

Slovak Economy in the Process of Transformation (Achieved Changes, Lasting Problems and Possible Direction)

By Peter Gonda and Karol Morvay

The conditions in which the economy, as well as the whole of society, functions in Slovakia in 2002 are of a diametrically higher quality than those during the period between 1948-1989.¹ Market rules which are characterised by a voluntary exchange of goods and services between those who offer (sellers) and those who demand (buyers) gradually replaced the most absurd features of „real socialism“ especially centrally planned and regulated individual economic decision making.

At present, as commonly accepted economic relations pushed out, although in some cases only partially, many deformations from the previous social and economic system, namely:

- private ownership in a majority of companies, financial institutions and activities and enterprises that conduct business independently have replaced centrally managed (state) companies and only one bank;
- consumption options related to an almost unlimited choice of goods and services of higher quality replaced previous shortages (or limited availability) and low quality goods and services;²
- prices that (in most cases) reflect the quality and value of respective goods, services and also partially labour, replaced deformed prices, e.g. subsidised prices for food and deformed and averaged price of labour that was not a motivating factor;
- more intensive and productive use of human capital as labour power removed its extensive use characterised by full employment (in fact over-employment).

These systemic absurdities and other irregularities (a monopoly in foreign trade and artificially maintained and protected foreign trade relations with the CMEA³ countries) were removed to a significant extent already in the first phase of transformation (1990-1992). But many others lasted in various forms and with a different intensity, e.g. the deeply embedded system of „social comfort“ that puts minimum pressure on „the personal responsibility of an individual“ or „the soft financial limitation“ of companies⁴ (causing „ill branches“ to survive though not on that large a scale).

¹ The authors point out the higher quality of the present economic (but not only) environment when compared with the conditions before 1989 although they realize that it is generally known. The importance of pointing this out is supported by the fact that a substantial part of the Slovak population perceive their present situation to be completely different. According to a poll by the FOCUS agency in 2001 no fewer than 63% of citizens think that they had a better life before 1989 than they have now.

² Humiliation and several hours spent queuing for a lot of goods (from oranges to cars) became an „accepted rite“ for buyers in the period 1948 – 1989. Moreover, the limited choice of most goods „contributed“ to the spread of corruption accepted by the majority of citizens and to the acquisition of privileges for some individuals. Shortage and minimum availability of many products along with the permanent increase in dead stock were a direct consequence of „the artificially and bureaucratically from above managed economy“.

³ CMEA – Council of Mutual Economic Assistance – an international economic organisation of (former) socialist states, which during its existence (1949 – 1991) co-ordinated the co-operation of member states (especially in trade).

⁴ „Soft financial limitation“, characterized by the non-existence of direct relations between obtaining sources and their effective use in the period of „real socialism“ was partially compensated for by party supervision. After 1989 when company management was freed from the Communist party’s supervision, the weakening financial limitation started to manifest itself in widely spread immoral behaviour (especially in „the tunneling“ of companies).

Negative trends that remain until the present

The quality and quantity in the level of economic conditions remains low, especially when compared to expectations by economists and the public. Progress in the economy is less than expected in 1990, but it is adequate when compared to other countries, including the transforming ones. This is also partially confirmed by the low economic performance measured by yearly GDP. Economic subjects have reached a pre-transformation GDP level only after ten years of transformation. Moreover, Slovakia still significantly falls behind more economically developed countries, not only as regards economic performance (in 2000 only 48% of the average GDP in the EU countries and 33% of the USA performance) but also with respect to technological developments and the ability to compete (only 44% of the USA level).⁵ Slovakia falls behind also when it comes to price and wage levels.⁶ The majority of subjects are able to compete on foreign markets only by maintaining lower prices but not by increases in the quality of their products.

Several negative tendencies are characteristic for low performance and competitiveness for the Slovak economy featuring low labour and capital productivity:

- low level of entrepreneurial and innovative activities and an insufficient flexibility and mobility of labour;
- insufficient effectiveness and return of investments;
- orientation of the economy structure and export towards products with low level increase in value and towards the production heavy on energy and resources and with little demand on labour;
- high level of dependency on economic performance and competitiveness of a few companies and on energy imports from only one country (Russia).

