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## Slovakia in the EU: An Unexpected Success Story?

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## Summary

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Slovakia has emerged as an unlikely success story of the 2004 EU enlargement. The country's first decade as a member state was marked by robust growth – spurred by pro-market reforms of the early 2000s – and relative economic resilience and political stability during the global economic crisis. Thematic priorities on the EU level have included cohesion policy, energy, EU enlargement, and the European Neighborhood Policy (ENP). Slovak diplomacy has seen regional groupings – above all the Visegrad format – as the most effective way of pursuing its policy preferences. As the only eurozone member in the Visegrad Group (V4), Slovakia remains a reliable if somewhat passive supporter of deeper European integration, supporting a fiscally responsible approach. This policy course reflects a broad pro-European consensus among relevant political actors in Bratislava and continued public support for EU and eurozone membership. Going forward, Slovakia faces steep structural challenges (high unemployment, regional disparities, social exclusion of Roma), and needs to recalibrate its export-led and industry-heavy growth model toward higher added value and innovation.

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## Slovakia in the EU: An Unexpected Success Story?

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Slovakia has had a good first decade in the EU. The country had initially been counted among the more troublesome of the post-communist transition states, owing to the authoritarian abuses and incompetence of Vladimir Mečiar's cabinets in the 1990s. In 2004, it barely scraped into the cohort of acceding states. Ten years later, however, Slovakia stands out as a success story of the 2004 enlargement. It has exacted tangible benefits from membership while being, with few exceptions, a stabilizing element amid the eurozone crisis. Popular support for the EU remains strong, with a recent Eurobarometer survey noting that support for the common currency is at 78 percent.<sup>1</sup> Greater EU integration is still seen as a guarantor of the country's prosperity and stability.

Before the global economic crisis, Slovakia enjoyed a period of rapid economic growth (2002–08), averaging approximately 6 percent of GDP annually – triple the eurozone average at the time. The boom, which earned the country the nickname “Tatra Tiger” (after the local Tatra mountain range), can be traced to the structural reforms undertaken before joining the EU and to the foreign direct investment that those reforms attracted. The Slovak economy, shielded from currency volatility and trusted by foreign investors, proved resilient enough to rebound from the 2009–10 downturn without inflicting irreparable damage to public finances.

Unlike its Visegrad neighbors, Slovakia managed to embed itself in the innermost tier of European integration, joining the eurozone in 2009. Lately, Slovakia has also been playing a stabilizing role in the region. Bilateral relations with Hungary, burdened by a difficult past, have never been healthier. In contrast to the recent government instability in Prague and the centralization of power in Budapest, politics in Bratislava remain stable, centrist, and largely free of anti-European populism.

This relatively benign context has allowed successive Slovak governments to pursue a pragmatic but responsible EU policy, grounded in the strategic imperative of sticking to the EU mainstream and eurozone integration. Save for the dramatic parliamentary vote on the bailout package for Greece in November 2011, Bratislava backed all of the crisis response measures – from the European Stability Mechanism (ESM) through fiscal compact to the banking union – without much controversy or even public attention at home. The current prime minister, Robert Fico, signaled in late 2013 that he would welcome even tighter integration in fiscal and economic matters; that a leader in today's Europe can make such a statement without fears of a nationalist pushback is a telling sign of just how robust Slovakia's domestic consensus on European affairs has become.

In fact, a broadly pro-integration agenda is espoused by almost all main parties, regardless of ideological persuasion, and underpinned by voters' continued trust in the European project and eurozone membership. This has engendered a degree of continuity and consistency in European policy unseen in any other Visegrad country: Slovakia's bid for eurozone membership, for instance, was set in motion in the mid-2000s by the center-right coalition of Prime Minister Mikuláš Dzurinda and duly completed (with credit duly claimed) by the first government of Robert Fico, Dzurinda's arch-rival, who otherwise worked to undo his predecessor's signature neo-liberal reforms. The downside of the tacit domestic consensus on Slovakia's European policy is that it choked any meaningful public debate on the country's place in Europe's changing institutional landscape. There is also a lack of interest in EU issues among a large part of the country's political and intellectual elites, a sort of passive consumerism of EU integration that may yet come back to haunt the country's instinctively pro-European establishment.

The first part of this paper will provide a retrospective overview of Slovakia's EU membership and focus on the main turning points in its relations with the EU, including in the pre-accession period. It will also examine the determinants of Slovakia's predominantly pro-European outlook. Two issues will be discussed in more detail: 1) the trauma of "being left out" from the initial accession process and the extraordinary effort of "catching up" with the rest of the Visegrad Group in the early 2000s; and 2) joining the eurozone in 2009 and the country's subsequent ambivalent position on bailouts of indebted southern members, which eventually led to the collapse of the Slovak government in 2011. The second part of the paper will describe Slovak priorities in the EU and Economic Monetary Union (EMU), its energy and climate policy, and finally its trade and economic relations.

## 1. Retrospective Overview

### 1.1. The trauma of being left out

The analysis of Slovakia's European policy cannot be divorced from a consideration of its domestic politics. Following the peaceful breakup of Czechoslovakia in 1992, internal political polarization was starkly reflected in Slovakia's international position. Between 1992 and 1998, the populist prime minister, Vladimír Mečiar, and his party, the Movement for Democratic Slovakia (HZDS), made a series of undemocratic decisions. These led to the country's growing isolation in Europe. Slovakia quickly fell behind its neighbors in the integration process. Its accession to the OECD was postponed in 1996 due to a lag in the market reforms. In 1997, reformist opposition leaders and a large part of society were dismayed to watch as Slovakia's three Visegrad neighbors were invited to join NATO, and later to start accession talks with the EU. The European Commission pointed out a long list of deficits in the area of democracy and human rights.<sup>2</sup> Out of all ten applicants, Slovakia was the only one that did not satisfy the so-called "Copenhagen political conditions" for EU membership talks. Being left out of EU and NATO enlargement in 1997 was one of the main sources of the country's soul-searching and identity crises, which eventually culminated in political change.<sup>3</sup>

The turning point came in the October 1998 elections. A broad democratic coalition, unified by opposition to Mečiar and the fear of falling further behind the region's integration mainstream, defeated the HZDS party. Despite the new coalition's heterogeneous composition, including Catholic conservatives, free-market liberals, former communists, and ethnic Hungarians, Prime Minister Mikuláš Dzurinda managed to keep the multi-party government together for a full four-year term.<sup>4</sup> Its main focus was on the strategic goal of getting the country back on the EU and NATO integration track and on reviving the stagnating economy.

