THE DECLINE OF THE CZECHOSLOVAK MARRIAGE AND THE ECONOMIC IMPACT OF THE VELVET DIVORCE

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Abstract

The article investigates differences in the transformation of Czech and Slovak economies and how these affected the overall economic development of the studied countries upon the dissolution of Czechoslovakia i.e. the Velvet Divorce. A contrastive comparison is embraced to grasp disparities in the transfer of one formerly centralized command economy with state-owned firms operating under the planned economy organization into two independent market economies under sovereign governance. Notwithstanding the common language and history, the Czech Republic and Slovakia underwent distinct transition processes crucial for the economic rise of the former and the development stagnation of the latter. The legal vacuum and the absence of strong monitoring over capital transformation on one hand, and a corrupted government and autocratic leadership on the other, ushered in scandalous privatizations with major Slovak firms depreciated and appropriated by small political elite without injecting capital or any significant restructuring of the corporate organization. The perpetuated growth of unemployment rates and fall in productivity illustrated by GDP decline, started to alarm for growing anomalies in the Slovak economic system as a whole, exhibiting ubiquitous distortions and a contiguous stagnation. These negative implications drew roots particularly from the imprudent economic policies of the first years of Slovak transition (1993-1998), until national elections had removed the first Prime-minister of independent Slovakia- Vladimir Mečiar from the Office. The Czech Republic led by Vaclav Klaus, meanwhile, benefited from a more responsible and democratic rule that put the Czech economy back on track and paved the way to its early integration within the EU market. Needless to say, the profiles of the first leaders of the independent republics of the Czechs and the Slovaks played an indispensable role in countries' overall progress or retrogression and their international recognition respectively. The main purpose of the article, therefore, entails an interdisciplinary identification of discrepancies in transition processes in the Czech Republic and Slovakia detrimental to the perpetuated and still observable disparities between the two countries in terms of economic development and standards of living.

Key Words: Czechoslovak marriage, velvet divorce, economic impact

As socialism and utopian concepts of equality, unity, and brotherhood began to crumble, a severe economic turmoil and uncertainty hit the former socialist countries right on the threshold of their long-sought independence. Amid national crisis and restructuring of borders, the common challenge of establishing an autonomous and functional economy came to be the principal and most pressing prerequisite for stable and sustainable development. Unfortunately however, the 75 years of inept and malfunctioning economic system significantly hindered the realization of countries' economic potential even in the years of transition and national sovereignty. What is more, in some countries this process of creation of prosperous economy was further impeded by the long history of dependency on the "big brother" country within the socialist family. Highly centralized economies and unequal industrialization heavily concentrated the capital in dominating states at the expense of the smaller and relatively underdeveloped sister-states. The latter served as resource centers deficient in financial investments with the exception of investments related to the production and supply of raw materials or final goods for the larger market of socialist empires. Although history abounds in such examples, the case of Czechoslovakia and the later constitution of the independent Czech Republic and Slovakia deserves a particular attention. Through a brief contrastive analysis of the two states while in the Czechoslovak federation and a more elaborate examination of their independent transitioning to free market economies afterwards, this paper would outline the roots of the perpetuated and still observable disparity between the two countries in terms of economic development and standards of living.

A multifarious approach is nevertheless needed for providing a full insight in the reasons and causes of the ongoing discrepancies between the economies of the Czech Republic and Slovakia. Recalling the statement above about the peculiarity of the case of Czechoslovakia and its later dissolution, a particular focus needs to be put on the different paths each of the countries took after the so-called Velvet Divorce. The most striking differences were indeed right in the aftermath of the "divorce" up until 1998, a year particularly important for the Slovak nation. According to interviewees of a Slovak citizenship, Slovakia embarked on a "real" transition in 1998, after the national elections that removed the first Prime-minister of independent Slovakia- Vladimir Mečiar from the Office. The Czech Republic led by Vaclav Klaus, meanwhile, benefited from a democratic and responsible rule that put the Czech economy back on track and paved the way to an early integration within the EU market. Needless to say, the profiles of the first leaders of the independent republics of the Czechs and the Slovaks played an indispensable role in paving the way of countries' overall progress and their international recognition respectively. In the spotlight of the disputes between the former allies was the issue of privatization which was approached in two divergent ways each of which will be discussed separately bellow. Inevitably, gaps between the Czechs and the Slovaks continued to widen and these will be illustrated by the two basic economic indicators: the rate of unemployment and Gross Domestic Product (including the level of GDP growth) alongside prospects of Foreign Direct Investments (FDIs). The timeframe of interest hereby stretches from the global decline of socialism (late 80's-early 90's) until 1998 i.e. the overthrow of Mečiar regime in Slovakia.

