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Slovakia's Neoliberal Churn: The Political Economy of the Fico Government, 2006-8

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Abstract

This paper examines the primary policy initiatives of the Slovak government led by Prime Minister Robert Fico between 2006 and 2008. Fico's 2006 campaign rejected the perceived inequalities and injustices of his predecessor's liberal economic reforms and promised to build institutions of social democracy. His government has achieved a mixed record of success. Bound by the threat of capital flight and devaluation, the government adopted the euro on Jan 1, 2009-successfully fulfilling its predecessor's policy.

Beyond this, the lack of any clear economic or social crisis - in fact, the success of his predecessor's reforms - weakened the case for a major rollback of policies. The Fico government thus never felt compelled to offer a coherent social-democratic policy vision appropriate to a small and extraordinarily open export economy. Some government measures have helped fix important institutional shortcomings, but as a whole, its measures have been disconnected, ad hoc, client-driven, often corrupt, and all too often, needlessly statist. Slovakia now faces a crisis of demand in its export markets. Its economy will recover with these markets. In the meantime, however, Slovakia has lost the chance to build socially-oriented institutions that would help it to better cope with the global market place.

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John A. Gould

Introduction[1]

In June 2006, Slovakia's voters delivered a plurality to Smer-Social Democracy, headed by Robert Fico. Fico had campaigned on a platform of rolling back Prime Minster Mikuláš Dzurinda's program of economic reforms. Among these, Slovakia's 19 percent flat tax, its employer - friendly labor code and attractive investor environment, were widely credited with producing Slovakia's emergence as one of the world's fastest growing economies. Fico was highly critical of the social burden these and other reforms created. Investors thus shuddered after Fico formed a ruling coalition with Ján Slota's nationalist Slovak National Party (SNS) and Vladimír Mečiar's Movement for a Democratic Slovakia (ĽS-HZDS). Between 1994 and 1998, a coalition including SNS and HZDS, headed by Mečiar, had brought Slovakia's nascent market democracy to the brink of semi-authoritarianism and economic ruin.

It was thus with some significant relief to investors that the new government's anti-market bark turned out to be worse than its bite. Far from rolling back reforms, Fico's government left the main framework of Dzurinda's neoliberal reforms in place and contented itself to make changes at the margins. To the new government's great credit, it continued to make strides towards fiscal consolidation in accordance with Maastricht convergence criteria. On January 1, 2009, Fico took Slovakia into the eurozone with one of the world's most stable banking systems. As neighboring countries suffered declines in the value of their currencies due to the global financial panic, Slovaks retained their hard - earned purchasing power. This is

[1] Special thanks to Simona Gould, James Thompson and especially Tim Haughton who provided conceptual insights and suggestions. Jozef Bátora, Jan Drahokoupil, Zsolt Gál, Darina Malová and Vladimír Zlacky provided excellent suggestions. Simona added invaluable research assistance. All remaining shortcomings are the exclusive 'unintellectual' property of the author.

certainly the Fico government's proudest and most notable accomplishment to date.[2]

But it was not one Fico had promised his voters in 2006. While campaign promises are made to be broken, Fico's inability to deliver on his major campaign promises is remarkable. This paper will focus on this puzzle. It will argue that the lack of any clear economic or social crisis—in fact, the very success of his predecessor's reforms—weakened the case for a major rollback of policies. It is hard to argue for fundamental change when one's economy is maintaining 7 to 10 percent growth with low inflation and a converging fiscal deficit! In addition, Fico's critiques of neoliberalism have focused on ad hoc populist attacks on its real or imagined side effects. In contrast to the Dzurinda government, the Fico government never offered a clear, coherent vision of why Slovakia's institutional structures were dysfunctional to the point of requiring systematic reform. Nor did the government build up the requisite expertise and capacity to offer a clear and coherent social democratic policy vision.

In lieu of dramatic action in the 2006-8 period, the country coasted ahead nicely on its merits. While the Fico administration can take significant credit for abetting this, from the perspective of a center-left government this was a missed opportunity. Slovakia's institutional reform efforts ground to a halt. Rhetorically committed to building a European-style coordinated market economy[3], the government did little to establish the functioning deliberative coordination mechanisms that are the hallmark of successful center-left

[2] Jurašeková Kucserová, Ľudovít Ódor, Matúš Senaj, Juraj Zeman, "Stručný prehľad vybraných indikátorov konkurencieschopnosti," National Bank Slovakia, Bratislava, Slovakia, March 2009

[3] This paper employs two opposing, ideal types of capitalism used by Hall and Soskice. In a 'liberal market economy,' atomized economic agents approach market bearing a high degree of responsibility for or vulnerability to economic outcomes. Exchanges are arms length and decentralized, relationships and networks tend to be fluid and transactional. In a 'coordinated market economy,' by contrast, market actors achieve higher degrees of risk insurance through networked relationships that promote consultation and contracting between and informal or formally organized corporatist, network and/or deliberative institutions. The political game remains competitive, but high value economic questions are settled through formal or informal extra political state-society bargaining generally 'socializing' costs of major economic transformations. Peter A. Hall and David Soskice, "Varieties of Capitalism. An Introduction to the Varieties of Capitalism," Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. (Oxford/New York: Oxford University Press, 2001), pp. 1-68.

structures in Europe. Rather, the government gave in to instincts to grease the palms of important clients while building new mechanisms of top down state control. The former did little to change the fundamental institutional structure of the economy, while the latter promises to render the economy less able to coordinate adjustments to painful shifts in the global economic environment. As Europe's most open, export-economy and dependent on only a handful of industries for economic survival, this is no small failure. Thanks to this lack of vision, it now seems unlikely that Slovakia will emerge from the current financial crisis with the same dynamism with which it entered.[4]

I: The political economy of neoliberal change in Slovakia, 2002-2006

Fundamental institutional change is hard. Yet this is what the Smer campaign promised in 2006. At the risk of oversimplifying a complex argument, we follow Mark Blyth in arguing that institutions contain within them certain ideas about the challenges societies face and how to best go about addressing them. Crises occur when institutions no longer address social challenges as effectively as they once did and people begin to question the ideas around which they have been organized. Crises are thus ideological as well as material phenomena. Agents, who formerly pursued their interests through a fixed set of institutional arrangements find these arrangements inadequate and begin to consider alternatives that will help them navigate new, uncertain waters. They are open to ideas which explain the current crisis, identify interests within the new context, and offer a new institutional "blueprint" that will help them cope. Not everyone will agree on these "narratives." Crises thus set the stage for an intensified political conflict and political placement and strategies of ideological entrepreneurs should help determine the outcome.[5]

Slovakia's political and economic turnaround from 1998 to 2006 reflects a process of major institutional change. From a crisis of virtual bankruptcy and

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[4] For a detailed examination of the government's anti-crisis policy in January through March 2009, see John Gould, "*Growth and Crisis in Slovakia: The Political Economy of the Fico Administration, 2006-2009*," Paper presented to the BASEES Conference, Cambridge, UK, March 28, 2009.