At the end of 1999, the EU recognized Bratislava's progress and invited the country to open accession talks, which began in February 2000, almost two years after the Czech Republic, Hungary, Poland, Slovenia, Estonia, and Cyprus. The main preference of the Slovak government was to conclude the accession talks as early as possible and join the EU with the first group of accession countries (along with the rest of the Visegrad Group). This goal was based on a wide political consensus in Bratislava; the only controversial issue that sparked a domestic debate – though without much impact on the course of membership negotiations – was the Slovak government's commitment to close down the two Soviet-era nuclear power reactors in Jaslovské Bohunice in 2006 and 2008 respectively. The opposition, which already included Fico's newly established populist center-left SMER party, criticized the government for giving a premature pledge to close the plant, weakening the country's profile in the energy sector, and for bowing to pressure from Brussels and neighboring Austria. For Slovak diplomats and negotiators, it was clear that decommissioning the two aging reactors in Jaslovské Bohunice was a precondition to EU accession; they focused more on securing higher amounts of EU funds to cover the associated costs.

The possibility of “catching up” with the other Visegrad countries and entering the EU at the same time was anything but obvious at the time.<sup>5</sup> The European Commission praised the hard work of the Dzurinda government and emphasized that the process was open to all qualifying candidate countries. During the talks, Slovaks could also benefit from advice and experiences shared by the Czech Republic, which had a similar legal system, a legacy of the former common state. Other factors also played a role. As senior Commission official Dirk Meganck explained in a public speech in Bratislava, “Slovakia is so much at the core of Europe that different accession dates for the various Visegrad countries could raise both external border and trade issues, which should ideally be avoided.”<sup>6</sup> With Slovakia left on the outside, the new EU states of Poland, Hungary, and the Czech Republic would find the job of policing the Union's eastern borders greatly extended. More importantly, if Slo-

vakia and the Czech Republic were to join at the same time, it would help avoid major difficulties concerning their existing customs union.

Benefiting from a positively inclined regional and European context, Slovakia finished accession talks in time to join the EU as a part of the 2004 enlargement, only five and a half years after Mečiar's ouster. The country thus escaped the fate of Bulgaria and Romania, which had to wait until 2007.

Joining the Union had wide support among Slovak citizens. An October 2003 opinion poll had 61 percent of respondents saying that Slovakia's membership would benefit Slovak citizens, compared to 30 percent who said it would not. The membership referendum showed even stronger support: 94 percent for and 6 percent against, with a turnout of 52 percent,<sup>7</sup> compared with an 84 percent to 16 percent ratio in Hungary (with a turnout of 45 percent), and 77 percent to 23 percent in the Czech Republic (with a turnout of 55 percent).<sup>8</sup>

The initial trauma of being left out and then having to catch up with the others undoubtedly shaped Slovakia's pro-European consensus. The legacy of misrule and rejection by Western institutions in the 1990s has long continued to inform the way Slovak elites – and a large bloc of voters – perceive EU integration. In the immediate post-Mečiar period, the main motif was to use the historical opportunity to anchor the country's young and weak institutions in a stronger European framework. Secondly, the experience produced a still-powerful narrative, whereby Brussels institutions are seen as the ultimate safeguard against government abuse and incompetence (including fiscal profligacy). Thirdly, the memory of erstwhile exclusion means that ever-deeper embeddedness in the EU's variable geometry – from the Schengen Area through the Economic and Monetary Union (EMU) to the fiscal compact and the informal camp of fiscally prudent members of the eurozone – became construed as a worthy political objective in and of itself. There was an implicit assumption that the EU framework would remain strong, and that deeper integration within the EMU would bring clear economic rewards to the new EU members –

an assumption later harshly tested by the financial and sovereign debt crisis. For an influential group of liberal economists centered around the Finance Minister Ivan Mikloš, the EU and OECD accession also signified the best institutional context for economic catching up with Western Europe and for shaping national responses to globalization.

### 1.2. Champion of market reforms

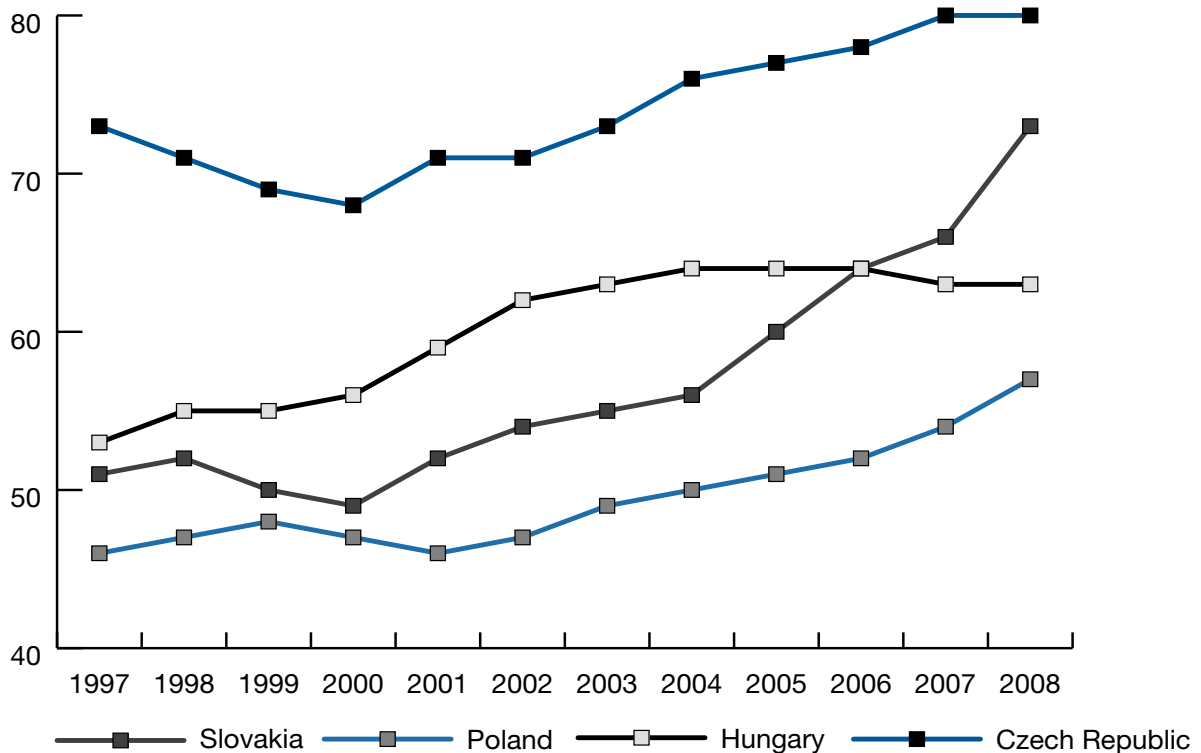
In the early 2000s, Slovakia successfully cultivated an image of a country that was business-friendly, fiscally prudent, and blessed with a lean state. The first package of austerity measures was passed in 1999 and included a reform of public finances to rein in fiscal spending (which had spiraled out of control during the Mečiar period) and the privatization of state-owned banks. The clean-up from bad loans and recapitalization of the banking sector came at a direct cost of about 11 percent of GDP covered by the state budget. The largest banks were then sold to new owners (Austrian and Italian ban-

king groups). As a result, the Slovak banking sector is now in much better shape than it is in most EU countries, and local banks are among the healthiest among others in their parent groups. A reform-oriented agenda helped Slovakia become a member of the OECD in 2001.

