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PRIVATIZATION IN THE SLOVAK REPUBLIC

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1. The Uniqueness of Czecho-Slovak privatization (1989 – 1993)

Privatization is a relatively new term in economic theory. It seldom appeared in economic texts before 1979, although the word itself was first coined in 1948. The term privatization, as such, was not even mentioned in the British Conservative Party election program of 1979, though it was this political force that effectively started the privatization process in Great Britain, the first target being the telecommunications company British Telecom.

The main goal of transferring public property into private hands -- perhaps the most common definition of privatization -- is to improve the efficiency and performance of different sectors of the economy by subjecting them to the market mechanism. However, this definition and goal of the privatization process may only work in a system that already has a properly functioning market economy. Given this necessary precondition, the privatization process in all countries of the former Eastern block was unlike anything we have observed in the standard Western market economies. Czechoslovakia was even more unique because, unlike Hungary or Poland, not only did the Communist party and its Central Planning Commission rule over the whole economy, but absolutely no private enterprise – not even the smallest firms owned by self-employed persons – was allowed to exist.

In November 1989, the Velvet Revolution changed the whole situation in the former Czechoslovak Socialist Republic. The economy became more efficient, but privatization was not the cause. The very first task facing the 1989 reformers, led by current Czech President Vaclav Klaus, was a restructuring of the whole economy. It was necessary to literally build capitalism from the ashes of this former directive economy. Privatization was not the goal, but perhaps the most important tool used to achieve this objective.

When the government was selling a few companies into private hands in countries like Great Britain in the belief that privatization would make the companies more efficient, its policymakers could rely on the information provided by market forces in a stable legal environment. By contrast, both market forces and a new legal environment were still being improvised in Central and Eastern Europe. The point of the privatization process was to undermine and break the economic power of the communist state, and to achieve a fundamental change in the government's role in economy. Increasing business efficiency was a secondary objective, if it was an objective at all, compared to the main task of privatization in transition economies: to create a new group of private owners, whose activities would later enable market forces to start functioning independently. Privatization creates private property, without which no real market can exist. Without a market providing the necessary information through its price mechanism, business efficiency simply cannot be measured.

Besides the significantly different objectives of privatization in a country transitioning from a centrally planned economy, there were three other basic conditions that made the privatization process in Eastern Europe unique from privatization in standard market-oriented democracies. The first of these differences was the enormous quantity of property that had to be transferred to private hands, especially in comparison to the overall amount of savings existing in the economy. The accumulation of capital was, not surprisingly, not a strength of the socialist economy. The gap between the value of state property and the assets available in citizens' pockets was huge.

The fact that savings were negligible compared to the value of state-owned property was a strategic concern which shaped early privatization policy in Czechoslovakia between 1990 and 1993. In the end, the government did not have a choice: if it really preferred true privatization to simple state-owned assets restructuring, they had to start giving out state property to people nearly free of charge. The task of transferring a huge amount of property as fast as possible to the widest possible group of citizens with almost no assets inspired the idea of voucher privatization that was later applied in 1992.

Another special aspect of the early stages of privatization in Czechoslovakia stemmed from the non-existence of standard market institutions. The whole process of creating a standard market environment with a stable legislative framework had to be built upon a set of transitional and absolutely non-standard sets of rules and legislation. This logical contradiction characterized the early years of privatization in Czechoslovakia. The government was trying to kill itself: temporary laws and one-time maneuvers needed to be undertaken to establish a standard set of official and unofficial institutions, such as a legal framework, private property protections, corporate governance regulations, and others. One of the main lessons to be learned from the economic transition in Eastern Europe is that a fall of one set of institutions (the socialist economy) does not mean that another set of institutions (market economy) will arise, Phoenix-like, from the ashes. In reality, creating standard market institutions was a long, painful process, accompanied by thriving corruption, a period of "crony capitalism," political populism and even a deep disappointment. The political and economic elites were not prepared for the complexity of rebuilding the economic system; nor were the western experts who arrived almost immediately after the fall of the Iron Curtain with blueprints of economic reform in their suitcases.

The final unique element of the privatization process in the former Czechoslovakia was the primacy of the issue for the government. De-nationalizing the economy required the government to focus nearly 100% of its attention to the privatization process. The economic transition overwhelmed all other governmental responsibilities, such as assuring the general operation of state-governed sectors – health care, education, environmental protection, and public transportation. Moreover, if the government wanted to fulfill its strategy and disseminate state-owned assets among as many people as possible and as fast as possible, it had to resist the temptation to raise a significant amount of money for its general operation through the privatization process – which would be a legitimate objective for any other government.

2. Methods of privatization in Czechoslovakia (1990 – 1993)

Bearing in mind the unique elements of privatization in Czechoslovakia at the beginning of its transition is crucial for understanding the five basic privatization methods that were used in this early stage of denationalization of the economy. The five methods included restitutions, small-scale privatization, large-scale (or "standard") privatization, voucher privatization, and the direct sale of companies to foreign investors.

