Bruno Schönfelder *

COURTS, CREDIT AND DEBT COLLECTION IN POST-COMMUNIST SLOVAKIA. NOTES ABOUT SOME UNDERSTUDIED INGREDIENTS OF A SUCCESSFUL TRANSITION

ABSTRACT: In economic terms Slovakia has been one of the most successful transition countries, but its advance towards the rule of law has been uneven and beset with numerous difficulties. While in the 1990s the judiciary increased its reputation considerably by standing up in the defence of democracy, it lost face only shortly later because of its apparent inability to prevent court corruption from spreading. Only quite recently government managed to take effective measures against it. Nevertheless debt collection has become much less of a problem than it used to be in the 1990s and liquidity constraints have been greatly relieved. This change seems only to a minor part due to increasing judicial efficiency, which has made slow progress only. Thus, Slovak experience has reconfirmed the conjecture that erecting the rule of law takes much more time than transforming the economic system.

Among the post-communist countries Slovakia has recently been identified as the place with the most rapidly improving business environment and is now being ranked among the twenty most business friendly countries of the world1. As of now it is widely recognized that since 1999 Slovakia has performed much better than expected and has joined the most successful post-communist countries. This stands in striking contrast with the mainstream forecasts of early transition2. Then the Czech republic, Hungary and Slovenia were the countries which got the best forecasts while observers tended to be sceptical about Slovakia’s prospects, in particular if it would leave the federation as it did in 1992. How much the Slovak economy has changed since then is most strikingly revealed by Slovak exports. Up to 1990 Slovakia merchandise exports were mostly directed towards the Czech republic and the CMEA-countries, exports to the

2 See e.g. Frensch (1993)
west made only for a minor share of Slovak output. In 1993, after acquiring independence Slovakia’s overall merchandise exports including deliveries to the Czech republic amounted to 4 bill USD and thus were in the same range as e.g. the merchandise exports of Croatia\(^3\). In contrast, in 2005 Slovak merchandise exports are going to exceed 30 bill USD. Since nearly half of the 1993 merchandise exports were exports to the Czech republic, what has been happening is a virtual explosion of exports towards the rest of the world which have increased by more than ten times in between 1993 and 2005. In terms of per capita GDP measured in units of equal purchasing power Slovakia was thought of as similar to Hungary in 1989 and this continues to hold today. Slovakia has outperformed all post-yugoslav countries including Slovenia. The strong performance of Slovak business is also revealed by profits, in 2004 nonfinancial corporations reported aggregate profits of 192 billion SKK (equivalent to 6 billion USD), this amounted to about 14 per cent of the Slovak GDP\(^4\). Small wonder, that investment is high and growth continues to be strong.

Such results might be thought of as attracting scientific attention. However, to this day the Slovak economy has not been studied very frequently. This paper\(^5\) seeks to fill part of the gap by investigating an aspect of Slovakia’s progress towards the rule of law: the enforcement of creditor’s rights and the resulting development of the loanable funds market. The development of this market is crucially dependent on judicial enforcement of creditor’s rights. Enforcing creditor’s rights presumably is one of the key contributions of the judiciary towards economic growth. Long-term judicial statistics lend some support to this view: Throughout most of

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\(^3\) Slovakia has a population of 5,4 mill, 22 per cent more than Croatia, but considerably less than Serbia.

\(^4\) *Trend* June 30, 2005 p. 32. Some may object that an unemployment rate of nearly 18 per cent – these were some 450000 unemployed in 2003 - indicates that performance has not really been so great. However, Slovakia has a growing labor force, and labour force participation is high. About 70 per cent of the population aged 16 – 64 is in the labour force, this is above both EU and the post-Yugoslav average. Constant unemployment ratios mean rising employment. Unemployment is primarily a problem of the Roma population which is estimated at half a million. Observers estimate that more than 90 per cent of the Roma labour force are registered as unemployed. This implies that more than half of all registered unemployed in Slovakia are Roma. Unfortunately, we must rely on rough estimates because it is well-known that in polls most Roma declare themselves as members of other ethnic groups. These findings surely do not imply that there is no problem or that the problems should be neglected. Rather they indicate that the problems are unlikely to go away quickly even if economic prosperity continues.