In the 2002 elections, the surprising victory of center-right parties was partly due to the lack of credible opposition and alternative. Campaigning as the only safe option for completing accession to the EU and NATO, the second Dzurinda government used the new mandate to implement ambitious reform packages on tax, health care, pension, and social systems.

An overhaul of the tax system was introduced in 2004. A flat tax of 19 percent was applied to all goods, as well as personal and corporate income. Taxes on property, inheritance, and dividends were abolished. While the reform was successful in reducing tax evasion and proved fiscally neutral, low-

GDP per Capita of the Visegrad Countries as a Percentage of the Euro Area (Figure 1)



Source: Eurostat, VUB Banka



income segments of the population were hit hard (previously, essentials like food and medicine had been taxed at 14 percent).

The reform was also controversial abroad, with Chancellor Gerhard Schröder of Germany, and Nicolas Sarkozy, then the French minister of finance, denouncing the tax reforms in new member states as tax dumping. The recurring debate on tax harmonization in the EU is thus looked upon with considerable skepticism; as a result, Slovakia allies itself with the Baltic States, Ireland, and the UK against what many see as Franco-German efforts to limit the competitive advantages of other EU countries.

The country's newfound political and economic stability, together with a flat tax rate and attractive investment incentives, meant that Slovakia saw a boom in foreign direct investment (FDI), and the automotive industry emerged as a key target. Investments started with Volkswagen in the early 1990s and sped up with investments by KIA and PSA Peugeot Citroën in the first half of the 2000s, attracting a large number of automotive parts manufacturers. In 2013, the country produced more cars than Italy (930,000) and remained the largest global producer on a per capita basis. The automotive industry generates some 26 percent of Slovakia's total exports and 20 percent of total imports and forms the backbone of the country's industrial sector.

Between 2002 and 2008, in the "Tatra Tiger" period, the country enjoyed high economic growth. In terms of per capita GDP (with the EU average as 100 percent), it was able to narrow the gap to the frontrunner Czech Republic from 18 to 8 percentage points and even to overtake Hungary before the 2009–10 crisis. (See graph.)

### 1.3. Qualifying for the eurozone

The economic growth and market reforms of the early 2000s laid the groundwork for Slovakia's drive to eurozone membership. In this ambition, economic arguments – and Slovakia's capacity to meet the Maastricht criteria – aligned with the prevailing

political discourse of EU integration as an overriding goal. Little changed after the 2006 election, as Smer-Social Democracy, led by Robert Fico, formed a coalition with the ultra-nationalist SNS and Mečiar's HZDS. Despite the government's mixed track record on protecting the rights of ethnic minorities, the momentum of EU integration continued. New efforts were concentrated on joining the Schengen Area in 2007, the EMU in 2009, and lifting the remaining restrictions to the free movement of persons within the EU.<sup>9</sup> These goals and the related agenda created a diplomatic and administrative overload in Bratislava's EU policy-making. Until 2009, there was simply less time and resources in the otherwise limited administrative and personnel capacities of the Slovak government for pursuing national interests in other EU policies and agendas.

The ministry of finance, together with the national bank, had already prepared a strategy at the time when the country entered the EU, proposing a target date for EMU membership of 2008–09. The main argument for an early adoption of the euro was Slovakia's very open economy. In 2006, foreign trade turnover accounted for around 160 percent of the GDP, and of that, over 80 percent was settled in euros. In absolute terms Slovakia's economy was about half the size of that of Hungary or of the Czech Republic. Thus the reduced exchange rate risks and transaction costs that euro-zone membership would entail for Slovak exporters were persuasive arguments. Slovak GDP growth had also been reliant on foreign direct investment, which was expected to increase, owing to both investors' perception of stability and reduced transaction costs and exchange rate risks. Traditionally, the most significant economic drawback – the loss of monetary sovereignty – had little significance for Slovakia. The effectiveness of Slovak monetary policy was already limited due to the size of the country's economy as well as deregulated capital flows and foreign impulses.<sup>10</sup>

Political support for EMU membership was a key factor in Slovakia's successful membership bid. Support was almost unanimous in the Slovak parliament, both on substance and on timing. Of

the six parties, only the Christian-democrat Party KDH was against joining the euro, fearing that the cessation of monetary sovereignty would harm the weakest segments of society.<sup>11</sup>

After joining the ERM II system in December 2005 and meeting the final inflation criterion in August 2007, Slovakia adopted the euro in January 2009 (two years after Slovenia). In joining the Eurozone, Slovakia was no longer playing catch-up but became a frontrunner in the region.

However, Slovakia was unable to bear more fruit from its eurozone membership, with the collapse of Lehman Brothers in New York occurring three months before the country abandoned its national currency. Instead of the hoped-for boom in investment and trade, FDI plateaued, exports tanked, and the economy went into a short recession. Nevertheless, the country was able to spring back from the crisis relatively quickly, with exports picking up within two quarters, and modest GDP growth returning in 2010.

In the run-up to the global economic crisis, Slovak banks proved very cautious lenders, and Slovakia avoided the credit boom associated with eurozone membership and the credit bust associated with its crisis. However, the ensuing Slovak recovery has been largely jobless, with unemployment continuing to plague the country. The average unemployment rates (over 14 percent in 2013) conceal high regional differences, with the southeast of the country recording rates of over 20 percent.<sup>12</sup>

#### 1.4. National controversies

Throughout the first decade of membership, Slovak politics allowed little scope for a eurosceptic insurgency (with the sole exception described below). While the Lisbon Treaty enjoyed broad support,<sup>13</sup> its ratification was delayed by a domestic power struggle and row over a controversial law limiting press freedoms pushed forward by the first Fico government. The center-right opposition refused to provide the votes necessary to meet the constitutional majority required for ratification of Lisbon without guarantees from the Fico government to change significantly the media legislation

seen as a threat to the quality of democracy in the country. In the end, it was the Hungarian-minority party that broke the stalemate and voted with the ruling coalition parties to ratify the treaty even without changes to the media law.

Back in 2006, the SMER-SD party was initially reserved about the EU agenda and flirted with a nationalist agenda. Eventually, it adopted a pro-European position – in part to gain international and domestic legitimacy after a power-maximizing deal taking two small populist parties as junior coalition partners – the notorious Ján Slota's extremist Slovak National Party (SNS) and Mečiar's fading HZDS. Their effort to rewrite the rules over minority policy triggered considerable pressure from EU partners and institutions (leading to a suspension of the membership of SMER-SD in the Party of European Socialists from 2006 to 2008).

The most visible exception to the pro-EU consensus came in the 2010–11 period, when Slovakia opted out from the first Greek bailout (€110 bn) and became one of the chief critics of what it saw as the “moral hazard” of eurozone bailouts. At meetings of euro group finance ministers, Slovakia demanded stricter rules for debtors as well as their tough enforcement, including automatic sanctions. There were differences of opinion within Iveta Radičová's center-right coalition on bailout mechanisms, all of which Bratislava supported in the end.

