

Slovakia: the Eurogroup's enfant terrible

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When Slovakia's parliament rejected the European Financial Stability Facility (EFSF) reform on 11 October it undermined Slovakia's reputation as a credible partner within the EU. Moreover, Prime Minister Iveta Radicova combined the vote on the strengthening of the EFSF – a key anti-crisis mechanism in the Eurozone – with a vote of confidence for her cabinet. This eventually led to the collapse of the government. Before Slovakia's decision, the strengthening of the EFSF had been endorsed by the national parliaments of all the eurozone countries. Slovakia, which had opted to be the last one to carry out the ratification procedure, adopted the EFSF reform only in a re-vote on 13 October, due to the support of the opposition left-wing party. However, problems with ratification have cast a shadow over the achievements of Slovakia which as one of the freshest members of the eurozone had been actively seeking to influence the creation of EU mechanisms for dealing with the debt crisis.

For the past eighteen months the Slovak government, formed by conservative and liberal parties, has consistently called for the controlled bankruptcy of Greece, a tightening of the rules of the Stability and Growth Pact, and for the private sector's participation in financing the rescue packages for indebted states. It was in part down to Slovakia that these proposals, previously regarded as extreme, were introduced into the mainstream EU debate. The constructive position presented by Slovakia's diplomacy in recent months has brought Bratislava tangible results, such as the reduction of its contribution to the permanent anti-crisis fund, the European Stabilisation Mechanism (ESM). Thus Slovakia, which adopted the single currency on 1 January 2009, has become an informal spokesman for the new, poorer members of the eurozone.

In recent months, the Slovak political scene has been dominated by the debate between the liberal Freedom and Solidarity party (SaS), a junior coalition partner which opposes the strengthening of anti-crisis mechanisms, and the rest of the coalition, who are convinced that Slovakia must accept these difficult and cost-incurring decisions to stay in the mainstream of EU reforms. Despite the stormy dispute following the debt crisis in the eurozone, most of the Slovak public believes that the adoption of the common currency was a good course of action. This position is shared by most politicians, which is a consequence of a broad political consensus, formed when Slovakia was seeking to join the eurozone (2003-2009).

This consensus has been sustained despite the uncertainty brought by the financial crisis (see Appendix). However, the development of a coherent position on how to deal with the eurozone crisis has proven to be too hard a task for the Slovak political elite.

The beginning of the crisis

The final preparations for the adoption of the euro in Slovakia coincided with the beginning of the financial crisis in the United States. The Slovak government declared that the adoption of euro in 2009 will allow its small and export-dependent economy to survive the expected downturn better than its Central European neighbours. Contrary to these predictions, in 2009 Slovakia noted a significant GDP decline (4.7%), a rise in unemployment and a deterioration of public finances¹. On the other hand, the crisis has hampered the rise in inflation, which was the society's main concern. Most Slovak economists shared the belief that the first year in the eurozone has brought the national economy more losses than gains. However, the politicians were not of the same opinion. They were convinced that it was the right decision to adopt the euro, and this conviction has even strengthened since late 2009, as Slovakia has noted economic growth² whereas non-eurozone states (Iceland, Latvia, and especially Hungary) coped with financial problems. Reports on Greece's difficulties with servicing its debt, recurring since early 2010, did not quite fit into this reasoning.

The loan for Greece and the EFSF

At the beginning of talks concerning the aid program for Greece, the centre-left government of Robert Fico then in power accepted all decisions made within the EU. This position was reinforced by European Commission's optimistic assumptions that Greece can regain the markets' confidence as soon as the second half of 2011. Slovakia's participation in the loan granted to Greece was set at €816 million³ and would entail a revision of the budget and make Slovakia incur a loan on the financial markets, for example by issuing bonds. The government in Bratislava also agreed with the establishment of a temporary European Financial Stability Facility (EFSF), created to help countries that find themselves in a similar situation as Greece⁴. Thus, Slovakia has obligated itself to grant loan guarantees for nearly €4.4 billion.

