LAGGARDNESS AS A FORMING POWER OF SECOND GENERATION REFROMS IN CENTRAL EUROPE

Comparative study of Slovakia and Hungary

by

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Abstract

My research question obliged me to find the factors causing unlike attitudes of external and internal actors towards reform processes aiming on the attraction of foreign capital in Slovakia and Hungary. In this respect I analyze the impact of the factors such political system, economic leverage, unemployment and EU conditionality on the reform attitudes of the main actors in both countries prior to Second Generation Reforms as well as during the process. I have identified political parties and labor as the main internal actors and transnational corporations as the main external actor. As a result I found out that political systems had emerged the reform cycles in Slovakia and the anti-reform cycles in Hungary. My research additionally shows that transnational corporations are able to exercise the leverage on the state government only if there are few or no alternatives to foreign corporations. Finally, the low institutionalization of industrial relation caused a smooth launch and consolidation of the reforms in Slovakia. The opposite applies in Hungary. I also provide causal explanations for the relationship between high unemployment and acceptance of reforms by labor.

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Introduction

The topic of reform processes has been discussed in political sciences for decades. Despite various theories, scholars do not agree on the point, which factors contribute to country's ability to implement reforms and which factors obstruct them from launching. Hungary and Slovakia are particularly interesting examples of the diverse reform attitudes despite many similarities. Hungarian government is often blamed for inability to perform economic and social reforms necessary to consolidate public finances. In contrary Slovakia is used as an example of the country which has succeeded to set the economy on a path of high growth and got the capability to attract international capital in highly competitive environment due to its ability to apply "socially painful" but economically necessary reforms. In order to objectively analyze reform approaches we shall reflect on initial situations in both countries and consider factors of different party systems, unlike labor position, different incentives to EU accession and different impact of TNCs on domestic politics.

First part of my theses aims at the identification of the factors prior to second generation reforms. Given that both countries went under specific political and economic circumstances, I must analyze to what extend did a path dependency influence their performance during reform processes. In this respect I will study economic legacies of both countries. I will focus on economic environment and a presence of local or foreign enterprises. Later I will check for the influence of EU conditionality on political decisions connected to reforms. And finally I will study how different political set up of the system determines the role of parties in the reform processes. In the same part I will additionally discuss previously developed concepts of O´Dwyer and Kovalcik and Gyorffy and compare them with my case studies. In conclusion I will summarize my results to be able to provide critical review of the theses as well as propositions for future research.

The second part will encompass details of SGR process in structuring of the economic environment. Main accent would be given on tax reforms and FDI support. Throughout the entire theses, but eventually in the third part, I will focus on characteristics the main actors. I will consider the impact of the transnational corporation on the parties' decision and the role of TNCs in the processes. Lastly I will scrutinize organized labor and legislative background of labor interests' reconciliation with accent on the unemployment.

Nonetheless, before I start I shall justify a choice of Slovakia and Hungary as my case studies. Many authors argue that V4 countries represent rather coherent cluster of similarly developing economies belonging to a particular variety of capitalism. While one group argues that mentioned Central Europe states converge to coordinated market economies (Feldmann 2004, 275), others claim the existence of Liberal market paths in their economies. Some moreover consider those countries to have their own, hybrid variety of capitalism. For the study I consider primarily their resemblance in the economic models as well as a number of similar characteristics of Hungary and Slovakia's capability to attract foreign investment.

They both represent countries with socialist history, similar industrial structure and location advantages for foreign investment. Slovakia and Hungary simultaneously became members of EU in 2004 and their population has similar characteristics in terms of religion, ethnic heterogeneity, and social class division. Thus, Hungary and Slovakia are usually considered to be comparable—sharing very similar socioeconomic institutions while being distinct from, for example, the Baltic States, the Commonwealth of Independent States, Romania, or Slovenia. (Nölke and Vliegenthart 2009, 61) However as described previously, Slovakia and

Hungary heavily differ in terms of readiness and capability to reform. Therefore, the focus of the research is to look at the determinants of launching and consolidation of reforms, especially the ones connected to attraction of FDI. I intend to scrutinize this question in following parts.

Research Question

Slovakia in contrary to Hungary has been able to launch and implement more structural and deeper SGR, aiming primarily at the attraction of foreign investment flows. Yet there is no agreement on what have been the driving forces of enthusiastic pro-reform orientation in Slovakia and lack of willingness of Hungarian parties to execute similar steps. In my theses I intend to delve reform processes in Slovakia and Hungary. I would like to find answers especially to the question: What was the driving force for fast and deep SGR program in Slovakia and what in contrary hindered Hungarian governments to commence similar reform programs? In particular, I would like to analyze the impact of party systems and position of labor on reform processes as internally driven factors. As externally driven factors forming the depth and speed of the SGR, I would like to research a presence of EU accession incentives and the impact of TNCs on domestic decisions.

Methods

My research is based on comparison between Hungarian and Slovak reform processes known as the Second Generation Reforms (SGR), more specifically reforms aiming at attracting

Foreign Direct Investment (FDI). I mainly identify comparative relevance of the actors on the mentioned reform processes in both countries. Since the actions of internal actors and external stakeholders are determining the behavior of one another, I will also delve into interaction of mentioned actors as independent variables. In addition I will mainly identify the party system, labor position, incentives of EU accession and influence of TNCs as the main variables determining different actor's behavior in connection to pro-reform or anti-reform attitudes. I attempt to consider the same variables at the same timeframe for both countries to eliminate unsystematic factors. However, the diverse development in the countries does not allow me to consider my dependent variable in the same time frame, since various SGR have been adopted in other time periods. However, all independent variables allow me to stay constant same for Hungary as for Slovakia.

In general I use qualitative methods but I also utilize descriptive statistics wherever possible. As a result my research is based on combination of comparative qualitative research with the use of quantitative methods. The research reviews the relevant literature on SGR in Hungary and Slovakia in detail and it identifies the relevant indicators to test my hypotheses.

Definition of Second Generation reforms

The narrow definition of second generation reforms (SGR) refers to reforms which are creating a favorable investment environment once the market is in place (O´Dwyer and Kovalcik, 2007, 4). Others argue that it introduces the deregulatory packages to strengthen business while undercutting organized labor (Bohle and Greskovits 2006, 21). SGR have been widely encouraged by international organizations including IMF or World Bank and neoliberal economists, but also deeply criticized by labor movement and many dependency theorists. Major differences are evident in diverse levels of readiness and enthusiasm in particular countries to launch SGR. Countries of the Visegrad group seem to represent a fine demonstration of different attitudes towards SGR in otherwise relatively similar political environment. My main research aim is the comparative analysis of two diverse approaches towards SGR in Hungary and Slovakia. While Slovakia chose very steep and radical way toward the reforms to form favorable conditions for Foreign Direct Investment (FDI) inflow, Hungary adopted much slower mode of the reforms. Dissimilar range and depth of SGR implementation can be observed in heterogeneous forming of socio-economic models in both countries.

Since there is no agreement on the definition of SGR in the literature, first of all I shall define the Second generation reforms. Term of SGR is usually used in connection to structural reforms and transformation. To avoid any misinterpretations I would like to point out differences between the broader meaning of SGR and the narrower in V4 countries, since they differ substantively.

Structural reforms are usually conceptualized as "an implicit commitment from the government that in exchange for short-term sacrifices and increasing uncertainty of long-term benefits will follow." (Gyorffy 2008, 2). SGR particularly represents the concept which was originally developed and promoted by the international monetary organizations, mainly IMF. Michel Camdessus, former managing director of IMF uses rather broader concept of SGR. He considers them as the ones "ensuring that the State fulfills its proper role in a market economy, by creating a level playing field for all sectors and implementing policies for the common good, particularly social policies that will help to alleviate poverty and provide more equal opportunity.″ (Camdessus, 1997)[1] His definition of SGR clearly aims at redefining the proper role of state in the market economy and links it with the reduction of poverty. However the variety of implemented reforms in Eastern Europe considered as SGR compel us to reconsider the definition and to use the term in a narrower way since the Slovak flat tax reform in 2004 or Hungarian pension reform in 1997 barely fit to the concept of alleviating poverty and providing more equal opportunity.

Narrower definition, which describes the transformation process in Hungary and Slovakia in more consistent way, can be found in O´Dwyer and Kovalcik. Unlike Camdessus or Wood they argue that SGR in V4 countries refers to reforms, which are creating a favorable investment climate once the market is in a place (once first generation of market establishing reforms are successfully executed). Their characterization of SGR does not presume that SGR shall ensure that the state performs its proper role in all sectors of market economy, but the aim of SGR ala O´Dwyer is to reform economy in a way, which maximizes the FDI inflow in the country. Transformation towards proper definition of the state role in the economy for common good and transformation towards maximizing FDI inflow clearly does not stand for the same intentions. I believe that narrower definition of SGR depicts the reform processes in a way that corresponds better to intentions of actors in Hungary and Slovakia. Therefore I will be using a narrower defined concept of SGR throughout my theses.

In addition to the problem described, SGR are usually applied in various dimensions of economic and social sphere. Due to the limitations of my theses and coherence of my research, I would like to focus exclusively on different approach to economic reforms in Hungary and Slovakia and leave the welfare reforms for future research. Therefore the

[1] Quoted in Wood 1997

reforms of my main interest are particularly tax system reforms, labor market reforms and reforms regulating the position of labor. However, the complexity of SGR does not allow me to completely exclude other reforms.

1. Initial heritage- Starting point of Second Generation Reforms

In order to infer causal arguments concerning the reform processes in our target countries, structural and background factors must be correctly identified and compared in the first place. At the same time, I must provide the theoretical background for each factor. Secondly, this section will also dissect the situation of the selected factors prior to SGR and the characteristics of identified actors in Slovakia and Hungary.

The first factor, I will turn my attention to, is the different economic legacies in both countries. Particularly, I will analyze economic performance by presence of domestic companies and foreign investors. I will also examine the tax systems and Foreign Direct Investment (FDI) support. Data will allow me to evaluate the capacity of the economies to attract FDI prior to SGR programs. I will additionally disclose the main differences between Slovak and Hungarian business environments from the perspective of enterprises. In this section, I will specifically focus on the diverse development of unemployment rate and its connection to future economic perspectives.

In the same section of my thesis I will study also the incentives of integration with international organizations as the main external factor. Unsurprisingly, the EU integration process seemed to shape the Slovak government's decision-making pertaining to reforms in a very significant way. In Hungary this factor did play such significant role. I attempt to provide the causal reasoning for the EU factor too. Besides the external factor of EU, the domestic political environment has to be considered too, since the political systems have been the main driving forces of changes in domestic policies as many authors suggest (Nelson 1993, Sklair and Robins 2002, Kohli 2009). Therefore in order to correctly identify differences during the pre-SGR stages, I also need to scrutinize in detail the factor of political system.

The analysis of the initial stages is very important due to path dependency arguments. According to path dependence theory, history simply matters. “Where we go next depends not only on where we are now, but also upon where we have been.” (Liebowitz and Margolis 1995, 207) Economic legacy and presence of market institutions shape future development of the countries.

