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A reformer's lessons learned: The case of the Slovak Republic[1]

This article explores lessons learned from the Slovak transition experience over the past four years focusing on the need for political support and human capacity in making legal reform progress. It discusses the successes and setbacks in three areas: amendments to the Commercial Code (reform of company law), introduction of a new Labour Code and a new collateral law system. The article offers an insight into the legal reform process from the perspective of a country pursuing a reform agenda.

Beyond technical solutions: political support and human capacity

For a reformer in a government of a transition country, there are two greater challenges than figuring out the technical solutions needed for reform. One is to design and implement reforms that are politically palatable and that will receive sufficient political support, including the backing (or at least non-opposition) of special interest groups. This is especially important in the latter part of the transition when the population has become increasingly disillusioned with the reform process and when the various interest groups are clearly defined. The other challenge is to ensure that there are sufficient human resources to design, develop and implement the reforms. This is a tall order in countries where the state administration has not been reformed or reorganised and where state officials are expected to support reforms and build institutions for a market economy – tasks for which they are ill-prepared or resent in principle.

Twelve years into the transition, policy makers in central and east European economies can tackle most reform issues with well-established technical solutions or a set of feasible policy options.[2]

The lessons learned throughout the past decade, which have been well documented in academic and popular literature, outline the policy options and present the measures needed to achieve stability and economic growth and to build the necessary institutions for a functioning market economy. In addition, the international institutions involved in advising and coaching transition governments, such as the Organisation for Economic Co-operation and Development (OECD), the European Union (EU), the International Monetary Fund (IMF), international development banks and bilateral donors, are more than happy to fly their experts into countries to present their versions of what needs to be done and by when. A World Bank report entitled *Transition–The First Ten Years*, offers useful commentary on the successful reformers within central and eastern Europe that managed from the outset to promote discipline among the key players in the economic process, as well as encourage new entrants into the market.[3] The report contrasts the successful reformers with the "laggards" of transition who, instead of implementing the "discipline-and-encourage" strategy, continue to protect socialist industrial and financial enterprises through taxes, budget or energy subsidies and various preferential policies, and to discourage new entrants into the market with high administrative and tax barriers.[4]

A government reformer who has the technical solutions readily available is in a very different situation from one at the beginning of transition where most reforms were based on nothing more than trial and error. However, while the pioneer reformers of the early 1990s were not certain of which reform path to take and which to avoid, they were able to test various reform efforts and policy options. Their reform efforts were not as strongly hampered by the existence and influence of special interest groups. The former socialist industrial managers were still finding their renewed strength and representatives of new interests were looking for their voice. Now in the later stages of transition, the technical solutions are in place but reformers are facing a new obstacle – a need to battle interest groups (old and new), while being confronted with the growing apathy and impatience of the population.

Supporters and opponents of reforms: timing is everything

Recent analyses have highlighted that for the reform process to succeed, transition countries need to build political reform constituencies and gain the necessary public support for the reform process.[5] The World Bank report *Transition–The First Ten Years* also recognises the importance of the political aspects of reform. It argues that competitive political systems have a better track record in successful economic development. It highlights the conditions conducive to reform and illustrates which constituencies are likely to embrace reforms and which are likely to oppose them. The report also upholds the theory that "early winners" of transition reform (groups that benefited from the partial reforms introduced at the beginning of transition) are hostile to, and often oppose, the continuation or later introduction of further reforms.[6] There are various examples of "early winners", from industrial managers who, as a result of the collapse of communism and the weakening of the central state administration, had the free rein to run their enterprises, to bank managers who could suddenly loan large sums of money to their friends and cronies. Stories like these were commonplace in many, if not all, transition countries.

1 This article is based on the personal experiences of the author, who has been involved in the transition reform processes in eastern and central Europe over the last decade and who participated in the policy making and reform process firsthand from two different perspectives. Between 1993 and 1998, the author advised on legal and judicial reforms out of the Legal Department of the World Bank in Washington, DC, and since 1999 she has been carrying out reforms in a small team under the Deputy Prime Minister for Economic Affairs of the Slovak Republic. All opinions and views expressed in this article are the author's own and do not reflect the opinions of any government official in the Slovak Republic.

2 There are exceptions to this statement. For example, healthcare continues to present policy challenges to all governments, rich and poor, developed, developing or those undergoing transition.

3 Eds. P. Mitra and M. Selowsky, "*Transition – The First Ten Years*", World Bank publications, (2001). The report mentions Estonia, Hungary and Poland as the most successful reformers.

4 The report cites a number of CIS countries, such as Belarus, Turkmenistan and Uzbekistan, as lagging behind in the transition process.

5 See "Ten Years of Transition", *EBRD Transition report 1999*.

6 Ibid. World Bank Report.

In the short term, reform is often painful and difficult for the population and even in the later stages of reform understanding and adjustment are not easy. Therefore, politicians frequently take the easier route of not embarking on short-term reform forcing their successors to worry about the long-term consequences.