Low labour productivity relates to a lasting unsatisfactory competitiveness, an ability to create, innovate and to a low capability of „business thinking“. Cheap labour with a high rate of high school graduates represents, at present, a certain comparative advantage for Slovakia. Similarly as with cheap energy also cheap labour means only a static and temporary advantage when seen from a desired long-term developmental point of view. Low labour price, especially when it comes to qualified labour, is not a precondition for the use of dynamic comparative advantages (predominantly of intellectual human capital) and for an improvement in the ability to compete. When considering innovative and creative abilities, computer and language skills and the rate of people with university education, Slovakia significantly falls behind many, and not only western, countries. The continuous problems with applying special knowledge causes an increase in the draining of the most qualified and innovative part of the population (the so called „brain drain“). Poor adjustment, minimum activity, failing to meet the labour market criteria as regards labour quality (mainly when it comes to a job that require higher education and qualification) and „deformed“ value priorities are typical for the majority of the economically active population. These features are even more remarkable when it comes to people who have lived most of their productive life under the previous social system. Also low labour

⁵ The comparison of countries economic performances reflects calculated GDP per capita in the USA adjusted to the parity of citizens purchasing power (OECD, www.oecd.org, 2002).

The comparison of ability to compete includes as well as economic performance, also companies effectiveness, government measures and the level of resource use effectiveness. (The World Competitiveness Yearbook, IMD, taken from Domino Forum 14/2002).

⁶ The price level in Slovakia (calculated by the parity of citizens purchasing power in USD) reaches only 37% of the average price level in the EU (OECD, www.oecd.org, 2002). The low comparative price level in the Slovak Republic confirms that economically Slovakia is falling behind many countries.

mobility represents a substantial limitation on the ability to find a job and on the noticeable growth of economic productivity in the Slovak Republic.

The limited compound economic productivity and effectiveness are caused by the low effectiveness and low return on investments. Obsolete technical and technological equipment in many companies together with poor use of information technology and better qualified labour pose an important restriction on capital effectiveness. Although the investment rate, calculated as a share of the created capital by GDP, has been since the second half of the nineties extremely high (e.g. in 1998 it reached 38% of the created capital by GDP), both previous and current investments do not have the required effect on the current formation of gross product. This high investment rate is also a result of the overblown investment activities in the public sector and the result of „forced“ investments provided by owners of privatised properties.⁷ A remarkable part of the investment activity was not motivated by the market. The investment structure remains distorted; it puts too high an emphasis on infrastructure and underestimates key areas that have a substantial influence on Slovakia's ability to compete. In the second half of the 90s only 20% of all investments was predestined for the processing industry. Therefore the investment efficiency is low. It is very much a consequence of a distorted allocation direction as well as of the fact that they require a high level of imports.

High requirements regarding energy and resources (low requirements of human capital on the other hand) and excessive weight of (half) products with a low level of processing emphasise the investment inefficiency in Slovak conditions. Even the biggest exporter from Slovakia – Volkswagen Bratislava – is, similarly like many others, characterised by „wage labour“. Most of the production consists of the assembly of imported components followed by export. Thus it contributes to fixing Slovakia's economic position as an “assembly workshop“ for foreign firms.

One of the fundamental and long-term lasting tendencies in Slovakia is also a high degree of compound economic performance and competitiveness dependency on a few companies. Slovakia's economic results are to a significant extent shaped by the performance of Volkswagen (Inc.) as well as by Slovnaft (Inc.) and US Steel (Ltd.) - although US Steel (Ltd.) is a restructured successor of a previously financially „broken“ company VSŽ. The dependence of export performance on a small number of firms is well documented by the fact that in 2001 two fifths of the exports were in the hands of only ten companies. The „fragility“ of today's competitiveness is escalated by great requirements on import necessary in order to have good export results, the fact does not apply only on important firms but on all production. The high level of dependence on the import of energy (oil and natural gas) from only one country, namely from Russia is also a problem. This dependency might restore (although not to such an extent as it used to) certain economic, security and possibly also a political dependency of Slovakia on Russia.

Grounds for continuing negative economic trends

The continuation (in some cases even deepening) of several negative trends and disorders from socialism after twelve years of transformation call for answers to a fundamental question: „What are the main reasons for there not being a more significant removal of negative economic features from the previous social-economic system?“ We present the key reasons from two, mutually interconnected and complementary, points of view. The first group of reasons are to a certain extent impossible to influence factors from the past (inherited from socialism and impossible to influence during transformation) and the

⁷ The main condition for privatisation was very often an obligation for new owners to make investments. The invested amount was then deducted from the sale price. If a new owner did not make the investment, he could have paid the extra amount. For new owners then it was worth to invest, although the investments were very often not effective.

other group includes subjective factors (that could have been influenced during transformation).