[5] Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge, Cambridge University Press, 2002). In this paper we define institutions as 'sets of norms, rules and decision making procedures around which actor expectations converge.'

autocracy in 1998, Dzurinda's two governments left the country a thriving market democracy enjoying fast, sustainable growth; a member of the European Union and NATO; and possessed of the macroeconomic preconditions necessary for euro zone membership—a goal the country achieved on January 1, 2009. That such would be the case was by no means inevitable. The first Dzurinda government was a relatively incoherent grand coalition of opposition parties united by little more than a commitment to liberal politics and EU membership, as well as antagonism to the outgoing government of Vladimír Mečiar. Over the next four years, however, these four factors coupled with EU and NATO tutelage, were sufficient for Slovakia to get its fiscal house in order, rebuild the institutions of liberal democracy, and set Slovakia firmly on the road to EU integration. Coalition ideological incoherence–particularly resistance from the formerly communist Party of the Democratic Left (SDĽ) helped prevent a number of major structural economic reforms.[6]

The elections of 2002 featured the fragmentation of the post-communist left and the nationalist right. The result was a large number of "wasted votes" cast for anti-transformational splinter parties that failed to make the five percent parliamentary threshold. The center-right cabinet that emerged opened a window of opportunity for a loose network of liberal economic reformers to influence policy. Nourished in liberal think tanks and American universities during the Mečiar-Dzurinda years, these reformers had a clear

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[6] Sharon Fisher, John Gould and Tim Haughton, "Slovakia's Neoliberal Turn, "*Europe-Asia Studies*, 59:6 (September 2007): 977-998; Milada Vachudova, Europe Undivided: Democracy, Leverage, and Integration after Communism, (Oxford & New York, Oxford University Press, 2005); Darina Malová and Tim Haughton, "Challenge from the Pace-Setting Periphery: The Causes and Consequences of Slovakia's Stance on Further European Integration," in Sadurski,W., Ziller, J. & Zurek, K., eds., *Après Enlargement: Taking Stock of the Immediate Legal and Political Responses to the Accession of Central and Eastern European States to the EU*, (Florence, Robert Schuman Center, 2006); Tim Haughton and Sharon Fisher, "From the Politics of State-building to Programmatic Politics: The Post-Federal Experience and the Development of Centre–Right Party Politics in Croatia and Slovakia," *Party Politics*, 14:4 (2008): 435–454; see also, Wade Jacoby, *The Enlargement of the European Union and NATO: Ordering from the Menu in Central Europe*, (Cambridge: Cambridge University Press, 2004); Heather Grabbe, *The EU's Transformative Power: Europeanization through Conditionality in Central and Eastern Europe*, (Basingstoke, UK: Palgrave, 2006). For a good overview of the 1998-2002 period in historical context, see Samuel Abraham, "Slovakia" in T. Rakowska-Harmstone and P. Dutkiewicz eds.: *New Europe: The Impact of the First Decade* (Warsaw, Institute of Political Studies, Polish Academy of Science, 2006) Vol. 2,, pp. 249-278.

vision of what ailed Slovakia's institutional framework and how to move the country forward. As their center-right patrons in Slovakia's new ruling coalition moved into power, these thinkers moved in with them. It is thus a favorable political opportunity structure rather than external pressure that best accounts for "Slovakia's neoliberal turn" in 2002.[7]

While a number of key officials sought to reform existing institutions based operating on the principle of social solidarity, the Dzurinda government made its most profound changes based on an ideologically-informed commitment to market liberalism. Neoliberals believe that markets function most effectively where individuals are freer to make economic choices and reap their consequences. They argue that people have an incentive to compete harder when the downside of competition is more severe and upside more profitable. Eliminating the upside or downside of competition may encourage people to take (or fail to take) risks they otherwise could not afford; society will bear the costs of their failure. This is known as "moral hazard": the rational incentive to make collectively irrational individual economic choices that reflect the presence of social guarantees. Social solidarity, they argue, can undermine economic efficiency and reduce aggregate wealth. In this paper, the term "Neoliberal" refers to policies that unfetter decentralized voluntary transactions by dismantling institutions providing social guarantees and solidarity.[8]

There was nothing inevitable about Slovakia's neoliberal turn. As noted, it emerged by chance through a robust democratic process. Beginning in 2002, a network of neoliberal thinkers gained policy influence with a new center-right government. Together, they offered Slovakia a clear explanation of the crisis

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[7] The reformers' neoliberal vision was of course compatible with the European Union accession process and the vision's framers consistently justified reforms as being part and parcel of the EU accession process. Yet, the bulk of the reforms were launched by the ideologically more coherent second Dzurinda government, not the first. Meanwhile, EU pressures remained relatively consistent. Similarly, strong EU pressures were felt across the 10 applicant countries, yet their active reform designs varied enormously. While external conditionality is thus an important part of the story, it cannot explain either the timing of neoliberal reforms or their appearance in some countries but not others. EU accession thus played a limited role in Slovakia's neoliberal turn-- Slovakia's political opportunity structure was far more important. Fisher, Gould and Haughton, "Slovakia's Neoliberal Turn."

[8] Fisher, Gould and Haughton, "Slovakia's Neoliberal Turn," p. 978; D. Harvey, "Neo-liberalism as Creative Destruction," *Geographical Annals*, 88B:2 (2006), p. 145.

facing the country's economic institutions and a range of ideologically consistent blueprints to reform or replace them: including a 19 percent flat corporate and personal income taxes; a clear plan for fiscal consolidation; a new business friendly labor code; a new private pension savings scheme; and privatization of public enterprises. Neoliberals also sought to transform state healthcare providers into cost-conscious joint-stock companies and to raise the threshold for customer use by charging co-payments and fees. They also introduced the "*tri krát a dosť*" system of justice--based on the Californian program of life sentences for repeat offenders.[9] The government attempted but failed to adopt similar measures in higher education.[10]

The Dzurinda government's reform timing was also propitious. Encouraged by Slovakia's increasingly business-friendly market, impending EU membership and commitment to joining the euro, the country absorbed a disproportionate share of regional investment–particularly in the electronics and economy automobile sectors. Meanwhile growing markets in Western Europe, locally, and the former Soviet East produced an export boom. Market friendly tax, labor and fiscal reforms placed Slovakia at the head of a regional development trend.

Despite this success, the Dzurinda coalition suffered from a number of political scandals and the disintegration of its controversial center-right junior coalition party, Alliance of a New Citizen (ANO), in summer 2005. Further defection by the Christian Democratic Movement (KDH) in 2006 led to early elections in June. Meanwhile, the anti-transformational electorate whose votes had been dispersed across splinter parties in 2002, found new champions. On the left, the government faced a steady tattoo of criticism from Robert Fico and his populist social democratic party, Smer-Social Democracy (Smer-SD).[11] On the right, the divided nationalists once again reunited under the controversial leadership of Slovak National Party chief, Ján Slota.

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[9] While Justice Minister Daniel Lipšič (KDH) probably did not see this as related to neoliberal economic reforms, neoliberal critics like John Gray argue that efforts to "dis-embed" markets from limiting social structures are usually accompanied by greater criminality. It is thus no wonder, Gray argues, that the United States has such high levels of incarceration. John Gray, *False Dawn:* The Delusions of Global Capitalism, (New York, New Press, 1998), Chapter 1.

[10] For a detailed review of Dzurinda-era measures, see Fisher, Gould and Haughton, "Slovakia's Neoliberal Turn."

[11] In 2004, Smer absorbed the remnants of the Party of the Democratic Left (SDĽ).

Fico won a 29 percent plurality and embarked on lengthy negotiations with a range of potential partners. As Haughton and Rybař have pointed out, Smer-SD entered negotiations in an extraordinarily strong position: it had more than half the deputies needed to support a government and several viable coalition options. After a brief two-week negotiation period in mid-summer 2006, Fico settled on a 'brown-red' coalition of Smer's social democrats and SNS's nationalists. Mečiar's ĽS-HZDS held an ambiguous position in the ideological center. On the face of it, little appeared to bind the parties together ideologically beyond a desire to benefit from power.[12]

Fico justified his abrupt termination of coalition negotiations arguing that an alliance with SNS and ĽS-HZDS would be most likely to help him meet his campaign promises. There was something to this. As expected from its position as the dominant party, Smer-SD emerged with a disproportionate degree of influence in the new government. Neither Slota nor Mečiar took positions in the cabinet. Smer-SD acquired 11 of 16 cabinet positions, SNS took three and ĽS-HZDS took two. The most important economic ministries went to Smer-SD, including the Ministries of Finance (Ján Počiatek); Labor, Social Affairs and Family (Viera Tomanová) and Economy (Ľubomir Jahnátek)[13] Smer thus had a relatively unfettered hand in designing economic policy. This was important. As Haughton and Rybař have shown, 2006 was the first Slovak election focused more on socio-economic than identity issues.[14]

Explaining policy continuity under Fico

At a casual glance, one might have expected Fico's first two years to lead to significant institutional change. Given Smer-SD's control over the key economic ministries, the subordinate position of his junior coalition partners, and his campaign rhetoric, it may have seemed likely that he would make good on his promise to roll back the institutional changes of the Dzurinda-era.

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[12] (Tim Haughton) "Slovakia: Lust for power unites new coalition," *Oxford Analytica*, July 6, 2006.
[13] Tim Haughton; Marek Rybář , "A Change of Direction: The 2006 Parliamentary Elections and Party Politics in Slovakia," *Journal of Postcommunist Studies and Transition Politics*, 24:2 (2008): 232-255.
[14] Haughton and Rybář, "A Change of Direction," p. 252.