\(^5\) Part of the material used in this paper was already presented in Schönfelder (2003, see www.tandf.co.uk) which however covers only the development up to 2001. The present paper covers developments up to summer 2005. The years 2001 – 2005 have witnessed significant change. For the convenience of the Serbian reader this text uses some Serbian legal terminology (in addition to Slovak).
the modern age creditor-debtor disputes have dominated the dockets of civil courts in Western and Central Europe as well as in North America.

In Slovakia’s post-communist development three phases may usefully be distinguished. In the first phase 1990 – 1992 it was still member of the Czechoslovak federation and participated in the rapid reforms which were initiated and pushed by the federal government. By and large, Slovakia was a reluctant participant. The primary concern of most Slovak politicians rather was autonomy and independence. The country was sort of free-riding both on the velvet revolution and the subsequent reforms which were pushed by Czech politicians. The Slovak anticommmunist opposition was weak and unprepared to rule the country, it consisted mostly of people who did not want to be in government. In particular it turned out as very difficult to find a minister of the interior for the revolutionary government set up after the velvet revolution. Since none of the genuine revolutionaries wanted the job, an unknown person whose real role under the communist regime never has been clarified managed to slip in\(^6\). His name was Mečiar and he became Slovakia’s strong man throughout most of the 1990s. The reforms initiated by the federal government soon became highly unpopular in Slovakia. This was most clearly indicated by the electoral results of 1992. In the Czech republic, the key reform party led by Vaclav Klaus got more than 30 per cent of the votes and was able to form the government. In contrast in Slovakia, the (liberal) parties who argued both for continuing reforms and keeping the federation with the Czech republic alive jointly received less than five per cent of the votes and were thus no longer represented in parliament.

In 1993, after independence was achieved, reforms stalled. The major exception from this was privatization. Since 1990, none of the major Slovak parties has ever opposed privatization\(^7\), the Communists largely vanished from the scene already in 1990\(^8\). However, under the Mečiar-governments privatization policies

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\(^6\) For a while it was thought that Dubček had recommended him, but Dubček later denied this. The suspicion that he really was an agent of the communist secret service never has been disproved. As a minister of the interior Mečiar was in a position to create perennial doubt about this, he was able to destroy the relevant records. On this see Leško (1997).

\(^7\) This was also observed in the federal reform debate undertaken in 1990. While Slovak participants were sceptic about most other reforms, they were consistently enthusiastic about privatization.

\(^8\) The prevailing Slovak view has stressed, that communism had weak roots in Slovakia and had been imposed on the nation by the Czechs. So, supporting communists was unpatriotic, and it became even more so after 1968 when the country was occupied by Soviet forces and the remaining communists posed as collaborationists of a highly unpopular occupying power. The view that the Czech were at fault why Slovakia got into this quagmire was not totally unfounded. In Slovakia after World War II electoral support for the communists was much weaker than in the Czech lands. Developments at Prague were decisive for the communist takeover, which resulted in tremendous sufferings for a large part of the Slovak population. On this see e.g. Báta (2001).
shifted towards building a crony capitalism. The underlying ideas were similar to those which stimulated the Croatian privatization drive undertaken under Tudjman’s rule. Mečiar’s predominance was only shortly interrupted in 1994, when his party split up and several reform-minded groups formed a coalition government, the Moravčík-government, which tried to restart reforms. However, they were defeated in the subsequent elections and Mečiar returned to power. Subsequently, fiscal discipline declined so dramatically that by 1998 Slovak government was dangerously close to insolvency. In 1998 the minister of finance often could not find buyers for public bonds even though the real (!) interest rates offered exceeded 20 per cent. The financial position of the major banks and some key enterprises was similarly desperate.