Restitutions

Restitutions (i.e. returning property confiscated by the Communist government to its original owners or their inheritors) were the very first modification of the government's plan to distribute state-owned property to the public "for free". As Tomas Jezek, Privatization Minister in the first cabinet of Vaclav Klaus and father of the idea of restitution, commented[1], "The government very soon realized that public opinion expects the renovation of market structures to go hand in hand with the restoration of property rights of those individuals, who lost them during the nationalization process in the socialist era."[2]

Restitutions were given priority within the privatization plan. Citizens were given a deadline by which they had to file a claim of their rights to nationalized property[3]. Only assets without restitution claims were eligible for sale through other privatization methods.

Although these restitutions were originally intended as a remedy for past socialist injustice, the public soon realized that no injustice may be redeemed completely. While the basic idea of restitutions was that the property would be given back to its original owners in its present condition, the parliament added requirements for appreciation and depreciation of the value of property to the law, which later caused significant bureaucratic problems in calculating the value of restituted property.

When property could not be returned to its original owners because of its current use, these eligible persons were either reimbursed with cash, or, later, with shares in a special "Restitution Investment Fund", a special-purpose fund into which 3% of the shares of each company put into the voucher privatization system were allocated.

It is interesting to note that Czechoslovakia was the only state in the region that decided to deal with the issue of property injustice caused by the Communist regime. Other countries, such as Hungary or Poland, decided to draw an imaginary red line demarcating the past from the present and refused to confront the idea of restitutions at all. Therefore, despite the unevenness of the restitution process – for example, restitution of the Church property remained an open question until 2004 – Czechoslovakia clearly made better progress in coping with the specter of Communism.

Small-scale privatization

The very first stage of "real" privatization of state-owned property was the small-scale privatization that officially began in February 1991 and officially ended in March 1994.

The small privatization was primarily used for selling small companies in the retail sector, service providers, and smaller production facilities. It is important to note that unlike in large-scale privatization, property sold during small-scale privatization was sold as a "clear" asset, without receivables or liabilities.

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[1] Husák, Petr: Budování kapitalismu v Čechách (Building Capitalism in the Czech Republic), Volvox Globator, Prague, 1997 (Page 117)

[2] The Communist nationalization process in Czechoslovakia, after the World War the second, culminated in February 1948, and its main phase lasted until 1959.

[3] This applies to restitutions based on the Act. No. 403/1990 on Alleviation of Property Injustice; Later, in 1991, other two laws related to restitutions were approved.

The only method used in small privatization was the public auction. The Privatization Ministry nominated district privatization committees who were responsible for preparing documentation and lists of companies and company units to disbursed through small-scale privatization. These lists had to be approved by the Privatization Ministry. All auctionable property had to be visibly marked with so-called "privatization cards" for at least 30 days prior to the auction. Every participant of the public auction had to deposit 10 % of the outset price before the start of the auction.

Nearly ten thousand companies or company units were privatized during the small privatization program in the Slovak Republic. Quite often, the so-called "Netherlands Auction Method" was used in the public auction, based on auction practices from the Dutch flower markets. In the Netherlands public auction, if no auction participant is interested in purchasing the property for the upset price, the auctioneer gradually decreases the price of the property by 10%[4]. This auction method originally developed because the goods bought and sold at the Dutch flower market degraded quickly and needed to be disbursed quickly. This method was therefore ideally suited to Czechoslovakian small-scale privatization, where a main goal was that state-owned assets should be distributed to citizens in the fastest possible way, regardless of privatization revenues earned.

It was clear that small-scale privatization alone may not be sufficient for a successful economic transition. However, small-scale privatization, along with the first restitutions and founding of the first small companies, helped create a new class of entrepreneurs whose numbers skyrocketed in the second year after the fall of socialism. This new group of companies played a crucial role in the dynamic growth of the private sector in Czechoslovakia. Also, successful dissolution of former socialist-era service and retail monopolies into small, independent and competing units with local owners became the life- blood of the evolving competitive business environment.

Large-scale privatization

Despite its undeniable success, small scale privatization was a minor improvement relative to the effect of large-scale privatization. Simply put, large-scale privatization concerned the selling of large companies. Its major element was that the companies or company units sold through large-scale privatization were privatized including their liabilities and receivables, and that the process of their privatization had to based on specific privatization projects, submitted by interested bidders and management of the privatized companies.

The first problem to be solved at the start of the large-scale privatization process was the conflict of interests between large- and small-scale privatization. In effect, any of the companies could be privatized through either of these processes, which meant a direct conflict of interest for two groups: the potential bidders, who preferred small-scale privatization, and company management, who preferred large-scale process that would allow them to remain in the company and prevent the property of the companies from being divided.