Yet, few informed observers actually thought this would happen when Fico's government took office in summer 2006.[15]

Indeed, institutional change theory outlined above would lead us to predict continuity.[16] Objectively, there was no crisis in summer 2006. As Table 1 indicates, economic performance could not have been better. Buoyed by high foreign direct investment, growth accelerated to an annualized rate of 8.5 percent during the government's first five months in office and then accelerated again to a torrential 10.4 percent in 2007. Well over a third of Slovaks credited Fico's policies for producing the rapid growth. Thus, one of the government's most self-interested policies was that despite its rhetoric it did so little to threaten the institutional foundations of the country's "economic miracle."

TABLE 1: SLOVAKIA'S ECONOMIC PERFORMANCE, 1998-2008

Source EBRD	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
GDP Real growth in %	4,2	1,5	2,0	3,4	4,8	4,8	5,2	6,6	8,5	10,4	6,4*
Inflation %	6,7	10,6	12,0	7,3	3,3	8,5	7,5	2,5	4,5	2,8	4,6
Fiscal balance %GDP	-5,5	-7,1	-12,2	-6,5	-8,2	-2,7	-2,4	-2,8	-3,6	-2,2	-2,5
Foreign Direct Investment (USD-millions)	374	701	1,897	1,520	4,130	1,913	3,052	2,279	3,797	2,881	3,000
Curr.acct.bal. % GDP	-9,2	-5,3	-3,5	-8,3	-7,9	-5,9	-7,8	-8,5	-7,0	-5,3	-6,0
Unemployment	12,5	16,2	18,6	19,2	18,5	17,4	18,1	16,2	13,3	11,0	9,4**
Koruna/USD at year end	36,9	42,1	48,6	48,2	40,0	32,9	29,1	31,9	26,2	22,9	21,4+

*Additional Sources: *Slovak Statistical Office; **eurostat;* + www.oanda.com

[15] (Tim Haughton) "Slovakia: Lust for power unites new coalition," *Oxford Analytica*, July 6, 2006; (Simona Gould and John Gould), "Slovakia: June elections offer change not revolution," *Oxford Analytica*, February 14, 2006.

[16] Blyth, Great Transformations, pp. 34-45.

On the other hand, given such a favorable economic inheritance, there was little need for the Fico policy community to develop a clear economic vision--defined as an ideologically consistent set of policy ideas that aspire to serve as a guide for institutional change. Yet, other factors contributed to the party's conservatism. Smer was from its inception earlier in this decade a popular-leftist party peppered with a convenient sprinkling of nationalist sentiment that addressed the insecurities of a population deeply divided over state identity. One observer asserts that Fico keeps his rhetoric broad and his policy initiatives ad hoc and populist to avoid alienating any of his key constituencies with a definitive stance. Smer rose to power by the bite of Fico's negative attacks on the Dzurinda-led coalition policies, not by the beauty or coherence of his policy vision.[17]

Nevertheless, the numerous areas of policy continuity in the 2006-2008 period are hard to square with the government's economic rhetoric. In both the eyes of its critics[18] and those of external observers the Fico government allowed the economy to coast on its merits. By the end of 2008, Fico's government had failed to improve Slovakia's rating on *any* of the ERBD's 14 transition indicators. Some of this inevitably reflects significant earlier progress—areas in which the EBRD feels the "transition" is near to complete such as privatization, price liberalization or trade and foreign exchange. Yet the EBRD clearly feels that Slovakia has made no improvement where it there is still room for progress—particularly in competition policy and various aspects of infrastructure.[19]

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[17] Interview with Beata Balogová, Journalist, Bratislava, Slovakia, March 23, 2009.

[18] Tvaroska Interview, April 28, 2009; Žitňansky Interview, April 24, 2009; See especially scathing comment by Richard Sulík, "Fico: Ak nás porazí kríza, bude to čestný súboj," *Hospodárakse Noviny*, April 20, 2009

[19] "Transition Indicators by Country," EBRD, 2009.

http://www.ebrd.com/country/sector/econo/stats/index.htm [accessed March 19, 2009]. Note that there are many critics of the concept of "transition." The primary concern is that it privileges a narrow, neoliberal vision of Anglo-American capitalism as the ultimate, desirable and inevitable finishing point of the postcommunist transformation processes. Critics argue that this is a teleological world view that privileges one form of democratic capitalism over many alternative and equally legitimate forms of democratic capitalism. For a representative sampling of critiques, see David Stark and Laszlo Bruzst, *Postsocialist Pathways* (Cambridge: Cambridge, 1998); Vladimír Mykhnenko, "What Type of Capitalism in Post-Communist Europe?" Poland and Ukraine Compared," *Actes du GERPISA*. No. 39 (December 2005): pp. 83-84; For an excellent entry into the literature on varieties of capitalism, see Hall and Soskice, "Varieties of Capitalism."

Fico did a relatively good job of detracting attention from this fact by maintaining *ad hoc* and *ad honimum* attacks on his political opposition and critics in the media. Media critics were at best “unprofessional” and at worse “jackals.”[20] Opposition alternatives were “subversive,” and when the 2008-9 economic crisis came, blame lay squarely with the opposition, or, more recently, Wall Street[21] Such heated rhetoric helped masked broad areas of policy continuity with the previous government.

II. Fico Government Socio-Economic Policy before the Crisis, 2006-2008

Fiscal Consolidation and the Maastricht Criteria

The new government’s August 2006 Program Declaration promised to build a “social state” and a “knowledge economy.” Yet, despite heady Smer-SD rhetoric about establishing a “third way” social democracy,[22] the government quickly found itself bound by prior commitments to fiscal restraint as outlined by the Maastricht criteria for joining the euro. Maastricht was admittedly a powerful normative standard, but it was one the government was initially willing to challenge. In the end, Slovakia’s vulnerability to international capital flight convinced the government to adhere to its provisions.

Shortly after taking office, Fico publically questioned the value of euro accession. Slovak crown (*koruny*) holders predictably led a rush out of the currency forcing a costly intervention by the National Bank.[23] In subsequent meetings with leading financial officials, Fico must have come to a better understanding of the country’s vulnerable position. While we can only speculate about the lessons he drew from the experience, its seems reasonable that a man committed to the end of the Slovak "low wage" development

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[20] (Simona Gould and John Gould), “Slovakia: Official ire and falling ratings dog STV,” *Oxford Analytica*, September 3, 2007.

[21] Ibid.

[22] Indeed, at one point Fico called his party Smer-Third Way, following a December 2000 meeting with British Prime Minister Tony Blair, Haughton and Rybář, “*A Change of Direction*,” p. 244.

[23] Juliet Johnson, “The Remains of Conditionality: The Faltering Enlargement of the eurozone,” *Journal of European Public Policy*, 15:6 (September 2008): 833.

program and the "knowledge economy" could not countenance the further cheapening of the labor force that would have occurred had the crown devalued significantly. In Slovakia's boom economy, there was also the problem of falling into a spiral of devaluation and inflation--that could only be stopped by a devastatingly restrictive monetary policy by the Slovak National Bank (NBS). So, Fico's personally-engineered bout of capital flight may have taught him that it was either Maastricht today or some form of slow growth “uber-Maastricht” tomorrow. Regardless, Fico never again questioned Slovakia’s commitment to the euro.

Fico’s quick tutorial in fiscal management initially strengthened the independence of Smer-SD Minister of Finance Ján Počiatek. One of the minister’s first efforts was to reassure his skittish officials that he would keep and even improve upon the policies of his predecessor. He retained Richard Sulík—Dzurinda’s neoliberal tax code architect--for about a year after taking office. He also sought but failed to retain Dzurinda-era Ministry of Finance official, Janka Červenáková, and he successfully recruited key Dzurinda-era ministry officials such as Michael Horváth and Martin Filko. Finally, Počiatek provided a haven for talented, liberal analysts who felt ideologically unwelcome in other ministries, including his General Director of Strategic Planning, Marek Lendacky.[24] As a result, the Ministry of Finance has established a reputation as a center for policy expertise and fiscal discipline. Počiatek even won an international prize as Europe’s best Minister of Finance in 2008.