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Public sentiment, unwilling to help Greece, along with the approaching parliamentary election made the anti-crisis mechanisms an attractive argument in political disputes. The opposition right wing groups pointed to the high living standards in Greece and their reluctance to reform, noting that support for 'rich Greeks' funded by 'poor Slovaks' has nothing to do with solidarity. To illustrate the existing disparity, it was said that Greek salaries are approximately three times as high as in Slovakia, and pensions are four times as high. Over time, Robert Fico also joined in with the criticism of Athens' economic policy, making the aid granted to Greece dependent on the adoption of austerity measures by the Greek parliament. However, this change in rhetoric did not protect him against the loss of power after the parliamentary election of 12 June 2010. Despite the victory of the left-wing Smer-SD party led by Fico, it was the centre-right parties that managed to form a majority coalition.

After taking power, the centre-right parties did not abandon their criticism of the EFSF and the decision to grant Greece the loan. For the new cabinet, the crisis in the eurozone has become one of the key issues. Upon assuming power, Iveta Radicova's cabinet had

¹ Tomasz Dąbrowski, *Slovak economy one year after entering the eurozone*, CEWeekly, 13 January 2010, www.osw.waw.pl

² In the first quarter of 2010, Slovakia's GDP grew by 4.5%.

³ On 2 May 2010, eurozone member states granted Greece a three-year loan of €80 billion, and the International Monetary Fund has added €30 billion more.

⁴ The European Financial Stability Facility, as agreed upon on 9 May 2010 by the Council of the EU, creates a pool of guarantees totalling €440 billion. The EFSF issues bonds and other debt instruments, thereby collecting the funds for loans for those eurozone countries which are at risk of insolvency. Eurozone countries have granted the EFSF their guarantees in proportion to their contribution to the capital of the European Central Bank (ECB). Estonia, which joined the eurozone on 1 January 2011, will become an EFSF member after ratifying the amendments to the EFSF Framework Agreement negotiated in June 2011. Simultaneously, a European Financial Stabilisation Mechanism (EFSM) was established, wherein the European Commission raises funds for loans by issuing debt securities on the European market, guaranteed by the European Union budget.

a much better reputation in the EU than Robert Fico's government, co-formed by xenophobic and populist groups. The largest party of the new government, the Slovak Democratic and Christian Union-Democratic Party (SDKU-DS) led by Mikulas Dzurinda was associated with Slovakia's successful return to the European scene after a period of 'democratic deficit' under Vladimir Meciar. Other coalition members also enjoyed a good reputation: the new, liberal SaS party, the Christian Democratic Movement (KDH) and Most-Hid, a party linked to the Hungarian minority. Since its beginnings, the new government's work has been significantly influenced by the liberal economic debate between Minister of Finance Ivan Miklos (SDKU-DS) and his former adviser and the leader of SaS, Richard Sulik. The position of Prime Minister Iveta Radicova, formally a deputy chair of SDKU-DS, has been limited from the very beginning by the top officials of her own party led by Mikulas Dzurinda, and by the leaders of the remaining coalition parties.

A few days after assuming their positions, the Slovak prime minister and the minister of finance tried to convince EU leaders in Brussels that banks should also contribute to the aid to Greece, along with the taxpayers, and that the poorest countries of the eurozone should pay less⁵. Slovak leaders also stressed that upon entering the eurozone, their country had to conduct a series of socially painful reforms, whereas the government in Athens has so far ignored the necessity of such reforms.

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According to the Slovak leaders, stricter principles of the Stability and Growth Pact, the introduction of concrete sanctions for the transgression of these principles and the establishment of a mechanism for controlled bankruptcy should be prescribed for Greece's problems, so that

the costs of rescuing indebted countries are also imposed on the banks providing the loans. As the EU leaders were unwilling to make concessions, the new Slovak government and parliament eventually agreed to the establishment of the EFSF (while maintaining reservations), however, they sustained their objections to providing the loan to Greece.

Slovakia's decision of 10 August 2010 to refuse the loan to Greece has bred serious discontent in the European Commission and among the representatives of the eurozone. Slovakia was accused of violating the principle of solidarity and failing to stick to its commitments. Opposition left-wing party Smer-SD voiced similar accusations, emphasising the importance of Slovakia's shared responsibility for the future of the eurozone. It should be noted that the members of this party had a chance to change the result of the vote on the loan for Greece, but despite earlier declarations they did not participate in the vote, arguing that they lack sufficient information about the current financial situation in this country.