The legislative framework for large-scale privatization was approved in February 1991[5]. The

[4] In Czechoslovakia, the legislation allowed to decrease the price of the auctioned property by 50 % at most in the case of the Netherland Auction Method in the small-scale privatization; this limit was increased to 80 % in case of a repeated auction

[5] Act No. 92/1991 on the Large-scale Privatization; later amended by the Act. No. 171/1991.

process of large-scale privatization itself started in early June of the same year with the publication of four lists of state-owned companies: a) a list of companies to be privatized in the first wave of large-scale privatization; b) a list of companies to be privatized in the second wave of large-scale privatization; c) a list of companies not to be privatized; and d) a list of companies to be liquidated.

Three basic methods were used during large-scale privatization: 1) direct sale to a chosen buyer or a foreign investor; 2) public auction, the least used method as it required the buyers to pay the whole price within 30 days of the end of the auction; and 3) public tender, when factors other than the purchasing price (such as company development and restructuring strategies, investments, etc.) were used as the main criteria for selecting the new owner. Both Slovakia and the Czech Republic also put aside a group of companies that were to be privatized by a non-standard method – "voucher privatization."

It is important to mention that in the case of large-scale privatization, potential investors had to explain in their privatization bids how they would deal with possible restitution claims to the newly-privatized company's assets. As mentioned earlier, under large-scale privatization whole companies were transferred to private hands with all assets as well as all liabilities (including liabilities that might occur from the restitution claims).

Voucher privatization

State-owned companies designated for large-scale privatization, management teams which did not submit clear privatization bids, and other companies selected by the Slovak Privatization Ministry were sold through a process known as voucher privatization.

The first wave of voucher privatization started in Slovakia on May 14, 1992 and ended by the end of the same year. A property with a registered book value of more than 90 billion crowns was designated for voucher privatization in Slovakia, and more than 2.5 million Slovakian citizens participated in voucher privatization.

Voucher privatization was the main tool used for transferring large amounts of assets to a wide group of citizens with a very low level of capital. It was an experiment unique to the Czechoslovakian privatization process. The main goal was the distribution of shares of privatized companies to the citizens. Every adult citizen could purchase a book of vouchers worth 1,000 "privatization points" for a symbolic fee of 1,000 crowns, and exchange these vouchers for the shares in companies designated for voucher privatization (or for a stake in the newly-established Investment Privatization Funds).

In each round of voucher privatization, the federal Privatization Ministry would first announce the "exchange rate" of shares of particular companies for the privatization vouchers. Citizens would then assign their vouchers to shares in the company of their choice. After the collection of inquiries, the ministry announced any of the following results of the privatization round: a) if the total demand for shares of a particular company was lower than the supply of shares, all inquiries were satisfied; b) if the total demand for shares exceeded the possible supply by more than 25%, no inquiry was satisfied; c) if the total demand for shares of a particular company exceeded the supply by less than 25%, the ministry could cut from the round the inquiries submitted by the investment privatization funds (the number of spared privatization points could be used by the funds in the next privatization rounds); or d) the inquiries that could not be satisfied by any of the previous methods were spared and could be submitted in one of the following privatization rounds. This primitive market mechanism allowed the government to regulate the shares' supply and voucher demand throughout the voucher process.

Investment Privatization Funds (IPFs) played a special role in the voucher privatization process. These funds were founded by private businessmen and companies with the goal of collecting privatization vouchers from citizens and exchanging them for the shares in the privatized companies. In the first round of the voucher privatization, 169 IPFs were founded, and they were quite successful, acquiring shares in nominal value of almost SKK 55 billion, which represented about 70% of the assets put into the voucher privatization. The overall experience with these entities was mixed, however. It was positive in the sense that for most Slovaks and Czechs, dealing with the IPFs was their first experience with capital markets and collective investing. However, the IPFs gained significant economic power which, paired with the underdeveloped and unstable legal framework, provided ample opportunity for fraud and misappropriation. Several IPFs obtained voucher books from citizens in exchange for promises to buy back their stakes after a certain period of time for a price exceeding the value of the original voucher. Other IPFs were simply "tunneled[6]" by their founders and managers; in the end, even many of the honest managers were almost forced to tunnel their funds due to rising government intervention that finally cut the process of voucher privatization in Slovakia[7]. It is also interesting to mention that in most cases, the IPFs were founded and run by the new generation of entrepreneurs, mostly young, dynamic, market-oriented people, who had to fight for power against the old structures and managers of the state-owned companies from the socialist economy.

3. An unstable economic environment in Slovakia (1993 – 1998)

June 2002 was a breaking point for the Slovak Republic, and not only in terms of the privatization process. A party called Movement for a Democratic Slovakia (Hnutie za demokraticke Slovensko – HZDS) won the parliamentary elections, and the division of Czechoslovakia into two independent countries soon followed. The government of Vladimir Meciar then subjected Slovakia to several years of international isolation, misuse of political powers, and substandard economic policies.