In practice, the Ministry of Finance fought to ensure fiscal discipline in line with ERMII convergence criteria. The 2007 budget included a low deficit 2.9% of GDP through which Počiatek sought to reassure crown holders of Slovakia’s commitment to adopt the euro in 2009.[25] The government inherited almost perfect conditions for maintaining this fiscal discipline. Rapid growth from June 2006 through the third quarter of 2008 provided the means to adhere to ERMII criteria without significant new cuts in government expenditures. 2007 was literally a miracle economic year with one of the world’s fastest growth rates, a fiscal deficit within ERMII expectations, high

[24] Interview with Anton Marcinčin, Economist, Bratislava, Slovakia, March 25, 2009; Interview with Robert Žitňanský, Journalist, April 24, 2009.

[25] (Simona Gould and John Gould), “Slovakia: Populism could overturn economic success,” *Oxford Analytica*, August 7, 2006.

levels of new investment, and a remarkably low 2.8% inflation rate. Slovakia's 'tiger'-like performance was also reflected in its more valuable currency as Počiatek deftly managed appreciation of the Slovak crown. Appreciation helped dampen inflationary demand for Slovak goods and services through a more expensive domestic currency rather than higher interest rates (TABLE 1). While this made Slovak labor more expensive to foreign buyers, worker productivity kept up or outstripped the increase in cost. By simply adhering to the euro-accession policies it inherited, the government thus adhered to its promise to reduce the role of low wage labor in Slovak development.

The Flat Tax

In late 2004, the Dzurinda government passed a pro-investment taxation package that helped make Slovakia become one of the most competitive locations for investment in Europe. The government replaced the two-tiered sales tax system with a universal 19% value-added tax (VAT). This eliminated an existing lower rate for food, medicine, and other necessities. It also replaced the previous income tax with a flat personal income tax of 19%. Similarly, corporate taxes were reduced to a flat income tax of 19%. Other taxes, such as the dividend tax, the real estate transfer tax, the gift tax, and inheritance tax, were cancelled. Finally, it increased excise duties on cigarettes, fuel, and alcohol to meet EU standards.

There was some worry that a significant reduction in corporate and income taxes would reduce revenue and endanger fiscal consolidation. Yet, higher voluntary compliance with the less punitive and more transparent code, eventually contributed to offsetting increases. It is also notable that while the higher flat VAT and excise taxes hit the poor and middle class disproportionately hard, the law raised the level of income that would go untaxed, meaning that Slovakia's poorest paid no income tax at all.[26] An unwieldy and complex bureaucratic structure of high social and health

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[26] Karol Morvay and Ivana Morvayová, "Celkový ekonomický vývoj" in Miroslav Kollár, Grigorij Mesežnikov and Martin Bútora, eds., *Slovensko 2008: súhrnná správa o stave spoločnosti*, (Bratislava: Institute for Public Affairs, 2008), pp. 407-411; P. Golias and R. Kicina, "*Slovak Tax Reform: One Year After*" (Bratislava: INEKO/Business Alliance of Slovakia, 2006). Sharon Fisher, John Gould and Tim Haughton, "Slovakia's Neoliberal Turn," *Europe-Asia Studies*, 59:6 (September 2007): 981-2.

payments characterized by high rates of non-compliance went largely untouched—an ongoing irritant to the business community.

Smer campaigned on the complaint that the new tax code undertaxed Slovakia's wealthiest while overtaxing its poor consumers. Accordingly, the government sought to raise taxes on higher income earners and reduce the VAT on essential products—a return to the progressive tax schemes of the past. Led by Dzurinda-era holdovers in the finance ministry, like Richard Sulík, and criticized even by junior coalition partner HZDS, the government limited itself to relatively minor tweaks in the tax code. It backed off on Fico's campaign promise to lower the VAT—reducing the tax on medications, medical tools and books, but keeping food and other essentials at 19 percent. It also lowered the minimum taxable income level for workers who make more than 1300 euro a month: Wealthier workers pay proportionally more because more of their income is taxed.[27] More recently, in a measure supported by the center-right opposition, in February 2009 the government took the additional step of raising the non-taxable income level for Slovakia's poorest. They can now earn more untaxed income than before.[28]

The redistribution is slight, but the Fico government has fulfilled its promise to make Slovakia's tax system more progressive. It's main accomplishment however is that by retaining the expertise of Sulík and others, the Ministry was able to do so while retaining the essential simplicity and clarity of the flat tax—no small accomplishment. Even the IMF failed to find the new measures "unduly distortionary."[29]

Since then, the Ministry has continued to tweak the tax code to make it simpler to administer. In spring 2009, the Ministry halved the time it took corporations to receive their VAT refunds – a popular measure. Despite these gains, the Ministry has made precious little progress in unifying and

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[27] Richard Sulík, "Ako bude fungovať milionárska daň," *Pravda*, December 6, 2006.

[28] Another government proposal was to lower the taxable deduction for charitable giving from 2 percent of income to 1.5 percent. Opposition from junior coalition partner ĽS-HZDS and loud complaints from the NGO sector, however, ensured that this minor change did not become law.

[29] IMF, "Slovak Republic—2007 Article IV Consultation Discussions, Preliminary Conclusions of the Mission," *International Monetary Fund*, Washington, DC, March 13, 2007. http://www.imf.org/external/np/ms/2007/031307.htm [accessed March 19, 2009]

simplifying its complex, bureaucratic system of social and health payments—a major problem for the local business environment.[30]

Labor Policy

Slovakia is the most export-dependent postcommunist country in postcommunist Europe.[31] There is no avoiding external vulnerability to economic shocks. Rather, the country needs to develop an agile and skilled labor force that can perform well in multiple sectors and switch sectors and regions quickly. Slovakia also needs to build social mechanisms to help the unemployed transition across sectors and regions without devastating hardship.[32] From a continental center-left perspective, it would help were the country to develop effective deliberative institutions to gain voluntary compliance of labor, business and other key actors in coordinating collectively rational responses to painful adjustment choices imposed by global markets. Ideally, these would be based on the social democratic principle of social solidarity rather than the neoliberal principle of individual responsibility and vulnerability.

The need to ensure that such institutions function well is particularly acute since Slovakia's accession to the Euro in 2009. The country has lost the ability to adjust monetary policy to deal with inflationary or deflationary trends. Unfortunately, Slovakia's new labor policy does not appear to be moving in this direction.

Along with the 19% flat tax observers often credit the Dzurinda government's 2003 labor code for Slovakia's investment boom. The 2003 reduced the cost of hiring and firing workers. Among other things, it allowed corporations to renew temporary contracts for up to three years and in some instances of open abuse, indefinitely; permitted greater overtime--much of it compulsory; marginalized unions in the workplace; and encouraged unemployed workers to return to the workforce faster, including requiring those receiving unemployment compensation to visit the local labor office

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[30] Interview with Matej Stuška, United States Steel Košice, May 29, 2009.

[31] (Sharon Fisher), "Is the Emerging Europe Region Heading Towards Collapse?" *HIS Global Insight*, April 3, 2009.

[32] Interview with Vladimír Tvaroska, Slovak National Council (SKDÚ), Bratislava, Slovakia, April 28, 2009.

every two weeks (ostensibly to encourage workers to take lower paying, less attractive jobs). In 2004, the Dzurinda government went a step further by abolishing the Tripartite Act, effectively eliminating a formal channel by which union social partners might influence economic policy.[33] The tripartite had never functioned as an effective deliberative mechanism in Slovakia due to the political weakness of its unions. Nevertheless, its abolition was a clear step in the direction of a liberal market economy in which workers would bear more of the risk and cost of failure in the open global economy.

The Fico government has taken a few significant steps towards building the labor institutions typical of a 'coordinated market economy.' In 2006, it restored the tripartite and has since provided government support in setting up sector-specific collective bargains. Yet is's major initiative was to reform the labor code. In 2007, under ongoing pressure from Slovakia's umbrella union of trade unions (ZMOS),[34] Minister of Labor, Social Affairs and Family, Viera Tomanová, pushed a new code through parliament. Taking effect on September 1, 2007, the law limited the use of independent contractors; reduced compulsory and overall limits overtime hours; prevented the repeat use of temporary contracts (with exceptions for seasonal work); raised the notice and compensation periods for fired workers, and lowered the threshold for workers who can be fired without cause from 20 hours a week to 15.