A telling example of the resistance to change and preference for the status quo by the "early winners" in the Slovak Republic is the attitude of the bar association to further reform of the legal profession and the judiciary. Legal practitioners, who are by no means the only example of "early winners" in the Slovak Republic, benefited enormously from the liberalisation of the profession in the early 1990s when all legal services became private entities. The bar association is currently actively opposed to further liberalisation such as opening up the market for legal services to foreign competition and is relatively passive in relation to the reform of the judiciary. It seems that the current practice of often arranging the outcome of litigation through connections, rather than the quality of legal argument, is easier and more beneficial to many lawyers.

In their book on Russian reform, *Without a Map: Political Tactics and Economic Reform in Russia*,[7] A. Shleifer and D. Traisman similarly recognise the crucial importance of the politics of reform. They explain the reform process in Russia as a continuous battle among divergent interest groups referred to as "stakeholders". Such groups include state officials, enterprise managers, employees, local and regional officials, bankers and media moguls, all of whom oppose reform for various reasons. According to the authors, government reformers either have to quash the stakeholders ("expropriate" them) or ensure they buy-in ("co-opt" them) both at the reform planning stage and at the implementation stage.[8] They take the politics of reform contention one stage further and argue that the relevant framework for comparison of the success of a reform is not to compare reforms with an ideal outcome, but rather compare the existing outcomes with their politically feasible alternatives.

The EBRD *Transition report* 1999 states that "politics is to blame" when reforms have not taken place or are insufficient. [9] In the short term, reform is often painful and difficult for the population and even in the later stages of reform understanding and adjustment are not easy. Therefore, politicians frequently take the easier route of not embarking on short-term reform forcing their successors to worry about the long-term consequences. [10]

Experience in the Slovak Republic supports the notion that, despite the merits and quality of a reform proposal it may falter at the implementation stage or may not even be adopted if it has not gained sufficient political support.[11] It is often more advantageous to design or adapt policies resulting from political compromise that still achieve a substantial part of the reforms than to go for a "perfect" solution and risk not having the reform adopted at all. A prime example is the privatisation programme in the Slovak Republic in 1999. Under the pre-1998 Government, several sectors of the economy, including banks, insurance companies and utilities, were declared "strategic enterprises"[12] and were thus excluded from privatisation. Initially, the Government coalition[13] agreed that the law stipulating this would be abolished and all companies would eventually be privatised. However, during the parliamentary process the ex-Communist party – a member of the broad ruling coalition – decided not to support the plans for full privatisation. After several days of parliamentary debate and following threats that the ex-Communist Party would withdraw from Government, the rest of the coalition agreed to compromise by capping the stake of utilities slated for sale at 49 per cent, in exchange for the full privatisation of government stakes in all the state-owned banks and insurance companies. This imperfect solution upset many in the Government, the press and the public. However, it proved to be a stepping-stone in enabling future governments to press ahead with the full privatisation of both the financial and utility sectors. Adjusting the original policy to get full political support for the "imperfect" solution has indeed been worthwhile.

As has been demonstrated, politics are important in ensuring the design and implementation of reforms. The existence of government reform groups; the ability for a coalition government to agree on policies; the existence of political competition and the free press pushing politicians to make responsible choices; the ability to maintain public support; or the ability of government reformers to convince or defeat special interest groups are all preconditions to wide-reaching and systemic reform. As was the case in the Slovak Republic in 1998, it took a general election for all of these elements to come together and open up what commentators refer to as a reform "window of opportunity."[14]

Who will carry out the reforms? Help wanted

Another important factor underpinning the success or failure of reform is the existence of sufficient professional human resources, or in other words, the ability of key individuals to formulate policies and design, develop and implement the tasks that will bring about reform. The lack of human capacity in transition countries is often overlooked. It is hard for the commentators of well established Western democracies to imagine a situation where advertisements for a head of a newly established network regulator or a debt reduction agency fail to generate a well-qualified pool of individuals.

Over the past four years in the Slovak Republic, while difficult, it was ultimately possible for the broad governing coalition to agree on a reform agenda, with a few notable exceptions.[15] It is the author's belief that it was the lack of qualified and talented individuals, rather than the lack of political will or a blockage imposed by interest groups, that limited the scope and speed with which reforms could be carried out.

Some of the human resource issues in the public sector may be specific to the Slovak Republic, but many are likely to occur in other countries. At all levels of the public sector from policy makers to operational staff, there is virtually no foreign training or expertise. The lack of cross-fertilisation of ideas and knowledge that come with exposure to foreign educational systems and work experience is more pronounced in the legal, economic and accounting professionals working in the government. The Slovak Republic has traditionally had a particular problem with a large brain drain. Under communism the destination was the West, now it is usually the Czech Republic. There are clearly insufficient incentives, moral and financial, for Slovaks with education and experience abroad to come back and work with the Government. This makes the situation very different to Serbia, for example, where a great number of people returned immediately after the fall of the Milosevic regime to work for the current Government.