The fate of the Radičová government was sealed, however, when a new liberal party, Freedom and Solidarity (SaS) and junior coalition partner, refused to support the country's participation in the European Financial Stability Facility (EFSF). By October 2011, Slovakia remained the only eurozone country that had not ratified it. In the previous weeks, Slovak leaders were waiting for the votes in the German and Dutch parliaments hoping that the ratification would collapse before it reached the Slovak parliament. That did not happen, although votes in both the Bundestag and the Dutch parliament proved controversial. In order to enter into force, the EFSF rescue mechanism had to be ratified by all eurozone members: there was enormous pressure on Bratislava from the EU institutions and relevant partners.

In a last-minute bid to persuade the party to provide the necessary votes for ratification, Prime Minister Radičová linked the vote to a vote of no-confidence for her own cabinet. Undeterred, the majority of SaS MPs abstained, bringing about the government's collapse after only 15 months in office. In the end, Radičová and other leaders of the government coalition accepted help from the opposition SMER-SD party to get the bailout package approved in parliament, in exchange for early elections (won in a land-slide by Fico's party).

The episode captured another Slovak attitude to the EU at the time: a populist revolt at home against the EU's solidarity with its indebted southern members. Contributing to rescue funds for richer countries that had behaved irresponsibly with their debts and public finances was deeply unpopular in a country that was poorer (Slovakia's per capita GDP of \$21,000 compared to Greece's \$32,000 at purchasing power parity in 2010) and had had to undergo painful transformation and adjustment in order to join the EU.

Moreover, key positions in Radičová's cabinet were held by the chief architects of the liberal economic reforms of the early 2000s (the finance minister, Ivan Mikloš, and the foreign minister, Mikuláš Dzurinda), who maintained that bailouts would help only if the debtor countries were able to stick to structural reforms to remain credible for the markets.

In the end the episode proved unique. The image of Slovakia as the eurozone's enfant terrible did not last long, and Slovakia remained a constructive, predictable, and stable partner in the following years. The euroscepticism of the SaS, while prominently touted in the election, failed to gain significant traction among voters (the party received 5.8 percent of votes in 2012, down from 12.1 percent in 2010).

## 2. Perspectives

This part will describe the formation of Slovak national preferences and views on EU institutional issues. It will then discuss the national perspective on regional cooperation, energy policy, and the country's trade and economic profile and partnerships.

Slovakia's continuing enthusiasm for European integration – even amid the economic crisis – stems from a combination of structural factors and idiosyncrasies tied to national legacies and discourse. The former are clear to see. Having an extremely open economy and mostly trading with EU partners, the country's future is existentially wedded to the success of the European project. Policymakers in Bratislava are acutely aware that any fracturing of the eurozone would have a domino effect on the Slovak economy and upend the very fabric of society, to say nothing of the country's geopolitical anchorage and external security. On the other side, Slovakia stands to gain a lot from »more Europe«. For instance, a truly common EU energy policy would help alleviate Slovakia's dependence on Russian supplies, just as the completion of the single market would provide an additional boost to exporters. Another structural factor pertains to power plays inside the EU. As a small member state, Slovakia has been well aware of the risks involved in the gradual abandonment of the community method in favor of new intergovernmentalism. In the past, Bratislava has positioned itself among the European Commission's best friends and emphasized that its long-term national interests would be best served by a strong, cohesive Union.

But the structural logic of objective national interests fails to capture the distinctive pedigree of Slovakia's pro-EU consensus, as described above. Shaped by the trauma of having been left out initially, EU integration was never framed in Bratislava as a fateful loss of national sovereignty, as was the case in many member states. Rather, in Slovakia's discourse, it has been perceived as a marker of the country's success. Eurozone membership, for instance, is seen as a point of pride: a symbol of how far Slovakia has come from the mid-1990s when it was seen as the "black hole of Europe".<sup>14</sup> This pride is also reflected in opinion polls. Between 1999 and 2008, national pride increased from 75 percent to 88 percent, corresponding to the low and high points of the country's EU integration.<sup>15</sup>

## 2.1. The formation of national preferences

The flip side of Slovakia's commitment to EU integration is that it conceals the lack of interest – of political elites and voters alike – in the process itself. Policy formulation is technocratic rather than political and often more ad hoc than systematic, depending on the actual configuration of influential players. European policy choices in Bratislava thus seem to emerge almost by default instead of growing out of any longer-term strategy. Important matters of Slovakia's EU policy are not widely debated in public, and relevant discussions are usually kept among small groups within the political, business, and bureaucratic elite. While voters are periodically reminded of the necessity of Slovakia's presence at the core of EU and EMU integration dynamics, the implications or reasoning behind it are rarely spelled out and discussed (save for debates over the eurozone bailouts).

Public attitudes toward the EU are characterized by the same combination of support and disinterest. For instance, according to Transatlantic Trends survey data from October 2013, over 60 percent of Slovaks assess the country's membership in the EU and the eurozone positively. In the EU, only Germans and Poles are more positive. And yet, voter turnout in the 2004 and 2009 European Parliament elections was the lowest among all member states: 16.9 and 19.6 percent, respectively.<sup>16</sup>

It is therefore difficult to distil a consistent ordering of Slovakia's national preferences when it comes to the future institutional architecture of the EU. Similar to other small member state capitals, Bratislava has also been suspicious of enhanced inter-governmental coordination in the eurozone, possibly based on contractual agreements outside the Treaties. Rather, Slovak diplomacy has leaned toward a more inclusive and communitarian model but remained skeptical of any radical leaps forward, including a possible treaty change. So far, governments in Bratislava have proved tactically astute in navigating such contradictions without alienating any of the principal players, above all Germany, and the European Commission. Slovak leaders, from both the ruling SMER-SD party and the mainstream center-right opposition, share a strong

belief that, in the emerging multi-speed EU, the country must wind up in the fastest lane – but they care comparatively little about the construction itself.

There is also very little reflection of it in academia, owing to a limited pool of informed experts and a lack of high-quality research on the EU. As a result, few independent experts apart from the “privileged players” are able to monitor the government's performance and to reflect critically on Slovakia's policy choices in the EU. The base of experts and participants in the public debate on EU issues is much smaller than in other Visegrad countries, which results in less domestic scrutiny over Slovak positions at EU summits.

In his 2009 study of Slovakia's EU policy formation, Marek Rybář concluded that the majority of actively pursued Slovak positions and preferences are a result of ideological and bureaucratic concerns of the privileged players (the political elite, business groups), rather than of the government's consultation with societal groups.<sup>17</sup> A notable exception is the Catholic Church's strong influence on the national position on cultural issues in the EU context. Back in 2004, in reaction to the Hague program of mutual recognition of national court rulings within the EU, the Slovak government issued a unilateral declaration that Bratislava would not support family law harmonization. This policy line has been respected also by the current center-left government, which in its Program Manifesto (April 2012) declares its intention to focus on the following EU policies: energy, transport infrastructures, internal market, and the environment. It has also pledged to engage in active consultation with civil society and social partners on thematic priorities for Slovakia's EU presidency in the second half of 2016 (following the next parliamentary elections).