This period was characterized by many privatization scandals, with some having long-term effects on Slovakia's society and burdening the economy of the nation for several years, even after this period. As some public policy analysts in Slovakia noted, government policies and a lack of transparency in the privatization process distinctly undermined the confidence of Slovak society towards private entrepreneurship and the whole market system. This period, also called a period of "crony capitalism", was an era of new local privatization tycoons, each with good connections to the governing party.

[6] "Tunneling" is a folksy term first coined during the transition years in Czechoslovakia – it describes the situation when management of a company, bank or investment fund misuses the poor legal framework to deliberately transfer the assets of his firm or fund to his own business, offshore locations, etc.
[7] More information in part 3.

Brief overview of the privatization process in Slovakia between 1993 and 1998

Due to the political, economic and legal turbulence of this period of privatization, the Slovak economic think-tank MESA 10 divided the period into several phases for the purposes of analysis. While 1993 was a year of stagnation, when privatization slowed dramatically, the second and third months of 1994 – just before the temporary suspension of Meciar's cabinet for about half a year – was a phase of the "wild privatization". The Privatization Ministry was quickly approving privatization projects and literally handing out state-owned enterprises to directly selected buyers, chosen personally by political elites. One high profile case was the transfer of a significant share in one of the largest Slovak companies, the Vychodoslovenske zeleziarne (VSZ) steel mill, for just a fraction of its market price, just a couple of hours before the cabinet was dismissed. Its new owners, the "Rezes" group, named after their main player, Transport Minister Alexander Rezes, later became involved in several privatization scandals, including the fall of one of the biggest Slovak banks, the Investicna and Rozvojova bank.

From March to November 1994, the temporary opposition cabinet tried to launch a new wave of voucher privatization, and to investigate some of the privatization scandals from the previous year and a half. However, Vladimir Meciar regained power in late 1994, and perhaps the longest period of uncontrolled privatization in Slovakia resumed. Most of the government's privatization tasks were transfered to the National Property Fund privatization agency, and the practice of the direct sales of companies to selected owners for just a fraction of their market price (even this fraction was often to be paid in several installments over long periods of time) prevailed among all other privatization methods. The general public as well as foreign investors were excluded from the process. This new group of Slovak privatizers lacked capital, and their practice of covering the purchasing price by leveraging privatized assets resulted in the failure of many potentially prosperous enterprises. Most of the biggest privatization scandals, such as the transfer of the remaining significant stake in the VSZ steel mill to the "Rezes" group, sale of the Slovnaft crude oil refinery or the case of Nafta Gbely gas storage company, occurred during this period.

The process of privatization continued along the same lines through 1997 and 1998. Although the number of privatization-related scandals dropped due to the decision of the Slovakia's Constitutional Court to transfer regulation of privatization from the National Property Fund back to the Ministry of Privatization, the sales were increasingly disadvantageous for the government. Even brazen revisions of past privatizations, with the goal of further reducing the purchasing price for the buyers, cropped up. Connections between economic and political groups also became increasingly visible.

Most of the problems of the Slovak banking sector occurred during Vladimir Meciar's reign. The VSZ group was involved in taking control of the Investicna and rozvojova bank in 1997, one of the four biggest banks in Slovakia. Other major banks were not privatized in this period, but were taken over by political nominees of ruling political parties. The current bailout cost of mismanagement of these banks and bad loans approved during Meciar's era amounts to about SKK 130 billion (which equaled over 15 % of the Slovakia's annual gross domestic product in 1998).

The end of the voucher privatization

The impulse for a second wave of voucher privatization in Slovakia came in March 1994, when early elections led to a temporary dismissal of Meciar's cabinet. The provisional government ordered registration for privatization vouchers to start on September 1, 1994. Over 3.4 million Slovak citizens decided to participate (about one third more than in the first wave). The first round of the second wave of voucher privatization was scheduled for December 15, 1994. This round was cancelled with the return of Meciar's cabinet to power. For a long period of time, privatization failed to be a tool for transition towards a market economy, and was merely a tool for strengthening the power of the governing elites.

The legislative end of voucher privatization came in 1995. The cabinet decided to cancel voucher privatization, and instead offered so-called "privatization bonds," issued by the National Property Fund, to all persons who registered for the second wave of voucher privatization. Privatization bonds with a nominal value of SKK 10,000 were issued for five-year periods and yielded interest equal to the interest rate of National Bank of Slovakia (the central bank), to be paid at the time of repayment of the whole bond (on December 31, 2000). Although national law recognized several means of using the privatization bond, only two were actually effective: people could either hold the bond until it matured, or they could sell them to legal entities to use for repaying liabilities to the National Property Fund (this was, for example, the case for recently privatized companies whose owners were paying the privatization price in several installments).