Labor also reasserted some power over the workplace, although not nearly as much as the unions demanded. Most importantly from the perspective of unions, workers gained the right to employer compensation for time off due to union obligations. Labor representatives also gained the right to be consulted on employee performance standards.[35] While rarely invoked,

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[33] D. Gerbery and E. Kvapilova, "Nové inštitucionálne črty sociálneho štátu na Slovensku," *Ekonomický časopis*, 54:2 (2006).

[34] The other union social partner in the tripartite is the Independent Christian Unions of Slovakia (NKOS). Combined, KOS and NKOS represent over 30 percent of Slovak employees with about 40-50 percent currently covered under collective agreements. Ludovít Cziria, "Industrial Relations developments – 2006," *European Industrial Relations Observatory Online*, # SK0703019Q, June 13, 2007. http://www.eurofound.europa.eu/eiro/studies/tn0703019s/sk0703019q.htm [accessed April 30, 2009]

[35] Ludovit Cziria, "Parliament adopts controversial new amendments to Labor Code," *European Industrial Relations Observatory On-Line*, # SK0709029I, October 15, 2007. http://www.eurofound.europa.eu/eiro/2007/09/articles/sk0709029i.htm [accessed March 19, 2009]

collective bargains could also be imposed on non-union enterprises within a sector.

According to one key analyst, the law succeeded in providing employees with better protections and more influence over manager decisions to raise performance criteria.[36] Despite these improvements, however, many questioned whether the new code encourages the agility and flexibility labor needs to deal with external shocks. On the left, critics charge that the law does not adequately address labor's lack of geographical mobility within Slovakia. From 2006-8 wages generally rose in line with productivity in Slovakia's booming west where unemployment was as low as 1.8 percent (Bratislava). But in the East, unemployment could reach as high as 28 percent. Higher wage minimums and limitations on employer discretion over employees does little to address the need to attract workers west and investors east. Indeed, the law may make it harder for Slovakia's hardest hit areas to attract investment.[37]

The government designed the law in a defensive response to an important and demanding social client, Slovakia's labor unions. Missing, was a concerted, coordinated active employment policy that seeks to deal with Slovakia's deep regional imbalances and sector inflexibilities. Such a policy would require a broad governmental initiative in areas as diverse as education, housing and infrastructure among others.[38] In late 2006, the government commissioned a broad multidisciplinary visionary study from the Slovak Academy of Sciences. The study took two years to complete, however, and its impact has been minimal so far.[39]

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[36] Ibid.

[37] It is notable that according to one expert, Slovaks are more likely to relocate abroad to find work than to relocate within Slovakia. Conversation with Zsolt Gál, Political Scientist, Comenius University, Bratislava, Slovakia, May 21, 2009.

[38] As an anti-crisis measure in 2009, the government significantly raised the travel stipend to help employees meet the costs of commuting to more distant jobs.

[39] Interview with Peter Stanek, External Economic Advisor to the Prime Minister, Slovak Academy of Sciences, Bratislava, Slovakia, March 23, 2009; "*A Long-Term Vision of the Slovak Society Development*," Institute of Economic Research, Slovak Academy of Sciences, Bratislava, Slovakia, 2008.

Views from the right have been much more critical.[40] A panel of experts convened to rate the value of government policies, gave the Labor Law the lowest rating of all government actions in 2007.[41] Business predictably did not agree to the final package. They complained that the measures would raise the cost of doing business in Slovakia, suppress investment and reduce long term growth in Slovak living standards.[42] IMF analysts felt that more wage flexibility should be a crucial prerequisite for euro entry in 2009. Their primary concern was that once the National Bank of Slovakia (NBS) lost its discretion over monetary policy, labor would have to bear the brunt of adjusting to major misalignments. This should also mean easing, rather than restricting, the flow of employees across sectors and regions during hard times. IMF advocated that wage negotiations occur at the enterprise level and that increases in workers income be tied to some fraction of productivity increases. From this perspective, the new law was a step in the wrong direction.[43]

Finally, both the IMF and the OECD fretted that raising minimum wages was the wrong method to ensuring a 'living minimum.' Rather than fixing wages—a measure that would lower employer incentives to hire more workers--the IMF advocated providing low wage workers with an earned income credit that would raise their income to the living minimum, encouraging people to take jobs that would let them qualify for the credit, and

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[40] Opposition critics charge that the law was little more that a direct payback for union support in the 2006 election. Interview with Vladimír Tvaroska, Member of Parliament, Bratislava, April 28, 2009.

[41] HESO ratings are derived by averaging the estimates of a panel of experts, drawn from business, NGO's and universities. Dušan Zachar, ed., "*Slovensko 2007: Hodnotenie ekonomických a sociálnych opatrení (Projekt HESO)*," Inštitút pre ekonomické a sociálne reform, Bratislava, Slovakia, 2007, pp. 53-57.

[42] Ivan Stefanic, "Experience of labor reform in the Slovak Republic," Business Alliance of Slovakia, Presentation in Belgrade, Serbia, November 30, 2007. www.poslovnamreza.org/download%20serb/Konfprez/Ivan%20Stefanec.ppt [accessed March 19, 2009]

[43] IMF, "Slovak Republic." Legislation allowing sectoral wage agreements to be extended to non-union firms not covered by the negotiations threatened to limit wage flexibility and potentially impose employment-reducing expenses on enterprises located in high unemployment areas. While the measure extension is rarely invoked in practice, the OECD advocated that it be eliminated. OECD, *Economic Survey of the Slovak Republic*, (Paris: Organization for Economic Cooperation and Development, 2009).

encourage higher employment levels in places where unemployment was highest and wages lowest.[44]

Pensions

Smer's 2006 campaign reserved particular vitriol for the Dzurinda-era's pension reform. Taking effect on January 1, 2005, the reform dealt with a predicted long term shortfall in financing for the existing pay as you go (PAYG) system with a private savings program. Young people were required to put 9 percent of their earnings into both the PAYG and private "pillars," plus more into a third pillar to support vulnerable groups. All others (excepting those on the verge of retirement) could opt to participate in the private pillar as desired. None of these contributions was taxed.

Earnings in the savings pillar were not guaranteed, and savers had to select their investment choices from a range of products provided by private pension investment companies, in exchange for fees. These firms naturally tended to support Fico's opponents among the center-right parties. This continued a trend established during the 1990s as capital market actors came into conflict with the left over such issues as capital markets regulation, soft credits and voucher privatization.[45]

Private pension savings have the status of private property and can be passed on to a designated beneficiary.[46] Despite the higher risk and compulsory participation for younger workers, the second pillar became a political success. Close to a third of the population entered the private scheme, contributing to a 1.3 percent increase in national savings in 2007.[47]

The private pillar was a significant blow to the principle of solidarity. The nine percent contribution was higher than even the reform's architects had expected. This promised to create financial problems for the state PAYG

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[44] IMF, "Slovak Republic."

[45] Michael Ollson, *Ownership Reform and Corporate Governance: The Slovak Privatization Process in 1990–1996*, (Uppsala, Uppsala University, 1999).

[46] Correspondence with Michal Stuška, Spokesperson, Ministry of Labor, Social Affairs and Family, May 26, 2009.

[47] Richard Ďurana, "Slovakia," in *The State of the Union: The Progress of market oriented reform in the EU*, Stockholm Network, London, UK, 2009, p. 49 http://www.stockholm-network.org/downloads/publications/SN_SOU3_web.pdf [accessed march 23, 2009]

provider, Sociálna poisťovňa, which would have less revenue to meet growing PAYG obligations. Implicitly this would extract even greater intergenerational transfers as the state would have to borrow to meet current costs. Worse, the poor and unemployed paid little to nothing into the pillar and could thus not benefit from the program. On the technical side, there were a number of unresolved issues. The framework overseeing annuities, for example, was poorly articulated, and the tax status of second pillar savings was unclear. Would the saver's beneficiaries have to pay taxes on the savings account upon the saver's death, for example? The law did not resolve the issue.