On the other side, Gerschenkron argues that for one country it pays to be lagging behind in perspective of future development. The state, upon realizing its relative economic backwardness, becomes quite interested in promoting industrialization. Since missing industrial structure and institutional background causes its backwardness, the state creates better institutional framework. In this manner, the slow and time-consuming process of waiting for the industrial structure to evolve towards industrialization with the growth of per capita income and import substitution can be avoided, and the industrialization process speeded up. (Gerschenkron 1962, 7)

The main hypothesis in this section predicts that the market experience and wide presence of domestic and other alternatives to foreign capital in Hungary resulted in comparatively low level of unemployment. This caused a lack of willingness to implement the “socially painful” reform innovations oriented towards cuts in corporate taxes and VAT increases that would raise prices. Thus, favorable regional position prevented Hungary from the creation of new institutional framework. In Slovakia the lack of domestic investments and other alternatives to

FDI as well as the highest unemployment rates in the region[2] forced political parties to almost fully implement the SGR package such as innovative institutional setup and promoting industrialization.

1.1. Economic legacies and the business environment prior to Second Generation Reforms

1.1.1 Post-communist legacies

Usually, market institutions emerge in later stages of reforms owing to the necessity of implementing a proper law enforcement environment to foster the development of capitalist enterprises. Paradoxically, the first Hungarian market institutions are rooted in the socialist regime. In 1968 the ruling Hungarian Socialist Workers´ Party (MSZMP) launched a visionary plan of New Economic Mechanism (NEM). NEM practically established a second economy, which allowed the existence of private enterprises (Bertlett 1997, 136). Similar initiatives in Czechoslovakia resulted in very different outcomes. Dubcek´s project calling for "market socialism" was associated to democratization initiatives and conspiracy against working class in the Czechoslovak Socialist Republic (ČSR), which led up to the occupation of Czechoslovakia by the troops of the Warsaw pact in the same year when Hungary successfully launched NEM. Instead of witnessing the establishment of private entrepreneurship and early market institutions, the CSR experienced "normalization" and re-usurpation of all power over the state by Soviet-like elites. None of the private institutions have been established before the breakdown of the Soviet empire in 1989.

[2] Slovak unemployment in 1999 was more than 16% and in 2001 exceeded to over 20%.

On the other side, early formation of the market institutions in the 60´s gave Hungary an advantageous position in the region for the future (Kaminski 2000, 6). Present private enterprises as well as foreign investors could build their businesses on highly constrained however still existing market institutions. Market building transition process in most countries of the region led previously State Owned Enterprises (SOEs) to several difficulties demanding adjustments to the market competition reality. Problems of knowledge transfer, loss of market shares, as well as the establishment of brand new networks in a fairly uncertain legal environment were great challenges for managers, usually not very skilled in adjusting SOEs to a different market situation. All these uncertainties have been weakened by the existence of early market institutions (Swaan, 1994, 8).

Foreign companies encouraged by the existence of a more developed market environment channeled their investments almost exclusively towards Hungary. The 1988 act on foreign investment supported FDI inflow by guaranteeing compensation in cases of potential nationalization, import of duty free investment goods and the right to repatriate the profit of foreign companies (ITD Hungary, 2010)[3]. These investment incentives have been a pioneer in Central Europe and turned Hungary into the regional leading country for foreign investors. Between 1990 and 1993 Hungary absorbed almost half of the total FDI inflows targeting 25 countries of the former Soviet Union and Central and Eastern Europe (Kaminski 2000, 16). Hungary cumulatively absorbed more than 5% of the total FDI inflows between 1990 and 1999. High FDI inflow has been reflected in GDP per capita, which was 1.8 times larger than in Czech Republic (second best in FDI per capita). Privatization of state owned companies exclusively to foreign owners contributed to Hungary's FDI attraction in the 1990´s effortlessly. Therefore, Hungary was able to attract many foreign companies. Except direct

[3] For more information see http://www.itdh.com/engine.aspx?page=doc_publication

ownership of production facilities, many companies chose a form of joint venture with Hungarian companies involving joint production and market entry by licensing, i.e. franchising. (Kaminski 2000, 17) The opposite scenario happened in Slovakia.

Slovakia became an independent state only in 1993. Entrepreneurial elites and national bourgeoisie were almost absent in Slovakia due to a subtraction of military industry from Western Slovakia and smaller industrial tradition compared to Czech Republic or Hungary. (Beblavy 2000, 245) The first Slovak government led by Prime Minister Valdimir Meciar lacked political attention towards economic questions. Moreover, Slovakia was short on experiences with market institutions.

Entrepreneurial elites were formed by fast and corrupted privatization, when most "national treasures" did accrue to a small group of people. These entrepreneurs came to a market with little or no experience with market institutions. However, they had fair links to politics what ensured a good lobby. By contrast, small and medium enterprises (SMEs) had to deal with a lack of attention at the political level. In Slovakia, the government's policy until 1998 concentrated on the preservation of national champions in the energy and steel sector at the expense of small and medium enterprises, and against the official rhetoric that acknowledged unfavorable economic structure but did not act towards changing it (Beblavy 2000, 231). High levels of unemployment in Slovakia in combination with a corrupted economy obstructed the Slovak economy from growth.

1.1.2. Tax systems and economic environment prior to Second Generation Reforms

The tax system is usually regarded as the key element in the state's income. "Governments continually balance the desire to offer a competitive tax environment for FDI, with the need to ensure that an appropriate share of domestic tax is collected from multinationals." (OECD 2008, 1) Different distribution of taxes on labor and taxes on capital perceptibly form a country's attractiveness to foreign capital. SGR usually shift the tax burden on labor. In this part, I will analyze the tax system prior to SGR as the key incentive for FDI inflow.

Tax systems in the entire region needed to be adjusted to a brand new market environment. State bureaucracy had only limited or no experience with taxes. Since taxes became a major source of revenue, tax reform and the functioning of the tax system represented the essential aspect of economic transformation. Most of the reforms in the tax system had to be done at the first stages of transformation. Both Hungary and Slovakia firstly introduced tax on labor, particularly personal income tax and indirect taxes that did not exist during the communist period. Hungary introduced progressive taxation where the highest income groups were initially taxed at 60%. The Slovak government introduced initially progressive taxation as well. However the rates were lower; between 15 and 47%. Higher taxes on personal income in Hungary can be explained by more extensive welfare provision (Duman 2010, 5). Still, developments of taxes on labor were similar in both countries.

Taxing capital is particularly interesting for my study, since the state can provide various incentives towards foreign investors via fiscal tools, particularly in the system of CIT. Lower corporate taxes are expected to attract more investors. Initial rates levied on corporate bodies have been rather high compared to the current rates in Hungary and Slovakia. During the 1990´s we can observe the implementation of several exceptions and tax subsidies in order to attract foreign investment in Hungary, while no similar measures were performed in Slovakia. Hungary started to provide tax subsidies much earlier than other countries in the region. They also ensured repatriation of profits abroad (ITD Hunagry, 2010)[4]. Provision of generous tax incentives creates a burden on public resources. Slovakia as well as Hungary followed the general trend in the region and shifted the tax burden onto labor, especially by significantly rising indirect taxation, which was reflected in higher consumer prices (Tanzi 1993, 21). Share of indirect tax incomes rose in average from 19,3% to 25,3% in Central and Eastern Europe (Duman 2010, 7). This trend has created a completely new chapter in the tax system of post-communist countries. Most of the reforms in Value Added Taxes (VAT) had been accomplished by the end of the 1990´s, when Hungary and Slovakia introduced several rates on consumption. Hungary had one of the highest taxes on consumption, at almost 25% (Duman 2010, 8).

Hungary in general could provide various incentives to foreign investors, the main ones being a favorable business environment with market experience, industrial tradition, skilled labor and favorable tax schemes for foreign companies. Foreign companies were also able to take part in the privatization, which considerably increased FDI inflow to Hungary.

Slovakia on the other hand experienced a different economic situation. The lack of market institutions and domestic industrial capacities, shortages of skilled labor, incentives provided by the government to foreign investors and privatization to domestic subjects made Slovakia

[4] For more information see http://www.itdh.com/engine.aspx?page=doc_publication

a very unattractive country for foreign investors in the 1990´s. Up until 1999, there were, in fact, restrictions on foreign residents owning businesses in Slovakia. As a result, Slovakia received only one sixth of the amount of the per capita investment received by other Eastern European countries such as Hungary and the Czech Republic until 1999. The backwardness of Slovakia pressured the state to adopt more policy innovations. SGR represent an innovative institutional environment promoting industrial and economic growth.

1.1.3. Unemployment prior to Second Generation Reforms

The unemployment as a factor of reform activity is usually analyzed in connection with other factors already described in the previous section. However, it appears that the very different development on labor market caused different levels of importance assigned to unemployment rates. As Drazen or Pierce suggest, especially labor perceives the unemployment very sensitively, which is largely reflected in election results. Therefore, I will scrutinize the factor of unemployment in connection to the role of labor in SGR. For now, let me provide a theoretical basis for the role of unemployment as the background factor of SGR.

Gerschenkron´s concept of backwardness assigns a significant role of pressure on the labor to create new jobs in the industrial sector. According to his theory, one of the most important obstacles hindering this industrialization is the poverty of the country as well as the inability of old sectors to create new employment opportunities. Indeed, the majority of the labor force is engaged in agriculture using ineffective cultivation methods that yield low agricultural incomes. Furthermore, aggregate demand is insufficient to support rapid industrial growth, and the low per capita income generates a demand pattern favoring low-income elasticity branches, such as food products and textiles, rather than the heavy industry branches that promote industrialization. (Gerschenkron 1962, 8) In this respect, Gerschenkron considers low incomes and low unemployment as a key background factor to steer further development in the country. On the other side, sufficient employment opportunities and comparatively higher wages will be relaxing the pressure on innovation in the institutional framework.

Additionally, Drazen´s concept of Political Business Cycles (PBC) ascribes additional political perspective to the factor of unemployment. He suggests that actual levels of unemployment rate prior to elections can significantly modify results. Since labor perceives an increasing unemployment as a very unpopular development, it tends to support parties with job creating policies.

Hungary experienced a very different situation than Slovakia during the 1990´s. Above all, a low unemployment of 8,4% in 1998 (Central Statistical Office, Hungary 2010)[5] constantly decreasing combined with positive experiences of numerous "success stories" of TNCs investing in Hungary caused general satisfaction with the performance of the country and low pressure on necessary changes. Positive development on labor market continued, when unemployment in 2001 dropped to 5.8% (Central Statistical Office, Hungary 2010)

Slovakia by contrast was an economic laggard in the region with a general shortage of domestic and international employment opportunities and an unemployment rate reaching 20% in 2001 (Slovak Statistical Office, 2011)[6]. This different context in terms of unemployment gives rise to different needs in foreign capital, especially if no domestic

[5] For more details see http://portal.ksh.hu/portal/page?_pageid=38,119919&_dad=portal&_schema=PORTAL
[6] For more details see http://portal.statistics.sk/showdoc.do?docid=4

alternatives are available.

Gerschenkron´s theory as well as Drazen concept of PBC necessarily connects unemployment rates with the position of labor in the transformation process. So far I have provided only a theoretical basis for the role of unemployment, although I have not discussed the role of labor in the SGR. Conclusions regarding actual impact of unemployment in Hungary and Slovakia will be provided after a deep analysis of labor position.