Politics versus economic principles

The EFSF was first launched in November 2010 to grant a €85 billion aid package for Ireland⁶. Slovakia supported this decision, though once again raised objections to the principles of the EFSF. Subsequent reports on the problems with debt servicing in Portugal, Spain and Italy further radicalised the moods in the Slovak ruling coalition. Speaker of the Parliament and leader of the coalition party SaS Richard Sulik appealed for the development of a contingency plan should the Slovak koruna need to be restored⁷. Sulik pointed out that the Eurogroup has changed its principles after Slovakia had joined it⁸, and that covering the debts of subsequent countries with further loans only fuels the spread of the crisis. References to the scenario of abandoning the euro ran counter to the official position of the government that was engaged in difficult negotiations on the EU forum, and were immediately denied by the prime minister Iveta Radicova.

⁵ Guarantees granted by Slovakia within the EFSF are relatively extensive and may reach €4.5 billion, or 7.1% GDP in 2009. To compare, the guarantees granted by Luxembourg represent 3% of its GDP. Similarly, the Slovak participation in the loan for Greece set at €816 million is equivalent to 1.3% GDP in 2009, while the share of the much richer Luxembourg is equivalent to 0.6% of its GDP.

⁶ The contribution of the EFSF totalled €17.7 billion, the remaining amount came from the IMF, the EFSM, Irish funds and loans granted by Great Britain, Sweden and Denmark.

⁷ In 2002-2003 Richard Sulik was an adviser to minister of finance Ivan Miklos (SDKU-DS), who also holds this position in the current government. In 2006-2007, Sulik advised minister of finance Jan Pociatek (Smer-SD).

⁸ The main change is the abandonment of the principle that each state is responsible for its own financial obligations and that the European Central Bank may not buy the bonds of the member states.

Thus, SaS proposals began to seriously diverge from the demands of its coalition partners, primarily SDKU-DS; the latter has been increasingly taking into account (along with the rules of economics) the constraints of political negotiations within the eurozone.

The dispute between SaS and the rest of the coalition intensified in late May and early June 2011, when Portugal was granted a loan⁹. It was also becoming clear that the first rescue package transferred to Greece was insufficient, whereas the risk of Spain and Italy's insolvency had increased significantly. While SaS consistently stuck to the same arguments, its coalition partners began talking ever more often about shared responsibility for the monetary union, which was at risk of a 'massive debt avalanche', and much less frequently about the 'injustice of the poorer countries financing the richer ones'. The coalition partners were also divided over the decisions made by the Eurogroup leaders and the EU ministers of finance in June and July 2011, which were meant to increase the EFSF funding and to strengthen its authority, to create the European Stability Mechanism (ESM) and to grant Greece a second aid package. The amount of securities provided to the EFSF by the Eurogroup countries was to be increased from €437 to €773 billion, thereby increasing the effective loan capacity from €250 to €440 billion. Iveta Radicova's cabinet agreed to increase the guarantees provided by Slovakia from €4.4 to €7.7 billion.

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buying up the bonds of the indebted countries of the Eurogroup on the primary market. The EFSF is to have the right to preemptive intervention, activity on secondary markets and support for those countries which have not been covered by the EFSF aid programme. In mid-2013, the temporary EFSF is to be replaced by the permanent ESM, which is an important step on the way to the creation of a eurozone economic governance. The eurozone member states have committed themselves to completing

the necessary ratification procedures by the end of 2012. Within the new mechanism, apart from loan guarantees, the member states also agreed to transfer funds from the budget and so-called 'capital on demand'. Slovakia's contribution to the ESM, estimated at €4.77 billion over five years (nearly €650 million annually, of which €132 million in the form of a direct transfer) is to be covered from loans. However, the most heated dispute between Slovak supporters and opponents of the anti-crisis mechanisms negotiated within the Eurogroup concerned the second loan for Greece financed by the EFSF. The Slovak government pledged to grant €800 million for this purpose, i.e. Slovakia's participation would reach 1.07%.

Why lend to the rich?