Fico campaigned hard against the private pension system and since taking power has sought to undermine it. The government would clearly like to use part of the 2.3 billion euro in savings currently being managed by the private pension management funds to bolster Sociálna poisťovňa.[48] Yet, it has not had much success in getting savers to voluntarily exchange their private savings for a state IOU.

This is not for want of trying. Allegedly, Minister Tomanová ordered her civil servants to put aside good social science research in order to orchestrate an information campaign against the second pillar. Feeling that social science was being forced to conform to politics, a number of talented Dzurinda administrators left for the Ministry of Finance. Not surprisingly, relations between the two ministries are often strained.[49]

Having encouraged second pillar defenders within the ministry to leave, the government "opened up" the pillar structure for six months starting in January 2008 and encouraged Slovakia's 1.5 million private savers to return their private savings to state hands. The government also made technical changes that made it unclear whether savers over the age of 45 would be able to access their savings at retirement. Meanwhile, Fico and Tomanová spearheaded an information campaign, complete with a leaflet entitled "Time to Decide" which highlighted the risks of 'speculating' on capital markets. Ministry officials emphasized that private savings schemes elsewhere, in Argentina for example, have proven insufficient to cover the needs of retirees-

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[48] Robert Žitňansky asserts that the 2009 Sociálna poisťovňa budget counts on at least 150,000 second pillar savers switching to the first pillar and thus making their pension savings available for current spending by the government. Žitňansky interview, April 24, 2009.

[49] Another irritant was her marginalization of the Ministry's market reform-oriented Institute of Labor. Marcinčin interview, March 25, 2009.

-hence the need to force savers over 45 to work longer to build up an adequate private stake.[50] They also accused private pension firms of charging exorbitant fees. In the midst of the campaign, Fico asserted, "I would not be in the second pillar and I would recommend everyone to get out very quickly."[51]

Private pension defenders, like the OECD, argued that the government's attempt to eliminate the second pillar was not coupled with a solution to the demographic problem that inspired it in the first place: the inevitable explosion in PAYG obligations as Slovakia's demographic balance shifts to proportionally more retirees in the next three decades.[52] Indeed, the ministry's current statement on this issue is to reiterate that that first pillar pensions are guaranteed by the state. According to ministry officials, "in the case where the state is unable to pay, the state will provide Sociálna poisťovňa with financial help."[53] Tomanová also points out that Slovakia's demographic decline is not as ominous as feared: 3000 more children were born in 2008 than in 2007, for example.[54]

Overall, however, the debate has gone poorly for the government. The spring 2008 campaign netted less than 90,000 decisions to switch to the PAYG pillar (from a potential total of 1.5 million). People over 45 were the most likely to switch, reflecting the government's rule change and strong confidence in the second pillar (or greater inattention to the issue) among younger savers.[55] Arguing that the global financial crisis demonstrates how savers in the 20s have no guarantees that they will have anything to retire on, the government reopened the pillar in November 2008. Yet, Slovakia's funds

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[50] Confidential discussion with Ministry of Labor and Social Affairs official, March 6, 2009; Filip Obrdadovič, "Čo chce Fico od DSS-iek?" *Hospodárske Noviny*, March 4, 2009.

[51] The Association of Private Pension Fund Management companies questioned the accuracy of the government's campaign. Average earnings had been 3.5 percent, not 0.85 as the leaflet stated. Tomanová countered that her figures netted out fees and inflation. The Association also pointed out that older and risk adverse savers could choose highly conservative investments should they so choose. "Campaign targets private pensions" The Slovak Spectator, April 28-May 4, 2008, p. 1; "Option to leave private pensions ends; few do so" *The Slovak Spectator*, June 30-July 6, 2008, p 1.

[52] OECD, *Economic Survey*.

[53] From e-mail with Michal Stuška, Spokesperson, Ministry of Labor and Social Affairs, Slovak Republic, May 26, 2009.

[54] "Tomanová napadla leták DSS," *SME*, June 11, 2009, p. 8.

55 "Option to leave private pensions ends; few do so," *The Slovak Spectator*, June 30-July 6, 2008, p 1.

have been quite conservative and have not suffered as badly as they might have in the crisis.[56] From close to 1.5 million second pillar savers the new opening netted only 8700 PAYG savers by the end of the campaign on June 1, 2009.[57]

Part of the government's failure is self-inflicted. Tomanová states that she does not want to take the controversial step of forcing younger savers to save future earnings in the PAYG system. Rather, she says she hopes to provide more information to savers and provide them the freedom they need to choose between the options. At the same time, however, the government has recently introduced regulations that will limit reduce both the potential risks and benefits from participating in the second pillar. In early spring 2009, the Ministry of Finance significantly reduced the maximum fee pension fund management companies can charge their clients. The government also plans, beginning July 1, 2009, to compel fund managers to guarantee 100 percent of pensioners' savings—this will in effect force the fund managers to convert all portfolios to conservative, low risk, and often low growth assets.[58] Given such guarantees, there seems to be even *less* incentive for savers to leave the second pillar.[59] Yet, a number of foreign management funds now threaten to leave the market altogether.[60]

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[56] *Hospodárske Noviny* reports that from February to 2008 to February 2009, most private savers lost only 4.23 percent while conservative savers earned 3.23 percent. The minority of savers who placed their funds in aggressive growth funds lost 6.23 percent. As cited in "More pension changes loom," *The Slovak Spectator*, March 9-15, 2009. By comparison, during the same period, the Dow fell by about 46 percent. http://stockcharts.com/charts/historical/djia1986.html [accessed March 25, 2009]

[57] "Tomanová napadla leták DSS," *SME*, June 11, 2009, p. 8.

[58] Internal NBS studies predict that the lower fees will render most fund management companies insolvent. In response, the labor ministry has proposed a less drastic cut while the Ministry of Finance returned the NBS report demanding they work on it more. "Filip Obrdadovič, Keď búranie druhého piliera potvrdí Národná banka," *Hospodárske Noviny*, March 20, 2009

[59] The minority of savers invested in aggressive growth funds may now be forced to watch as funds are compelled to convert portfolios from stocks to low growth potential assets at severely depresses prices. "Akcie nahradia terminovane vklady," *Hospodárske noviny*, March 24, 2009, p. 3.

[60] The measure was associated with an initiative to create a "guarantee account" to supplement the pensions of those who suffer losses in the private savings pillar. Ibid; Balogová interview, March 23, 2009. While the details are not clear, the idea would seem to create a significant risk of moral hazard. Specifically, a guaranteed private pension bailout might encourage savers to take on more risky pension fund portfolios than they otherwise would. Since private firms carry this risk, they will be forced to greatly limit the range of investment options they offer.

Healthcare

Dzurinda-era reforms were among the government's least popular initiatives. The measures introduced price incentives and other market measures to reduce costs, boost service and increase long term financial sustainability—effectively replacing social guarantees with more personal responsibility and risk. Reforms consisted of a package of six bills. It introduced fees to reflect scarcity and discourage unnecessary medical use; pushed hospitals towards eventually operating out of their own resources (one quarter become corporations allowed to make a profit); transformed state-owned insurance providers into self-funding joint-stock companies; and opened up the insurance sector to private competition. The reforms produced an immediate social backlash and provided an important issue for Smer in the 2006 parliamentary campaign. While complaints were many, Slovaks most resented the schedules of fees and co-payments and the ability of the new, cost-conscious health insurance provider's ability to deny access to basic medical services.[61]

Of all the Fico government's actions, health policy has offered the most complete and thoroughly statist response to Dzurinda-era neoliberalism. Rather than reducing costs, the government made healthcare a budget priority--it was one of the few sectors to receive a substantial increase in the 2007. More than in any other area, moreover, the Fico government undid the initiatives of its predecessor. One of the prime minister's first measures was to instruct Health Minister Ivan Valentovič (SMER) to abolish healthcare co-payments and reduce drug prescription fees. Valentovič also halted the process of transforming a range of healthcare facilities into joint stock companies, ensuring that the state remains direct owner of teaching hospitals, national specialized healthcare facilities and "institutions that perform in special situations."[62]

More importantly, perhaps, the government took aim at the new private health insurance providers lured into the Slovak market by Dzurinda reforms. Legislation now prevents companies from paying dividends to their shareholders—effectively forcing profits to be reinvested in the sector but discouraging additional investment that would have improved services and

[61] Fisher, "Slovakia's Neoliberal Turn," p. 984; Ďurana, "Slovakia," p. 49.
[62] Ďurana, "Slovakia," p. 49.

brought down prices. Similarly, insurance companies can spend no more than 3.5 percent of their premiums on operating costs. The rest must go to healthcare providers. Finally, the ministry set up a list of 34 hospitals which *must* be granted insurance contracts, rewarding inefficiency and creating a significant problem of moral hazard among already underperforming institutions.