1.2. EU conditionality

EU in CEE always represented various incentives for different actors. While process of European integration might be only a matter of international reputation for state bureaucrats, while for a company it means new markets and further possibilities. Same differentiation of incentives applies for the countries. While some countries such as Hungary had clear perspectives to enter the EU from the very beginning due to favorable legacies, other countries needed to implement more radical changes in the domestic policies to become eligible such as Slovakia. Some authors argue that the EU has become the key external driver for policy reforms in Central East Europe (CEE). (Grabbe, 1999, 2) EU conditionality criteria for 10 CEE countries have been amended at the Copenhagen Summit in 1998. It introduced a detail schedule of required policy changes. Successful accession meant fulfillment of every capitol of the accession process, since no negotiation was available for these countries.

1.2.1 Factor of EU conditionality in Slovakia

The Meciar government left open wounds hurting the international reputation of Slovakia. Structural problems of the Slovak economic and political system, repression of opposition, corruption and lack of interest towards SMEs were soon reflected at international level. Slovakia was the only country of the V4 region entering NATO in 2004 in the 5th enlargement round. Its candidacy was declined in the 4th enlargement round contrary to Poland, Czech Republic and Hungary, which entered as early as 1999. Additionally in July 1997 after the official visit of Commissioner Hans van Den Boerk, the European Commission declared the postponement of the invitation of the Slovak Republic on its initial accession negotiations to the EU along with six other countries of the region including Hungary, Poland and the Czech Republic. During a visit Van Den Boerk said: “Slovakia has significant room for improving the situation in the functioning of institutions guaranteeing democracy, the rule of law, press freedom and human and minority rights.” (Jancik, 1997) He also expressed doubts about Slovak political development.[7] Prior to the election in 1998, politics was characterized by struggles for power between the government and the opposition rather than having consensual economic planning with a long term perspective.

Its status of democratic and economic laggard of Central Europe has been a deep wound to national pride for the newly constituted nation. On the other side, international disapproval with routing of Slovak transformation mobilized the opposition political elite. Fears about eastwards course-turning were present on the domestic as well as the international political scene. Meciar´s obvious difficulties to gain international acceptance only accelerated the worries at the international level too.

[7] More on http://www.sme.sk/c/2076106/van-den-broek-expresses-eu-concern-over-slovakia.html

In addition, the economic elite represented mainly by newly created firms SMEs as well as larger firms suffered from international insulation and became depressed by constant marginalization on economic issues domestically. Opposition parties as well as the national bourgeoisie realized that failing to enter international organizations such NATO and the EU would have deep consequences on the Slovak democratic and also economic transformation process.

The re-orientation of the Slovak foreign policy according to EU standards played a key role during the 1998 parliamentary election. The victory of the political opposition to Meciar´s regime has been decisive for the future orientation of the Slovak foreign policy. Since accession processes were already progressing in most countries of the region, the EU and other international players required fast steps as a proof from Slovakia that it will redirect its foreign policy on international integration. SGR encouraged by the EU and the IMF were presented as the return to European integration. The Slovak government took the same rhetoric to justify initial reform plans requiring several austerity measures in the tax and welfare system. Reform activities of the government were promptly appreciated once the official start of accession rounds to the EU during the Summit in Helsinki in December 1999. Slovakia received the invitation two years after the invitation of Hungary and optimism about the results of reforms was reflected in further SGR planning. Based on this development, reforms had been perceived as austere, nevertheless as an unavoidable economic tool to wider international integration and the way to a “brighter future” in the EU. Reelection of reform-oriented parties and the creation of governments with obvious reform intentions to perform further changes have been a conscious choice of voters to continue on the track of reforms mandatory to EU accession process.

1.2.2. Factor of EU conditionality in Hungary

Hungarian politicians had been able to take advantage of the beneficial position of Hungary among Central European countries. More importantly there was more or less a common consensus among the major political actors over the main tasks of transformation. Internal and external politics had been set up to establish democracy, the rule of law and market economy that would eventually lead the country into the EU (Balázs 1996, 4). It certainly did not mean that political parties in Hungary agreed on every economic question during the transition; however the professional and political consensus has been settled in the field of economy and international affairs. Its aim was to become a member of international organizations, especially NATO and the European Union. Nevertheless, the intensity of international integration has been a matter of debate, since some parties defended reliance on national independence as MSZP, while SZDSZ advocated maximal international integration. For instance, the Alliance of Free Democrats (SZDSZ) was a liberal opposition party during the Antall government from 1990 to 1994. They strongly advocated in favor of deeper integration with Europe and cross-border cooperation with neighbors. They became a part of the government in 1994 with the Hungarian Socialist Party which meant a clear inclination to EU integration.

Since Hungary has been not only the first country to redirect its trade to Western Europe, but also to adopt European institutions (Gyorffy 2008, 8), there was no doubt that Hungary would be among the first CEE countries to access the EU on its Eastern enlargement. The country adopted European standards for policy-making and polity relatively easily as well as several improvements in public administration. (Gyorffy 2008, 9) The only problematic point seemed to rest in the Hungarian inherited debt from the communist era at the level of 73% of GDP in 1989. However, robust presence of foreign companies together with an increasing number of domestic companies, growing export potential and successful rounds of privatization modeled a very competitive economy. After successful crisis management (Gyorffy, 2008, 8), by 1996 Hungary had set up a path of dynamic, seemingly sustainable economic growth. The Hungarian economy recorded serious decrease in its international debt (Agh 1999, 842). The socialist government successfully achieved the Hungarian integration efforts by joining the EU in 2004 with nine other countries of the region. Eventually Slovakia joined the EU too. However, the EU accession brought also the removal of external pressures and conditionality to enforce fiscal discipline. It resulted in a continuation of short-term politicized decisions and a radicalization of political competition. Plans for early Euro adoption became a hot topic of the election in 2002 as well as in 2006.

However, the Hungarian perspective of Euro zone accession has changed with time. Domestic political struggles have had an uneven impact on the ability of governments to perform any reforms, including the ones to boost FDI inflow. Medgyessy as well as Gyurcsany pressured by political and economic concerns decided to postpone convergence programs initially planning to launch reform on pension, health, education and public administration. A decade of only few improvements in the Hungarian business environment and the carelessness about the rising indebtedness brought many concerns about the future of the Hungarian economy. Hungary faced also lower confidence levels on the international financial market. Moreover, foreign investors started their relocation plans of labor intensive manufacturing production to countries with cheaper labor (Greskovits 2008, 284). In 2004, the company SAMSUNG which used to be one of the largest investors in Hungary decided to enlarge its activities, but instead of Northern Hungary it moved its expansion to Southern Slovakia.

1.3. Political systems and party systems

When speaking about launching of reforms, it might seem appropriate to delve into governments and especially their interests in a reform program as a key internal factor. Nevertheless the political system and particularly political parties represent a better unit of analysis due to the fact that party interest is more stable and easier identifiable.

Hungarian party system is usually considered as well institutionalized, especially after elections in 1998 (O´Dwyer and Kovalcik 2007, 5, Markowski 2000, 77). Some authors even regard the Hungarian election system as "two party democracy" after year 2000 (Greshkovits 2008, 284), since government has been formed either by Hungarian Socialist Party (MSZP) or by Hungarian Civic Union- Fidesz. Slovak party system is often described as less institutionalized or underinstitutionalized mainly due to the fluctuation of the parties in the Slovak parliament. In the younger period of Slovak democratic system, governments had been often formed by various parties entering the political arena in one election and exiting in the following.

Consequently a coalition building in Slovakia and Hungary follows very different paths. While Hungarian coalitions can be roughly explained by the cycles of socialist and right-wing governments, Slovak coalitions have always included unsystematic elements, which had a significant impact on government's decisions due to never-ending bargaining.[8] In addition Slovak party system is far from "two party democracy" as even current government consists

[8] First Dzurinda´s government was right-liberal coalition formed after election in 1998. It included Party of Democratic Left (SDL), which tend to oppose radical reforms. Also Fico´s social democratic government was formed with nationalist Slovak National Party (SNS) and Meciar´s party HZDS.

of 6 parties.[9] Multiparty coalitions can accommodate more and less reform-oriented parties in the same time and therefore the reform performance can only be a compromise which might not be in particular interest of any party. Clear difference can be seen between reform-moderate 1st Dzurinda´s government in 1998 and 2nd reform-radical government in 2002. The first government was formed as an acceptable compromise of diverse ideological backgrounds, where current reform performance did not represent particular interest of any party. In contrary, the ideologically consistent second government was able to exercise reforms and was better representing the interest of parties. In order to correctly identify a factor of political systems in reform processes we shall describe Political development prior to SGR as well as during the implementation period of SGR.

1.3.1 Slovak political development- emergence of reform cycles

In contrary to most countries in the region including Hungary, attitudes of Slovak political parties towards SGR can be described as dichotomous. This contrast is highly observable on the Slovak political scene and it seems to be deeply connected with the capacity of Slovak government to handle ex ante and ex post constraints of the reforms. I believe dichotomy of reform attitudes is the word accurately describing situation of political change, which has taken place more or less every other parliamentary election. It can be observed in changing of two different types of government, with completely opposite goals in terms of reforms. Gyorffy conception of political parties partly opposes O´Dwyer and Kovalcik conception of underinstitutionalization by assigning primary roles for Slovak SGR to other factors. My argumentation goes deeper, however in the same direction.

[9] Slovak government in 2010 has been composed of 4 parties – SDKU-DS, KDH, Most-Hid and SaS, however SaS and Most-hid had joint ballots with additional 2 parties (OKS, in ballot of Most-Hid and Obyčajní ľudia, in a ballot of SaS).

First type can be generally described as authoritative, nation-building and middle-left oriented governments, with preference of concentrated power, sustaining in status quo, populist economic decisions and high aversion to risk of reform process. Their counterparts can be characterized as almost radically neoliberal, reform oriented, very fragmented and decentralized governments, proclaiming European rhetoric instead of national and willingness to take all the risks of reforms on their backs for "better Slovakia" in the future. Different attitudes of these governments can be directly observed. Governmental programs of first types of government coalitions is always clearly anti-reforming and preserving the status quo, second type of governments always claim to take all the "blameworthiness" for painful, but necessary reforms.

The period between 1994 and 1998 has been characteristic not only by institution building of the new Slovak Republic, but also for the very controversial state governance led by Vladimir Meciar. Meciar´s government consisted of his party- Movement for Democratic Slovakia (HZDS), nationalist Slovak National Party (SNS) and Union of the Workers in Slovakia (ZRS). Especially repeated infringement of constitutional rights, elimination of proportionality in designation of state representatives in state organizations, firms or other positions, and the kidnap case of the opposing president's son created later the descriptions of this period in Slovak history as "struggle for character of the regime", "period of democratic deficit" or "desire for changing the rules of the game" (Butora 1999, 73, Beblavy 2006). As a result Slovakia in late 1990´s was perceived as a political laggard of Central Europe with deep democratic deficit.