While the constraints on human resources are most visible in the public sector, this problem is not exclusive. The various trade associations regulating private professions have similar problems, as outlined on the following pages. Such is the legacy of the Mečiar era, when government and business were closed to anyone

who did not support the former Prime Minister, that many of the Slovak Republic's most talented and educated individuals occupy positions in the non-governmental organisations.

The lack of English language proficiency among those in key positions within the public sector, for example among ministerial staff, further compounds the problem of human resources.[16] Usually, the only English speakers are in the sections that are focused on forging relations internationally and with the EU. Most of the non-English-speaking ministerial staff end up working in a different policy, knowledge and even value environment from those who have been exposed to international experience and contacts. This turns every reform dialogue into a challenge when many concepts and reform goals are impossible to communicate accurately. Conversely, a vast majority of the people in the non-governmental organisations and think-tanks are fluent in English and are able to benefit from and contribute to the global discourse.

Can foreign advice and assistance help? An absorbing issue

Before donor attention and resources shifted away from central Europe to southern and eastern Europe, the public sector in the Slovak Republic, to a large extent, failed to benefit from foreign advice and assistance. This was due to the isolation during the Mečiar years, during which the Slovak Government was not open to donor advice nor welcoming of international assistance and therefore did not climb the steep international assistance learning curve. This has had an impact on the country's current skills base and has meant that it is still developing proficiency in dealing with foreign institutions and their advice and assistance. It has also meant that many areas still experience difficulty in handling relationships with donors and in absorbing international assistance programmes. This is most evident in the EU accession process, in terms of both planning for and implementing EU pre-accession financial assistance and benefiting from EU policy advice. For example, the EU could assist the Government in setting up tax policy planning, but if the relevant ministry does not have people capable of participating in the discussions, such advice is wasted.

The key process in all central European countries and Baltic states is accession to the EU. While often burdensome and unwieldy, it can provide useful policy guidance for the transition countries and can be of particular importance in instances of internal political debates and disputes over various policies by breaking political impasses and promoting political consensus. It also imposes a rigorous schedule in place for reform efforts that would otherwise drag on. At the same time, the accession process, especially the harmonisation of the national legislation with the EU *acquis communautaire*, can be rather formal, especially when accession countries lack the human resources to absorb advice and implement necessary reforms. As a result, the accession process, at times, risks missing the desired outcome.

If carried out properly, through assistance programmes, donors can often boost domestic capacity and expertise in critical areas. However, there are also risks. Foreign experts sometimes lack the ability to translate the considerable expertise in their field into the local context and do not know how to work effectively with locals. Sometimes, the donor agenda may be biased, exporting their home expertise with insufficient regard for the local context. Yet another problem may be that some foreign donor programmes are more an employment agency for their nationals than assistance for transition countries.

Despite such difficulties, the top economic policy makers and institutional reformers in the current Slovak Government have benefited from international policy advice and guidance. The reform dialogue with the World Bank, IMF, OECD, EU and bilateral contacts, helped anchor the policy agenda of the Government. Many good policies and Government decisions were prepared in consultation with these institutions or benefited from their advice. Also, they provided the critical support that made the adoption of some difficult decisions possible, such as the Slovak Republic's commitment to invest roughly 12 per cent of its GDP into restructuring the banking system.

7 A. Schleifer and D. Traisman, *Without a Map: Political Tactics and Economic Reform in Russia*, (2000).

8 Ibid. p. 8.

9 Ibid. *Transition report*, p. 102. The report states that "narrow interest groups, populist politicians and obstructive bureaucrats are often viewed as blocking reforms that would benefit the entire society."

10 Ibid.

11 In order for a reform to be a success, apart from political backing, reformers need to secure support from broader constituencies, such as the free press, non-governmental institutions and, in many instances, the population at large. For example, in the push for macroeconomic stabilisation and the opening of privatisation in the Slovak Republic in 1999, the support of economic journalists and think-tanks was critical.

12 Law on Securing the Interests of the State in Privatization of Strategically Important State Enterprises and Joint Stock Companies, No. 192/1995 Z.z.

13 Following the 1998 elections that removed the non-reformist and autocrat Vladimír Mečiar (1994-98) from office, a broad coalition led by Mikuláš Dzurinda took office. Despite the breadth of the coalition that consists of five parties (two of which are coalitions themselves), the Government has managed to carry out a number of key political, economic and institutional reforms.

14 Ibid. *Transition report*, p. 103.

15 The two areas that caused an impasse for the Government's left and right parties were: first, setting the appropriate level of taxation; and second, the introduction of tuition fees for higher education.