Slovakia's prime minister and the minister of finance argued that the dynamics of changes in the crisis-hit eurozone require efficient and flexible institutions similar to the International Monetary Fund, which can adequately respond to the early signs of crisis in subsequent countries. Prime Minister Iveta Radicova declared that the ESM was the best solution that could be negotiated. In her opinion, Slovakia, as a small country with an economy dependent on exports (in 80%) cannot risk a lone struggle against the crisis, therefore it has to agree to compromise solutions negotiated with larger partners in the eurozone.

A more difficult task for the Slovak cabinet was to convince the Slovak public that the second loan for Greece was reasonable. First of all, the government had to explain why €109

⁹ On 17 May 2011, the leaders of the Eurogroup and EU ministers of finance granted Portugal a three-year aid package amounting to €78 billion, wherein equal contributions were made by the EFSF, the EFSM and the IMF.

billion worth of aid for Greece makes sense, since the first loan (rejected and still criticised by Radicova's cabinet), did not bring the expected results, just as Slovakia had anticipated. The cabinet's key argument was the participation of the private sector in the loan: the private sector pledged to assign €105.6 billion to rescue Greek finances by 2020. After the June EU summit Prime Minister Iveta Radicova also argued that the terms of the new loan agreement in fact prove that Slovak demands had been met, i.e. that Greece be deemed partially bankrupt. On the other hand, she stressed that Athens has thus received a chance to complete the reforms and to avoid an uncontrolled bankruptcy, which could hit the entire eurozone.

Another argument the government used for raising support for the anti-crisis mechanisms was Slovakia's success in negotiating the correction of the calculation of individual states' contributions to the ESM: they became more favourable to the poorer members of the eurozone. Iveta Radicova's government demanded that these calculations be based exclusively on the countries' economic potential and not, as in the case of guarantees for the EFSF, half on the economic potential and half on the country's population¹⁰ To push this demand through, the Slovak government was ready to support most of the provisions of the German and French Competitiveness Pact, presented in early February, and to mute its objections to the idea of a harmonisation of the base of the corporate income tax¹¹. During the meeting of the Eurogroup ministers of finance on March 21 a compromise was reached under which for 12 years from the accession to the euro area, the contribution of Slovakia and other countries whose GDP does not exceed 75% of the EU average, will be 75% based on their economic potential, and 25% based on the previous conditions (half on the economic potential and half on the population)¹². Slovakia will thus save nearly 17% compared with the previous principles.

Why block the struggle against the crisis?

Critics of the current crisis mechanisms from Slovakia have consistently used the same arguments and suggested the same solutions since the spring of 2010. In their opinion, despite a much larger extent of the debt crisis, these solutions remain the only way to rescue the eurozone economy. In the opinion of SaS, Greece, which is unable to repay existing debts, should not receive new preferential loans, but should go bankrupt as soon as possible. The party's leader Richard Sulik criticised the very logic of anti-crisis mechanisms: in his opinion, the repayment of old debts with new ones is intended first of all to protect the profits of foreign banks and further deepen the debt crisis in the eurozone. According to SaS, the extension of the EFSF fund is pointless, as its current budget is sufficient to help Greece. And should Spain or Italy suffer solvency problems, both the extended EFSF and ESM will be too weak to save them from bankruptcy.

Richard Sulik criticised the extension of the EFSF instrument's authority, whose growing reserves seriously restrict the powers of national governments. In his opinion, the share of banks in the second aid package for Greece is too limited. According to SaS, the anti-crisis mechanisms in their current form actually encourage indebted eurozone members to ask other countries for money: they do not need to prove their reliability, have guarantees of low interest rates and, furthermore, they do not have to pool for the aid to other countries in trouble. According to Sulik, Slovakia's participation in such a project is too risky for economic reasons and, considering the risk of the Eurogroup disintegrating, Slovakia must be particularly reasonable while managing its finances if it wishes to stay on the side of the healthy EU economies. Similar arguments were used by the four members of the Civic Conservative Party (OKS), assembled in the Most-Hid parliamentary grouping.

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¹⁰ The mechanism was modelled on the ECB's capital subscription key: each country is assigned a weight equal to the sum of 50% of the country's share in the EU population and 50% of its share in the EU's gross internal product at market prices.

¹¹ Ultimately the Competitiveness Pact was adopted by the European Council on March 24 in a compromise form (under the name of Euro Plus Pact). The Czech Republic, Sweden, Hungary and the United Kingdom remained outside the pact, because of the demands included concerning the coordination of fiscal policy. Slovakia and Ireland, similar to the aforementioned countries, have for many years opposed any ideas of harmonisation of taxes.