## 2.2. EMU, EU institutional affairs, and fiscal integration

Under the Fico government, Slovakia's policy on EMU institutional reforms oscillated between enthusiasm for more Europe and aversion to radical positions and innovative ideas. Consider



Slovakia's stance on the two overarching debates on the future of Europe: the principles of austerity-versus-growth and intergovernmentalism-versus-community. In both, the government crafted positions that reflected Slovakia's interest in genuine integration, as well as the Smer party's ideological proclivity to Keynesian economics, while striving to minimize the political costs of doing so. So far, Prime Minister Fico has proved tactically astute in navigating such contradictions without alienating any of the principal players (Germany, France, and the European Commission). At the same time, leaders in Bratislava have always been mindful of the preferences of Berlin, as it is the country's most important EU partner.

Likewise, on the issue of a possible treaty change to pave the way for a genuine political union, Slovakia is unlikely to oppose it but equally unlikely to advocate it. Notwithstanding its objections to the first Greek bailout in 2010, Slovakia supported all of the EU's crisis measures of 2010–13, and even joined the vanguard of countries pushing ahead with the financial transaction tax initiative. Most recently, during Council discussions leading up to a decision on the banking union, Slovakia even stood for a common resolution mechanism – initially opposed by Germany – that would see member states lose control over the fate of troubled banks. Afterward, Fico repeatedly stressed that neither banking union nor fiscal compact are enough to restore the EU's competitiveness and that more integration is needed, including in fiscal matters. In reality, however, the model of fiscal integration envisioned by the government in Bratislava is far from sweeping; it merely implies closer coordination in the Council and Slovakia's potential entry into contractual agreements on structural reforms, as long as it remains of a voluntary nature.

Slovakia has been generally supportive of deeper political and fiscal integration based on the EMU, including the Fiscal Union. However, there are clear limits to Slovakia's willingness to give up fiscal sovereignty. One such »red line«, referred to explicitly by Fico, concerns the budgetary authority of national parliaments.

At the EU summit of December 2013, Slovakia insisted on a voluntary nature of contractual arrangements and solidarity mechanisms. Fiscally responsible eurozone countries should not be punished and forced to enter legally binding arrangements with the European Commission.

The underlying concern in Bratislava seems to be twofold:

- 1) Burden sharing in solidarity mechanisms for southern European countries will go against new eurozone members and hurt their fragile fiscal positions. Southern member states should not have the motivation to postpone reforms until they are rewarded with financial support from joint solidarity mechanisms. Slovakia therefore favors loans rather than non-return grants and bailouts.
- 2) The Fiscal Union has to be open to all EU partners, otherwise it will deepen divisions in the region and undermine Slovakia's relations with its Visegrad neighbors. The choice of whether to participate in the Fiscal Union and in contractual arrangements should be left to eurozone and non-eurozone member states to decide alike.

As for solidarity mechanisms, it was crucial from the Slovak point of view to agree not only to clear benchmarks but also on contribution criteria. Bratislava is concerned about national allocations and the impact on its own fiscal position at home. Public debt in Slovakia is forecast to rise very close to 57 percent of the GDP in 2014. Under the constitutional law on budget responsibility (2011), public debt above this level obliges the government to submit a balanced budget, which means either making considerable cuts in state expenditure or raising taxes.

On macroeconomic issues, Slovakia supports the relaxation of austerity and a shift of focus toward job creation, warning that the current pace of fiscal consolidation might be choking economic growth. But the attitude is largely rhetorical. The Fico government treasures Slovakia's affiliation with the German-led »northern« camp of fis-

cal prudence too much to become a champion of a progressive alternative to the conventional wisdom.

The same balancing act characterizes Slovakia's positions on the future of the EU and EMU institutional architecture. Being a small country whose interests lie in preserving the integrity of European Community institutions and treaties, Slovakia supports a strong role for the European Commission. For instance, Bratislava explicitly endorsed the Lisbon-enabled innovation tying the selection of the Commission President to results of European Parliament elections in May 2014, thus conferring greater democratic legitimacy onto the Commission. The Smer party even took the step of putting Maroš Šefčovič, current vice-president of the Commission and Slovakia's presumptive for another mandate as commissioner, at the top of its EP election list.

### 2.3. External policies

Upon entering the EU, Slovakia's diplomacy opted to focus on the neighboring regions of the Western Balkans and Countries of the Eastern Partnership (Ukraine, Belarus, and Moldova). Actively shaping the EU's role toward these regions has perhaps been the most consistent Slovak priority in its EU policymaking. Bratislava deserves credit for an assertive, deep engagement with the most advanced EU membership aspirants in the Western Balkans (Montenegro, Macedonia, and Serbia) and also for its long-term focus on Belarus, where it has pressed for political liberalization of the Lukashenko regime.

Slovak political leaders and diplomats have played a key role in various stages of the EU enlargement process in the Western Balkans, including in an early opening of the accession talks with Croatia in 2005 and in Montenegro's successful referendum on independence from Serbia a year later. The current Slovak foreign minister, Miroslav Lajčák, served in 2006 as the special representative of the EU's High Representative Javier Solana for Montenegro, and in 2007–09 in the doubly unpopular position of the international high representative/EU special representative in Bosnia and Herzegovina. Linguistic and cultural proximity, historical ties, and the Slovak ethnic minority in Serbia

and Croatia have also been important connecting points. So is the country's own example as an attractive model of economic transition and EU integration for individual Balkan governments.

While it is one of five EU countries that does not recognize Kosovo as a state, Slovakia has been strongly encouraging of Serbia to improve relations with Kosovo. Together with Athens, Bratislava has kept the profile of a more constructive "non-recognizer" than Cyprus, Romania or Spain. The Slovak political elite is also divided on Turkey; the center-right camp prefers a privileged partnership instead of full EU membership. The opening of EU accession talks with Turkey in 2005 was the subject of a heated parliamentary dispute in Bratislava, which split the center-right parties and resulted in a positive vote with no promise of the prospect for Turkey's future EU membership. The crucial support was provided by Fico's Smer party, then in the opposition.

Slovakia also has very dynamic NGOs and medical doctors with a footprint in the EU official development assistance agenda. The latest scorecard published by the European Council on Foreign Relations in 2014 praises Slovakia for development aid to Africa (South Sudan, Kenya) and for consistent leadership in attempts to achieve a visa-free regime with the EU's Eastern neighbours.<sup>18</sup> However, in contrast to its engagement on behalf of the Balkan region, Slovak diplomacy has not found its own niche in the EU's Eastern policy, except perhaps in its continuous support for the democratic opposition and fledgling civil society in Belarus.