16 In a key ministry in the Slovak Republic, which has approximately 700 employees, there are fewer than a dozen fluent English speakers, including the minister.

Ingredients for reform: three concrete examples

Three recent reforms outlined below illustrate the effects the issues discussed in this article have had on the reform effort. Each of the three examples, the new company law,[17] the new Labour Code,[18] and the reform of the collateral regime,[19] have a significant impact on the economic and institutional development of the country, as noted by the OECD, the World Bank and domestic commentators.[20] The first and third examples have a positive outcome, while the second represents a reform failure. The three reforms illustrate different, though interrelated, lessons.

1. The new company law

Company law reform was championed and prepared outside of and initially against the resistance of the regular state administration structure, the Ministry of Justice (MOJ). Despite a difficult beginning, and unlike the case of the Labour Code, company law reform ended as a success. Unlike the collateral reform, however, the company law reform did not benefit from well-structured and effective donor assistance and the private sector was not actively involved in the preparation and adoption of the reform. The company law reform process clearly revealed gaps in the Slovak Republic's skills base and the inability of private sector groups to get their legitimate interests represented in the legislative process.

The EU Company Law Directives[21] deal with important issues such as the maintenance of capital, the registration of companies, publication of company information, and mergers and acquisitions. They, do not, however, deal with the crux of company law, for example, the type of companies, their structure, the relations between the company and its directors and officers, or shareholders' rights, including minority shareholders. These issues, which arguably are central to the proper and effective functioning of company law, are regulated and sanctioned by the national legislation of the individual EU member states. This means that even with full harmonisation of all the relevant provisions of the Directives, Slovak company law would not necessarily be compatible with standards found in the member states or those expected of a future member. At the start of the process of harmonisation in this area at the end of 1999, the Slovak Government paid little attention to issues outside of the Company Law Directives. Harmonisation was seen purely as a mechanical process of transposing the relevant provisions from the Directives into Slovak law.

It was not until the Deputy Prime Minister's office – a key player behind the Slovak accession to the OECD – started to take an active role that the company law reform agenda was considerably broadened. In addition to harmonisation with EU law, the Cabinet agreed to incorporate the OECD Principles of Corporate Governance into the company law in order to make the legislative environment for economic activity more transparent and predictable. The new company law (an amendment to the Commercial Code) was thus drafted using EU law and OECD principles as guidance. The new law was adopted in early Autumn 2001 and entered into force on 1 January 2002.

What contributed to the success of this reform? What impeded it?

The existence of a champion of the company law reform contributed greatly to its success. The Deputy Prime Minister for Economic Affairs and his team argued the case for predictability, transparency and, ultimately, economic efficiency, and convinced the Cabinet to expand the mandate of the MOJ in the company law reform to include the OECD Principles of Corporate Governance. This was achieved through preparation and progression through the full intergovernmental process of a policy document, or "blue print" for institutional reform for a market economy, entitled Improving the Legal, Regulatory and Tax Framework for Entrepreneurship and Investment.[22] The document was necessary to force an agreement among Cabinet members to review the legislative framework for a market economy and expand the legislative reform process beyond strict EU harmonisation requirements. Had it not been for this intervention, the MOJ would have put a great amount of effort into preparing a piece of legislation that would have lacked fundamental elements of corporate governance, such as directors' and officers' liability, information duties in relation to shareholders and other stakeholders, and the introduction of shareholder action, thereby missing the important elements of market economy transition.

Initially, the MOJ was resistant to the changes and did not welcome the expanded mandate. Therefore, it was necessary to make it identify with the reform through a Cabinet decision. It soon became apparent that the underlying reason for the hesitation in tackling the broadened agenda for reform was the fact that the Ministry lacked sufficient staff with the necessary understanding, knowledge, and experience. The notion of corporate governance was an alien concept to the predominantly non-English speaking lawyers in the MOJ.[23]

The Ministry created a drafting committee for the company law that consisted mainly of judges and some MOJ staff. Their input was critical and the author strongly believes that judges should be given the opportunity to comment on draft legislation as frequently as possible. This is especially true in the civil law countries where so much of law implementation and enforcement hinges on the quality of draft legislation. The problem in the company law case was that, as most people who have ever been part of a legislative process will acknowledge, legislation cannot be drafted by committee. A committee can review, comment and brainstorm on specific provisions, but every piece of legislation needs a dedicated drafter (or small group of drafters) to produce the first draft. This role was initially missing from the committee process and therefore, very little was achieved in the first year and a half. Consequently, the entire drafting process experienced difficulties in meeting the EU accession-mandated deadlines. In response, the reform team around the Deputy Prime Minister identified and retained an experienced lawyer with an academic background who later became the principal drafter of the entire Commercial Code amendment. This was the solution "outside of regular structures" that made the full company law reform possible.