¹² The countries' percentage share in the contribution corresponds with their voting weight in the ESM decision-making bodies. However, the reduction of the Slovak share from about 0.99% to about 0.82% will not significantly undermine Slovakia's position in this institution.

The opposition offensive

The Slovak opposition, formed by the left-wing Smer-SD (led by former prime minister, Robert Fico) and radical Slovak National Party (SNS) could not work out a coherent position on the eurozone crisis, either. Smer-SD, an advocate of Slovakia remaining in the mainstream of European integration, supported France and Germany's proposals for battling the eurozone debt crisis. However, the leader of Smer (the largest party in parliament) decided

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The Slovak National Party, the only party that withdrew its support for Slovakia's membership in the eurozone, adopted a different strategy. The party's chair Jan Slota announced that he had been unaware of the disastrous state of the European economy and urged the government to prepare a project to abandon the common currency and return to the Slovak koruna. Thus SNS is trying to attract that part of the electorate which is the most distrustful towards the EU.

Attempts at compromise

As they could not reach a common position on EFSF reform, the coalition leaders decided that Slovakia will be the last of the eurozone countries to carry out the ratification procedure. The coalition partners of SaS party took several attempts to persuade it to accept the changes in the stabilisation mechanisms: as with Finland, Slovakia was to obtain loan repayment guarantees from the Greek government (the 'collateral deal'), and each EFSF loan was to be made dependent on consent from all coalition partners. Eventually, the SaS demand that the coalition pledge to reject the permanent ESM anti-crisis mechanism became the bone of contention between the parties.

However, SaS chose not to change its position and turned its criticism of the EU's anti-crisis mechanisms into its catchphrase, which allowed this relatively new group to take a stable position on the Slovak political scene and expand its electorate at the expense of the main political parties (SDKU-DS and Smer-SD). To this end, Sulik decided to go against the previous arrangements with his coalition partners, under which the ruling parties were supposed not to use the crisis in the eurozone in political disputes¹³.

Vote on the strengthening of the EFSF

As there were no prospects of an agreement among the coalition partners, Prime Minister Iveta Radicova decided to combine the vote on the EFSF reform with a vote of confidence for her government. Radicova decided to stake her cabinet's work on this vote, as she might have recognised that the lack of agreement on the EU agenda would be too great an obstacle to her cabinet's work. SaS deputies considered the combination of the EFSF reform ratification with the vote of confidence for the cabinet as attempted blackmail, and refused to participate

¹³ SaS's weapon in its dispute with the opponents was a brochure, in which the party explained in great detail why it did not agree to the EFSF reform and the establishment of the ESM. The English version of the booklet is available at <http://strana-sas.sk/esfs---a-road-to-socialism/405>

in the poll. The opposition party Smer-SD also abstained from voting. Shortly after the vote, the leaders of the SDKU-DS, KDH and Most-Hid, as with the chair of Smer-SD, declared that their priority was the ratification of the EFSF reform. The next day the leaders of these parties agreed that parliament would approve the strengthening of the EFSF immediately upon the adoption of a constitutional law that shortens the term of parliament, which would enable an early election on 10 March 2012. As a result, the EFSF reform was ratified by the Slovak parliament on 13 October. The compromise was reached unusually quickly, given that what was at stake in the negotiations on the national political scene was the composition of the future government. The talks between Smer-SD and the three parties of the former coalition were probably sped up by the pressure exerted on Bratislava by some of the EU states and institutions.

Throughout the weeks preceding the vote, Slovakia's problems with ratification were closely followed by the eurozone member states. By late September, during the Eastern Partnership summit in Warsaw, Prime Minister Iveta Radicova held a series of difficult talks with the leaders of Germany, Portugal and Greece, along with other states. On the day of the vote, the EU foreign ministers called on the Slovak parliament to vote 'responsibly'. These appeals, however, had no effect. After the vote, a number of key politicians in the EU appealed to Slovaks to 'reconsider' support for the EFSF reform. Still, in comparison with the criticism Slovakia received after its refusal to grant the loan to Greece in 2010, the comments made by European leaders this time were more restrained, as it was clear that the outcome of the re-vote would be positive.