The 1998 elections marked a turning point. It was won by an anti-Mečiar coalition which subsequently formed the government. Dzurinda became prime minister and has been ruling the country every since. His governments managed to overcome the crisis and restart reforms, even though they appeared as notoriously fragile and in a state of perennial crisis. E.g. his first government depended not only on the support of several conservative and liberal groups, but in addition he needed the votes of two socialdemocrat parties, among them the SDL’ (Party of the Democratic Left). Unfortunately, the reform-minded leadership of SDL’ was challegend and eventually dethroned by a populist undercurrent which ultimately established itself as a new party named Smer, that became the strongest opposition party of the country. After the 2002 elections Dzurinda no longer depended on social democrats which actually vanished from the political scene but was still in a difficult position because his coalition comprised no less than four parties, out of which only two appeared as stable and fully reliable. Im sum, Slovak reforms have not been plain sailing, rather they passed through numerous moments of crisis.

The main focus of this paper is on giving as full and reliable a description as possible, it does not strive for much theoretic generalization. This description is hoped to be of some interest to the reader because Serbia is about to face many of the problems with which Slovakia has already dealt with. All of the problems which the paper touches upon are at the interface between economics and law. This interface has remained understudied in the transition literature. Instead of carefully investigating the facts observers unfortunately often have rushed to conclusions and engaged in wild speculations9.

The rest of the paper is organized as follows. Many of the basic reforms including setting up an independent judiciary, the return to traditional civil and

9 In the view of this author most of the utterings of Stiglitz and his followers really amount to such wild speculations but they mask this by high-powered math.
commercial law doctrines and a reform of civil procedure occurred from 1990 to 1992, but Slovakia made important additions after 2002. They will be reviewed first. Second the paper shows how Slovak tax law and bank regulation for years crippled civil law mechanisms inherited from the former federation. Section three and four focus on various organizations involved in law enforcements, specifically the judiciary, land registers and bailiffs. The fifth section considers amendments of bankruptcy legislation which have occurred since 1993 and evaluates their consequences. The sixth and seventh section evaluate the empirical evidence on debt arrears and failures. The final section presents a few tentative conclusions.

1. RELEVANT REFORMS OF SUBSTANTIVE AND PROCEDURAL LAW

The bulk of Slovak commercial law was inherited from the former federation, and till today continues to be quite similar to the Czech republic. Slovak jurists routinely refer to Czech jurisprudence and court decisions when a controversy arises on an issue of commercial law. Considering the more advanced stage of legal studies in the Czech republic, as well as the sheer size of Slovakia this is only reasonable. Arguably a nation of five millions needs to rely on transplants if it wants to enjoy the benefits of a developed legal system.

In 1991/92 the Czechoslovak federation enacted numerous new laws and amended a number of others, among the new laws was a code of commercial law, a bankruptcy law, while the civil code and the code of civil procedure both were thoroughly amended. These enactments largely provided for a return to the Habsburg tradition and thus reintroduced law which is not unfamiliar to Serbian jurists. Czechoslovak communists had extinguished this law more thoroughly than Yugoslav communists. In Czechoslovakia, after communism both of the two key doctrines of traditional secured transaction law, i.e. zalog (Slovak: zaloh) and osiguranje prijenosom vlastništva\(^{10}\) (Slovak: zabezpečovací prevod vlastníckeho práva) needed to be reintroduced into statute law. Communist Czechoslovak law had a doctrine referred to as zaloh but this was conceived as a sort of contract right (valid only \textit{inter partes}), not as a property right (\textit{stvarno pravo} i.e. valid \textit{contra omnes})\(^{11}\). This caused much confusion after 1991 because judges sometimes failed to realize that zalog had become a property right.

\(^{10}\) This transfer of ownership may be invisible to third persons because it is not or not yet recorded in any public record. Different e.g. from Croatia an announcement in the official gazette is not required either. All kinds of assets can be subject to a \textit{prijenos vlastništva} irrespective of whether they are recordable in public records.