Objective factors - „embedded" socialistic deformation

The deformation of the 40 year long centralised system is deeply embedded in the behaviour of many people, even those who carry out business. They have probably become much more common and accepted than it was anticipated at the beginning of the transformation process and possibly even more than the majority of people (including the intellectuals) are willing to admit. Hidden deformations and barriers, that have not been overcome and that cause a continuation of negative economic trends, were characterised in socialism by:

- false wealth, and the suppression of people's personal activity and responsibility for their lives;
- in fact the deteriorating economy featuring autotelic structures (production for production, not to meet consumers' demands);
- tendency to imbalance and
- twisted criteria.

The citizens of the Czechoslovak Socialist Republic (CSSR) lived, unlike citizens of other socialist countries, in relative (although to a significant extent false) financial wealth. The statistically shown year-on-year average rates of personal consumption growth (provided in comparable prices) in the 80s reached in the CSSR 1,6% and in the SSR 2,4%. (Okáli et al., 1999). But every year this growth was overestimated on average by 2-3% when hiding an increase in prices that had not been calculated. Therefore the personal consumption growth was actually stagnating or even dropped. The resources created in the ineffectively functioning economy with absurdly high taxation (taxation on company's profit amounted to between 75 to 85%) were used to keep a certain (averaged out) living standard. This caused shortages in other spheres. It showed up especially in the lack of resources for the modernisation of production capacities that was followed by a widening of the technological gap between the country and more developed western countries. The financial emergency had notable impacts on the technical infrastructure (halting of road building, technical stagnation of the railways, and the slow development in telecommunications) as well as on social infrastructure (insufficient reconstruction of cities and the emergency condition of city networks). A remarkable advance in public spending growth (spending on the school system, health system, culture, defence, security and administration) and over growth in the production of resources in the economy, represented an important limitation to economic growth. Logically, public spending pumped out the resources that could have been used for personal consumption or as investments to companies. Consequentially, investment shortages led to a technological falling behind, to a deterioration in the environment and an increase in ecological debt. A permanent worsening of the population's health condition (heart diseases and cancer), a decreasing quality of life and low life expectancy were the consequences.

The creation of false impressions of financial sufficiency and wealth together with efforts leading to egalitarianism and paternalistic care, have also had more serious impacts on individuals and their attitude towards their own life. Socialist governments built a culture of dependency – a condition where citizens expected help and were not able or willing to bear responsibility for their own destiny and economic situation. This led to the gradual creation of a passive society, to inaction and activity recession. The deformation in thinking and behaviour patterns by the majority of citizens greatly affected economic performance.

This is well confirmed by the fact that the economy in 1989 entered the transformation as a de facto declining economy. Within the period 1981 – 1988, the average year-on-year economic growth rate in permanent prices reached around 1,5% in Czechoslovakia. But after the deduction of statistically not calculated hidden inflation the real economic performance was actually falling in the 80s. The socialist economy in Czechoslovakia was thereby significantly falling behind (western) economies. While in the inter-war period the economy in the CSR ranked among the ten most effective economies in the world (in 1937 it reached 84% of the economic level in Austria), in 1990 Czechoslovakia occupied 46th position (17% of the Austrian economy level according to the official exchange rate). This falling behind more developed economies became more obvious in the second half of the 70s. Czechoslovakia (as other countries with centrally planned economy) was not able to rise to the challenge requiring more intensive and better economic use of resources that arose after the „oil-shocks“ in the second half of the 70s and at the beginning of the 80s. The demanding programs concerning the armaments industry only contributed to a lower adaptability.

Low adaptability of that time economy to development trends in the world led to a decrease in the compound economic product. By contrast, the rate of input sources into production started increasing.⁸ Unsuccessful attempts to make the economy stronger by the use of further investments together with an „insatiable“ hunger for production consumption made the economy turn in a vicious circle. The functioning of the economy was then based not on satisfying personal consumption but on continuous efforts to keep the production running. The production structure within the system of a centrally planned economy imprinted backward tendencies also into personal consumption structures and people's life style. At the same time, the quality of exported goods was falling more and more behind the quality of the same commodities traded on the global market. This fact also manifested itself in unfavourable developments in export prices.