Slovakia's pursuit for democracy and economic welfare, however, has its roots long before Mečiar's era. The lack of geopolitical affirmation and the persistent threat of Magaryzation (assimilation imposed by Hungarian authorities during the Austro-Hungarian monarchy) led Slovaks to seek preserving their identity by uniting with the Czech neighbors. From the very foundations of the socialist federation of Czechoslovakia, under the flag of equality and brotherhood, Czechs and Slovaks had been recognized as distinctly developed nations with an imposed superiority of the first over the second. As the first president of Czechoslovakia, Tomáš Masaryk himself put it:

> There is no Slovak nation…the Czechs and Slovaks are brothers. Only cultural level separates them—the Czechs are more developed than the Slovaks, for the Magyars [Hungarians] held them in systematic unawareness. (Masaryk, 1934)

Slovaks grew to be greatly dependant on the Czechs who maintained political dominance throughout the entire existence of Czechoslovakia. The federation itself, particularly after World War II, shaped its status as a Soviet satellite state with a high influence and political control coming from the communist East. The Slovakian region that geographically was predisposed for a greater submission to and influence from the USSR, became the Soviet manufacturer and major supplier of arms and military equipment; another factor that added to the staggering unemployment rate and steep decline of industrial output during privatization in early '90s since the armament production technology was "not easily transferable to civilian production" (www.GlobalSecurity.org).

Whereas major Slovak production served the military purposes of the Soviet Union with industrialization and employment markedly reliant on the demand for arms and weaponry in the Soviet bloc, Czechs benefited from the relative exposure to Western markets, particularly notable in the relations between Germany and the advanced region of Bohemia. In return for the unequal regional development and highly centralized economy, Slovaks were regularly subsidized by their Czech "brother". This, however, gave right to Czechs to claim higher representation thus greater amount of power in the federation. A unique dichotomy between Czech "sponsors" and "sponsored" Slovaks was developed as a result of unequal distribution of wealth and administrative power. Nationalist movements simmered among Slovaks with Vladimir Mečiar rising as people's protector of nationhood and promoter of Slovakia's status as an equal partner within the Czechoslovakian borders. Yet nationalist movements did not spur any ambitions for independence but a mare desire for equality of representation aspired by the Slovak part. A poll conducted in 1990 in Slovakia attested that "only 16% of the population favored secession" (Bookman, 1994). Abby Innes further contends that indeed:

> Mečiar was able to emerge as the most popular politician in Slovakia precisely because he came out against independence and took a centrist position between federalists and more radical nationalists. (Innes, 2001)

The issue of maintaining the federation and co-existing with Slovaks, on the contrary, was not of a primary concern of the Czech Minister of Finance and later Prime-minister, Vaclav Klaus. In the midst of the Prague Spring, Klaus was attending Cornell University where he was imbued with capitalist ideology of free and competitive market economy. Assuming position as Minister of Finance in 1990 and later becoming the Prime-minister of the confederative[21] Czech Republic in 1992, Klaus intentions were to pursue radical and rapid economic reforms to the benefit of all. However, when privatization was called into question, Klaus was careful to observe that:

> Privatization of the state-owned economy is not yet on the agenda. We cannot do it immediately; my colleagues would not agree to it. But we must put all forms of ownership on an equal footing immediately and let different types of ownership compete with the state firms. (Klaus, 1990)