\(^{11}\) See e.g. Giese et alii (1999 p. 15)
The authors of the Czechoslovak enactments of the early 1990s typically opted for conciseness, the new paragraphs were brief and thus left it up to caselaw to clarify the details. This was done for reasons of expediency and also as reaction to the shortage of sufficiently qualified legal scholars. How justified this concern was became obvious soon because the reintroduction of these traditional security instruments into civil law was actually done in a way which created various inconsistencies which turned out to cause problems. This was fixed only years later. In 1991 legislators also voiced the intention to recodify the law as soon as possible. Nevertheless Slovak legislation up to 2002 did rather little to provide for a further development of secured transaction law. In 2002 two important reforms were enacted.

The first of these two reforms entailed a significant departure from the legal legacy of the former federation. Foreign observers assessed it as extremely progressive and a model which the world should emulate. The reform intended to render movables and some other sorts of assets into convenient lien assets. Traditionally, under Roman law pledging movables requires a physical transfer of property to the lien-taker. Clearly, this often is unpracticable, as a result movables excepts ships, airplaines and certain kinds of securities which are recorded in public registers often cannot serve as collateral because the owner needs them for his business. To avoid the requirement of physical transfer of property Slovak legislation created an internet based recording system for such liens. Perfecting a security interest in an asset without physical transfer of property requires that the interest is recorded in the electronic register. The record must describe the lien asset in sufficient detail to allow third parties to establish its identity without doubt. E.g. if a machine has a serial number, recording the name of the producer and the serial number in the electronic register may be sufficient to identify the asset. It was hoped that this electronic register would increase the supply of collateral considerably, this should enhance the flow of credit and remove liquidity constraints.

Building and operating this electronic register was up to the public notaries of the country, no budgetary means were made available for this task. The system is supposed to fund itself, records can be made only by notaries who charge a fee for this service. Indeed, the system was launched without delay and has ever since worked without significant problems. This new opportunity to take security interests has been used to quite some extent, but less frequently than its most

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12 On this see Andrová (2003).
13 For an enthusiastic report about this reform see The Economist 366 (2003): 8308 p. 70, which dubbed it the best system in the world.
14 e.g. a company as a whole can also be pledged according to this scheme
enthusiastic supporters had hoped. As it seems this has been mostly due to two reasons. First, with many assets it is not easy to write a short description which is nevertheless detailed and precise enough to leave no doubt about their identity. The space available for the required description is one type written page which is sometimes thought of as little. Second, and more importantly, the fees charged by notaries for making records are high, they range from 1200 to 14700 SKK\textsuperscript{15}. To be sure, notaries do not decide about these fees themselves, similar to other countries with a Latin-type notary system an ordinance of the minister of justice determines them and prohibits undercutting. However, as officials of the ministry of justice readily admit they know little about the revenues of notaries and the costs of their services and as a result depend on the information provided by the notaries’ association. All notaries are compulsory members of this association, their monopoly power is enhanced by restricted entry into the profession. Slovakia has altogether 285 notaries. If all of these positions are filled, anybody who wants to apply has to wait until one of the sitting notaries retires or dies. The minister of justice thought of restricted entry as a problem and pushed for reform which would allow anybody who has passed the notary exam to set himself up as notary. However, in 2004 this proposal was defeated in parliament\textsuperscript{16}.

Similar problems have plagued a device for creating enforceable titles which has a long tradition in Austrian resp. German law and was reintroduced to Slovak law by the reform of civil procedure which the Czechoslovak federation undertook in 1991. According to this device a creditor may condition his loan on the debtor’s signing an enforceable title against himself at a public notary before the loan is actually provided. These titles are thus created by notarial deed and referred to as notárske zápisnice (roughly comparable to what in Yugoslav law before World War II was referred to as a ovršna javnobilježnička isprava). A creditor who holds a zápisnica does not need to get a court order to initiate enforcement (prisilno izvršenje) if the debtor fails to fulfill his promises. This saves him about two years\textsuperscript{17}. Instead he gives the enforceable title immediately to an exekútor\textsuperscript{18}. Exekútori are known for their ability to react quickly. They seize assets nearly immediately. Except if the debtor raises certain types of objections courts are not at all involved in the affair, this saves a lot of time, hassle and money. When

\textsuperscript{15} In recent years the SKK/USD exchange rate has fluctuated between 33 and 30, before it was somewhat higher.