Under such pressure, one private health insurer (*Európska zdravotná poisťovňa*, a.s.) with a 2.3 percent market share left the market in spring 2008. With little discussion, the government gave its client portfolio to the state provider. The company's international shareholders are now seeking up to US$ one billion in damages from the government.[63]

Competition and Anti-monopoly Policy

While the Fico government's statist instincts have been most apparent in healthcare and pension regulation, the government has also heavily interfered in the functioning of several key sectors, energy, banking and food retail. Most affected are Slovakia's energy monopolies, and particularly the gas monopoly, *Slovenský plynárenský priemysel, a. s.* (SPP). Partially privatized by *Ruhrgas* and *Gaz de France* under the Dzurinda government, Fico has argued that the purchase price of the 49 percent stake was scandalously low and has offered to buy them back for the same price. After gas prices spiked in 2008, SPP requested that the state regulatory agency approve a price hike to prevent running at a loss. The request was turned down and Fico told the company it should cover its losses from its large profits on its gas transit company. The government then altered the energy law so that price change requests can hence forth only come from general shareholder assemblies where the state has a 51 percent stake.[64] In the wake of the Russian-Ukrainian oil dispute of January 2009, the Fico government has (perhaps justifiably) also changed the

[63] Ďurana, "Slovakia," p. 49. Beata Balogová, "No dividends to shareholders allowed" The Slovak Spectator, May 12-18, 2008, pp. 4+ "Health minister quits surprising no one," *The Slovak Spectator* June 9-15, 2008, pp 31.

[64] "Pressure Builds as PM acts against SPP Shareholders," *The Slovak Spectator*, November 10-16, 2009. Economic advisor to the Prime Minister, Peter Stanek asserts, that he would like limit SPP foreign partners' ability to use SPP profit to fund *Ruhrgas* projects outside the country. These resources, he asserts, should be used as part of anti-crisis Slovak industrial policy. Stanek Interview, March 23, 2009.

law to enable the government to control gas reserves during crises. And it has reminded energy companies that should they insist on profiteering from their monopoly positions, they can be renationalized.[65]

Similarly, in April 2009, ruling coalition MP's drafted legislation that would limit the price mark-ups large food retailers can pass on to consumers to 20 percent.[66] This followed on threats to the banking industry that strongly suggested retail banks should loan more to alleviate the emerging global economic crisis.[67] Both measures were Smer-led populist attacks on market actors generally perceived to be profiting from their market position in Slovakia.

Privatization, Infrastructure and Procurement

The Dzurinda government's privatization policy was the most controversial aspect of all its reforms. Scandals and rumours of corruption dogged high stakes tenders for enormous sums. The J&T Group, and especially Penta Group, a.s.—two leading financial groups with murky origins in the Mečiar years--seemed to be involved in a suspiciously large number of successful bids. Nevertheless, the government sold major state assets to international and domestic actors for very high prices. Having paid significant sums for their enterprises, the new owners could usually make a return on their investment only though significant investment and restructuring.

Smer-SD campaigned, however, on the premise that the Dzurinda government's privatization policies had sold out Slovak national interests in corrupted tenders. Fico promised to halt tenders in progress and reverse a number of sales yet to be finalized. Among his first acts as premier was therefore to suspend negotiations with an Austrian buyer for the state freight

65 "PM Warns about expropriation option," *The Slovak Spectator*, August 25-31, 2008 p. 11.

66 Beata Balogová, "Food retailers margins to be regulated," *The Slovak Spectator*, may 4-10, 2009; Tvaroska Interview, April 28, 2009.

67 Slovakia's banking system recently received the only "stable" rating in the post-communist world. Fisher, "Special Report," p. 5. The country has bought this stability at a great price, by bundling and securitizing bad 1990s-era debt and by restraining fiscal spending to ERMII levels through 2008.

operator, Cargo, and to cancel a recently completed controversial tender for Bratislava and Kosice airports.[68]

Since then, the government has been slow in retendering the airports and has elected to keep Cargo and other remaining state-owned enterprises in direct ministerial control. Worse, infrastructure development projects and other transfers of state entrusted assets to the private sector have allegedly been marred by a high degree of corruption and clientalism. The worst offenders are coalition junior partners HZDS and especially SNS, whose ministers have arguably run the Ministries of Defense (SNS), Construction (SNS) and Agriculture (ĽS-HZDS) and Environment (SNS) as party patronage machines. The Ministry of Construction, in particular seems unable to run an uncontroversial highway tender possibly costing the Slovak tax payer tens of millions in additional charges.[69] While such cases of corruption have dominated the headlines, Transparency International alleges that clientalism in procurement and other services takes on more sophisticated and equally costly forms in other ministries.[70]

To his credit, Fico has ensured that outright scandals have led to a series of high level resignations among coalition partners, yet he has generally protected his own ministers when confronted by similar evidence. Most notably, Minister of Finance Ján Počiatek (Smer-SD) was caught attending a

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[68] It allowed a close to $ 1 billion investment into *Slovenske elektrarne* by Italy's *Enel* to be completed, however. Gould and Gould, "Slovakia," August 7, 2006.

[69] For just a small sample, see the superb investigative reporting by Beata Balogová, Ľuba Lesná and Tom Nicholson in: *Spex,* Spring 2008, p. 5; *Spex,* Fall 2007, p. 4; "Road gets bumpy for PPP tenders," *The Slovak Spectator*, February 25-March 2, 2008, p. 1+;. "New Briza-era SPF deals uncovered," *The Slovak Spectator,* April 28-May 4, 2008, p. 3; "Režes link to Mečiar villa revealed," *The Slovak Spectator*, October 6-12, 2008, p. 6; "Chaos Surrounds Euro-funds *The Slovak Spectator*, Feb 25-March 2, 2008, p. 2; "Pežinok dump gets go-ahead," *The Slovak Spectator,* September 1-7, 2008, p. 1; "Friends in high places," *The Slovak Spectator,* March 17-23, 2008, p. 1+; "Not your average bureaucrat," *The Slovak Spectator*, June 16-22, 2008 p. 3; "Ministry Tender Linked to SNS Allies," *The Slovak Spectator,* December 8-14, 2008, p. 1+. *Sme* and *Hospodársky Noviny* have also done excellent work keeping apparent "irregularities" in the public eye.

[70] For example, Emilia Sičáková-Beblavá points to a recent health ministry tender for ambulances in which tender specifications ruled out all competitors but one. Interview with Emilia Sičáková-Beblavá, Director, Transparency International, Bratislava, Slovakia, May 28, 2009. Liberal-oriented government watchdog, INESS estimates that clinetalism and other forms of state waste have caused the Slovak a cumulative total of 27 billion Slovak crowns (close to 900 million euro) between April 1,2007 and June 1, 2009. "The Price of the State," Institute of Economic and Social Sciences, Bratislava, Slovakia. http://www.eng.cenastatu.sk/plytvanie/ [accessed June 10, 2009]

J&T Group yacht party in Monte Carlo shortly before J&T made some highly profitable and suspiciously accurate bets on the final pre-accession euro-koruna conversion rate. Fico did not sack the minister, however. He also sent a bad signal after his Minister of Labor, Social Affiars and Family, Viera Tomanová was observed granting—albeit, relatively minor--tenders to four firms with which she had direct relations. Asserting that the connected firms had provided the best bids, Fico said that it was not cronyism if the rules were followed. More broadly he declared, "We won't let the media... terrorise us, only because we do not intend to disadvantage our members, sympathizers and mayors of towns and villages."[71] Critics quickly pointed out that *any* recognition of political affiliation as criteria in open competitions was essentially a form of cronyism no matter how close the leading bids.[72]