The imbalance⁹ between supply and demand that surfaced as a predominance of demand over supply was a permanent feature of the socialist economy. This imbalance influenced both domestic consumers „market“ (where it was relatively low, because households had adopted, unlike companies, hard budgetary restrictions) and on „the market“ of production inputs and „the market“ of investments . One of the forms of imbalance was also a structural imbalance (shortage in some commodities while there was an increase in dead stock of other commodities). Finance started to flow in the shadow economy where prices were markedly higher. A structural imbalance led to hidden inflation. The imbalance manifested itself also as a global imbalance – the supply of goods (production) was not up to people's available incomes. The supply structure was at great variance with consumers preferences. The shadow economy functioned and still functions as a specific mechanism helping to maintain balance.

In the period of real socialism the inside embedded imbalance „stimuli“ led to a degradation in the quality of goods, unsuitable production structures and also a hidden increase in prices because of consumers willingness to buy lower quality and more expensive goods. The macroeconomic imbalance in the socialist economy could not surface as official inflation and deficit in foreign trade balance for instance. It survived in its latent form. But the inflation manifested itself in hidden forms although it was not so obvious from the statistics.

⁸ Share of production consumption on total output in the CSSR grew from 52,6% in 1960 to 63,3% in 1988 (Statistics year-book CSFR 1991).

⁹ While assessing the socialist economy it is necessary to understand that there was no functioning market and no key market tools – price changes – which could have balanced the market, therefore the term imbalance must be perceived with respect to this fact. A decisive criterion of plan making was balance of material (as a replacement for the term balance).

Administratively set prices until 1989 did not represent the criteria for rational and effective use of resources within the economy. The gap between wholesale and retail prices was widening. Retail prices diverged from necessary costs. They included considerably differentiated turnover tax (there were about 1500 different turnover tax rates) or subsidies from the state budget. This deformed price system was a result of the implementation of the price policy giving preference to retail price social functions. Retail prices thus served as a tool to shape the living standard of citizens instead of wages. Price liberalisation after changing the system allowed prices to meet their basic objective and to be a value gauge. But with certain commodities the question whether they are to be a value gauge or a tool of government social policy has not been solved yet. The irrationality of price systems and price deformation continued to distort the structure of economic activities and supported energy-intensive production (outdated and ecologically demanding). The deformed value gauge was one of the barriers to a faster real restructuring of the economy even in the transformation course. Economic subjects got used to the fact that some „prices“ serve as social policy tools and refused to understand them as prices.

Subjective factors – no adaptation to changed conditions

The „inherited“ distortions (e.g. as regards thinking) from the period of the centrally planned economy lasted, although in a modified form. Respective subjects (employees, employers, entrepreneurs, and the government) have not been able to significantly get rid of them so far. They have not succeeded in adjusting to qualitatively changed conditions. A considerable number of citizens have not changed the common socialist habits. None of the Slovak governments has so far succeeded in solving the key economic problems and in the implementation of substantial and complex economic reforms. Moreover, respective governments (and especially less democratically oriented governments e.g. 1995 – 1998) contributed to a generally accepted value relativism with only a *de iure* but not *de facto* emphasised adjustment to the market requirements from their specific activities. Therefore the lasting negative trends are being deepened by „vicious circle“ of deformations in thinking and decision making by citizens as voters and governments, and again retrospectively citizens as economic subjects.

This thinking deformation is based on an overrating of the government's abilities and a distorted view on its tasks in the economy, on a distrust in individual (economic) freedom, personal responsibility and enterprise as well as a distrust for the observance of principal moral values. The reliance on government decisions and a frequent choice of less democratically or/and pro-market oriented political parties are negative manifestations of this deformation (that is only very slowly fading away). The deformed thinking by citizens has impacts on the deformation of the economic system (although this deformation disappears a bit faster). But a substantial minimisation of the economic system deformation is retarded by an insufficiently of „pro-reform tuned“ government political parties.