\textsuperscript{16} As a partial compensation for this failure and in order to create some competitive pressure, the minister of justice later nearly doubled the number of notaries.

\textsuperscript{17} See Trend March 11, 2004 p. 75

\textsuperscript{18} For more on these kinds of enforcement professionals see below. Creditors other than banks lost this privilege in 1998 and since then again have needed to get a court order first before the bailiff sets to work.
mortgage loans started to pick up in 2000 banks nearly always required their debtor to sign a zápisnica. However, there is a drawback, the notarial deed is expensive and zápisnica is inflexible. Since 2003 the fees for the issue of a zápisnica range from 600 to 44400 SKK. To change the content of the zápisnica e.g. because the conditions of the loan have been renegotiated another notarial deed is required which costs another fee.

For most mortgagors this problem lost its former relevance in the course of 2004. In 2002 parliament emulated a Czech model and enacted the law on voluntary auctions which opened up an alternative route towards rapid enforcement. When contracting a loan the creditor may make it a condition that the debtor signs a covenant which authorizes the creditor to have the lien asset sold by a so-called auctioneer if some condition is met. The condition usually is failure to pay back the credit in time. This auction is called voluntary because the debt contract which includes this convenant is a contract-at-will. The covenant must be in writing, but the involvement of a notary is not required. When “voluntary” auctions actually started in 2003, it remained to be seen whether this procedure would run as smoothly as it was hoped, and thus banks at first remained cautious. Subsequently it turned out that the “voluntary” auction covenant is not much less reliable than a zápisnica. As a result banks have become more courageous. Since 2004 they have usually no longer required a zápisnica if the debtor instead signs the descibed convenant. As an additional security he is often required to issue and sign a security which in Slovak language is referred to not as a bianco mjenica, but as a bianco zmenka. The liability on this bill remains blank at the time of issue, the creditor is authorized to insert it later. In the 1990s courts had often taken a sceptical attitude towards bianco zmenka, and the creditor had reason to fear that he might be held up in court. However, more recently caselaw has made a decisive move towards accepting such bills as legitimate and, except in a few courts, legal uncertainty is no longer prevalent. The bill is not an enforceable title, the creditor needs a court order to initiate enforcement. However, in contrast to other court orders whose issue the debtor may delay by a variety of maneuvers, the holder of a bill of exchange usually can fairly quickly get hold of the court order which he needs in order to mobilize the bailiff.

Auctioneers need to be licensed and are required to carry liability insurance of at least 25 million SKK. Often the applicants for such licences had been in the auctioneering business already before the law on voluntary auctions, but a license under this law provided them with another line of business. Auctions need to be announced in a central public register 15 days ahead, this register is administered by the notaries’ association and accessible through internet. Auctioneers charge a fee for their services, the fee is between 3 and 20 per cent of the revenue earned in the auction. Auctioning off an asset usually takes about 40 days except if some special difficulties arise. See Trend Aug 21, 2003 p. 28.
2. HOMEGROWN OBSTACLES TO SECURED TRANSACTION LAW

The early 1990s witnessed some developments of tax law and banking law which obstructed secured transaction law although this was not their primary intention. This section describes these dysfunctional elements and their ultimate removal.