### 2.4. Regional dynamics

Regional cooperation and coordination – above all in the Visegrad Group – plays a crucial role in Bratislava's EU policy. Being the smallest and the most multi-ethnic country<sup>19</sup> within the Visegrad Group (Hungary, the Czech Republic, Slovakia and Poland, also known as the V4) – and the only one sharing a border with each of the three others as well as with Ukraine – Slovakia has seen the Visegrad format as its vital interest and its core group of partners within the EU and NATO. For Slovak diplomacy, the most effective way of shaping EU

policies and decisions (except in the EMU issues) has been through the Visegrad format. Also, Bratislava has become the most consistent defender of the V4's present format. Potentially expanding the group to involve a single new country would require consensus of all four present members. Since all direct EU neighbors are already in, and Austria has not been interested, preferring its own regional initiatives instead, Slovakia does not have any interest in enlarging this regional grouping. But that position has other reasons as well. The so-called "Visegrad revival" was possible only after post-Mečiar Slovakia "returned" to the region in 1999, and the group members then supported Bratislava's fast-track EU integration. The "V4 Plus formula" has moreover proved very useful and flexible for incorporating other external interests and partners of the current Visegrad countries.

During the first decade in the EU, the Visegrad Group has remained the only recognizable regional organization and trademark. On the EU level, the V4 has helped Slovakia build effective coalitions, supporting for instance, the continuation of solid EU cohesion policy; more focus on energy security issues; EU funding for regional interconnectors; and upholding the EU principle of freedom of movement against recent Dutch and British efforts to limit EU migrants' rights to social protection.

In intra-Visegrad relations, the Hungarian-Slovak relationship is the most problematic one and has the potential to weaken the whole regional cooperation. The shakiness of the current bond is the result of historical developments, and remaining issues will need work to be solved over the long term.

In the early 1990s, Slovak-Hungarian bilateral relations and the position of the ethnic Hungarian minority in Slovakia were widely seen as a potentially destabilizing factor within Central Europe. With the integration into the EU and NATO, however, this risk factor has been significantly marginalized. After Fico's center-left Smer-SD party formed a coalition government with two smaller extremist parties in 2006, tensions with Hungary quickly escalated. A controversial, and vaguely defined amendment to the Slovak State Language

Law (2009) was followed by a heated diplomatic spat between Bratislava and Budapest during the summer, which claimed that the new legislation breached European standards. One infamous episode in August 2009 included stopping Hungary's then-president László Solyom at the border to prevent one of his frequent private visits to ethnic Hungarians in Slovakia.<sup>20</sup>

The EU as well as the two countries' European partners, including Germany, quickly stepped in, and both governments realized that their wider interests were at stake. As a result, both prime ministers met in September 2009 to agree on a ten-point plan of how to diffuse tensions. Prior to that meeting, Bratislava sent its state language law to the Venice Commission and entered into an expert dialogue with the OSCE High Commissioner on National Minorities, which resulted in corrections of the most problematic parts of the law.

Despite the disputes, Slovakia and Hungary have developed a very constructive dialogue on EU issues, which has continued uninterrupted even during bilateral disputes. This pragmatic dimension became more apparent once the Radičová government (2010–11), which included ethnic Hungarians, moved swiftly to address the complaints of ethnic minorities and improve relations with Hungary. Though the Radičová government was short-lived, bilateral dialogue has since intensified significantly.

The relative international position of Fico's Slovakia compared to Viktor Orbán's Hungary, an improved perception of Slovakia in Budapest, and an uneasy period in Hungary's relations with Romania have been some of the factors contributing to a gradual change of paradigms. Most recently, Prime Ministers Fico and Orbán have reshaped bilateral agendas to focus on those issues where agreement was possible and on developing existing opportunities in trade, economic cooperation, and cross-border infrastructure. In mid-2012, Hungary joined the Czech-Slovak coupled electricity market, and contacts between the governments are becoming more frequent. A joint session of the Slovak and Hungarian cabinets took place in July 2013.

Without the EU and Visegrad frameworks, low points in the countries' relationship would certainly have been much lower, and more drawn out. Common interests within the region and the EU make dialogue unavoidable. However, regular political dialogue has yet to spill over into a wider reconciliation and productive exchange on the two countries' common but divisive history. While civil society and expert groups from both countries have taken inspiration from the Franco-German reconciliation, so far this has not been adequately supported by either government.

## 2.5. Energy policy

The importance of energy policy has increased substantially for Slovakia in the decade since EU accession, both in terms of regional cooperation and EU policy. This section will concentrate on natural gas, nuclear power, and renewable resources, as these will be the most salient for the country from the perspective of Visegrad cooperation and EU policy.

Previously, Slovak energy policy was driven by two seminal events: first, the interruption of gas supplies in the winter of 2009 due to a Russian-Ukrainian dispute and the economic damage that the interruption caused; and second, Germany's 2011 decision to phase out its nuclear power plants by 2022. While this first prompted Slovakia to seek greater regional cooperation in order to bring energy security to the forefront of EU policy, the second, by contrast, made the country keen to keep nuclear power (and the country's energy mix) outside the EU's purview.

The Slovak economy is among the most energy intensive in the EU. The current energy mix consists of gas (30 percent), nuclear (22 percent), oil (21 percent), and coal (20 percent), with renewable resources accounting for the rest (7 percent).<sup>21</sup>

The companies RWE and E.ON hold a 49 percent stake in the first and third largest electricity distributors in the country respectively, and both are also large distributors of gas. RWE has also until recently operated a combined-cycle gas turbine near Trnava but has mothballed it because of lower than expected demand.

Gas plays a significant role in energy security calculations. In one of his first public comments after the Russian invasion of Crimea, Prime Minister Fico reassured the Slovak public that, owing to a mild winter, the country had a five month supply. But while Slovakia's restrained response to Russia was certainly informed by energy security considerations, the Fico government has always tried to strike a more cautious line toward Russia than Warsaw and Prague have.

At the same time, Slovakia is an important link between Ukraine and the West, with a transit volume of one-fifth of European consumption. During 2013, Slovakia undertook to upgrade its pipeline network to allow for substantial volume of gas to flow eastward to Ukraine, thereby supporting its bid to reduce energy dependence on Russia. While negotiations had stalled after the association agreement between the EU and Ukraine was suspended in the fall of 2013, the offer was again on the table following dramatic events in Crimea in spring 2014. At the time of writing, this option of reverse flow of gas from Slovakia to Ukraine seems to be of crucial importance to the new government in Kiev.

Otherwise, Slovakia lags behind Poland and the Czech Republic in diversifying imports and remains more dependent on Russia. The 2009 interruption of gas supplies prompted investments in storage and reverse-flow capacities, with the lateral lowering emergency imports from the west. Low diversification also has an impact on prices, with Slovakia currently paying 13 percent more for Russian gas than Germany, despite the shorter transit distance.