Privatization bonds were a very special kind of security, much different from normal bonds. In fact, from an economic point of view, the privatization bonds were not real debt papers, as there was in fact no debt existing that would be backed by these bonds. It was just the government's decision to compensate the citizens for the cancelled privatization in this manner. Therefore, privatization bonds were nothing more than a somewhat securitized transfer from government to the citizens.

The decision to issue privatization bonds had a significant impact on the citizens and economy. Issuing such a debt to be repaid in the next election period was an irresponsible decision from a fiscal point of view. The original idea of exchanging vouchers for shares in companies, which would mean a transfer of ownership, was effectively abolished. Also, the privatization bonds became another tool for the new group of privatizers who managed to get the formerly state-owned enterprises for a fraction of their real price, to grab other additional profits – through purchasing the bonds from citizens for a negligible price and then using their nominal value to repay the purchasing price of the companies they privatized.

Another effect of issuing these privatization bonds stemmed from the existence of privatization funds that tried to attract citizens for a second wave of voucher privatization by providing them SKK 1,000 loans for getting the privatization voucher; of course, when the privatization was cancelled, these funds had to ask for a repayment of these micro-loans to minimize their losses. This alone became a powerful, immediate symbol of the diminished credibility of anything connected with privatization in the eyes of the general public.

Privatization of strategic companies

The privatization of the public monopolies in Slovakia deserves its own detailed description. These companies were not touched by previous privatization waves in Slovakia, and their shares were never offered through voucher privatization.

The first legislative step regarding the privatization of public monopolies was introduced in 1995, when the Slovak parliament adopted a law concerning the privatization of strategically important companies[8]. This law specified two groups of companies owned by the state, or its privatization agency, the National Property Fund. The first group included 26 companies that could not be privatized at all, among them all the public monopolies. The second group included 45 companies of strategic importance, in which the government would keep its control. According to this law, assets owned by companies in the following sectors could not be privatized: the gas industry; electricity generation, distribution and transmission; the pharmaceutical industry; the postal and telecom industry; the armaments and general engineering industries; agriculture; the forest and water management industry; railway transport and oil transport. This legislative norm clearly defined the strategic companies in Slovakia. However, its character was more or less symbolic. By the end of the Meciar's rule in 1998, no public monopolies were privatized, but out of the "strategic" companies in the second group, only 10 remained in under total government ownership: 35 of them were privatized to varying degrees of transparency between the years 1995 to 1998.

4. Standardization of Slovakia's economy (1998 – present)

Parliamentary elections in September 1998 caused a radical change in the whole political situation in Slovakia. Vladimir Meciar's government was replaced by the more open government of Mikulas Dzurinda. However, as the new ruling coalition was the result of anti-Meciar sentiment, it consisted of ideologically different political parties that could not agree on a consistent program in the area of privatization. Despite great progress achieved in this period, leftist parties in the ruling coalition became an obstacle for a more radical privatization process.

The new Dzurinda cabinet put the continuation of the privatization process among its top priorities. Its main goal was to improve the transparency of the privatization process, and to investigate the legality of previous privatization deals. The National Property Fund started examining all privatization contracts closed in the period between November 1994 and November 1998. Anomalies were found in 186 cases out of of 906 investigated privatization contracts. However, investigations also showed that only 47 privatization contracts could be declared invalid, and the National Property Fund decided to start legal action only when the likelihood of winning was very high. Despite several cases in which the National Property Fund succeeded in repossessing government property, the investigation of the privatization cases from Meciar's era cannot be called a success story.

The Dzurinda government was successful in fully covering the value of the privatization bonds issued by Meciar's government as a compensation for the cancelled second wave of voucher

[8] Act No. 192/1995 on Ensuring the interests of state in privatization of strategically important companies and joint stock companies.

privatization. As of November 1999, the government allowed trading with the privatization bonds at the stock exchange and in the over-the-counter market, and during 2001 all the bonds were repaid to their owners.

Despite improved transparency of the privatization process, and skyrocketing privatization revenues for the government, allegations of cronyism and corruption in the privatization market have not completely disappeared. Unproven allegations continue to dog the biggest privatization contracts, such as the Slovensky plynarensky priemysel gas utility, Slovenska sporitelna bank, Transpetrol oil transport and storage company, and others. What has changed significantly in Slovakia however, is the general orientation towards foreign investors who entered the biggest Slovak market, the utilities and banking sector. One of the last actions of Vladimir Meciar's government was to draft a constitutional law stating that state-owned companies in the gas and electricity industry may not be privatized. This law was not adopted by parliament, and the public referendum on banning the privatization of selected strategic companies[9] was unsuccessful.

In 1999, the new government successfully initiated a change in the law on privatization of strategic companies[10] by effectively redefining the public interest in companies from the energy, telecommunications, engineering, and transport sectors, among others. The amended law named 19 companies with the character of public monopoly (see chart). The law also stated that the privatization of these companies must be approved by the Cabinet, after being negotiated in the parliament; in six of the companies (SPP, ZSE, SSE, VSE, SE and Transpetrol), a stake of at least 51% must remain in the government hands. (In the privatization process of the minority stakes in the companies, this provision was effectively bypassed through selling minority stakes to foreigners with a so-called "golden share": managerial rights. Therefore, even if the investor purchased a minority stake, he was in charge of managing the company.