Evidently, while advocating the "shock therapy" in most economic domains, Klaus took the gradual approach towards privatization as a means of both providing an incubator for the onset of sustainable and competitive private sector and a time interval for the creation and implementation of a rigid legislation that, according to Klaus, would impose "strict rules so that property is not sold by Communist managers for a low price. They often get payments under the table to sell to the first bidder " (Klaus, 1990). Additionally, when being attacked about the ignorance towards Slovak regional economy and lack of interest for attracting foreign investors interested in buying out Slovak state-owned factories, Klaus sarcastically went on to say:

> They [Slovak trade union executives] asked me whether I would allow a money-losing, old plant in Slovakia to be sold to foreigners. I laughed and said, "Do you know what you are saying? A money-losing, run-down plant and a foreigner wants to buy it? We should be lucky if we find a fool in the West who wants to buy it and try to make it profitable. Everyone will benefit from that, except perhaps the Western investor." They had to agree. (Klaus, 1990)

And it was exactly when the economic system required transformation that Klaus' and Mečiar's trajectories diametrically diverged. While Klaus aimed at retaining some control over the process of privatization in Czechoslovakia in order to prevent "asset-stripping", Mečiar's deep interest in privatization in the Slovak region was associated with concentration of political power. These basic disagreements in the political rhetoric between the two leaders of the Democratic Movements in the constituent Czech and Slovak regions of Czechoslovakia, gave grounds for the inevitable Velvet Divorce, or put in other words, the demise of Czechoslovakia and the creation of the independent Czech Republic and Republic of Slovakia on 1 January 1993.

The great challenge of replacing socialist planned economy with capitalist free market was differently approached by the new leaders of the now-independent republics. The ardent proponent of Milton Friedman's ideas on liberal market economy with minimum state intervention ushered in gradual but steady privatization, which by June, 1995 resulted in "80 percent of the economy [being] wholly or partly privatized" (Perlez, 1995). Referring to Klaus' speech in the Cultural Hall of Sokolov, Perlez in the New York Times cheers the pioneering feat of the Czech Republic as the leading post-socialist country in the stabilization of a deregulated economy:

> Unemployment, at 3.3 percent, is the lowest in Europe. Inflation is 10 percent, one of the most moderate rates in the former Eastern bloc. And the country has a healthy budget surplus of $400 million, the only Central European nation in this enviable position. (Perlez, 1995).

This speedy decentralization was achieved by implementing the model of mass privatization where 8.5 million Czech citizens were included in the bidding process. The Government served only as a mediator between enterprises and shareholders in order to make the process smooth, transparent, and effective. Government mediation also incorporated nationwide public information and general education about privatization, issuance of vouchers, the rights and roles of shareholders etc. The fact

[21] By 1992 federation ties had loosened up transforming Czechoslovakia into a confederation which itself was precursor of the full disintegration into Czech Republic and Slovakia on Jan 1, 1993.

that “more than three medium-scale and large-scale enterprises, on average, per day” (Shafik, 1993) went from state to private ownership within a period of 14 consecutive months reflected the innate success of the program and its overall impact on the outstanding macroeconomic figures.

Clearly, the positive outcome steered a wave of Western investors interested in investing in the Czech Republic particularly injecting capital from the Netherlands and Germany. This interest was further increased with the Czech Republic’s accession to the OECD in 1995 with inflow of FDIs almost doubled from the preceding year; US$ 4.546 million in 1994 vis-à-vis US$ 7.350 million in 1995 (Milanovic, 1998). High level of solvency and an overall constructive economic performance granted foreign investors with sky-high return on investments. Parallel to this, international financial institutions were not reluctant to provide state loans much needed in the first transition years. What is more, according to the Czech National Bank report “all debts to the IMF were paid off in 1994”, four years before repayment was due. The Czech Republic was in full swing whereas its Eastern ex-spouse was not that fortunate.