3rd Meciar´s government had paradoxically declared the EU integration process as the main objective of the government. However integration activities of his government stayed only on the paper. Government additionally imitated the coupon privatization. Foreign companies were restricted from participation on the privatization of SOEs. Governmental parties have been very active in the privatization process and they politically influenced the privatization process. Privatization in fact gave up the SOEs and state properties to the small elite connected to ruling political parties.

First sign of Slovak dichotomous political development interesting from our standpoint appears in 1998, when controversial government leaded by V. Meciar was replaced by united opposition in 1998. As described at beginning of the section, the government created very fragmented, but also very reform-oriented coalition. However due to different ideological background, they have not been able to find agreement on the most of SGR. The government was formed by rare alliance of very diverse political parties. We certainly should note that creation of the government was not based on similar ideological background. In contrary they gathered as the opposition to authoritarian regime, which was quickly accommodating in Slovak society during Meciar´s era. Government collation consisted of Slovak Democratic Coalition (SDK) a joint alliance of 5 smaller parties. The second party in the government was the official successor of communist party in Slovak Republic- Party of the Democratic Left (SDL). Also ethnically defined - Party of the Hungarian Coalition (SMK) and newly created left-oriented Party of Civic Understanding (SOP) joined the coalition. Despite general victory of Meciar´s HZDS he was unable to form the government with SNS and ZRS. As a result they were forced to stay in opposition as well as the communist party of Slovakia (KSS).

Initial enthusiasm of ruling government was quickly replaced by a number of inter-governmental issues. Government formed by very heterogeneous parties needed to agree on structural changes. The democratic deficit, the disastrous economic situation caused by privatization to HZDS elites and bankrupting banking system were only some of the issues. Nevertheless most challenging task was to rehabilitate international recognition of the country and rebound Slovak chances to access the EU. Government was in addition formed by parties with diverse attitude towards reforms. Especially left-oriented parties found problematic to support business oriented SGR. The final compromise among them was found only in the questions of democratic opposition to Meciar´s regime and in re-launch of EU accession process. Due to lack of agreement in economic matters, some economic reforms had to be postponed. Reform processes during first election term therefore involved only economic reforms of the highest emergence as for example sanitation of bankrupting banking sector and allowing the foreign subjects to participate in privatization. (Zachar 2007, 61)

Second Dzurinda´s government formed in 2002 represented ideologically consistent, neoliberal and reform oriented government. Final collation agreement included reformed Slovak Democratic and Christian Union (SDKU), Christian-democratic movement (KDH)[10], SMK and newly created liberal Alliance of the New Citizen (ANO). Political orientation of the parties in government was uniquely consistent in right-wing orientation with focus on the neoliberal restructuring of the state. (Hurska 2009, 18) Political parties gathered on ideological background were able to articulate clearly its reform program. This was focused on the economic tools aiming to fix the extremely high unemployment[11] and inability of domestic enterprises to boost jobs creation. "… under Prime Minister M. Dzurinda and finance minister I. Miklos, the Slovak Government undertook the radical second generation reforms." (O´Dwyer and Kovalčík 2007, 4).

[10] KDH was a part of SDK coalition for elections in 1998. In 2002 they have decided to go to election with their own ballot.
[11] Unemployment in Slovakia in 1999 and 2001 was culminating around 20%.

Following the development of the election in 2006 our dichotomy towards reforms appears and complete redefinition of "national priorities" occurs again. SMER leaded by Fico has been able to mobilize the electorate by opposing further reforms. Despite the fact that HZDS and SNS represented parties with very different ideological orientation, they were able to find agreement on reform-reversal policies or at least reform delaying policies. Parties forming the government received their mandates with clearly reform-reversal rhetoric and total disagreement with previous government about future routing of Slovakia. The new government announced clearly the reform-reversal measures and total disagreement with future direction of Slovakia. Acting along with opportunistic tradition SMER rebranded from "third way party" to social democratic party with an accent on national interest. Fico successfully established SMER in Slovak political arena. They scored almost 34% of votes in 2010 election.

SMER with HZDS and SNS brought up corruption practices back in public sector. Overpriced public tenders, sale of C02 emissions to "garage firm" or orders given to friendly companies became a habit of governments encompassing SNS and HZDS. Populist campaign combined with authoritative practices towards critical media aimed clearly on reelection in 2010 rather than on responsible policy making, which economic crisis necessarily require. However social-oriented government did not completely reverse the reforms taken by former government. They rather focused on correction of harmful SGR consequences in the social sphere and improvement of labor position on the labor market. Changes oriented on wider welfare provision and social inclusion. Government also succeeded to finalize entry to Eurozone on 1st of January 2009.

Strong intellectual and media opposition against irresponsible public spending caused a sharp decline of HZDS and SNS preferences in 2010 election. Despite a decisive victory of SMER, Fico was not able to form his second government and share his anti-reform program with other parties. Elections in 2010 will be also remembered as the end of HZDS period, since party did not cross the threshold of 5% minimum votes. Fixed stars of previous reforms SDKU-DS and KDH made a collation with new liberal party SaS and Hungarian-Slovak moderate Most-Híd party, replacing radicalized SMK. Government leaded by Iveta Radičova introduced several reforms as 1% temporary increase in VAT or significant scratches in public spending. Slovak dichotomous reform cycle of governments ends with success of the parties with clearly pro-reform rhetoric once again in 2010. The path of complete turnout started again with first women on the chair of Prime Minister in V4 – Iveta Radičová. Dzurinda could not continue as prime minister due to scandal with unexplained party finances during election campaign, following by abdication from a post of potential prime minister.

1.3.2. Hungarian political development- emergence of anti-reform cycles

Contrary to Slovakia, Hungary had been enjoying favorable position not only among international business elite but also its political life seems to be much more consolidated in 1990´s. Hungarian politicians had been able to take advantage of the beneficial position of Hungary among Central European countries. More importantly there was more or less a common consensus among the major political actors over the main tasks of transformation. Internal and external politics had been set up to establish democracy and rule of law and market economy that would eventually lead the country into the European Union (Balázs 1996, 5). It certainly did not mean that political parties in Hungary agreed on every economic question during the transition. However the professional and political consensus has been settled in the field of economy and international orientation. Agreement in economy had two major areas, priority of privatization to foreign investors and hardening the budget constraint, which has been the major problem for all political parties later (Gyorffy 2008, 8). Its orientation was to become a member of international organizations, especially NATO and European Union. Nevertheless the intensity of international integration has been questioned, since some parties defended reliance on national independence as MSZP, while SZDSZ advocated maximal international integration. For example, the Alliance of Free Democrats (SZDSZ) was a liberal opposition party during the Antall government in 1990 to 1994. They strongly advocated in favor of deeper integration process with Europe and cross broader cooperation with neighbors. They became a part of government in 1994 with Hungarian Socialist Party which meant a clear inclination to EU integration.

As mentioned previously Hungary did not undergo such turbulent development during parliamentary election in 1998 as Slovakia. However ideas and planes of the Hungarian future routing differentiated significantly. Different visions formed political enemies between socialists in MSZP and rightwing political elites in Fidesz. Hungarian election system practically become consolidated "two party democracy" (Greshkovits 2008, 283). Surprise package implemented in 1995 by finance minister Lajos Bokros and introduction of pension reform by his successor in 1997 appeared to have major influence on election results in 1998. (Gyorffy 2008, 8) MSZP recorded momentous defeat and pension reform remained practically the only SGR in Hungary for another decade.

After election in 1998 we can observe a trend when even previously reform-oriented socialist MSZP became very reluctant to launch any kind of austerity measures and especially fiscal restrictions. Promises of more generous social care and material benefits become a norm for all parties during of election agenda. Buying of voters became part of Hungarian political folklore. (Gyorffy 2008, 10; Greshkovits 2008, 283) Reluctance to reforms emerged anti-reform cycles in Hungary.

Fidesz formed a coalition government with Independent Smallholders Party and Hungarian Democratic Forum. However new central-right government quickly realized that continuation of fiscal adjustment implemented by previous government might harm their political preferences during upcoming elections. First two year of relative fiscal discipline was replaced by long and intensive campaign for national election in 2002. Period since 2000 can be described as permanent election campaign with lack of any major reforms even at the beginning or middle of the government term, especially due to large number of elections, referenda and intensification of antagonism between two major political camps. (Gyorffy 2008, 10) Fiscal decision becomes politicized and Hungarian economy emerged political business cycles in a form of massive pre-election spending.

Election in 2002 emerged very close victory of socialists. Socialist government successfully terminated Hungarian integration efforts by joining EU in 2004 with other 9 countries of the region, finally with Slovakia too. However EU accession brought also the removal of external pressures to enforce fiscal discipline. It resulted in continuation of short-term politicized decisions and radicalization of political competition. Plans for early Euro adoption became a hot topic of election in 2002 as well as in 2006. Socialists created a convergence plan for entering Euro zone originally in 2006, aiming at cuts in expenditures and introduction of new taxes. Convergence plan also aimed at reform of welfare state and education system. When the government plans became public, their popularity rapidly plummeted. (Greskovits 2008, 284) Medgyessy´s government had to balance on the edge of risking defeat due to implementation of fiscal restriction or adopt SGR and prepare the economy for the entry to ERM II. Opposition adopted "euro-populism" rhetoric, attacking the government for inability to implement fiscal adjustment and also for lack of sensibility to in social sphere. (Greskovits, 2008, 283)

Hungarian political parties generally embarked on the road of short-term benefits perspectives. None of the leading political camps were able to sacrifice their short-term losses of political preferences for launch of much needed reform programs. During socialist incumbent starting in 2006 there were several attempts to articulate and implement convergence program for EURO adoption. However public disagreement with further reforms was reflected in referendum result. 80% of voters in referenda voted against doctor visit fees, hospital daily fee and tuition. Clear refusal of reforms brought also this SGR initiative to end.

World economy crisis deeply influenced Hungarian economy too. Crisis in Hungary was connected with negative GDP growth in 2009, sharp decrease in tax incomes and particularly a graduation of Hungarian never-ending problem with public dept, when Hungarian state bonds started to be almost untradable on worlds´ financial markets. "Hungary has been particularly exposed to the financial crisis due to still high levels of government and external debt." said the EU Commission.[12] In 2009 Ferenc Gyurcsány resigned with words that he would be an obstacle to further reforms. Later Gordon Bajnai replaced him on a chair of prime Minster. In 2010 Fides came to power after 8 years in opposition by winning absolute majority in the parliament. New government had to aim on finding a solution for uneven economic situation, although they remain rather reluctant to SGR reforms too. However government was forced to implement assessments to avoid further loans from IMF as well as

[12] http://ec.europa.eu/economy_finance/sgp/pdf/20_scps/2009-10/03_commission/2010-03-24_hu_recommendation_for_co_en.pdf

adjustments of public debt. In November 2010 Viktor Orban´s government introduced flat tax rate system as one of the last countries in the region. However policy-making so far is often reflected as democratic experiment with absolute majority than serious intention to consolidate public finances.