Respective governments have not started to solve the basic economic problems which consist of three (mutually interconnected) problems:

- „large“ centralised and none economic general government¹⁰, that intervenes to a great extent and represents great burden for other, especially for entrepreneurial, subjects;
- chaotic and none cohesive „game rules “ for enterprise and market competition;

¹⁰ Central government in Slovak conditions means central budgetary organisations, state special-purpose funds, privatization funds (National Property Fund and Slovak Land Fund), Slovenská konsolidačná, a.s., fund of social welfare (Social Insurance Company, National Employment Bureau and health insurance companies) and local governments (municipalities).

- low morals in economic processes and its wide acceptance.

In Slovakia the general government still distributes almost half of the economically created resources. Moreover, public spending does not decrease on a year-on-year basis. Respective general government subjects limit and stand in for other economic subjects as regards their potential activities. The Slovak governments have not made any reform of public spending targeted at a decrease in its weight and restructuring. They „contribute“ to a deepening of a citizens “reliance on the government (including general government). A high level of centralisation of public finance administration makes citizens „acceptance of reliance on outside sources“ last, and keeps them well away from public finance control.¹¹ Governments have not made financial decentralisation of public finance. The deepening of citizens reliance on the government and from this a resulting passivity are typical for the social sphere. Governments have not resolved to put reforms in the social sphere, and especially in pension, health care and school systems, in motion. At the same time, in Slovakia, the central government unfavourably intervenes in the entrepreneurial environment and changes market conditions by high volume subsidies. The competitive environment is unfavourably influenced especially by direct subsidies to agriculture as well as by various forms of “indirect subsidies” (for instance to some banks until recently). Subsidies that selectively favour some chosen subjects demotivate other, mostly prosperous, enterprises. Governments do not lower subsidies and they have not made their subsidy policy more transparent either. Tax and social welfare contribution rates remain high in order to finance high volume public spending¹². This results in high tax and a contribution burden for economic subjects causing an increase in their expenses. Income tax is particularly one of the tools by which the central government pumps out potentially free financial resources. Governments have not implemented a fundamental tax reform targeted at the tax and contribution burden and at making the tax system transparent and simple. The central government thus hinders an increase in private savings, investments and thereby suppresses the speeding up of productivity dynamics. The problem is being made even worse by the considerable need to finance a year-on-year increase in the deficit of the central government. The increase in public debt followed by an increase in interest rates and other problems related to central government management represent direct consequences. Respective governments therefore “pass on” the current public finance problems to the future. They submit “an unsettled bill” that will be made even higher by interest to future tax payers. In Slovakia, governments have not succeeded in making the public finance management more economical and they have not been able to stop the increase in the public deficit.

Transparent rules of business have still not been created. The current „game rules“ do not often apply to everybody equally. Legal tools allowing the selection and exceptions contribute to it. Subsidies, tax relief, and exemption from taxes, government guarantees or special advantages for certain investors may serve as examples. And especially support for big companies helps to preserve the inequality of opportunities on the market. Preferences for some by the state controlled companies and financial institutions or other people „interconnected“ with political parties in various ways (e.g. Devín Bank) are also a serious

¹¹ Data on the actual extent of revenue collection decentralization as well as the fact that the government has not decided about their more significant transfer to municipal governments further confirms the reality, i.e. no financial decentralisation has been made, so public finance control is still neither more direct nor more democratic. Central government’s share on revenue collection amounted to 92,2% in 2001 while the municipal governments share was only 7,8%.

¹² First of all, social welfare contribution rates (in Slovakia it means pension scheme, sickness and health insurance and unemployment insurance) amounting to 50,8% of gross wages are excessively high. They represent a difference in rate of 3,3 percentage points when compared to the Czech Republic, 9,8 percentage points when compared to Hungary and even 26 percentage points when compared to the average rates in the OECD countries. (estimates for the OECD countries are based on the MMF calculations, see the IMF, 2000).

problem. Governments do not carry out any limitation on their regulatory activities as regards market and competition. There is also an insufficient protection of minority shareholders that also creates barriers to the development of the capital market and is another problem for carrying out business, particularly for partnership companies, in Slovakia. The inequality of opportunity for enterprise and the non-transparency of rules for leaving the market in the case of failure were worsened by the inactivity of supervisory institutions – capital market and banking supervision. The constant insecurity and low enforceability of the law remain a substantial problem especially for small and medium enterprises. This condition is a consequence of inflexibility and the long time delay in taking court proceedings, the low effectiveness of the law on bankruptcy and settlement as well as extensive corruption in the judiciary. Governments have not provided real improvements in law enforceability.

