exchange. When the settlement of the deficit turned out to be a cost to the Czech Republic, the latter country's political elite proposed that the treaty be cancelled.

One of the completely new institutions that the state was compelled to establish was the National Bank of Slovakia (NBS). There was no ministry of foreign affairs in Slovakia, and the country also lacked diplomats—even worse, the same was true for experts on currency. Before the foreign exchange reserves of the State Bank of Czechoslovakia (ŠBČS) were divided at a ratio of 2:1, the State Bank of Czechoslovakia sold two thirds of its foreign exchange to banks in the Czech Republic, and only a residual was left for this distribution. The emerging National Bank of Slovakia therefore had such low foreign exchange reserves that it was forced not only to take strict restrictive

measures in disposing of these funds, but it also pressed the government to seek foreign loans. Although the loans from international financial institutions such as the IMF and World Bank carried lower interest rates than those on the free market, their approval required the government to commit to meeting so-called conditionalities. In other words, it was to implement the reform program of neoliberal transformation. For this reason, too, the Slovakian transformation, according to the Mečiar government, could not be realized; on the contrary, it took on some elements that further deepened the transformation-linked recession. The keywords here are so-called privatization á la Mečiar, “crony capitalism”, and corruption.

Even after the establishment of the customs union between the Slovak Republic and the Czech Republic (which existed until the accession of both states to the EU), the expiration of the currency agreement and the Clearing Treaty, the full settlement of the ČSFR estate was still not yet concluded. Both states still were obliged to implement legislation regarding the division of the Czechoslovak Federation’s property. This division of ČSFR assets was conducted according to either the 2:1 or the territorial rule. Over the course of several years, with varying degrees of success, about 95 percent of the federal property was dispersed. By the end of the third government of Mečiar in 1998, however, a disputed 5 percent remained outstanding—particularly in the domain of finance. With negotiations deadlocked, the Slovak and the Czech Republics could not even sign an agreement prepared several years earlier regarding a common approach to the implementation of the Constitutional Act No. 541/92. The agreement concerned transfer of divided property to the Czech and Slovak Republics. Protracted negotiations were not concluded until 1999 (formally at the beginning of 2000). The National Council of the Slovak Republic did not adopt the agreement on the joint approach of the Czech Republic and Slovakia to the division of the Federation’s assets, i.e. the so-called zero option, until February 1, 2000. This was preceded by intensive negotiations between the government of Miloš Zeman and the first government of Mikuláš Dzurinda.

The bone of contention was the handling of financial relations, especially where the splitting-up of the various banks was concerned. For some time, agreements between the Czech and the Slovak Republics regarding the balancing of the Federation’s 1992 budget deficit, and the settling of organizational financial relations with the 1992 state budgets of the Czech and Slovak Republics each, had awaited their signatures. However, because these agreements had not in fact been signed, implementation could not be carried forward. Most media attention in any case was focused on the retention of a third of the 4.1 tons of gold whose transfer from the Czech National Bank (ČNB) to the Slovak Republic was linked to the final settlement of the complex division of ŠBČS assets.

The resumption of the frozen negotiations did not proceed without problems, but there the political will did exist to resolve the disputed points of the agreement and to finally unite the others under the auspices of the so-called Great Zero. A political solution proved to be the only one possible if the negotiations were not to drag on for several more years. Otherwise, the pledges of the two heads of government, Zeman and Dzurinda, to settle the long-running disputes over the division of the remaining assets from ČSFR might never have been fulfilled to this day.

The commitment of Zeman and Dzurinda, however, could only be honoured by way of a grand compromise. This involved the Czech side returning one third of its gold to Slovakia, and finalizing the separation of their banks. The result was the “Great Zero”, or zero option: that is, the commitment of both sides to see through the definite completion of the division of ČSFR assets. According to Article 4 of the treaty between the Slovak and Czech Republics, the common approach to the division of property required the contracting parties to declare that “they do not and will not make any claims to property in connection with this division”.

The First Two Phases of Transformation and the International Financial Institutions

Czechoslovakia, which had rejoined the IMF in September 1990, obtained its first standby agreement from the IMF as early as January of the following year. The arrangement was conditional on the government's commitment to fulfil a memorandum regarding the policy of ČSFR and its so-called performance criteria. It was on this basis that the loan funds were gradually released.

The memorandum entailed the government's commitment to price and foreign trade liberalization measures by set dates; a shift to the internal convertibility of the Czechoslovak crown; and the realization of a surplus in the ČSFR's "state budget system", by, for instance, taking certain steps on tax policy and reducing subsidies to agriculture and business. The government also committed itself to a restrictive monetary and credit policy, and to a tightening of financial discipline within firms. The conditions outlined by the memorandum on economic policy thus formed the basis of the so-called "reform under Klaus". The federal government was accommodating in its dealings with international financial institutions, although this was motivated by the wish to increase foreign currency reserves through borrowing.