1.4. Underinstitutionalization of Slovak political system

After we characterized political systems and political parties in both countries, we might finally progress to identification of interactions contributing on diverse reform attitudes. Political parties represent one of the major actors in reform processes. Hereby I would like to challenge the argument of O´Dwyer and Kovalcik that underinstitutionalization of Slovak party system grounds the modest opposition to reform programs in Slovakia, while better institutionalized party system in Hungary did not allow such steep changes in a state resources allocation. O´Dwyer and Kovalcik argue that Slovak ability to implement steep SRG program, providing generous investment incentives, cutting significantly social benefits and increasing indirect taxes, was possible due to underistititutionalization of the Slovak party system. According to them in more developed party systems as for example in Hungary, parties could not effort to implement such "antisocial" austerity measures for the reason that they would be risking an exit from political arena. (O´Dwyer and Kovalčík 2007, 4) Despite the fact that a level of party system institutionalization directly determines a political pressure of social groups on governments, my thesis provides evidence that Slovak party system during SGR processes proofed not to be significantly less institutionalized than one in Hungary. Majority of the reforming parties in Slovakia continued to gain voters support with reform rhetoric even during election in 2006 as well as in 2010.

Despite the fact that underinstitutionalization of party system might play a significant role in the reform processes, it did not prove to be relevant during SGR in Slovakia. Reelection of the government announcing further reforms does not seem to support the argument of O´Dwyer and Kovalčík about underinstitutionalization, but rather oppositely clear orientation of voters towards reforms directing to EU and economic reconstruction. However I shall dissect my contra-argument in more details.

O´Dwyer and Kovalcik argue that reforming governments have always had “newcomers” as the one in 1998, 2002 and finally in 2010 too. I can hardy challenge this fact, since we can find new parties in all of mentioned governments. On the other side core reformer parties SDKÚ, SMK and KDH always have had very stabile electorate. Nevertheless those parties similarly than other parties in Slovakia and Hungary survived a number of internal crises too. What I am trying to illustrate here is not a claim that Slovakia has not experienced lower levels of the party system institutionalization during a reform process compared to Hungary. However I claim that major reform parties did not suffer by deficits of responsibility to their voters. Major party exits, swaps and reestablishments have been more significant in reform-opposing left and middle-left parties. Voting outcomes in 2010 gave a revival to same reform parties again despite better institutionalization of lefty parties in SMER.

Nevertheless a reborn of liberal parties every election period[13] and current steep transformation of Hungarian minority parties[14] puts a question mark on Slovak party system institutionalization. However my main claim is that proprietor parties of reform movements in Slovakia are the most stabile ones. Relevance of the underinstitutionalized political system is

[13] ANO in 2002, Free forum in 2006 and Freedom and Solidarity (SaS) in 2010.
[14] After radicalization in SMK between 2006 and 2010, former chairman B. Bugar created new ethnically oriented party Most-Hid based on rhetoric of cooperation and inclusion of Hungarian minority. Most-hid get to parliament with over 8% of votes and SMK did not make it to parliament when they have been missing 0,5% of votes.

therefore questionable.

1.5. Better institutionalized party system in Hungary

"In institutionalized systems, elections present voters with manageable and meaningful choices: there are a limited number of stable parties with familiar coalition-building preferences to choose from." (O´Dwyer and Kovalcik, 2007) As mentioned previously, Hungarian party system is often regarded as well institutionalized and consolidated, especially after elections in 1998 (O´Dwyer and Kovalcik 2007,5; Markowski 2004, 77). Some authors even regard the Hungarian election system as "two party democracy" after year 2000 (Greshkovits 2008, 284). Since 2000 the government has been formed either by Hungarian Socialist Party or by Hungarian Civic Union- Fidesz. However Hungarian parties including mentioned ones have gone thorough significant transformations too.

Major reforms in Hungary have been implemented in 1995. MSZP won absolute majority in the parliament and therefore did not have a problem to pass the reform laws in the parliament. Reforms were implemented by a party already well established on Hungarian political scene. Their success in election and the intention to implement reforms did not seem to come from the underinstitutionalization of political system. Despite later change in reform orientation, MSZP is still part of Hungarian parliament. In the same time MSZP has been forming the government in 2002 and 2006. Additionally recent reforms in the Hungarian tax system do not support the argument. Fides in 2010 same as MSZP in 1998 won absolute majority in the parliamentary elections. Despite the fact that reforms in Hungary are very unpopular economic situation required several reforms.

As it appears from the above descriptions Hungary and Slovakia have faced very different situations in terms of institutionalization the party systems. Hungarian parties appeared to be more institutionalized than Slovak ones. On the other hand changes and transformation are present in Hungarian political spectrum too. Also political successes of reform parties in Slovakia make the claim very unconvincing.

2. Second Generation Reforms

The very fundamental aim of second generation reforms is to attract foreign capital to boost national development that was heavily lagged in Slovakia during 1990´s. The expectations in Slovakia were the same concerning impact of extensive SGR package. Attempts of Slovak reformers turned into creation of the most competitive business environment in Central Europe. Recalling from previous chapter, a need for investments in Slovakia appeared to be much more emerging than in more industrialized Hungary. Additionally, the level of infrastructure development, uncertainty about sustainability of the reform development and comparatively lower quality labor due to underdeveloped education system required some additional incentives for transnational corporations to invest in Slovakia.

Hungary experienced the opposite situation at the end of 1990´s. A political stability, historically lowest unemployment levels, stable economic growth and gradual decrease of the public debt meant were paving a direct road to EU.

2.1. Restructuring of economic environment – Second Generation Reforms in tax systems and FDI support

While Slovakia had to face a difficult economic situation in 1998, Hungarian government in the same time inherited the country in much better shapes. Hungarian tax system also offered better possibilities to domestic and foreign companies by special corporate tax schemes. In almost all other economic indicators important for investments, Hungary highly outperformed Slovakia. Since year 1998 Slovakia launched a substantial reconstruction of the economy.

2.1.1. Slovak tax system under Second Generation Reforms

Slovak tax system had been highly unattractive to domestic and foreign companies too. 40% of corporate income tax until year 2000 (Mitra and Stern 2003, 129) caused only a minimal attention of foreign investors. First changes in the Slovak tax system started in 1999. CIT was reduced to 29% and later to 25%. Minor changes were performed in VAT and personal income taxes too.

The tax reform initiated in 2003 was envisaged as part of a broad and wide-ranging program of structural reforms in Slovakia. State technocrats in cooperation with foreign neoliberal consultants and domestic foreign educated elites started courageous plan of SGR. "Slovakia's turnaround was based on a radical set of business-oriented reforms, including sharp reductions in taxes, the institution of a uniform flat tax for individuals and businesses, steep cuts in social programs, weakened labor regulations, and generous incentives to foreign investors." (IMF on Slovakia, 2004; EIU on Slovakia, 2004)[15]

It seems complicated to exclude one reform from another, when analyzing them, for the reason that reform conception in Slovakia represented a very complex reorganization procedure starting with tax system and connecting all public activities, including welfare system, education, health system etc. (Mitra and Stern 2003, 124) However the tax reform became the central element of all SGR processes in Slovakia. Basic aim of the conception became to create a business and investment friendly environment for individuals and

[15] For more details please see http://www.imf.org/external/np/ms/2004/052704.html or www.eiu.com

companies, to eliminate existing weaknesses of the complicated tax system and inefficiencies in the tax law and to achieve the highest possible degree of tax fairness by taxing all types and all amounts of income equally shift the tax burden from direct to indirect taxes. (SARIO, 2010)

Accordingly the flat tax system came into a force on 1st January 2004. The general flat tax rate for personal and corporate income taxes as well as for value added taxes was stated on 19%. In accordance with a conception of no double taxation, fairness, effectiveness and simplicity of new tax system, the reform abrogated the inheritance, gift and dividend tax accordingly. The reform was completed by the introduction of zero tax rates on real estate transfer in 2005. (SARIO, 2010)[16] It is necessary to note that reform of the tax system represented an absolute novelty in the Central European area. New tax system was unquestionably beneficiary for TNCs as well as for domestic companies. However it caused doubts for labor as well as for neighboring countries. "Slovakia's tax policies have pressured the Czech Republic, Hungary and even Austria to lower their taxes as well." (O´Dwyer and Kovalcik 2007, 5) Federal Chancellery of Austria noted "The reduction of the corporate tax rate from 34 to 25 percent is to create vital impetus for the relocation and foundation of new businesses" (O´Dwyer and Kovalcik 2007, 5).

Opposition parties building on anti-reform agenda announced plans to increase taxes for wealthy (Jančík 2006) and decrease VAT for drugs and food (Hambalkova 2006) immediately after government formation in 2006. In fact no significant changes in the flat tax system had been introduced. The only change in the tax system was the decrease of VAT for books and medical products on 10% in 2008. Additionally the reduced tax rate of 6% for home-made

[16] For more details please see http://www.sario.sk/?why-invest-in-slovakia

diary and grocery products was introduced to support small farmers. (SARIO, 2010)

As many countries globally, Slovakia was hit by the crises above all during the last 2 years of Fico´s election term. From 2008 FDI inflow recorded a significant decease. (SARIO 2010)[17] The current trend combined with decreasing production capacities caused by lower European demand for Slovak products was reflected on GDP growth. While annual gross GDP growth in 2007 was among the highest in EU (10.4%), in 2009 Slovakia experienced a bulky decline of -4.9%. (Slovak Statistical Office record, 2010) Negative GDP growth in combination with an inefficient public spending due to corruption brought up the gross Slovak public debt from 27,48 % of GDP in 2008 to 43,78 % of national GDP in 2010.

Last corrections in the Slovak tax system have been introduced by the current incumbent in 2010. Tax reform in 2010 has been initiated by the same financial minister Ivan Miklos as tax reforms in 2004. The increase of VAT by one percentage point was a part of the rehabilitation package, which aims to decrease the government spending deficit over 8% of GDP as Maastricht criteria requires.[18] The validity of this temporary increase will expire when the general government deficit reaches less than 3 percent, what is planned by 2013. Reduced VAT for small farmers have been abolished too.

2.1.2 Slovak FDI support

First Slovak state incentives schemes have been introduced in 1993. „These measures lasted only for a short period of time and were later replaced by measures to support revitalisation of

[17] See more on http://www.sario.sk/?fdi-and-success-stories
[18] Maastricht criteria require maximal government deficit of 3% of GDP.

state companies. Since 2000, tax breaks were automatically granted to all investments, on condition that the ownership share of a foreign owner exceeded 75% and that investment costs exceeded the amount stated in the Income tax Act." (Marcinekova and Mihok 2007, 8) Slovak State Aid and regional Aid schemes are regulated by the Act No. 231/1999 Coll. on State Aid and Act No. 561/2007 Coll. on Investment Aid and they are fully compatible with European regulations, which restrict completion via state aid proposals among EU countries. These schemes allow investors to reimburse up 50% of eligible costs from various types of investment incentives. Most frequent types are especially direct cash grants, free real estate transfers, tax relief or contributions on newly created jobs. (SARIO, 2010) "The primary role of the investment incentives should be the motivation of investors to place their new projects in the so-called disadvantaged localities." (SARIO, 2010) Despite huge amounts of allocated public resources and the aim to support especially project in less developed region, most investors has established their production capacities in the most industrialized parts of Western Slovakia. The regions had highly developed industrial infrastructure. Less developed regions of Central and Eastern Slovakia still record up to 25% of regional unemployment. None of the governments changed the existing schemes. Moreover the Ministry of Economy lowered he minimal investment requirements in 2008 to attract more investment as a part of Fico´s anti-crisis package.