With its serious capacity constraint it is unfortunate but not surprising that the MOJ's attitude towards harmonising legislation was initially rather formalistic. This is frequently the case when transposing the EU *acquis communautaire* throughout the accession countries. Overwhelmed by the complex harmonisation process, countries tend to transpose the "letter", rather than the "spirit" of the Directives. The danger is even greater in traditionally formulaic legal cultures such as those found in central Europe. It may be that more of "coaching" approach by the EU negotiating and review teams could help the countries overcome this shortcoming. Such an approach might breathe more "spirit" into the transposed legislation, particularly in instances where – such as in company law – the member states themselves have not yet reached an optimal level of harmonisation.

An important aspect of the adoption of the company law was the conspicuous lack of input by the private sector. This was the case despite the effort of the drafting team to solicit comments both from private lawyers and the business community. The Slovak legislative and policy-making process has become rather more open over the last four years. As the various drafts of the law evolved, they were all accessible via the MOJ Web site and many businesses, associations, chambers of commerce, large foreign and domestic investors and large legal offices were approached for their comments. Many of those contacted felt that the Commercial Code amendment with its 300 new or revised provisions was too large and complicated to comment on. A curious attitude from lawyers and business people for whom the Commercial Code is one of the, if not *the*, most important pieces of business regulation. As will be seen with the Labour Code, business associations and groups representing legitimate interests of the business

community that would be interested in and capable of producing timely feedback to the legislative process are still in a nascent stage of development in the Slovak Republic.

2. The new Labour Code

The Labour Code is an example of a reform failure on many fronts. Unlike the other two successful reforms described here, it did not have a visible champion in the Government. The Labour Code was prepared by the Ministry of Labour and Social Affairs (MOL), an entity both strongly resistant to change and market reforms and lacking in professional skills to prepare modern legislation. Unlike in the collateral reform case, there was no effective donor assistance in the preparation of this Code. Perhaps even more importantly, as with the company law (and unlike the collateral reform), the private sector and professional associations were not sufficiently involved in the preparation of the Code.

The Slovak Republic carries the gloomy distinction of having the highest level of unemployment among the EU accession countries, at approximately 18 per cent in July 2002. While no single factor can be pinpointed as the cause of this situation, both domestic and international commentators agree that the rigidity of the Slovak labour market and insufficient labour mobility are among the main causes of high unemployment and low levels of job creation.[24] Unfortunately, the Labour Code as proposed and adopted further diminishes labour flexibility; makes labour more costly; restricts the hours and overtime one can work; curtails the ability to work part-time; contains disincentives for further hiring; makes reorganisation harder and more costly; and significantly increases the role of trade unions in the operation of companies in ways that are mostly beneficial for trade union functionaries.

The MOL took two years to prepare the Labour Code. During that time, the Code went through a full legislative process where it was vetted several times by the executive, examined several times by the Tripartite Council (comprising the Government, the trade unions and the employers), and read three full times in the parliament. Through the entire process no one seriously objected to the Code as a whole. It was adopted by the parliament in Summer 2001, with an effective date planned for 1 April 2002. Only several months after its passage, in late autumn 2001, did various chambers of commerce and associations of employers start criticising the new Code as one that would hinder economic development and contribute to the continued low employment situation in the Slovak Republic.

In early 2002, under pressure from the business and investment community, both domestic and foreign, the Deputy Prime Minister agreed to coordinate the preparation of a "quick fix" amendment that would be adopted prior to the effective date of the new Code. This, in fact, took place and on 1 April 2002; the new Code came into force, together with its new amendment. The new amendment improved the Code somewhat (the allowable overtime hours were extended from 48 to 58; the professions dependant on irregular work schedules, such as transport, cultural and medical workers, were allowed broader exceptions to the rigid rule on work time; the option of part-time work contracts was reinstated) but it failed to transform the Code into a truly solid modern framework for labour relations.[25]

Why was a faulty Labour Code adopted and why did no one object?

There are several reasons. First, one needs to understand who was behind the Code as drafted, and whose interests the Code serves. Second, one needs to examine whether the preparation of the Code was done in the open, and verify if there was a chance to influence its content. Third, one needs to look at the competing interests and see whether they were adequately represented.

The MOL, an entity reminiscent of the communist era in its physical appearance and work practices, prepared the Code to reflect their ways of thinking. In other words, the State should govern and if that is no longer possible by being the universal employer, then one compensates for it through legislation severely restricting the scope for private agreements. The MOL claimed that one of the key motivations behind the new Code was the desire to increase employment. The logic was such that by legislating the restriction of overtime, employers would hire more workers and unemployment would decrease. The trade unions, with their old-line representation and dramatically decreasing membership and popularity among the workforce, happily cooperated in the preparation of the Code. From the point of view of trade unions, the Labour Code broadens their influence in the management and operations of enterprises.