Corruption and delay ensured that Slovakia's infrastructural development languished during Fico's two boom years. After Fico vetoed Dzurinda's airport privatization deal, the Ministry of Transport took 2.5 years to retender the Bratislava's airport. In the same period, Schwechat airport (Vienna)--a lead partner in the original consortium—unilaterally expanded capacity and cancelled its original plan to link the neighbouring airports with a high speed rail link. In the current tender, Bratislava's role has been reduced from an integrated part of Central Europe's Vienna-based transport hub to a regional airport handling discount airlines. To add insult to injury, the Ministry of Transport unilaterally replaced a tender to expand terminal capacity with a more expensive no bid tender to the coalition-linked firm Ikores. Despite the higher cost, the new tarmac access-ramps will not even directly connect to aircraft.[73]

The freight transport carrier, *Železničná spoločnosť Cargo Slovakia, a.s.* (*Cargo*) has suffered a worse fate. Profitable in 2006, the company's margins began to decline in 2007 and 2008 before inevitably slipping into the red during the crisis. Meanwhile, opposition leader Ivan Mikloš alleges that the original Austrian suitor bought Hungary's rail carrier instead and is routing east-west traffic through Hungary.[74] Worse, *Cargo* is now a major burden on a government. To prevent workers from losing their jobs in the ongoing crisis,

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[71] "Fico unveils his tender doctrine," *The Slovak Spectator*, September 1-7, 2008, p. 11

[72] Ibid.

[73] "Ikores wins another deal," *The Slovak Spectator*, Feb 25-march 2, 2008, p. 11

[74] Ivan Mikloš, "Čo je horšie?" *Hospodárske Noviny*, March 16, 2009.

the government is assisting the company with a 166 million euro loan. *Železnice Slovenskej republiky*, the state-owned railway network operator, will get a 69.9 million euro loan.[75]

Meanwhile, tenders run by Smer's junior coalition partners continue to be marred by insufficient public notification, irregular procedures, and subsequent contracts that are padded or which balloon after signing. The European Commission has now weighed in, decided to withhold reimbursement for suspect Ministry of Construction tenders involving EU funds. Minister of Construction and Regional Development, Marian Janušek (SNS), resigned, only to be replaced by Igor Štefanov (SNS), the official who ran the suspect tenders.[76]

Other infrastructure projects are pending. The government has approved a project to build an extension of Russian/Ukrainian wide gauge railroad from Kosice to Bratislava and Vienna. Given the current over capacity of Cargo, however, critics feel the utility of the costly project is unproven. Additional mismanagement and especially suspicious transactions are found in the Slovak forestry service, run by HZDS.[77]

More so than the economic crisis, self-dealing among Smer's junior coalition parties self-dealing has become its major liability. Fico is caught between trying to protect the ruling coalition from instability and attempting to discipline it. While one occasionally hears rumors that Smer will jettison SNS for an opposition party, overall, Smer's coalition potential is low.[78] For better or worse, Smer appears wedded to junior parties which openly seek to profit directly from power at public expense.

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[75] Mikloš, "Co je horsie?" March 16, 2009.

[76] SNS Minister of the Environment Ján Chrbet appears to have presided over the further looted the state budget through suspect underpriced sales of carbon credits. "Chrbet čaka, vyhovára sa," *SME*, April 28, 2009.

[77] For more on developments in combating corruption in Slovakia, see Miroslav Beblavý and Emilia Sičáková-Beblavá, "(Anti)corruption in Slovakia and the European Union: Comparison of pre-accession and post-accession policies and situation," Transparency International, Bratislava, Slovakia, working paper, May 2009; for more about the destructive role of Euopean Structrual Funds on anti-corruption efforts, see Emilia Sičáková-Beblavá, "Conditions for effective large-scale anticorruption efforts and the role of external actors: What does the Slovak experience tell us?" *Transparency International*, Bratislava, Slovakia, paper under review, May 2009

[78] Conversation with Zsolt Gal, Political Scientist, Comenius University, Bratislava, Slovakia, May 20, 2009.

Conclusion

Prime Minister Robert Fico inherited a successful economy in June 2006. Given high growth, declining unemployment, fiscal convergence and low inflation, there was an overwhelming incentive to send market actors reassuring signals—particularly when the alternative was capital flight, a depreciating currency, inflation and subsequently punitive domestic monetary policy. Starting in June 2006, the Ministry of Finance thus outperformed its predecessor government, placing a tight limit on the fiscal budget and outpacing even the strict ERMII requirements. Changes to make the flat tax more progressive through income-based variations in the taxable minimum did little to threaten this while providing an important nod to the principle of social solidarity in the tax system.

Yet, where the Fico government did undertake major new initiatives, it did little to build a more effective coordinated market economy. Cancelled privatizations saddled it with responsibility for poorly performing firms that now need to be buoyed during the crisis. Threats to second pillar savings did little to repair the program's flaws, did not help the government meet its current obligations, and have not made it easier for future governments to pay for their retirees. Labor reforms have curbed some employer abuses but have also done little to improve labor flexibility across regions and sectors.

Nor has the government done enough to improve the business environment. Despite recent measures to speed VAT refunds and other minor tweaks, the state's costly and complex system of multiple social insurance payments looks unlikely to be unified and simplified in the near future. In addition, efforts to strengthen the rule of law and contract enforcement have stagnated while education and healthcare structures continue to underperform. Nor has the government done enough to ensure fairness and transparency in numerous state tenders. But most troubling of all is perhaps the state's tendency to bully private market actors with real or threatened market controls and even expropriation.

As of his writing, Slovakia is reeling from the 2009-9 global financial crisis. Industrial production is down around 20-25 percent from a year ago, corporate profits and VAT tax receipts have tumbled, and the government will most likely have to finance a deficit of at least 4-5 percent or more in 2009. There was of course little the current government could have done to avoid this.

Yet, the current crises should be providing a new opportunity to rethink and restructure. As Fico economic advisor Peter Stanek explains, the crisis is a chance "to get major change." It is perhaps unfortunate then, that, according Stanek, the "government does not want major change."[79] Indeed, critics from both left and right have accused the government of complacency and even overreliance on the economic policies of its predecessor.[80] As Minister of Finance Ján Počiatek claimed in March 2009, "the Slovak economy has no principle economic flaws, only momentarily, nobody wants what it produces.... we all believe that is temporary."[81] For a government that came to a power amidst promises to roll back Dzurinda era reforms, this is a remarkable admission.[82]

Of course Minister Počiatek is correct in one thing, the crisis is temporary and Slovakia will assuredly recover from the current mess in tandem with its export markets. Sadly, however, recovery will have little to do with the government's main policy initiatives. Three years into his term, Fico and his ministers have failed to articulate a coherent, center-left vision to take the country forward. Rather, the government's measures have been disconnected, ad hoc, often corrupt, and all too often, needlessly statist. While these flaws will not prove fatal to Slovakia's long term growth prospects, Slovakia has lost the chance to build socially-oriented domestic institutions that would help it to better cope with the global market place.

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[79] Interview with Peter Stanek, External Advisor to the Prime Minister for Macroeconomic Development, Bratislava, Slovakia, March 23, 2009.

[80] Ibid.; Among many others, see, Interview with Marcinčin, March 25, 2009; Interview with Žitňanský, April 24, 2009. Interview with Vladimír Zlacky, Economist, Bratislava. Slovakia, June 11, 2009; Conversation with Richard Ďurana, INESS, Bratislava Slovakia, March 23, 2009.; Interview with Vladimír Tvaroska, Slovak National Council (SKDU), Bratislava, Slovakia, April 28, 2009; Rado Baťo, "Retardovaná krajina: Aké Slovensko vylezie z krizy," *Trend*, March 24, 2009; Richard Sulík, "Dalšia fatálna chyba," *Hospodárakse Noviny*, 9 March 2009, p. 7; Richard Sulík, "Fico: Ak nás porazí kríza, bude to čestný súboj," *Hospodárakse Noviny*, April 20, 2009.

[81] "Jan Počiatek, "Nervózny? Kto by nebol" *Trend*, March 24, 2009.

[82] Phone conversation with Anton Marcinčin, Economist, Bratislava, Slovakia, March 19, 2009.

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