Chart: Public Monopolies in Slovakia in 1999

	Company	Abbreviation	Sector
1.	Slovensky plynárensky priemysel	SPP	Gas utility
2.	Zapadoslovenske energeticke zavody	ZSE	Power distributor
3.	Stredoslovenske energeticke zavody	SSE	Power distributor
4.	Vychodoslovenske energeticke zavody	VSE	Power distributor
5.	Slovenska posta	SP	Postal monopoly
6.	Slovensky vodohospodarsky podnik	SVP	Water management
7.	Zeleznice Slovenskej republiky	ŽSR	Railway transport
8.	Transpetrol		Oil storage and transport
9.	Slovenske elektrarne	SE	Power generator
10.	Slovenske telekomunikacie	ST	Telecom
11.	Lesy Bratislava		Forestry
	Lesy Trencin		Forestry
	Stredoslovenske lesy		Forestry
	Severoslovenske lesy		Forestry
	Lesy Kosice		Forestry
	Lesy Presov		Forestry

[9] Through the referendum, the government tried to establish a permanent ban on privatization of the *Slovensky plynarensky priemysel* gas utility, three regional electricity distributors – *ZSE*, *SSE* and *VSE*, dominant power producer *Slovenske elektrarne* and oil pipelines operator and oil storage company *Transpetrol*.
[10] Act No. 92/1999

Privatization of strategic companies followed these legislative changes. A 51% stake in the dominant telecommunications operator, Slovak Telecom, was sold to German Deutsche Telecom. The remaining stake remains in the hands of government and is slated for privatization by the end of the current election period (October 2006). Slovak Telecom was sold with a monopoly position on the fixed lines market that should have been valid by January 1, 2003; to this day, however, no effective competition at this market exists, and the Antitrust authority issued a decision that Slovak Telecom still has a dominant position in the market.

Privatization of energy companies soon followed. First, a 49 % stake in oil pipelines operator and oil storage company Transpetrol was sold to the Russian company Yukos. In July 2002, a 49% stake in the gas utility Slovensky plynarensky priemysel (SPP), perhaps the most valuable company in Slovakia, was sold to a consortium of three companies – German Ruhrgas, French Gas de France and Russian Gazprom. This privatization contract was the subject of numerous debates. Political games deeply influenced the privatization process as well, with members of the ruling coalition's parties actively working to abort the deal until days before it was signed. There were allegations of corrupt practices because the other six bidders – apart from the winning one – withdrew from the public tender and did not submit their final bids. The selling price for the stake (USD 2.7 billion) was also lower than the lowest analysts' expectations. Perhaps the most crucial factor was the fact that the regulatory framework for energy utilities was effectively created only after its privatization. Deregulation of the gas sector therefore did not precede the privatization of its dominant player, which was a key mistake.

The privatization of the electricity sector remains an issue. The Slovak power sector is dominated by one power generator – Slovenske elektrarne (SE); the transmission grid Slovenska elektrizacna a prenosova sustava (SEPS), which was separated from Slovenske elektrarne in the beginning of 2002; and three regional power distribution companies – Zapadoslovenska energetika (ZSE) in Western Slovakia, Stredoslovenska energetika (SSE) in Central Slovakia, and Vychodoslovenska energetika (VSE) in Eastern Slovakia.

While the transmission grid (SEPS) remains completely in state hands and is not likely to be privatized in the future, minority (49%) stakes in regional power distributors were sold to foreign investors in the first half of 2002. The privatization of Slovenske elektrarne was problematic, and initial attempts to sell a minority stake in SE by the end of Dzurinda's first cabinet election period in 2002 failed. Dzurinda's second cabinet came to power in 2002, and was more successful: the sale of a 66% stake of Slovenske elektrarne to the Italian company Enel was finally closed in mid-February of 2005. The railway transportion sector underwent a fundamental restructuring process during the past few years as well. The public monopoly ZSR was split into two companies in January 2002: Zeleznice Slovenskej republiky (ZSR), the railway network operator, and Zeleznicna spolocnost Slovensko (ZSSK), the railway transport company. ZSSK was later split into two other companies: ZSSK, responsible for passenger transport, and ZSSK Cargo, responsible for railway cargo transport. While ZSR and ZSSK are not planned to be privatized at all, the process of privatizing a 100% stake in ZSSK Cargo was launched in the beginning of 2005.

The postal market in Slovakia is dominated by Slovenska posta, which has a monopoly on delivery of all mailings up to 50 grams of weight. This market was expected to be privatized by the end of 2009; however, proposals for privatization by the end of 2006 were recently announced by the Slovak Ministry of Transport, Post and Telecom.