2.1.3. Hungarian tax system under Second Generation Reforms

Development of the Hungarian tax system was more dynamic than that one in Slovakia. The trend of shift from direct to indirect taxes continued even after 2000. However in Hungary the trend was the lowest in caparison to other countries in the region. In 2002 Hungary had the average VAT at 20,4% (Mitra and Stern 2003, 124). The Hungarian tax system was changed very often, however no flat tax rates were introduced. Tax rates corrections were amended as a part of Bokros package in 1995. Corporate Income Tax (CIT) was reduced from 36% to 18% and the reduced rate of VAT increased from 10% to 12%. However social and health contributions paid by employer rose to 40% of a gross income.

Hungary chose rather gradual approach to the tax reform agenda and mostly only reacted on a current situation. Slovakia's tax policies had pressured neighboring countries including Hungary to lower their taxes to retain their competitiveness for domestic enterprises as well as for FDI. (O´Dwyer and Kovalcik 2007, 19) „Fidesz did manage to make only cosmetic changes in this area during its period in government, and the Socialists also made modest reductions in 2004 in rates of income tax, from 20, 30, and 40 percent to 18, 26, and 38 percent, respectively, but overall, personal and employers' taxes remain high" (O´Dwyer and Kovalcik 2007, 19) Since 2004 only minor changes have been done in the tax system till 2010. In 2008 tax on real estate has been introduced with promises of further tax changes. However changes in the tax system did not come true after all. From 1st, January 2011the new law on tax came into a force. The major amendment is that a personal income bracket system will be replaced by a flat tax rate model. Tax rates for personal incomes ranging from 17-32% were equalized on 16% for all income groups. The tax on capital gains was also reduced on 16%. The anti-crisis package also charges the companies with annual turnover lower than 500 mil Ft. with reduced rate of 10% till 2013. Cuts in direct taxes created a burden on labor also in Hungary. Already in 2009 the previous government approved the rise of VAT from 20% to 25%. They also stated exceptions for the staples such as bread, grain, flour, milk and other dairy products and district heating on 18%. (ITD Hungary, 2011)

2.1.4 Hungarian FDI support

As mentioned in the previous section, Hungary was the first country in the region to implement investment incentives in a form of tax relief and special tax schemes for foreign companies already in 1988. In 1993 tax exceptions have been introduced. Investments exceeding 500 mil. Ft. entitled an enterprise for a 10-year exemption from taxation. "Since 1998 the investors, who invest at least 10 billions HUF in stipulated low developed areas, are eligible for a 10-year tax holidays, if the investor creates 500 new jobs and the turnover annually grows at least by 5%. Those incentives are available till 2011. Next to the tax holidays, the investor can use incentives for small scale investments and retraining of labor force." (Sedmihradsky and Klazar 2001, 88) From 2003 foreign and domestic enterprises have "access to a development tax credit applicable to the first five years of a new investment project valued at more than HUF 10 billion (or HUF 3 billion in "underdeveloped areas")". (Mitra and Stern 2004, 124)

Except several reassessments in the pension system, which started already in 1997, the introduction of the state and regional incentive law and several changes in the tax system, we can hardly find measures considerable as SGR. SGR did not embody interesting institutional innovation to relatively well functioning existing institutional set up. However, I shall mention that Hungary was the first country of the region to implement reforms towards three –pillar pension system in 1997. Slovakia followed the pension reform only 8 years later, however much more extensively. In addition later introduction of flat tax rate and significant increases in VAT in Hungary followed the regional development creating a tax burden on labor in more extensive way.

3. Actors in the development of Second generation reforms

In the first section I provided the characterization and theoretic background for the factors contributing to reform processes. I focused on economic legacies of communist regimes and of early post-communist era. I identified a potential role of unemployment connected to labor opposition. I have also provided a characteristic of diverse party systems and the role of EU.

Third part shall identify the actors of the reform processes and possible interactions among them. Based on previously developed concepts I aim to investigate the actual role of actors performed during the SGR initiatives as well as the impacts on reform processes. In other words I will be interested in the launch of reform activities as well as in consolidation of respective reforms. In the same chapter I will additionally focus on a particular interaction of each actor in the processes of second generation reform.

I have already identified and scrutinized the domestic political actors in the previous chapter. Governments and political parties have also characterized in connection to the development in party systems. Due to a fluency and complexity of my theses, I provided the characteristics of the actors and their position in the reform processes already in the first part.

In last section I will therefore focus on the identification of TNCs and the role performed in SGR. Since in Hungary and Slovakia TNCs participated on reform processes in a different manner, I will provide causal inferences, which shall explain differences between the position of TNCs in Hungry and in Slovakia.

3.1. Influences of transnationals´ on domestic implementation of Second Generation Reforms

We have analyzed domestic political incentives of SGR programs. Herewith I would like to dedicate my attention to describe how a presence TNCs in the country shaped SGR. I will also consider a role of domestic companies.

An iimportant issue discussed by a number of authors scrutinizes the impact of TNCs on a domestic political and economic development. Dependency theorists argue that less developed countries has been always dependent on the TNCs for technology, financing, markets and basic imports. (Smith 1991; Stallings 1992) Other authors argue that domestic political environment has to be considered at the first place, because their domestic political systems has been the main driving force of changes in domestic policies. (Nelson 1993, Sklair 2002, Kohli 2009)

TNCs are usually regarded as the source of support to neoliberal measures. *Laissez-faire* economies provide a more cost efficient production, mainly due to more flexible labor market, less administration costs and lower expenditures on health and social contributions. (Stallings 1992) Hungary was historically more successful in attracting TNCs.[19] Except direct ownership of production facilities many TNCs chose a form of joint ventures with Hungarian companies and thus became also domestic companies (Kaminski 2000, 17) Opposite situation happened in Slovakia. Up until 1999, there were, in fact, restrictions on foreign residents owning businesses in Slovakia. As a result, till 1999 Slovakia acknowledged only one sixth of

[19] For more details see the section on economic legacies

the amount of the per capita investment received by other Eastern European countries such as Hungary and the Czech Republic.

Based on described figures we shall expect that an influence of TNCs on domestic policies is exercised directly to improve their local positions. Hungary in this respect should have been pressured to implement a wider range SGR in favor of TNCs. However an actual development turned out to be opposite. SGR performed in Slovakia has been steeper and clearly oriented to support inflows of foreign capital rather than on a creation of national framework for development of domestic enterprises. Hungarian policies has been also largely oriented on TNCs, however, they succeed to develop also the schemes to support domestic companies. An unusual development requires the scrutiny of alternatives to foreign capital and characteristics of relation between TNC and political parties.

In Slovakia economic elites emerged after a fast privatization, which brought previously state owned enterprises into hands of several privileged people with unique connections to HZDS party elites. By 1998 most of SOEs had been sold in the coupon privatization, with several exceptions of strategic industries in utilities, energy sector and transportation. However most of production capacities in the national industry went to new entrepreneurial elites with political connections to HZDS. Political parties forming a government in 1998 had therefore a very challenging task to find supporters and sponsors in domestic industrial sector, which was already highly politically saturated. Especially privatized large and medium enterprises were politically related to HZDS. Current links obstructed them to cooperate with a new political establishment. Since parties in the government were relatively new, they have not achieved good connections with private sector yet. Due to saturation in the private sector, coalition parties were not able to find the sufficient number of reliable allies in private sector. For this reason the scope of their interests started to turn increasingly on abroad. Greater openness of the Slovak economy and wider international respect after initial reforms, which had been negotiated during the first Dzurinda´s government,[20] created wide opportunities for future FDI inflow to Slovakia.

Reelected government therefore needed to additionally improve the business environment in order to complete their successful orientation on foreign companies and to secure a future support and finances. Foreign companies lately investing in Slovakia naturally became enthusiastic supporters of neoliberal incumbent, rather than compromised HZDS, SNS and ZRS or forming left-oriented opposition announcing reform-reversal measures. Close connections of the reform-oriented parties with foreign TNCs were proved correct after several scandals with unexplained endowments to SDKU-DS, published several weeks before the parliamentary election in 2010. Also other parties have been suspicious form shady practices. However, the final proof has never been found. In this particular case M. Dzurinda was not able to explain incomes and loans coming from companies connected to TNCs involved in privatization of state owned hotels in Bratislava during Dzurinda´s incumbent. Sympathy to foreign companies rather than to domestic ones can be also observed from an early exclusion of Slovak companies from the investment incentives schemes. In the first investment aid law approved in 1999, Slovak entity was not eligible for the investment stimuli application. Investment incentive regulations were reformed in this regard only in 2006, when these parties were not in the government anymore.

The situation in Hungary seems to be very different in this respect too. The country had a well developed and attractive business environment already at beginning of 1990´s. As described

[20] Mainly privatization of a banking sector to foreign companies largely increased opportunities and easiness of TNCs investments in Slovakia, when Slovak banks were incorporated into world-wide banking networks.

previously, Hungary consumed most of FDI in first half of 1990´s. Domestic market has been penetrated by large amounts of foreign companies or joint ventures as well as emerging domestic enterprises. Privatization with an exclusive orientation on foreign companies accelerated FDI inflow to Hungary. In addition, privatization has not created monopolized economic elites connected to one or several political parties. Privatization was more gradual, long-lasting and transparent. Consequently political connections in industrial sector have been created accordingly. Hungarian political parties have not been forced to search for a foreign source of party support or incomes, since domestic market provided sufficient opportunities. In this regard governments had fewer incentives to implement drastic SGR to massively attract new industrial players in industrial sector and to risk significant looses in the election. Additionally steep and sudden SGR has not been necessarily required to ensure survival of political actors in political arena.

TNCs in Slovakia could exercise their conditionality due to a lack of any domestic alternatives or higher penetration of TNCs already investing in the country. Hungarian private sector provided sufficient amount of TNCs as well as domestic firms since 1990´s. Political elites, neither labor has been dependent on further FDI inflow. Alternatives to FDI have relaxed TNCs´ pressures on the reforms.

3.2. Labor and SGR

In this section I will turn my attention on the important role of labor. Working population is usually regarded as a likely source of reform backlash, which obstruct or block the government from consolidation of reforms. In SGR processes organization of labor and its position within the state is particularly important as reforms, attracting foreign capital, must be on the expense of some other actor, usually on the expense of labor. The shift is mostly exercised by a shift in sources of taxes, when burden created by tax exceptions and special incentives as well as lower corporate tax rates is shifted to indirect taxes – especially VAT on consumption. (Tanzi 1993, 21) In this respect, labor reactions on increasing life expenses and lowering funds for welfare and social protection due to reforms implemented in favor of corporate level is a limit for consolidation or withdrawal of SGR. (Bohle and Greshkovits 2006, 22)

In the part dedicated to labor, I analyze the sources of diverse position of labor in the SGR processes as well as the impact of unlike interests of labor in Hungary and Slovakia. Because both countries experienced socialist past, new position of the labor in industrial relations after a regime change the required a reconstruction of the whole system. Job security and no stress from loosing one had always weakened social conflicts during communist regime. Nonetheless establishment of market institutions and pressures on budget constraint paved the way to an emergence of conflicts between interests of government, employers and labor.

