Czechs and Slovaks Unhappy With the Split

Czechoslovakia's "Velvet Divorce"

By Phil Barta

ON January 1, 1993 two newly independent countries will emerge in the heart of Europe. While Czechoslovakia will cease to exist as a federation, its republican components will evolve as its internationally recognized successors. The Czech Republic (Bohemia and Moravia) and Slovakia will thus become the latest additions to a new Europe. We can be fairly confident that the break-up of Czechoslovakia will not boil over into chaos and carnage as it has in the former Yugoslavia. Nevertheless, a growing number of Czechs and Slovaks (and ethnic Hungarians living in Slovakia) are openly regretful of the coming split. Many, including former Czechoslovak president Vaclav Havel, are hopeful that politicians will be able to forge a new governmental system, possibly a confederation, after a successful separation. Both nations are determined to make the division as smooth as possible; the process has been referred to as the "velvet divorce," reminiscent of Czechoslovakia's "velvet revolution" of 1989. While the debate over who is responsible for the disintegration of Czechoslovakia continues, the Czech Republic and Slovakia are quickly moving ahead of this question to address the concerns linked to establishing market economies. While the disollution of the country will be painful, the rapid and generally successful measures taken by the federal government to develop the foundations of a market economy and democratic society have prepared the Czech lands and Slovakia for independence.

This article has been reprinted from:
East/West Letter
Okno Group's Bimonthly Analysis of Economic and Political Issues in Eastern Europe & the former USSR
Volume 1, No. 4 Fall 1992

Under the leadership of President Havel and then finance minister Vaclav Klaus, the recently elected premiere of the Czech lands, Czechoslovakia asserted its desire to move quickly into the European order; Havel held out a vision of hope in the bleak domestic situation and pursued a high profile internationally, while Klaus has pushed the economy full-steam towards privatization. Since 1990 Czechoslovakia has laid parts of the basic foundation of a market economy: legal reform, price liberalization, the crown's (koruna's) convertibility, a conservative monetary and fiscal policy, the liberalization of foreign trade, and a highly visible privatization strategy that stressed the importance of both foreign capital and citizen involvement. However, as is true throughout Eastern Europe, the excitement over the collapse of communism has subsided among people frustrated with waiting to reap the benefits of capitalism. In Czechoslovakia, one of the results has been a greater focus on the disparities between the Czech lands and Slovakia.

Regional Inequalities

In the past and present, Slovakia has suffered from a more desperate social and economic situation than have the Czech lands. Under Austro-Hungarian control, the Czech lands were the empire's industrial center and enjoyed a living standard superior to Slovakia's. The formation of the Czechoslovak federation in 1918 combined two nations dissimilar in economic development and wealth. As an independent country, the Czech Republic will see much greater benefits from its western orientation, a more developed infrastructure, a larger supply of skilled labor, a greater technological base and more competitive production.

During Communist rule, poorly developed Slovakia experienced significant industrial growth, particularly in arms manufacturing, and an increase in living standards. The lesser-developed republic was further aided by federal budget transfers equaling 5% of the Czech republic's income—money most Czechs see better spent at home than in subsidizing Slovakia. The post-1989 collapse of Slovakia's arms industry (arms exports dropped from 27 billion crowns in 1987 to less than 6 billion in 1991), speeded by Havel's view that the production of war machinery was a relic of Communist inhumanity, has been the significant factor in driving up Slovak unemployment from negligible to 11.8 percent. In contrast, 4.1% of the Czech labor force is unemployed.

Since the revolution of 1989 Slovak resentment toward the Czech Republic has snowballed. Slovaks point to what they call an exploitative relationship: raw materials and semi-finished products from Slovakia are predominantly processed into final products in Bohemia and Moravia. This resentment is fuled by perceived neglect; Slovaks cite that only 4% to 11%

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of foreign investment has found its way to Slovakia and that only $500 million of a $10.5 billion U.S. government investment in Czechoslovakia this past spring was allocated to the eastern republic. Slovaks frequently argue that their interests have been undermined by a federal government in Prague that fails to look beyond the Czech border. Annual price increases amounting to 21.6% in the Czech lands and 22.5% in Slovakia have also been unsettling and had a greater net impact in the poorer region. Slovaks' belief that their interests have been ignored by the federal government and damaged by the unstable economic situation has given rise to movements (and charismatic leaders) supporting independence and a slower approach to economic reform.

Politics of the divorce

General elections in June which made Vladimir Meciar of the Movement for a Democratic Slovakia (HZDS) premier echoed Slovakia's two-fold desire to increase its political position and slow the transition to a market economy. Voters in the Czech Republic endorsed the rapid approach to a market economy embarked on by the federal government by supporting Vaclav Klaus' party, the Civic Democratic Party. The inability of Klaus and Meciar to reconcile their political differences has resulted in the dismantling of the federal government. As a result, the division of Czechoslovakia will transfer the federal problems to the two nations as well as prolong the period of hardship in the Czech lands and Slovakia.

Vaclav Klaus has been able to maintain support for his sweeping reform program because of its successes and because of the smaller sacrifices (particulary unemployment) the Czech lands' 10.3 million inhabitants have had to make in comparison to Slovakia's 5.3 million people. Klaus' domestic popularity has also been inflated by his international reputation as a democratic leader of economic change.