After the shelving of the Nabucco Pipeline in favor of the Trans Adriatic Pipeline (TAP), Slovakia has two hopes for diversifying its own gas supplies: connecting to an expanded TAP or to liquefied natural gas (LNG) terminals in Poland and Croatia.<sup>22</sup> Both assume expanded interconnectors. The successful cooperation of Visegrad countries has borne fruit, with the north-south route accepted as a priority energy corridor, and with the EU co-funding the main interconnectors between Poland, Slovakia and Hungary.<sup>23</sup>



Slovakia also has an interest in pursuing a common EU energy policy, with the hope of gaining a better negotiating position on both price and supply disruptions when acting collectively.<sup>24</sup>

SPP, the Slovak natural gas company responsible for distribution and transmission (through its EU stream subsidiary), has since its 2002 privatization been part-owned by E.ON and GDF Suez. In early 2013, however, the companies sold their 49 percent stake to EPH, a major Czech energy company with substantial backing of a leading Slovak financial group (J&T).

In stark contrast to Germany, nuclear power has strong support in Central Europe. In the case of Slovakia, nuclear power is popular among the public and with parties across the political spectrum. The country's share of nuclear electricity production is 55 percent (2012), the second largest proportion in the EU after France. Slovakia sees this energy source as an important determinant of its energy independence.

After the decommissioning of two Soviet-type reactors in Jaslovské Bohunice, which was a precondition to the country's EU accession, four reactor blocks are currently in operation, while two more, in Mochovce, are due to come online in the next several years. Another possible reactor, in Bohunice, is planned to be built by 2025. Last year Slovakia successfully lobbied the European Commission and the European Parliament to receive substantial funding – over 200 million euros – to defray the costs incurred in the decommissioning of the two ageing reactor blocks in Jaslovské Bohunice in 2006 and 2008.

After Visegrad cooperation on nuclear energy faltered, Slovakia and the Czech Republic formed the European Nuclear Energy Forum in order to further the issue at the EU level, but the forum failed to gain traction. Limited cooperation exists in practice; Slovakia has integrated electricity markets with the Czech Republic and Hungary, and Poland is negotiating joining them; research cooperation on a fourth-generation reactor prototype also exists, although funding is uncertain.

Indeed, the building of further Slovak nuclear plants has come under considerable pressure. Italian energy company Enel's postponement of the commissioning of the Mochovce plant reactors, amid battles with the government over additional funding, is unlikely to be the last. The Czech ČEZ group, a partner in the planned construction of a new reactor at Bohunice, has retreated. Rosatom has signaled its willingness to fill the void but only under the condition of guaranteed electricity rates. Challenges also remain when it comes to storage of spent nuclear fuel, a part of which Slovakia currently exports, mainly to Russia.

Visegrad cooperation can hope to solve some of these challenges by further increasing market integration in the region, hoping a larger market will attract investment. Furthermore, the V4 can be a vehicle for securing EU financing for both cross-border electricity interconnectors and common spent fuel storage capacities.<sup>25</sup>

Slovakia has been an especially reluctant adopter of renewable forms of energy, even among the V4 countries. This sluggishness has been driven by concerns that the introduction of feed-in tariffs will increase the price of electricity, which is already among the highest in the EU,<sup>26</sup> and discourage investments in other sources of energy, particularly the country's nuclear power plants.<sup>27</sup>

However, in recent years, concerns about the impact of renewables, and particularly of the solar farm boom, on the security of the grid have become a major factor,<sup>28</sup> with a recent study pointing out that Slovakia would be unable to meet the targets set out in national renewable energy action plans without significant investments in cross-border transmission capacities, particularly between Slovakia and Hungary, which could soak up peak supply.<sup>29</sup>

The problem of grid security and the lack of capacity for cross-border transmissions, is confounded by unplanned power flows between Germany and Austria. Because of market design, these often take the route from wind farms in northern Germany through Poland, the Czech Republic, Slovakia, Hungary, and finally to Austria.<sup>30</sup> The V4 has

cooperated on the level of transmission system operators to bring wider attention to the problem and to argue for the necessity of making changes in the market design.

When in 2010 the first Fico government dissolved the ministry for the environment as part of cost-cutting measures, it sent a strong signal about its view on the agenda's relative importance. And while the ministry was successfully re-established by the Radičová government, and the second Fico government has so far kept it in place, the agenda remains of relatively little importance. Nevertheless, Slovakia is on track toward fulfilling 2020 targets (emissions 13 percent above 2005 levels) by a wide margin, driven mainly by structural changes in the economy and reduced energy intensity.<sup>31</sup>

Looking ahead, Slovakia has also been critical toward the European Commission's proposal for 2030 climate goals. Like many other new EU member states, Slovakia sees the targets to reduce emissions by 40 percent (relative to 1990 levels) as

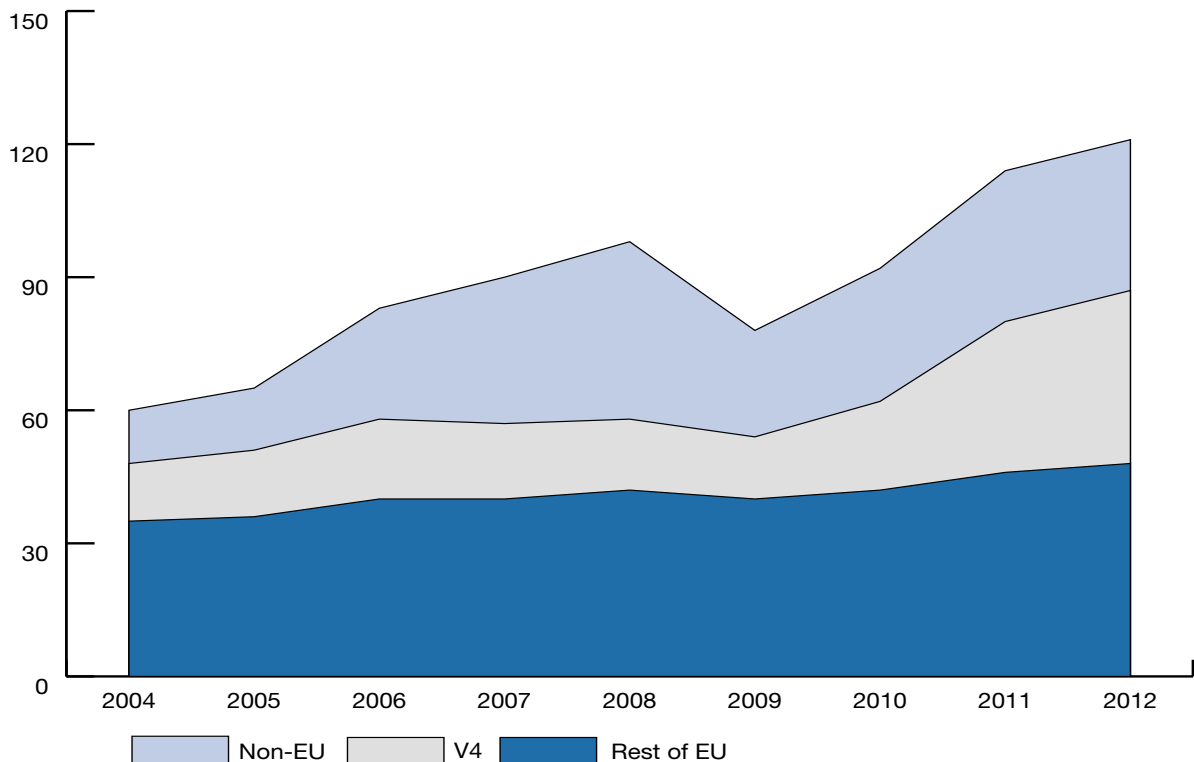
detrimental to the competitiveness of its industry, and it opposes setting a quota for renewables in the country's energy mix.