3.2.1 Hungarian industrial relations

Despite the fact that tripartite was established in both countries, its functions and actual influence as well as bargaining powers towards government and employers differ significantly. Functions assigned to Hungarian tripartite institutions have been much more extensive that extent of social dialogue in Slovakia. Hungarian unions have been enabled to annually negotiate the wages indicators and they have actively participated on drafting of the labor legislation as well as all legislative changes affecting labor position. (Avdagic 2005, 29)

Hungarian labor relations in 1990´s can be characterized as decentralized with plurality of organizations speaking for the labor. Similarly to Slovakia major unions have emerged as successors to communist unions. Most important one was especially Hungarian Confederation of Trade Unions (MSZOSZ). The newly created unions representing interests of existing firms such Democratic League of Independent Trade Unions (LIGA) have also become significant. The last category of trade unions has been created on the bases of government's will as for instance Workers Council (WC). However, it mostly only undermined the existing structure of unions and their competences depended highly on incumbent motivations. Initial labor relations at the beginning of 1990´s had been rather calm. Labor code from 1992 established several important rights to unions including the consultative rights with the government and the right to create collective agreements.

After MSZP formed the government in 1994, it was generally expected that trade unions, openly supporting the party will gain more power than they enjoyed during previous incumbent. Paradoxically opposite became true. Hungarian socialist government, which was facing the economic crisis in 1995 have not been able to negotiate consensual solutions in a tripartite body. Socialist government relying on absolute majority in the parliament implemented a deep neoliberal austerity package that affected Hungarian labor instead. (Ost 2000) "Bokros package" introduced a nominal wages freeze in public sector and measures supporting domestic export, such as depreciation of Hungarian Forint and surcharge on import. The collapse of corporatism in Hungary and total miscarriage of trade unions in tripartite even deepened the diffidence of workers to their union representation. After a calm period the differences between interests of capital, labor and government appeared, despite the fact that unions had friendly relation to socialist MSZP.

3.2.2. Hungarian labor in Second Generation Reforms

The depression of Hungarian labor continued with liberal-conservative government led by Fidesz in 1998. Creation of WC and the amendment of labor code, giving the right to conclude collective agreements on the enterprise level, even decreased the impact of labor on economic decision (Kubicek 2004) Trade unions depressed by the austerity measures and threaten by a possibility of additional inclusion from social dialogue have finally found a way to step over the rivality and gathered against “common enemy”, to gain back the bargaining position with government.

Government additionally decided to create Országos Munkaügyi Tanács (National Labour Council, OMT) to provide a forum for national level social dialogue responsible in fields of employment and industrial relations. Another body, Gazdasági Tanács (Economic Council, GT) was created to supply an alternative for social dialogue on economic policy. Additional decentralization was highly criticized by all trade unions´ representatives. In fact a split of the tasks between two bodies reduced the coverage of effective social dialogue by transferring the social dialogue over economic policy to a new body. (Eurofound, 2004)[21] Conflict between labor representatives even enhanced when the minimal wage as well as other labor-related regulations were accepted and approved without any discussion on the tripartite.

Unions organized their first common demonstration of the six national union confederations in Budapest on 11, November 2000. “Unions protested against the amendment of the Labor

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[21] For more information see http://www.eurofound.europa.eu/pubdocs/2011/10/en/1/EF1110EN.pdf

Code and the government's sidelining the national level tripartite forum. The unions also demanded higher wage increases and a rise of pensions." (Eurofound, 2004) There were also sectorial-oriented demonstrations in 2000 and 2001. The biggest strike of 56 000 railway workers in January of 2000 lasted for almost 2 full weeks. Trade unions were able to involve people from all sectors and public services. A similar development, involving such large group of people can not be found in Slovak history of organized labor.

New social-liberal government came to a power in 2002. They decided to take complaints of trade union into a consideration and to reestablish one body being responsible for national level social dialogue in fields of employment, industrial relations and economic policy too. Two election terms of MSZP in government strengthened a position of labor in Hungary. First government formed by MSZP and SZDSZ in 2002 won the election by a small margin. Fear from next election defeat obstructed government from implementation of extensive reform program. However after reelection in 2006 "New Balance" package has been announced with primary aim to reduce the public spending deficit to 3% in 2010. Despite intended sweeping measures "the government assured the social partners that it would continue to support tripartite social dialogue and the social partner organizations. In accordance with this policy, the New Balance program was submitted to the National Interest Reconciliation Council, the national-level tripartite forum, for consultation.“ (Tóth and Neumann 2006) After public disclosure of predicted inflation on 7% and expected drop of wages by 3-4%, reform package had to be postponed due to massive public opposition to SGR program.

We can observe very different development with "new balance package" compared to previously taken "Bokros package" in 1994-1995. Labor interests have been reflected in the policy making and its bargaining power could be exercised due to several legal improvements of the labor position as well as thanks to several decisions of the Hungarian Constitutional court in favor of the labor. Firstly reestablished OMT provided a legal basis for social dialogue in tripartite. Secondly the socialist government threatened by previous strength of labor strikes in 2000 and 2001 did not want to risk further strikes. Thirdly "Decision No. 40/2005 of the Constitutional Court obliged the Hungarian parliament to introduce new legislation that should anchor "the social partners' right of co-determination, or the right of veto in public administration, lawmaking or rule-setting, constitutes public power that must not be exercised by bodies without appropriate legitimacy." (Eurofound, 2011)[22] Lastly the major changes in labor code had been made in favor of working population. This development of industrial relations secured a labor position on the policy-making in Hungary also for upcoming period.

Nevertheless due to delayed reforms, Hungary fell into a deep crisis with American credit crunch followed by the decrease of consumer demand. Due to extremely large public debt and deprecation of national currency, Hungary needed to relatively quick agreed on substantial credit line of 20 billion € with EU, IMF and world bank. The government, constructed only by Fidesz, introduced a new labor code in 2010. However only minor changes, easing employment of seasonal and casual workers, has been performed. Also new government promised to keep a social dialogue active during the entire term.

Current development and the involvement of trade unions in the Hungarian tripartite signify that labor interests succeed to be well established in Hungarian policy making.

[22] For more information see http://www.eurofound.europa.eu/eiro/country/hungary.htm

3.2.3. Slovak industrial relations

Constitution of Slovak trade unions pursues a different path than that one in Hungary. Confederation of Trade Unions of the Slovak Republic (KOZ) was established as a body representing interests of the labor. Slovak trade unions had not experienced inter-union rivality, since KOZ SR was formed as the only successor of monopolistic communistic labor union (ROH) with the continuation of legislative, administrative background as well as the property relations. (Hruska 2009, 6) Obviously, unified structure and continuity gave a strong weapon to hands of Slovak labor representatives. Also a concern of the Union of the Workers of Slovakia (ZRS)[23] in Meciar's government betokened the big expectations on future development in line with labor interests. On the other side unions had to bear authoritative practices of Vladimir Meciar too. Already in 1995 he brought the first assault on tripartite, when he was forcing the union representatives to sign the general agreement under pressure. Relations between the government and KOZ had become acute. After change of KOZ president to Ivan Saktor, KOZ became very active in all-society issues and became politicized. Saktor was often personally present at opposition meetings.

Meciar therefore decided to create unions wiling to support governmental policies and not "taking a labor as hostage of interests", in order to proceed a planned privatization. Federation of Employers' Associations of the Slovak Republic (AZZZ SR), feeling the opportunity to profit from upcoming privatization and delegitimate KOZ, embarked on Meciar´s boat. Trade unions involved in a political action openly criticized privatization in Slovakia. Nevertheless they also completely lost an influence over decisions made by government with AZZZ SR. They also become focused on political fight, rather than on a mobilizing labor to enforce labor

[23] ZRS is no labo or trade union, it is a political party.

interests in the economic policy. Opposition government formed in 1998 met KOZ deeply involved in the politics and rather alienated from its members and labor itself due to inactivity in labor questions.

3.2.4 Slovak Labor in the Second Generation Reforms

Slovak tax reform brought hard times to the neighboring countries by pressuring on tax decreases. Although the population, that has paid the most for the SGR, is clearly the labor. As many authors argue (Duman 2010, 2, Tanzi 1993, 21, Zachar 2007) foremost problem of current tax reforms in Central Europe is the fact that favorable condition for international capital inflow are paid from the pocket of working population. Zachar argued that the middle class in Slovakia can face the poverty line by a further implementation of SRG. Such tragic scenarios have not happened as after 2004 at least the in-work poverty has been decreased in Slovakia. (Gerbery 2008, 21) However enormous social inequalities in distribution and high social costs of reforms are observable especially among non-working population. “The overall impact of tax reform on public finances was estimated at minus 13.2 billion” (Zachar 2007, 29) Burden was transferred into indirect taxes. Mainly VAT, prices of energies and higher taxes on gas and mineral oils pasted the burden. “In Slovakia, tax cuts and business incentives were funded by cutting the unemployment benefits in half and a VAT increase that sharply raised the price of food, energy and medicine.” (Bohle and Greskovits 2006, 21)

As current Czech president and former finance and prime minister noted. "As a liberal economist, I view the Slovak economic reforms positively and I prefer them to our [Czech] 'quasi-reforms.' However, the fact that the whole reform process in Slovakia went very smoothly would suggest to me that it progressed without any public support. It is extremely unlikely that such reforms could be undertaken in Germany, France, Italy or the Czech Republic at such a pace without tough debates in society." (Klaus, 2004)[24] To approve or refuse his claim I will look on labor position during the first and than second Dzurinda´s cabinet as well as on labor interests in unemployment cuts as a relaxing factor of labor strikes.

The major change for Slovak labor movements came with alteration of the government in 1998. First Dzurinda´s government agreed to adopt a law introducing the tripartite and social dialogue with the biggest trade union confederation, KOZ. Law on the tripartite came into a force in 1999. The law modified the responsibilities of the social partners in the social dialogue. Law has been discussed publicly and it was additionally approved by government, AZZZ and KOZ on tripartite. However a critique against government and initial reform programs continued with further demands of KOZ concerning significant increase in wages or decrease of taxes. Minister of Finance announced that demands of KOZ can not be accepted due to their internal inconsistency and lack of reasoning. KOZ started with a preparation of protests and intensive collaboration with opposition. KOZ protest meeting in Bratislava in 1999 was also used for a propagation of HZDS and ZRS. Cooperation with HZDS and ZRS caused internal cleavages and undermined a perception of KOZ as representation of actual labor interests. (Janicek 2004, 11) In 2001 several protest actions forced the government to negotiate with KOZ about the reform of the labor code. Also the labor code as general law governing labor relations was approved by all parties of the social dialogue and accepted by government in 2001. Despite a common agreement KOZ was repeatedly criticizing the document during he legislative process.