Privatization of the banking sector

The banking sector reform that was initiated in the end of 1998 and completed in 2002 is considered to be one of the most significant success stories of Slovakia's recent past. As a properly functioning banking sector in a competitive environment, it is the strong and flexible foreign capital banks that now control the former state-owned dinosaurs. The stability of this sector provides the fundamental basis for the sustainable development of the entire country's economy.

However, the situation in the Slovak banking sector was not always so rosy. Again, a long problematic period preceded today's success. Prior to the 1998 elections, the gloomy forecast for the Slovak-banking sector was one of the main obstacles for completing a successful transition of the Slovak economy. More than 40% of all Slovak gross bank loans of that time – granted by state-owned banks – were defaulting. Political dependency of all state-controlled banks led to a period of chaos with substandard loans worth almost SKK 200 billion. The largest amount of bad debts accumulated under Vladimir Meciar's cabinet leadership. State-owned banks, operated by politically nominated management, provided unsecured loans to both state and private owned enterprises at unprofitable rates. Loans provided by state-owned banks without risk evaluation or adequate guarantees were one of the main symptoms of Slovak "Crony Capitalism" between the years 1994 and 1998.

Clearing the financial atmosphere of corruption and constructing a transparent framework required transferring all government stakes in commercial banks into private hands. However, prior to privatization, a drastic restructuring in the portfolios and assets of banks needed to be done. Therefore, the restructuring and privatization of state-owned banks was the main challenge for the new cabinet after the 1998 fall elections.

By the end of 1999, the new government reduced the proportion of substandard loans in state-owned banks to 18%. This was achieved mainly by transferring bad loans worth over SKK 100 billion from the three largest state banks (Slovenska sporitelna, Vseobecna uverova banka and Investicna and rozvojova banka) to two state hospital banks (Konsolidacna Banka and Slovenska Konsolidacna). The hospital banks were consolidated into one restructuring agency, which became – with no significant success – responsible for debt collection.

The Slovak government has issued special "restructuring bonds" totaling approximately SKK 105 billion to cover the costs of the banks' transformation. In this way, the bill for immoderate behavior had to be shouldered by all Slovak taxpayers. Despite legitimate criticism that such a solution was too expensive, this allowed the former troubled and state-owned banks to amass adequate capital and ready themselves for privatization.

The banking sector consolidated during this period. The Cabinet managed to reach all of the set targets for the privatization process; consequently all banks ended up in private hands, and most were purchased by strong international financial groups. The money market also consolidated itself due to the disappearance of weaker banks. The most unstable banks have gone bankrupt, like Dopravna banka, Priemyselna banka, AG Banka, Slovenska kreditna banka, and Devin banka. Others have found strategic partners, such as Prva komunalna banka (sold to Dexia bank), Polnobanka (sold to Unicredito Italiano), Vseobecna uverova banka (sold to Intesa BCI), Investicna a rozvojova banka (sold to OTP bank), Slovenska sporitelna (sold to Die Erste bank), and Istrobanka (sold to Bawag group).

6. Conclusion

Located in the very center of the European continent, Slovakia is known as the symbolic "heart of Europe". The country has changed dramatically since the fall of the metaphorical Iron Curtain, a great measure of which can be attributed to the process of privatization. Since the "Velvet Revolution" 15 years ago, these changes have been accompanied by joy, hope, and disappointment.

The democratic market-economy is comprised of three types of institutions: political, economic, and moral. Therefore, three new and different frameworks had to be developed after the fall of the Socialist regime. When Western experts came to Central and Eastern European countries to help build a free democratic society, they started with the political framework: popular elections, the freedom of speech, religious liberty and the other civil and political rights which are the tenets of a democratic society. However, Western experts neglected the establishment of the most basic of the three frameworks for a free society: the moral system. The damage that socialist rule inflicted on the moral system of the people was incalculable. While Western countries were building their success on individualism and personal performance, collectivist socialism successfully replaced the belief that "God will take care of you" with the "State will take care of you." Individual responsibility, responsibility of the citizens for their own destiny, and motivation to achieve results, were disturbed. This is the real transition Slovakia had to go through. True political and economic change could only arise after a fundamental change in the Slovak people's minds.

Privatization was the key element of such moral transition. Private property is the crucial element of a market economy: it is perhaps the crucial value that distinguishes capitalism from socialism. And although the implementation of privatization was thorny in Slovakia, the results are generally positive. More than 90% of Slovakia's gross domestic product today is generated by private companies. Not only economic theory, but economic reality proves that the private sector is more efficient than government, so the high share of private sector on Slovakia's GDP is good news for all Slovaks. It creates a sound basis for faster economic growth of the country in the future.