The draft Code was accessible to the public via the Internet early in the legislative drafting process. Moreover, it was made available to the employers' associations even earlier by way of the Tripartite Council. In a mature and well-functioning democracy, legitimate business interests with their own well-established channels of communication and influence would normally provide a counterbalance to the role of trade unions. Unfortunately this did not occur. The failure of all the relevant parties to comment on the Code was not caused by lack of access. The Labour Code was by no means a backroom deal cooked up by a circle of insiders in a matter of few weeks.

[17] Company Law reform took place in the form of an amendment to the Commercial Code No. 500/2001 Z.z., amending Act. No. 513/1991 Zb., the main code of commercial legislation.

[18] Act No. 311/2001 Z.z., as amended by Act. No. 165/2002 Z.z.

[19] Hereinafter, the terms "collateral" and "secured transactions reform" are used interchangeably.

[20] The recently published OECD Economic Survey, Slovak Republic, the first comprehensive publication since the Slovak Republic became a member of the Organisation, lists all three as important elements of the reform process in the country, Volume 2002/11 – June, OECD, Paris, 2002, pp. 17, 103 and 133. Both the collateral reform and the new Company law were parts of the conditionality of the EFSAL project, negotiated between the World Bank and the Slovak Government and approved in the summer of 2001. Changes in the Labour Code were recommended by the World Bank in its Slovak Republic, Living Standards, Employment, and Labor Market Study, The World Bank, 2002. A prominent Slovak think-tank, INEKO, in a comprehensive review of all the reforms measures in the Slovak Republic under the coalition Government ranked the collateral reform and the new Company law among the Governments top achievements. HESO, www.ineko.sk/heso.

[21] First Company law Directive No. 68/151/EEC from 9 March 1968; Second Company law Directive No. 77/91/EEC from 13 December 1976; Third Company law Directive No. 78/855/EEC from 9 October 1978; Sixth Company law Directive No. 82/891/EEC from 17 December 1982; Eleventh Company law Directive No. 89/666/EEC from 21 December 1989; and Twelfth Company law Directive No. 89/667/EEC from 21 December 1989.

[22] Adopted on 13 September 2000, as Cabinet resolution No. 703, Document No. 2024/2000. The preparation of this document was aided by the legal and institutional content of a World Bank loan and by a Foreign Investment Advisory Services (part of the World Bank) study on barriers to foreign investment. This document was limited in scope and did not cover all the legislation necessary for developing market institutions. It did, however, touch on the important building blocks, such as the Civil, Commercial Codes and alternative dispute resolution.

[23] The Slovak language – as all other Slavic languages – does not have words that directly translate the English words and phrases such as "governance" and "corporate governance".

[24] Slovak Republic, Living Standards, Employment, and Labour Market Study, World Bank, and OECD Economic Surveys, Slovak Republic.

[25] To achieve the political backing of the MOL and the ex-Communist party, represented by the Minister, for the passage of the partial amendment, a compromise was necessary: trade union rights remained untouched.

[26] As an indirect result of the inability to

The problem with access to credit in transition countries often constitutes a major obstacle to economic growth early in the transition process.

The Code passed the Cabinet and the parliament, so it may seem that there was sufficient political will and political backing for its adoption and that this important legislation was a result of a broad political consensus. However incredible as it may seem, the Code passed through all the legislative channels without an appropriate analysis of its contents and implications. At each stage of its review, the Code's implications were underestimated by all involved. Potential participants in the process seemed to be counting on others to analyse the legislation and make appropriate comments representing the interests of all relevant parties. As in the company law amendment, the draft was considered by many to be too onerous to read. The pace of reforms and the need for legislation was extremely demanding, especially due to the EU accession legislation that had to be passed during the election term. Both the executive and the legislative branches were overstretched and facing a lack of skilled staff. Parliamentary deputies only acquired their first assistants in 2000 before which time they worked without any professional support. Yet, not paying due attention to such a crucial piece of legislation is inexcusable, despite the limited capacity of the executive and the parliament.

The drafters of the Code had no interest in a broader consensus-building effort, because they instinctively felt that they would not get far. It was thought that once word got out about the proposed content of the draft Code and the press and business people homed in on it, the private sector would mobilise itself and lobby (probably successfully) against the Code.

The fact that the Code went essentially unnoticed through its long legislative process is extremely damning to the private sector, especially large companies. Enterprise managers (and other large employers) need to retain workers with flexibility; they must be able to restructure companies (which may involve redundancies). It is, therefore, extremely surprising that private companies, including large foreign investors in the Slovak Republic, failed to organise themselves sooner to comment on the draft Code. They "woke up" only several months after the passage of the Code, as the effective date was getting closer.