A low level business morality spreading in economic processes (similar to the whole of society) hinders the development of the market and the competitive environment and their natural advantages. „Tunnelling“ of companies by their own management, and low payment discipline are manifestations of the relevance of generally accepted values. These widely spread negative phenomena (which have become „standard behaviour“) are directly related to the lack of mechanisms that would automatically exclude people with poor judgement from the decision making process. The widely spread forms of (political) corruption and protectionism are specific and extremely dangerous. Political decision making is permanently under pressure from various lobbies that have large amounts of money. Also the wide authorisation of general government employees with respect to entrepreneurial activities (e.g. licensing, registration or litigation) make a „prefect environment“ for corruption. They may greatly restrict any efforts leading to the creation of a legal framework necessary for free enterprise and law enforceability. But there are also various forms of corruption as regards relations between citizens and the central government. A typical example is the long time embedded corruption in the health care system. The health care system suffers from a long-term shortage on resources although citizens pay substantial mandatory contributions. Respective governments have not eliminated corruption and have not created any conditions necessary to minimise its occurrence. The high level tolerance of corruption in Slovakia might lead to its further spread.¹³

In Slovakia, governments not only ceased to implement economic reforms (or they implement some of them but only in a limited form) but their measures worsen the economic conditions in many cases. The spread of protectionism and political corruption, favouritism of some selected subjects (e.g. banks)¹⁴ and poor public finance management are only a few examples. Several adopted government laws (especially by less democratically oriented governments) in the course of transformation have been harming the creation of a standard economic environment e.g. the law on revitalisation and the law on strategic companies adopted by the previous government and the law on state and public service and the labour code adopted during the current government's term of office.

¹³According to polls done by GFK Prague 48% of Slovak citizens understand bribing as a necessity which is to be accepted by everyone who wants to survive, and almost 80% of respondents think that the current government is not really interested in eliminating corruption (Economist 42/2001).

¹⁴The most obvious case was a „support“ for Devín Bank that was allowed to exact government debts abroad despite having problems meeting the criteria for banking activities. Also the attitude of the government towards banks (Všeobecná úverová banka, Slovenská sporiteľňa and Investičná a rozvojová banka), was a serious hazard.

During the previous government's term of office these banks had an opportunity to provide credits to „close“ clients on a large scale and the current government assumed these unsettled credits amounting to 105 billion SKK. Moreover, the government controlled banks received also interest on such unsettled credits. This means that current and future tax payers are burdened with paying out the „bad“ credits.

General expectations and fundamental preconditions for a long-term economic development

General expectations

In Slovakia, there will probably be no potential for a long-term economic development within the next few years. We expect moderate economic development when compared to the present situation, this will be connected with an increase in foreign investments (that will come as a result of increased international credibility and security of Slovakia as a member of NATO and the EU). But a significant flow of investments will be prevented by an insufficiently cohesive creation of conditions for motivating the entrepreneurial environment. The foreign capital will not only contribute to improvement of company management but also to improvements in „entrepreneurial culture“. But we certainly cannot expect that „imported“ rules will be accepted by the majority of domestic subjects and that they will identify themselves with them.

In the medium-term, Slovakia will keep on falling as regards economic performance, productivity, competitiveness, technological development and price and wage levels, behind economically developed countries. A remarkable difference between Slovakia's economic performance and an average performance of the fifteen EU members states will be getting smaller only very slowly.¹⁵ The economic performance and competitiveness of Slovakia will fall not only behind the most economically developed countries (e.g. the U.S.A, and Luxembourg) but also behind more recent dynamically developing countries (e.g. Ireland and Finland). The capital market will remain underdeveloped and not only behind western markets but also behind the Hungarian and Polish capital markets.

The current negative trends will continue unchanged in the next few years. Value attitudes, ways of thinking and peoples adopted behaviour patterns will not experience any change.

The scale of economic activities, personal responsibility and labour mobility will remain low in Slovakia. The cessation of many domestic companies (as a result of increased competitive pressure posed by foreign companies and in the context of a unified inner EU market) will support a high unemployment rate, particularly in some regions. An inability and unwillingness from a substantial part of the population to assume responsibility for their economic future will last. The number of people who are not able to find a job will remain high in the following years and will pose a problem. Production and export from Slovakia will be oriented to energy and resource intensive products with low added value in the medium-term period. The ability to compete will be supported more by low prices than by an increasingly higher quality of products. It will be determined by the production of several bigger companies and by a high level of imports.