Periods of privatization in Slovakia

If looking back at the past 15 years, we may clearly delineate three different periods of privatization in Slovakia. Each of them was dominated by one privatization method. The years until 1994 were the period of quick and very open privatization through public auctions and vouchers. Between 1995 and 1998, direct sales to chosen investors prevailed. Since 1998, privatization through international tenders has played the most important role. Each of these methods have their pros and cons. Voucher privatization was crucial in the first stages of transition, when the largest amounts of state-owned assets had to be transferred to the widest possible group of citizens with low levels of savings. International tenders are crucial for finding strong investors to the biggest companies. Perhaps the only thing to regret today is that privatization through the capital market was never used in Slovakia on a large-scale, which is the main reason why the capital market in Slovakia is undercapitalized and almost non-existent. If stakes of some of the public utilities would be offered for sale through the stock exchange, a group of blue-chip shares could help the Slovak capital market gain a more significant position in the economy of Slovakia.

Privatization was needlessly expensive

Apart from the political problems, the most important problem with the implementation of privatization from an economic point of view was not privatization itself, but its postponement, which increased the transformation costs. The pace of transformation of state property varied between different segments of the Slovak economy. The lag was most visible in the sectors of banking, power engineering, and transport. As the owner of these companies, the state drew them to the brink of bankruptcy, due to increasing inefficiency and significantly accumulating debts. Late privatization of these companies was consequently more expensive and more complicated than necessary. If we summarize the amount that the Slovak government has already paid, or will have to pay in the future (banks restructuring, sunk costs in power companies, liabilities of railway transport companies, and others), the final figure reaches SKK 300 billion, which is almost equal to the annual state budget of the Slovak Republic. This figure is not the price of privatization, as some politicians like to say; rather, it is a late payment for the delayed privatization of several companies. All the costs mentioned above could have been avoided if companies had been privatized in the early 1990s.

Rule of Law, Rule of Law, Rule of Law?

Ten years ago, Nobel laureate Milton Friedman had just three words of advice for countries crawling out from under communism: privatize, privatize, privatize. But now he says he was wrong – that establishing the rule of law is probably more basic than privatization. In fact, in some countries, privatization without the rule of law is just stealing. Russia, for example, created a democracy without laws to protect private property. Consequently, corruption is prevalent and Russia's economy has imploded. This is not trivialize its democratization efforts, but rather to emphasize that democracy alone cannot create prosperity.

Problems with transparency went hand in hand with the privatization process in Slovakia. One of the professors at the University of Economics in Prague described the privatization process in the Czech and Slovak Republics with the following words: “Imagine we were all in one room, where all the furnishings, equipment, everything around was common, state owned, property. Then, suddenly, somebody says: we are now going to turn off the lights, everyone can take anything they can reach, then we turn the lights on, and it will be privatized. So this happened, they turned the lights off, and everyone started grabbing what he could. Then they wanted to turn the lights on, but suddenly realized, that somebody has taken also the bulb. So we were living for many years in the dark.”

The rule of law is crucial for the privatization process. When undertaking privatization at such a scale as in Slovakia, problems with legal framework cannot be avoided, and they should never be used as an argument against the privatization. A changing country with a changing economy and legislature will not have a totally stable legal framework with perfect law enforcement. In Slovakia, actions during the very first years of privatization (1991-1993) laid the cornerstone of the privatization process that could not be overcome in the years after. When a large amount of formerly state-owned property was distributed among a huge group of small private owners, even further privatization scandals could not threaten the economic development, and the group of new privatization magnates, or oligarchy, never became as strong in Slovakia as in some other countries. That was probably the most significant benefit of voucher and small-scale privatization.

The future of privatization in Slovakia

More than 90 % of Slovakia's GDP today is generated through the private sector, while the state still holds stakes in several so-called "strategic companies." At the end of 2004, the Slovak Cabinet approved the idea of further privatization of these strategic companies.

According to this plan, privatization of the power distribution companies will continue, and the remaining stakes in these companies will be sold (10% through capital market, 39% to foreign investors). Fifty-one percent stakes in the biggest heating companies that were separated from the power distributors prior to their privatization will be sold to private investors, while a 49% stake will be transferred to municipalities free of charge. The remaining stake in Slovak Telecom will have to be privatized soon, as the European Commission criticized the conflict of interest of Ministry of Transport, Posts and Telecom, which both owns a 34% in Slovak Telecom, and is also partly responsible for the supervision and legislative framework of the telecom market. The cargo railway transport will also need to be privatized. All these deals are scheduled for completion by the end of 2005. On the other hand, remaining stakes in Transpetrol, SEPS and Slovensky plynarensky priemysel will not be privatized at all.

Another form of privatization on a large scale is the privatization of the social security system, which began in Slovakia in 2002 and became effective as of January 1, 2005. Introduction of mandatory personal retirement accounts was Slovakia's reaction to the looming pension crisis. With this step, Slovakia forged ahead of many Western countries that have yet to confront the ticking time bomb of unfunded (pay-as-you-go) pension systems.

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