Second reform government therefore decided to articulate a brand new conception of labor

[24] Quoted in Zsilleova 2004

relations by “substantially reducing the level of corporatism and in this respect to particularly analyze validity of the existence of chambers with compulsory membership and reduce them in a way that would not restrict on competition.” (Slovak government program announcement, 1998) In 2004, the new Labor Code was introduced as substantial part of the SGR package. It encompassed major changes on flexibility of the labor market. A higher flexibility was expected to boost the attractiveness of Slovak labor market to foreign investors. Labor code introduced three months probation period. It practically meant that employee could be released within three months for no particular reason. Maximum weekly working time was settled on 40 hours, excluding 30 min. break, and maximally 8 hours of overtimes per week. Annual leave was stated on 20 days, extended to 25 days after 15 years of employment. Slovak Labor Code also allowed one special measure to employers. 150 hours of overtime per year can be ordered by the employer with no extra bonus paid. The reform also diminishes impact and tradition in trade unions. Unions become practically non-existent. They remained with a very little power and only limited consultative competences. Labor code also diminishes monopoly of KOZ, allowing also smaller confederations to participate on social dialogue.

In order to block the reform KOZ firstly negotiated with government. Compromising solution was found and agreed, although KOZ was organizing protests after the final agreement. Its actions aimed again rather on a search for political partners that on the organizing of labor for common action. (Hruska, 2009) KOZ also got involved in petition for announcement of the new parliamentary election and announced their political support to SMER. Surprisingly the only responses to extraordinary harsh and steep SGR were the general hour strike and blockading of state borders in 2004.

The change of social dialogue came with SMER leading the government after the election in 2006. The renewed labor code supported competencies of trade unions and it also hardened a layoff process as well as overtime work. However no significant changed had been performed on the labor market, besides the fact that trade unions were rehabilitated in the social dialogue. Nevertheless their position remained consultative and therefore with no real impact on decision process. Recent government led by Iveta Radicova intends to create more flexibility on the labor market again. Plans mostly aim to return to the state of arts before year 2006, however no significant measures has been executed yet.

In general a role of trade unions in Slovakia was established as mostly consultative and it remains the same. Trade unions are often excluded from social dialogue concerning economic planning in Slovakia.

Different levels of trade union institutionalization provide us with answer, why trade unions in Hungary have been successful with bargaining over the SGR program. Lower institutionalization of the Slovak labor results in low mobilization possibilities. Low labor mobilization does not represent an effective and sufficient threat to the government and employers. As a result, the Slovak labor is exposed to a wider and deeper range of reform activities imitated by government and employers.

3.2.5 Unemployment as background factor shaping role of labor

In previous section I argue that the trade unions in Slovakia have a lower level of legal institutionalization due to their focus of political struggles and low interaction with labor. These facts caused comparatively smoother consolidation of reforms in Slovakia.

Nevertheless a question why labor movements in Hungary succeed to integrate into economic decision-making and Slovak unions linger with only limited influence on the economic policy remain unanswered. It appears that different levels of unemployment played a significant role in shaping of the labor resistance to SGR. Hungarian labor movement was able to mobilize in the critical situation of SGR launch as well as during the amendments of labor legislation. Absence of a legal base for labor competences restrains their influence on decision-making about the important economic decision with an impact on the labor. Slovak trade unions relied on a political involvement and on future benefits from supported political groups. In the same time they did not succeed to mobilize the labor for strikes in the most critical periods.

Strikes and riots as a demonstration of power and representation of most numerous segments of electorate appeared to be an effective tool to improve the negotiation power of organized labor in Hungarian tripartite. Strikes caused not only significant economic losses, but they usually had direct impact on behavior of the electorate via media as well as via limitations of services. Since such situations are highly unpopular, the government tries to avoid strikes via an institution of social dialogue. We can not observe similar developments in Slovakia especially due to a different progress with unemployment in Slovakia. I argue that the abnormally high unemployment rate and general lack of employment opportunities was the major reason for smoother labor acceptance of SGR policies in Slovakia. In contrary the labor in Hungary did not feel the immediate need to create new jobs due to significantly lower levels of unemployment during SGR plans.

Prior to SGR, Slovak labor appeared to be in a very different situation compared to the labor in Hungary. Sharp downturn in a national output followed by a significant decrease in employment was later accelerated by the coupon privatization and “tunneling” of state owned companies. The historical maximums of unemployment crossing a psychical threshold of 20% and attacking 25% caused serious doubts among the labor. In addition Slovak labor did not have any experience with unemployment. On the other side, reform-oriented governments were promising an inflow of foreign companies, sharp increase of employment opportunities and a decrease of unemployment for a short term austerity measures. Labor movements feared by the seriousness of the situation on the labor market were able to accept austerity measures. Situation of the economy, when almost every fourth person in active age was jobless, provided unquestionably much less maneuvering space and significant changes of the incentives in bargaining with the government and employers. Firstly employers threatened labor with additional layoffs. Additionally an increase of employment rates becomes the priority in bargaining, since wage increases would also cause additional layoffs.

Situation in Hungary during an economic transformation was generally on very promising path. A better situation was reflected on different incentives in a bargaining in tripartite. Unemployment of 6% did not offer a reason to panic about fears of drastic layoffs. Labor encouraged by generally good development path of the economy, emergence of new domestic firms in combination with fairly high FDI inflows was able to put much more pressure on the government and employers. In the situation of economic growth and decreasing unemployment, incentives to keep employment are rather less important than the bargain about collective labor rights and regular increases of wages.

Conclusion

While Slovak government has been able to implemented the extensive Second Generation Reform program, the main actors in Hungary achieved significant delays or blockages of the reform processes. My theses identified and analyzed the main factors of the reform enthusiasm in Slovakia as well as the factors causing delays or the blockage of Second Generation Reform processes in Hungary. In this respect I analyzed the impact of factors such politic system, economic leverage, unemployment and EU conditionality on the main actors of the Second Generation Reform processes. I have identified political parties and labor as the main internal actors and transnational corporations as the main external actor.

Political parties in Slovakia seemed to have much stronger incentives to launch SGR than in Hungary. Slovak political system emerged reform cycles with institutionalized reform-oriented parties same as anti-reform parties. In Hungary political system does not encompass institutionalized reform-oriented parties. It obviously caused major difficulties in the launch and consolidation of reforms.

I also argue that underinstitutionalization of the Slovak political did not allowed Slovak government to launch and consolidate SGR. It was rather institutionalization of the reform-oriented parties. The ability of Slovak government to implement SGR was based on high pressure of the social groups to rebound the economy on path of sustainable growth to decrease an unprecedented unemployment and to solve desperate need for sources of investments to creation of new jobs. Reform-oriented political parties consciously adopted reform rhetoric as a part of European integration program.

Due to a corrupted privatization, new business elite connected to previous regime did not provide source of a support for new parties in government. Massive attraction of TNCs and the emergence of new businesses represented very feasible alternative, how to set the country on path of re-acceptance for the EU accession and find new industrial allies needed for a political survival of reform parties.

TNCs has been successfully attracted to invest in the country with a perspective to join EU in 2004, uniquely generous investment incentive schemes as well as favorable tax system and low bargaining power of labor. The theses also showed that labor in Slovakia has beard the major costs for SGR, due to their bad institutionalization. Labor movements disheartened by an inability to participate on policy making were looking for political partners rather than for tools to enforce labor interests. Internally and externally depressed labor movement has not been able to fight for a respectful position in the economic policy making. Its bargaining power in a social dialogue has been abrogated due to high unemployment and the interests of labor in creation of new jobs. Without opposition from a side of labor, government could smoothly implement SGR austerity package.

In contrary Hungary experienced initially a more favorable economic situation than Slovakia with low unemployment, fast transformation to a market economy with stabile GDP growth supported by a massive FDI inflow and emergence of new domestic companies. Hungary has been the first candidate to EU accession and even short term crisis in 1995-1996 could not endanger the position of regional leader. Therefore austerity measures were perceived as highly unnecessary. Hungarian political system institutionalized to a presence of anti-reform parties with general reluctance to reforms. Favorable economic and international conditions allowed the Hungarian trade unions to organize and effectively represent the labor interests, despite initial difficulties caused by inter-union reality. The mobilization of labor and strikes in 2000 and 2001 threatened social partners. Particularly government and all political bodies accepted role of union as the voice of labor.

Lack of job opportunities for the labor and low legislative framework for organized labor in combination with no domestic alternatives to FDI and high national recognition of international institution have been major linkage between enthusiasm for reform processes in political parties and low backlash from side of the labor in Slovakia. However we must keep in mind that position of labor in Hungary was very different and more embedded in industrial policy making. While the Slovak labor had difficulties to find a relevant intermediary for their interests, the Hungarian trade unions are well established as the forming part of wage negotiation process or consultancy body for reforms labor code.

Suggestions for further research

The topic, which will require additional research, is especially the search for alternatives to SGR itself. While Slovakia still looks for the way of higher and deeper penetration of TNCs on the domestic market. Hungary tries to take an advantage of TNCs present already and boost national bourgeoisie. While Slovakia rely almost exclusively on the GDP created by foreign companies and lacks the support for domestic enterprises, (Uhrik, 2009) Hungary questions the advantages of the new dependency on TNCs and tries to levy additional taxes on foreign corporations. In the same time it increases the support towards domestic enterprises. Mentioned development can be clearly seen in reform of the tax system in

Hungary. The role of the state and traditions of state involvement seem to represent a breaking point between Hungary and Slovakia. SGR significantly limited the state bureaucracy from various important decisions, which forms the industrial policy of the country with society-wide impacts. Deeper and steeper SGR implemented in Slovakia significantly limited the state role in economic decision making. Opposite is true in Hungary. State has always played any important role in the economic and social sphere. Privileged position of the state seems to remain present in Hungary despite much discussion about its limits. However centrally made economic policy also appears to be less flexible and more susceptible to the political reasoning in Hungary. Higher involvement of sectorial lobbies in decision making concerning national economy appear to dynamize the economy, however economic targets often conflicts with state interest in Slovakia.

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Glossary

ANO - Alliance of the New Citizen
AZZZ SR - Federation of Employers' Associations of the Slovak Republic
CEE - Central East Europe
CIT – Corporate Income Tax
ČSR – Czechoslovak Socialist Republic
EU – European Union
FIDESZ - Hungarian Civic Union- Fidesz
FDI – Foreign Direct Investment
GDP – Gross Domestic Product
GT - Gazdasági Tanács (Economic Council)
KDH – Christian-Democratic Movement
KOZ - Confederation of Trade Unions of the Slovak Republic
KSS – Slovak Communist Party
LIGA - League of Independent Trade Unions
MSZMP - Hungarian Socialist Workers´ Party
MSZP – Hungarian Socialist Party
MSZOSZ - Hungarian Confederation of Trade Unions
NEM – New Economic Mechanism launched by Socialist Workers´ Party in 1968 in Hungary
OKS – Civic-conservative Party
OMT - Országos Munkaügyi Tanács (National Labour Council)
PBC – Political Business Cycles
SDK – Slovak Democratic Coalition
SARIO – Slovak Investment and Trade Development Agency
SaS – Freedom and Solidarity
SDKU-DS – Slovak Democratic and Christian Coalition – Democratic Party
SDL – Party of the Democratic Left
SGR – Second Generation Reforms
SMER – Direction party
SMK - Party of the Hungarian Coalition
SMEs – Small and Medium Enterprises
SNS – Slovak National Party
SOEs – State-owned enterprises
SOP - Party of Civic Understanding
SZDSZ- Alliance of Free Democrats
TNCs – Transnational Corportations
VAT – Value Income tax
WC - Workers Council
ZRS – Union of the Workers in Slovakia