In contrast, Vladamir Meciar rose to the foreground through his willingness to stand up for Slovakia's right to self-determination and by embracing a policy of gradual change to a market economy. Outside and inside Slovakia, he has been referred to as an ex-communist and nationalist. Under Meciar tensions between the government and Slovakia's 600,000 Hungarians have escalated; the Hungarian minority fears an increase in Slovak nationalism will result in discrimination against Slovakia's minorities. Meciar's decision to finish building a huge, controversial, hydroelectric dam on the Danube River has also embittered relations with the Hungarian government. Despite Hungarian opposition to the project and acknowledged environmental repercussions (wetlands destruction, flooded farmlands, and possible contamination of the drinking water supply of five million people), Slovakia has pushed ahead. Meciar's past as a communist and his current support of nationalist tendencies have damaged his, and Slovakia's, reputation regionally and internationally. At the least, the short-term price of Slovakia's negative image will be increased difficulty in attracting badly needed foreign capital.

The Czech way

The Czech lands and Slovakia have different approaches to establishing a market economy because of the broad differences between their economies. Klaus' unwillingness to back-off on reform reflects his belief that a slower speed in transformation could undermine the gains of the process. In his government policy address at the Czech National Council on July 14, 1992, Klaus explained that casting any doubt on the established "pillars" (or basic policies) of economic transformation "would automatically disrupt the effect of other pillars, it would lead to the return to state intervention, and the government and the whole economy would find themselves in a reform deadlock from which there is no escape." The Klaus government believes that the policies undertaken by the federal government were the "very lowest threshold for the reform to be able to continue to have an effect." Therefore, future legislation in the independent Czech lands will speed up the reform process, in the belief that rapid transformation will shorten the negative impact of the program.

Klaus has emphasized three steps to continue with the transformation started by the federal government:

• **Privatization of state-owned enterprises:** Privatization, Klaus argues, is the fundamental step in the transition to a market economy. This will be accomplished primarily through coupon privatization and direct sale by public auction or tender.

• **Controlled fiscal, monetary, and price policy:** Klaus wants to create a stable macroeconomic framework and stable currency by following a tight monetary policy and slashing government deficits (to slow inflation), as prerequisites for long-term economic growth.

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• **Initiatives on restructuring and economic policy:** To restructure the economy (to be more efficient and internationally competitive), the government will try to create a framework to make the reallocation of resources—capital, labor, land, technology, etc.—as easy as possible at the inter-state, regional and company level. The Czech government will refrain from taking a direct role in this process, but hopes to encourage it with privatization and the strengthening of market mechanisms.

To promote foreign investment the government will establish a chamber of commerce and specialized institutions to provide potential investors with information on investment possibilities and conditions. Further, the government will continue to pursue price liberalization to increase foreign competition (in hopes of spurring domestic productivity).

A Slovak alternative?

As in the Czech Republic, the economic reforms of an independent Slovakia will build on the foundations established under the federation. However, the reforms will pursue a more gradual path because the transitions have a more painful effect on Slovakia's population. Vaclav Klaus, in an interview with EKONOM (August 7-13, 1992 no. 32), states that Slovak reform initiatives will not differ greatly from those of the Czech lands: "In the past two and a half years, the Rubicon was crossed and the economic system was changed. It would require enormous efforts on the Slovak side to reverse this change.... The main difference will be, most likely, the ability—or inability—of the Slovak Republic to finance its budgetary spending from its own resources." Michal Kovac, a deputy chairperson and leading economist in the ruling Slovak party, stated in the June 16-22, 1992 *Prague Post* that the state should have a role in easing the social consequences of reforms. "We believe that many of our companies are suffering from debt. We should give them a chance to survive and make them competitive." He suggests Slovakia's investment plan would be funded by "privatization, interest from state loans, and foreign capital."

In an attempt to halt Slovakia's economic decline, the government will be playing a more dominant role than in the Czech lands. The gradual process Slovakia seeks could, if successful, take ten to fifteen years to establish a market economy. Given Slovakia's socioeconomic situation, its policy for gradual economic change seems warranted. The IMF has encouraged Slovakia not to support industries incapable of competing without protection, and to focus on encouraging the development of small- and medium-sized companies to help spur growth and reduce unemployment. The IMF has emphasized the value of foreign capital as central to the development of Slovakia's market economy and a positive image internationally. Slovakia's geographic position between the Czech lands and Ukraine will increase its importance as an economic and cultural bridge between the former Soviet Union and the rest of Europe. Slovakia could capitalize on its location by imposing reasonably high transit charges on the flow of raw materials and other goods between the former Soviet Union and the Czech Republic; revenue could be used to help develop its archaic infrastructure.

The disintegration of Czechoslovakia continues with little tension. Klaus and Meciar have recognized the necessity for a clean and brisk separation. On November 2, 1992, the division of the army on a two to one ratio, favoring the Czech Republic, began. Evidence suggests that the same formula will probably applied in dividing state property. Although the first round of coupon privatization will remain intact, it remains to be determined how following rounds will be handled. The Coupon Privatization Center acknowledges that several methods of division can be introduced to resolve the problem.

At the end of October Czech and Slovak leaders signed a customs union effective January 1, 1993 to provide for the duty-free exchange of goods. The agreement also addresses topics like agriculture and foreign currency. The customs union was a prerequisite the European Community had set for transferring Czechoslovakia's status to its successors.

While both countries will have their own currencies, it appears they will operate within a regulated monetary system; Klaus has suggested establishing a monetary system resembling the early stages of the Bretton Woods system or the "mark-schilling" exchange-rate regime. Ideas and forecasts abound across the spectrum from optimistic to grim as to how the split will effect the nations and the region socially, politically and economically. What is known is that the socioeconomic situation will certainly worsen before improving. Foreign investors, international institutions and the European Community must play an important role in strengthening the foundations laid by the lame duck federation in both the Czech Republic and Slovakia. ◊