The preservation of several negative trends in the Slovak economy will probably result from the activities of governments elected in 2002 and 2006 – their minimum ability and/or willingness to implement complex and fundamental economic reforms, and to solve essential economic problems. We do not expect that Slovak governments will be able to meet the criteria of being undoubtedly democratic, pro-market and pro-reform orientated, and the criteria of „being operational“ and the criterion of value affinity of government political parties, within the next few years.¹⁶ It is very unlikely that governments will be able to agree on a more significant decrease in public finance weight „inside“. There will be

¹⁵ It is presumed that 48% of Slovak economic performance when compared to the average performance in the EU countries in 2000, might reach only some 54% in 2007.

¹⁶ The scenario of the most probable developments considers two alternatives in a government's structure. The first one assumes that governments will consist of broader coalitions and it will contribute to the maintenance of non-standard political parties and political systems, and cause clumsiness and low effectiveness in decision making. The other (although less likely) alternative is a government (or governments) consisting of less democratically oriented political parties with an autocratic approach.

no more significant reforms of public spending (whether in regard to subsidies or social sphere spending). The high tax and contributory burden on economic subjects (although it might get smaller) will most probably last. Public finance management will improve only a little. It will be limited by pressure lasting from the past (e.g. costs of selected bank restructuring) and financial pressure related to the accession to the EU.

It is also not possible to expect minimal influences on various forms of imperfect competition, although several big foreign companies will enter the market in the Slovak Republic. Therefore a real low enforceability will remain low in the next few years. Corruption in the judiciary will restrict law enforceability. This will probably be also connected with the acceptance of low morals by all of society and thus have serious impacts on economic processes in Slovakia.

Fundamental preconditions of a long-term economic development ¹⁷

Despite these pessimistic expectations as regards the improvement of economic conditions in the next years, there is the real possibility of a significant qualitative change that could be made using inner potential but only over a long-term period. There are several examples of different ways of becoming a dynamic, competitive and educated country. For Slovakia, it is reasonable to compare itself to similar smaller countries which were economically underdeveloped and poorer, when compared internationally, only several (ten) years ago but now they achieve high economic performance and rank among the most dynamic and competitive economies. Ireland, Finland, New Zealand and, as a transforming economy for instance, Estonia may serve as examples. All these countries occupy top positions as regards economic freedom.¹⁸ To go a similar way Slovakia will probably need a longer time and it will be determined by the existence of many preconditions.

A long-term sustainable economic development in Slovakia depends, first of all, on the creation of systemic preconditions for a continuous real increase in productivity, permanent efforts to implement principles of economic freedom, a functioning market, personal responsibility, principles of transparent ownership rights (including protection of private property), and the equality of opportunities. As wide as possible access to education and knowledge (and opportunity to use them), especially to knowledge in highly specialised areas that require high quality human and technological capital, ability to apply this knowledge in practice represent an important precondition for having inner potential for a positive change in economic performance. The main precondition for a long-term economic development is meeting the following mutually interconnected objectives:

- a significant reduction in the role of central government and redistribution scope within the economy, its economic contouring and decentralisation;
- The creation and observance of transparent and unified „game rules“ for enterprise and competition on the market;
- minimising opportunities for the creation and spread of immoral behaviour, especially corruption, protectionism and their „pseudo rules“.

A significant reduction in the „size“ of central government, and in the scope of the redistribution of funds in the economy, should lead to the creation of a government that

It is also possible to accept the consideration of Peter Zajac that a wide-spectrum government of „mud democracy“ that was elected in 2002, will help less democratic and more autocratic oriented political parties to consolidate their positions and influence, at least, in Parliament .

¹⁷ The objective is not to present a complex set of measures within the government's economic policy. The authors focused „exclusively“ on fundamental preconditions for economic development of Slovakia.