Put in other words, Mečiar did not follow the steps of his former coalition partner Vaclav Klaus. By exercising an unprecedented power and abusing his supreme position, he engendered ubiquitous fear leaving Slovakia to toddle towards democracy and a better future. At the same time, Western criticism was interpreted as a pretentious interference in Slovakia with concealed capitalist attempts to hollow out its fragile and still vulnerable economy. Prospects for foreign direct investments were becoming more and more distant as privatization under Mečiar offered meager mechanism for securing property rights of the owners to be. Western investors like Westinghouse and Shell were soon driven out as the process of privatization proved to be lengthy and Slovak partners difficult to find. This type of systematically obscure and corruptive process “does not set a precedent for a market-oriented economy" (Green, 1996) as assessed by Jiri Huebner, the EBRD's senior banker for the Czech and Slovak republics. Not only foreign investors but also international organizations such as the EU and NATO lost interest in Slovakia as demonstrated by their reluctance to add Slovakia on their member-state lists at the time.

For the situation to go from bad to worse, during the shift in governments in 1994, Mečiar managed to undertake also the role of Minister of Privatization and head of the Fund for National Property, both bodies designed to monitor and administrate the process of privatization. The New York Times reports that by running the Fund, Mečiar “handed cronies 52 major industries at bargain-basement prices in just one month” (The New York Times, 1994). Not only were the state-owned enterprises sold out at understated prices, but they were also acquired by elites close to Mečiar’s government as a reward for their loyalty. The favorable group of “winning” bidders included former ministers, party associates and members of their close families. When people who were only partially given the right to participate in the privatization process for later in 1994 to be denied of this right too (vouchers were banned in 1994 and replaced with long-term securities- bonds) called upon accountability and explanation from the authorities in charge, the spokesman for the National Property Fund Ota Balogh vigorously asserted:

> We want to create a strong class of domestic entrepreneurs. We do not want control of strategic companies sold to foreigners. (The New York Times, 1994)

disguising real motives for accumulation of wealth and power in the hands of an autocratic ruler and his adherents.

Unavoidably, economic indicators started to alarm for growing anomalies in the failing system. In the same year (1995) when Klaus announced reduction of the unemployment rate to 3.3%, Slovaks had to struggle with 13.1%[22] unemployed labor force, approximately 10 times higher than the unemployment rate in 1989 while still part of Czechoslovakia. The annual percentage of GDP growth in Slovakia of 5.8% almost tied up with the 5.9% of the GDP growth in the Czech Republic in 1995, yet Czech’s annual output per capita was US$ 886 bigger than the same in Slovakia[23]. Perhaps a more accurate indicator would be the poverty rate which increased by 1.2 in the Czech Republic and by 5 in Slovakia between 1989 and 1994 (UNICEF, 1995). Interestingly enough, Gini coefficient in Slovakia remained almost unchanged between the period of 1987 and 1994 ranging between 19 and 20 meaning that there was more equal income distribution rather than in other transitional economies.

[22] World Bank World Development Indicators; downloadable from http://www.worldbank.org/data/wdi/worldview.html.
[23] GDP per capita (1995): Czech Republic US$ 5,596; Slovakia US$ 4,710. (Source: the World Bank)

Capitalism itself, however, naturally entails inequality in income distribution, such that was registered in all other transitioning countries including the Czech Republic with a Gini coefficient reaching 28 (Honkkilla, 1996). Although stagnant Gini coefficient should not be perceived as a negative phenomenon, it clearly pictures the almost non-existent transition in Slovakia which, in the long run, would undoubtedly prove to be costly upon Slovaks and their economy.

In light of this brief yet graspable comparison between two emerging post-socialist countries, it is important to conclude that given policies at a particular time always bear with them long-term implications that can have stimulating or retarding effects on country's future development. The economic and political development of the Czech Republic and Slovakia throughout the 90's illustrates examples of both effects and invites current developing countries to learn from the lessons of their past. The two offsprings of socialist Czechoslovakia drew their own distinct destinies of success and prosperity on one hand, and apathy and backwardness on the other as a result of the former choosing reforms over stagnation and even greater isolation. Thriving Czechs easily overcome the painful process of transition whereas inert Slovaks fell in the pitfalls of a greedy and degenerated regime.

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