## 2.6. Economic partnerships

Slovakia is the smallest and most open of the Visegrad economies, with a ratio of trade to GDP of almost 170 percent in 2012. As such, economic partnerships have a huge impact on the country's foreign policy and EU relations. The country's development in the past decade has been closely connected to rising exports and foreign direct investment (see figure 2). The crisis lowered Slovak exports by almost 20 percent in 2009. However, growth in exports quickly returned, reaching pre-crisis levels in the second quarter of 2011.

Slovakia's trade is predominantly EU focused, with its ratio of inter-EU trade being one of the highest in the Union (together with the Czech Republic and Cyprus). A total of 84 percent of exports are to EU members, with 63 percent of imports

Slovak Trade (Figure 2)



Source: Data from the National Bank of Slovakia

originating there. Oil and gas imports from Russia represent almost a quarter of imports from outside the EU.

Germany remains the largest trade partner in terms of both imports (16.8 percent) and exports (21 percent). This is in line with the rest of the V4. However, the central position of Slovakia in the region and its growing interconnectedness with Europe is responsible for the fact that its next biggest partners are the other three Visegrad countries, collectively responsible for over 17 percent of imports and 29 percent of exports. Of these, the Czech Republic is the largest trading partner, based on both the countries' shared past and the tight integration of their automobile sectors.

Inter-Visegrad trade has enjoyed rapid growth in the past decade, outpacing growth of trade with the rest of the EU. Slovak exports to the Czech Republic, Poland, and Hungary grew from just over 7 billion euros in 2004, to over 18 billion in 2012. The growth of trade among the V4 countries can be attributed to the activities of foreign companies serving the region from individual countries as well as to inter-company trade from production segmentation.<sup>32</sup>

While the electronics and automobile sectors dominate exports, worries about the impact of this high export reliance and low export diversity have been largely overstated. The fact that Slovakia supplies a wide range of cars (from SUVs to small family cars) has shielded exports from changes in consumer spending. Moreover, while exports to non-EU countries are the lowest in the region, exports to Germany are often re-exported to markets outside the European Union, a further protection from a fall in demand in Western Europe. The economic crisis had the most significant impact on exports to countries outside the single market, and exports here have still not returned to pre-crisis levels.

A favorable mix of investment incentives, stability, and a business-friendly tax code attracted foreign investors in the early 2000s, leading to growth in employment, productivity, and a quickly appreciating currency. Looking at the source of investments, the vast majority originated from the eurozone, with the Netherlands (28 percent), Germany (15 percent), and Austria

(14 percent) in the top three.<sup>33</sup> Investment from the Czech Republic and Hungary is relatively high, with approximately 6 percent of investments from each, while Poland accounts for less than 0.2 percent. Foreign investments are mainly in manufacturing and financial services.<sup>34</sup>

Slovak companies increasingly invest abroad, mainly in the services and energy sectors.<sup>35</sup> The close relationship with the Czech Republic is even more pronounced here, with over 41 percent of Slovak investments going to that country. This is followed by Cyprus (16 percent), Germany (7 percent), Luxembourg (7 percent), and Hungary (7 percent). Slovak investments in Poland account for approximately 1.5 percent of the total.<sup>36</sup>

As economic growth slowed following the 2009–10 crisis, investment funds dried up or moved to more rapidly growing emerging markets. The recovery has seen relatively low amounts of foreign direct investment, but its focus has changed. Recently, it has gone mainly toward upgrades and increasing the capacity and productivity of existing plants, as opposed to new large “green-field projects” before the crisis, which brought with them additional opportunities for employment.<sup>37</sup>

As a recent report on the future of Central Europe notes,<sup>38</sup> the Slovak economy is moving from a stage in which it was driven by improvements in efficiency to one where it is “innovation driven”. And while the region in general is slow to invest in research and development, Slovakia in particular ranks among the lowest spenders on research and development in the EU. The transition toward growth based on innovation and high added-value exports seems distant.

As the report notes, cooperation with other Visegrad countries that have similar problems is ripe for improvement, with only a limited number of projects (for example in nuclear energy) currently under way. However, Slovakia will need to do its homework in improving policy and increasing its commitment to research and education.

Higher education in particular is in dire need of an overhaul, specifically in terms of quality and

relevance to the needs of the labor market. While secondary education has long held firm in PISA rankings despite chronic underfunding, it has dipped below OECD average in the most recent tests.

Another problem that needs more attention is the low employment rate (65.1 percent in total), in particular for women (57.3 percent), which places Slovakia below the EU average. On top of that, Slovakia faces major demographic and societal challenges with its young and growing Roma population.<sup>39</sup> The vast majority of Roma continues to live in poverty in socially vulnerable communities in Central and Eastern Slovakia. Their job prospects are limited by low skills and geographic separation from job opportunities in towns of Western Slovakia – as well as by discrimination in the labor market. The European Commission has named Roma inclusion in its country-specific recommendations for Slovakia and encouraged it to use EU funds for targeted social programs. As a group, the Roma represent a significant yet underutilized potential in the Slovak economy. Much of the country's future competitiveness will depend on how fast the government, regional administration and local mayors can improve the employability of hitherto excluded Roma and help integrate their children into the mainstream education system. Regional collaboration and exchange of best practices with the Czech Republic and Hungary has so far been rather limited but could play an important role in the near future.

## Conclusions

While Slovakia's real income has grown rapidly in the past decade (outpacing the other V4 countries) and its per capita GDP now stands at over 76 percent of the EU-28 average (up from below 60 percent in 2003), the country faces considerable challenges maintaining the pace of convergence, and it risks becoming stuck in a middle income trap. Previously, economic growth was based on FDI and fuelled by low wages and growing productivity. With the FDI inflows dropping, the Slovak economy will have to look to a new model if it is to continue lowering unemployment and increasing productivity and competitiveness.

Looking ahead, Slovakia's consensus on Europe appears to be durable, at least in the medium term, barring any major economic disruption. As long as European integration commands public consent, no mainstream political party will have an incentive to break ranks. The fact that EU affairs are not subject to political contestation further reinforces the status quo. In the long term, however, absence of an informed debate – especially on the implications of deeper eurozone integration – and the capacity for populist revolt against the political establishment may render the domestic consensus in Slovakia more fragile than it appears today.

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