The need to strengthen foreign currency reserves was even more acute in Slovakia, where the level stood far below the minimum security threshold. For this reason, the first Slovakian governments after the collapse of ČSFR were forced to apply for loans from the IMF or the World Bank on the same terms as Czechoslovakia had previously. The first stage of Slovakia's economic transformation during the period of the Federation, and its second stage in the first years of independence were effectively controlled by these financial institutions. It was not until the third stage that the preparation for accession to the European Union came increasingly to the fore; in the institutional sphere, this meant adopting the *acquis communautaire*. However, the demands in the economic policy sphere made by the international financial institutions remained practically identical, including those of Brussels.

The transformation model of shock therapy was based on the rapid privatization of large companies in a process of large-scale privatization. Small-scale privatization, by contrast, took the form of auctioning off small businesses, while voucher privatization was implemented within the framework of large-scale privatization. The voucher was a procedure to ensure that state assets were transferred to the ČSFR citizenry, and later to the Czech and Slovak Republics. Its first wave was prepared and implemented while the Federation still existed. Two waves of voucher privatization took place in the Czech Republic, and one in Slovakia (during the term of the right-wing government of Ján Čarnogurský, and under the minister of privatization, Ivan Mikloš). Mikloš's effort, based on the motto "the state is a bad owner", put together a privatization package with the maximum number of large companies, including the largest bank, the General Credit Bank (VÚB), as well as the East Slovak Ironworks (VSŽ).

However, voucher privatization ran into several serious problems which contributed to the disintegration of Slovakian firms. It resulted in scattered ownership of firms in the hands of hundreds or even thousands of small investors, and engendered a severe "principal-agent problem". In this case, the problem meant that the fragmented ownership lacked access to company management, which as a result acted mainly in its own interest rather than that of its shareholders. Investment funds that could represent a more consolidated ownership were also established, but inadequate legislation and lack of oversight meant that these failed to develop into a viable alternative.

Mečiar's privatization, which was based on direct sell-offs, did not produce any new responsible owners either. Contrary to expectations, privatization resulted in asset stripping, protracted bankruptcies of companies, and their liquidation. The first bids launched by emerging financial sharks, such as private equity—which the SPD chairman Franz Müntefering once called locusts—sealed the demise of dozens of firms. The result was that in the first years of

transformation, unemployment rose, as did social exclusion of the unemployed. The Sinti and Roma were and still are among the most affected groups.

The second problem with voucher privatization and privatization under Mečiar was that the new company owners failed to attract capital or know-how. Acute lack of capital, strained current accounts balances, ailing companies, and high unemployment rates were all good reasons for governments to attempt to draw in foreign investors. Only the Slovak Republic's accession to the OECD in 2000 and the prospect of its joining the EU after the fall of the government of Mečiar created a more favourable situation. The Slovak Republic, which at that time was at the very bottom of the ladder in its ability to obtain foreign direct investment, was only then able to recruit its first significant investors. The Slovak Republic became an attractive country for them due to the tax benefits it granted and other investment incentives offered by the government—but it was especially attractive because of its low wages, which did not correspond at all to the skill and productivity of its workers. This low wage level was one of the reasons why the Slovak Republic became the assembly shop of the automotive industry, and why it will take a long time and will be difficult to escape this curse.

Brigita Schmögnerová is an economist and has worked for many years as a researcher and consultant to politicians. From 1994 to 1998 she was a member of the National Council of Slovakia for the Democratic Left Party (Strana demokratickej ľavice), a member of the Socialist International and successor party to the Communist Party in Slovakia, and from 1998 to 2002 she was Minister of Finance in the first government of Mikuláš Dzurinda. She is the author of several books, and in this text she looks back on the transformation of Slovakia as a contemporary witness. Translation by Joshua Rahtz.

Click here to subscribe to ESSF newsletters in English and or French. You will receive one email every Monday containing links to all articles published in the last 7 days.

P.S.

Rosa Luxemburg Stiftung

https://www.rosalux.de/en/news/id/43207/slovakias-threefold-transformation

---

Footnotes

[1] A breakthrough in the analysis of the transformation process came with the realization that the main ideology of economic transformation is neoliberal ideology and the economic model that results from it. Dorothee Bohle and Béla Greskovits, in their book *Capitalist Diversity on Europe's Periphery*, classified the transformation models as: 1. The neoliberal capitalist model (in the Baltic States); 2. The entrenched neoliberalism (in the Visegrád Group states); and 3. The neocorporatist model (in Slovenia). The first two models did not differ very much from one another. Slovenia, on the other hand, was not dependent on IMF loans, which would have presupposed a neoliberal transformation scenario, since it had sufficient foreign currency. Moreover, during period of so-called socialist self-government that existed in the former Yugoslavia, of which Slovenia was the most developed component, that country had already established the foundations of a market economy, and had relatively good connections to Western

markets.

[2] “There is no alternative”—this is the well-known slogan of the conservative British Prime Minister Margaret Thatcher.

[3] There were some initiatives by social democratic parties or foundations which proposed different transformation strategies, without success. The 1992 proposal by the group of experts headed by Egon Matzner, an economist and adviser to Bruno Kreisky, is one such example. Its title: *The Market Shock: An Agenda for Economic and Social Reconstruction in Central and Eastern Europe*.