Surprisingly, half a dozen employers' associations were part of the negotiations on the content of the Labour Code during its preparation as part of the Tripartite Council. These, however, are precisely the kinds of interest groups that resent, or are not interested in, the progressive reforms that lead to increased competition, create predictable and transparent rules, and promote a market that makes it easier for new enterprises to enter. Functionaries in employers' associations tend to be ex-socialist enterprise managers who partially transformed themselves to the post-communist marketplace, a classic example of "early winners" in a transition economy. It is likely that it is still more attractive for these "winners" to work to further their limited interests than to devote energy and resources to developing a modern and well-functioning company law and Labour Code.[26]

3. Collateral reform

This is an example of a successful reform that was also championed and prepared outside the usual state administration structure (MOJ), as in the case of the company law. Unlike the latter, however, donor assistance in this case proved very useful and efficient. Unlike both of the previous cases, the private sector (the Chamber of Notaries, law firms and commercial banks) has been actively involved in the preparation and adoption of the reform. Also, a comprehensive consensus-building effort, not seen in the previous two reforms, assured almost seamless passage of the collateral reform through the legislative process.

The problem with access to credit in transition countries often constitutes a major obstacle to economic growth early in the transition process.[27] Most of the central and east European countries[28] have introduced some collateral regime reform over the last decade. The Slovak Republic started its reform in this area relatively late, in 2000. The legislative and institutional changes had a two-year gestation period. Approval of this reform involved three distinct Cabinet actions. The Cabinet first adopted a concept outline in a broader policy document, then a legislative concept with details of the reform and, finally, an actual draft Civil Code amendment.

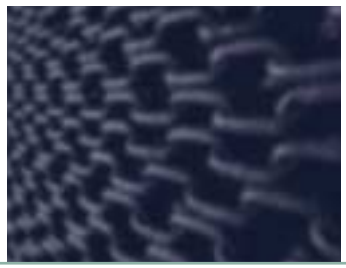
How did the reform come about? What were the factors that contributed to its successful outcome? What were the impediments to the reform?

Secured transactions reform is exclusively economic in content and rationale. From a legal or legislative point of view, there is no need for the arcane provisions regulating the creation and existence of a "non-possesory pledge",[29] a term that is sometimes hard to explain even to lawyers.

The collateral reform in the Slovak Republic is a story with a positive outcome. At the time of writing, a major amendment to the Civil Code, the main building block of the legislative changes, was adopted by parliament. The Chamber of Notaries, the entity selected to build, operate and finance a pledge registry, was busy building it. Members of the business community are becoming increasingly aware of the forthcoming legislative changes that will help them get easier and faster access to credit. Lastly, private banks, operating in an increasingly competitive environment, are looking forward to using the new law to expand their portfolios. The following paragraphs lay out the necessary elements that made the collateral reform a success as well as identifying constraints in the process. These lists apply not only to collateral reform but to a successful legal reform process in general.

What are the necessary ingredients for reform to take place?

- The existence of a champion of the reform, the Deputy Prime Minister (DPM) for Economic Affairs and his team, who managed to put together a few committed individuals to help develop the reform idea, gather support of a donor, draft the necessary legislative changes, as well as prepare the groundwork for establishing the registry of pledges.
- Securing a policy agreement among the principal economic reformers (the DPM and Minister of Finance) on the necessity of the reform. This reform was part of a package under the general reform policy umbrella of an Enterprise and Financial Sector Adjustment Loan (EFSAL) agreed between the Government and the World Bank. The fact that the collateral reform was part of a broader reform plan helped defeat the scepticism and resistance to the reform on the part of the considerably more conservative legal establishment, including the MOJ. An important factor in moving ahead with this planned reform was the reform team's promise it would use outside resources to prepare the reform, and would not rely on the over-stretched human resources of the MOJ.



- Effective assistance from a donor, the EBRD. The EBRD team provided timely and active guidance on the legislative part of the reform. Essential elements of the cooperation between the local team and the EBRD were, first and foremost, the ability of the EBRD to listen to their local counterparts, coach the overall process, and engage local teams in discussions, while letting them find the most appropriate drafting solutions. Another crucial element of the EBRD's advice that made its assistance a success, and one that donors often overlook, is that the EBRD remained involved with the passage of the legislation through parliament, and will remain involved in its subsequent implementation.
- Indispensable to the reform was the identification of a domestic drafter to interpret the EBRD's advice and turn it into Slovak legislative language. While finding the drafter was critical, it also presented one of the main constraints – lack of human resources to develop and implement reforms. The drafter was often overstretched and was acting as the principal drafter also for the new company law.
- Effective, although time consuming, consensus-building and dissemination of information about the reform. Consensus-building was necessary to ensure the successful introduction of a new legal concept into a very conservative legal environment. The challenge rested on the need to explain to groups of legislative drafters and policy makers why a non-possessory pledge was important for economic activity in the Slovak Republic. The situation was further complicated by the fact that neither Germany nor Austria – the two countries that Slovak lawyers usually take for inspiration – have similar provisions on secured financing, and yet they are rich and successful economies.[30] The Slovak Republic now had a chance to leapfrog the developments in Austria, Germany and other continental Western jurisdictions and introduce very modern legal concepts, a scary prospect for the traditionalist Slovak lawyer. The consensus-building process helped overcome this fear.
- The reform generated an agile and influential, yet inexperienced, private group – the Chamber of Notaries. The Chamber, selected by tender to run the pledge registry, used the example of the Hungarian Chamber of Notaries that has successfully operated a similar registry since 1996. The Slovak Notaries, who will benefit from the reform through considerably increased business in the near future, helped clarify the demand for the reform and promote it. They also provided the necessary support to ensure that reform passed through the parliament intact and participated in the preparation of the implementing regulations.