¹⁸ According to the results of world wide levelling of the Economic Freedom Index in 2001 (The Fraser Institute), for instance New Zealand occupied the 3rd position, Ireland was in 6th position, Finland in 14th, and Estonian 36th while Slovakia occupied the 68th position (NFAH, see Thomay, 2001).

will be able to perform the tasks which it is principally predestined for in a democratic society with a market economy (the legislative tasks, judiciary, foreign affairs, defence and security, social standard of objectively disadvantaged people, protection and education for children). Central government should be significantly smaller, economic, and more decentralised. But at the same time it should be stronger where it is supposed to be, for instance in the judiciary.

Reduction in scope of activities performed by central government and reduction in its interventions into the real economy will require mainly:

- substantial decrease in public spending weight, especially by the removal of any forms of government interventions into the entrepreneurial environment (mainly subsidies, loan guarantees, or other selection tools), reduction in central government consumption costs (wages and purchase of goods and services) and a reduction in the costs of social transfers (that should go hand in hand with reforms in the system of social sphere funding);
- substantial decrease in tax and contribution burden, especially by lower tax rates for legal entities and natural persons, lower social welfare contributions and by putting more importance on indirect taxes (particularly on VAT);
- transparent and simple tax system without selection tools (e.g. various rates within the same tax, or some other advantages and exceptions);
- achievement and maintenance of balanced year-on-year economic management (deficit is allowed only in the case of unforeseen external influences), suspension of public debt increase and its gradual elimination (primarily with respect to GDP);
- significant decentralisation of central government (including transfer of finance) meaning more authorities for local governments.

Markedly smaller role of central government in the economy followed by a significant reduction in tax and contributory burden should bring a greater portion of economic output into the private sphere including after-tax wages. An increase in available financial funds will then allow a greater scale of private savings and investments and the creation of new jobs. This will support an increase in (economic) freedom, personal responsibility and entrepreneurial activities.

A substantial reduction in the redistribution through public finance should support a solution in another two key problem areas in the Slovak economy – none transparent and diverse rules for enterprise, and growing corruption.

The removal of direct interventions by the central government to the entrepreneurial environment (through subsidies, loan guarantees and licensing) will not suffice to create transparent and unified rules on the market. To meet this objective and achieve equality of opportunities it will be necessary:

- to simplify, unify and make the criteria for entering and leaving the market transparent;
- to minimise forms of imperfect competition (monopoly and other dominant players);
- to reduce regulation scale (regulations, measures, etc.) on the market, and especially on the labour market;
- to provide (legislative) preconditions for law enforceability, including effective courts;
- to provide unquestionable protection of minority shareholders rights;
- to define precisely the criteria for leaving the market in case the subject fails.

A remarkable reduction in central government influences on the economy, a reduction in market regulation, the creation of transparent and unified rules of enterprise, decision making and selection processes would substantially contribute to minimising corruption opportunities. A side target to support this main objective should be a decrease in the influence of lobbies, particularly illegal ones. Meeting these objectives requires the elimination of informal rules and everyday practical observance of ethical values and active intolerance towards corruption. But this is a question for several generations.

The overall capability of human capital, especially higher quality labour (able to apply new mainly information technologies) represents a fundamental precondition for the achievement of the above named economic strategic objectives. The maintenance of a stable monetary environment, the prevention of inner and outside economic imbalances, effective functioning of the market and flexible labour market are fundamental preconditions for economic development. Political development based on pro-reform and pro-market orientation of respective governments is a must.

To achieve a successful economic development in Slovakia it will be necessary to implement a long-term supply oriented economic strategy targeted at support for private saving and private investments. Similar complex strategies were adopted and implemented by conservative governments in the USA, Great Britain and Ireland. The ability to explain legitimacy and rightness of the set of measures to citizens in a way that will allow them to accept it is also an important criterion of success. It will be necessary to overcome the hostility of several interest groups (e.g. farmers and the unions) and possible pressure put by the EU (that could try to hamper „more daring“ and univocal market oriented economic reforms). One of the preconditions for a positive direction, that cannot be questioned after a „simple“ exchange of governments, could be by the constitution guaranteed features, e.g. balanced public finance management (or just a strictly defined allowed total deficit) and a constriction of public spending increase.

Peter Gonda is an economic analyst for the Conservative Institute of M. R. Štefánik. Karol Morvay is an economic analyst for M.E.S.A. 10.

The article was published in the magazine **Conservative Views on Society and Politics (Spring – Summer 2002)**. It is available at <http://www.institute.sk>.

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