Summary

Slovakia entered the eurozone as the first of Central European countries, finding itself in a prestigious group, which raised the ambitions of its ruling class. However, over time, Iveta Radicova's government was forced to adjust its aspirations to influence the eurozone principles to the actual potential of Slovak diplomacy. Its proposals of economic solutions, regardless of their accuracy, have been revised by the political realities in the EU. Slovakia has achieved quite a lot: apart from the reduction of its contribution to the ESM, other Slovak proposals were also taken into account: to include the private sector in the anti-crisis mechanisms, to partially restructure Greek debt and to introduce penalties for breaching the Stability and Growth Pact. Other far-reaching proposals put forward by Slovak politicians, such as a complete withdrawal of aid programs or bankruptcy of any of the eurozone countries, have not been possible to push through – at least as yet.

The collapse of Iveta Radicova's cabinet and rejection of the EFSF reform has not wiped out the achievements of Slovak diplomacy; they have, however, significantly weakened Slovakia's negotiating position, at least until a new government is formed after the March election. The future government, probably headed by the opposition leader Robert Fico, will be far less troublesome for the leaders of the largest EU countries than the Slovak centre-right parties have been. The chair of Smer-SD is convinced that since Slovakia is economically dependent on Germany and France, it must cooperate with these countries also politically, otherwise it will find itself on the sidelines of Europe.

The controversy which has been underway for months over the EU anti-crisis mechanisms has divided Slovakia's centre-right camp. If the centre-right parties were to form a government again, they would first have to clearly define the direction of their European policy. The dispute over the EFSF reform has strengthened Smer-SD and helped the party to build the image of a responsible, pro-European social democratic group.

Slovakia's problems with the ratification of the anti-crisis measures have also once again laid bare the weakness of decision-making processes in the European Union. This is likely to reinforce the trend towards abandoning the unanimity principle while establishing key European economic mechanisms.

APPENDIX

The political context of adopting the common currency

The decision to join the eurozone promptly was taken in Slovakia in 2003, even before the country entered the European Union. A favourable economic situation in the following years helped Bratislava to adjust its macroeconomic indicators to the convergence criteria. In the euro adoption plan, approved by the centre-right government of Mikulas Dzurinda in the spring of 2005, the date of Slovakia's entry to the Monetary Union was set for 1 January 2009.

The arguments for the prompt introduction of the euro included: savings in transaction expenses for entrepreneurs, the lack of currency risk, and lower exports expenses. According to the government economists' forecasts, joining the eurozone was to result in faster economic growth and higher living standards. Apart from economic issues, the prompt adoption of the euro also illustrated Slovakia's ambitions. Joining the eurozone as the first country in the Visegrad Group, Slovakia had a chance of becoming a regional 'prodigy' and, above all, of outstripping the neighbouring Czech Republic.

The information campaign concerning the adoption of the EU currency included very few references to possible risks. Above all, the Slovak public feared a sharp increase in prices; the economic crisis, however, helped to avoid this scenario. Slovakia's populist, nationalist, Christian democratic and liberal parties reached a consensus concerning the adoption of the euro, which blocked the public debate on this issue. The only serious political party that openly opposed the adoption of the euro was the Civic Conservative Party (OKS), not represented in parliament at the time. As a result, the key laws necessary for the change of the currency were adopted by parliament almost automatically. The disputes in parliament concerned secondary issues, such as the information campaign, while the adoption of the euro, its timing and terms have not raised any controversy.

The consensus concerning the adoption of the common currency was sustained after the parliamentary election in June 2006, when a left-wing and nationalist coalition was formed under Prime Minister Robert Fico. However, shortly after the election it was not clear whether the government formed by the left-wing Smer-SD, a radical Slovak National Party (SNS) and the populist Movement for a Democratic Slovakia (HZDS) led by former prime minister Vladimir Meciar would retain the previous policy and continue its efforts to introduce the common currency. Eventually, the Fico's cabinet adopted his predecessors' strategy, which could have been influenced by business lobbies associated with Smer-SD. This decision has also helped the new government to tone down the wave of criticism from abroad which had been caused by Smer's decision to form a coalition with the xenophobic SNS and Meciar's party.



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