What were the constraints to the reform?

- The lack of human resources posed the main hindrance to the reform group. The company law and collateral reform efforts had overlapping schedules for preparation and adoption. As a consequence, the amendment to the Civil Code was adopted with literally only hours to spare before the parliament closed its agenda prior to the autumn 2002 elections.
- While the Notaries were helpful in lobbying parliament for the reform, they required a great amount of handholding and detailed assistance in their relationship with the private company supplying the registry and in developing an appropriate regulatory framework between the Chamber and the MOJ, their governmental supervisory body for running the registry. This highlights that the lack of human resources is not limited to state administration but it is also a problem in the private sector as well.
- The MOJ's lack of human resources became evident in their supervision of the Chamber of Notaries. The MOJ found it difficult to carry out their new duties *vis-à-vis* the Chamber; MOJ staff were sometimes daunted by the amount of effort required to draft and implement decrees and in establishing the appropriate procedures for overseeing the operation of the public registry of pledges.

make an impact on the content of the Labour Code, a group of enterprises and banks, under the leadership of a prominent economic think-tank, created an Alliance of Entrepreneurs of Slovakia (PAS). According to their mission statement, PAS is dedicated to making an impact on business regulations by commenting on pending legislation. For more details see www.alianciapas.sk. While this may be a positive outcome from the Labour Code, one can question whether the passage of a retrograde code is too high a price to pay for the creation of an effective business lobby.

27 The realisation that modern secured financing techniques needed to be introduced to ensure that enterprise reform and economic recovery were possible throughout the region led the EBRD to launch a secured transaction project in the early 1990s with the drafting of a Model Law on Secured Transactions. For more information see www.ebrd.com/pubs/index.htm or www.ebrd.com/st.

28 Among the notable exceptions were Bosnia and Herzegovina, Croatia, the Czech Republic, the Republic of Serbia and the Slovak Republic.

29 "Non-possesory pledge" is a pledge in which the pledged asset does not need to be transferred to, or deposited with, the secured creditor. In other words, the pledgor (the debtor) does not need to transfer "possession" of the pledged asset to the creditor. For example, a trucking company can create a non-possessory pledge over its trucks to receive bank financing. It can then keep using the trucks to make deliveries, rather than having to park them in the bank's car park.

30 One had to explain to the lawmakers that private financing works in these countries in spite of the lack of the provisions on non-possessory pledges in their Civil Codes, not thanks to it. On the European continent, the markets have forced over time the development of various exceptions and substitutes to the general prohibition of a non-possessory pledge.

Conclusions

This article is not about the content of reforms, but about the process, the "how to" element of reforms. Each reform government, whether in the Slovak Republic or elsewhere, needs to keep in mind that it is not only the design and content of reforms that matter. The potential obstacles, constraints and challenges to the reform process need to be borne in mind too, if reforms are to succeed.

In summary, the elements of the reform processes that contributed most to the success of the reforms described in this article were: (i) the existence of a champion of reform with a broader reform strategy, rather than haphazard changes to legislation; (ii) wide consensus-building effort around the reform goals; (iii) active participation of the private sector; and (iv) effective donor advice.

With many of the transition reforms already undertaken, the population's demand for more reform is likely to decrease and their tolerance for radical reforms will diminish. It will also be more difficult to overcome the entrenched powerful interest groups and lobbies. This will constitute the biggest challenge for the next government in the Slovak Republic that still faces a considerable unfinished agenda, especially in reforming the social sectors. The situation following September 2002 will be quite different from the one four years ago, when there was almost a universal consensus on the need to remedy the policies of the previous four years. Despite this rather gloomy prediction, there is a powerful engine for the continuation of the reforms for the next Slovak Government – the "strait-jacket" that the EU accession process imposes on EU hopefuls. Integration into the EU is the single most dominant desire uniting all political parties and it commands a high degree of support among the population.[31] This process itself ensures that a number of reforms will be undertaken in order to take the Slovak Republic further along the transition process.

[31] For some time the Slovak Republic has had the highest popular support rating for joining the EU among all accession countries in the first round. Most opinion polls show the percentage to be between 70 and 80 per cent.

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