2.1. TAX LAW AND CREDITOR’S SECURITY

From the former federation Slovakia inherited a statute which entitles the internal revenue service and social security administrations to take a statutory lien on assets owned by a delinquent tax payer (zákonné záložné právo). This was a matter of great practical importance. The lien came into existence by a decision of the internal revenue service resp. the social security administration which specified both the lien asset and the tax arrears secured by it. The statute remained vague on the point of time at which this statutory lien became legally effective as well as on its position in the priority ordering in relation to other secured creditors who had obtained a security interest in the same asset. This gap was filled by case law. Slovak courts usually decided that the statutory lien becomes effective as soon as the internal revenue service takes the requisite decision, irrespective of whether and when it was recorded in a public register, and that it has super priority over all other creditors be they secured or not, i.e. it is not subject to the first in time priority rule. Since financially distressed companies frequently were in tax arrears, this was quite detrimental to the interests of other creditors and, as a result, even mortgages turned out as a dubious security instrument. This problem was been further exacerbated by a long-standing habit of the internal revenue service of tolerating large tax-arrears for a protracted time if for some reason the debtor company was considered as important or if it had the right connections.

Secured transactions involving real property were also aggravated by a peculiar Slovak tax law from 1992 which regulated both death duties and realty transfer tax at one stroke. Except among close relatives, such transfers are taxed at a progressive rate which went up to 17 per cent. Under some circumstances this tax was payable by the secured creditor when foreclosing. Even if it was not he usually bore at least part of the burden because the tax clearly caused a reduction of the demand for real estate. Throughout the 1990s, the tax was not usually levied on the price at which the property was actually sold but rather on its appraised value determined according to an appraisal statute issued in 1991. While in Bratislava the market value of real estate often exceeded the appraised value, in most other regions the opposite was true. In the case of adverse market
conditions or a fire sale the difference between the appraised value and market price tended to become large, driving up the effective tax rate even further.

The threat of statutory liens which the internal revenue service might decide to take prompted some Slovak creditors to dare using the aforementioned security device osiguranje prijenosom vlastništva even though it was clouded by considerable legal uncertainty. The paragraph of the civil code which regulates it is extremely brief, so for quite a while it was far from clear what needs to be done to establish a security agreement which is likely to hold up in court. If the creditor succeeded in that he no longer needed to worry about his debtor’s tax arrears. Whatever they were, the internal revenue service could not reach the lien asset because it is owned by the creditor. A drawback, however, was that the transaction was quite costly if it concerned real property as usually was the case. In principle, until 2002, property transfer tax had to be paid twice, first when the property was conveyed from the debtor to the creditor and second when it was reconveyed. In addition, the notary public and the land register charged fees. However, the minister of finance provided some relief and bent the tax law a bit by issuing an ordinance that in this case property transfer tax must be paid only once\textsuperscript{20}. Quite a number of Slovak creditors and their debtors were ready to bear all these burdens to avoid worries about statutory liens.

A first step towards changing this state of affairs was an amendment enacted in 1998 according to which the super priority of the internal revenue service is voided if a company is declared bankrupt. In practice, this change was of limited relevance. Usually, the time elapsing between a bankruptcy petition and the actual opening of the procedure has been long enough to provide the internal revenue service with opportunities to exploit its super priority. This unfortunate situation became a topic of public debate in 2000 when some members of Dzurinda’s coalition government then in power called for the abolishment of statutory liens and a change in the tax treatment of property transfers. However, their coalition partner SDL\textsuperscript{\textdegree} rejected these requests until 2002\textsuperscript{21}.

Statutory liens, the tax treatment of ownership transfers as well as some other regulations described below testify to the predominance of narrow fiscal interests in the Slovak legislation of the 1990s. This can be partly explained by continuous stress on the Slovak budget. The stress was due to the big government policy implemented after 1995 which brought the share of public expenditure in GDP up to some 45 per cent, while the share of taxes has increased considerably less leaving the minister of finance in a very uncomfortable position. A possible explanation for this policy stance is that until fall 2002 parties favoring big gov-

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\item \textsuperscript{20} For a discussion see Fehéř (2000).
\item \textsuperscript{21} See Trend May 5, 2001.
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ernment continuously enjoyed a solid 60 to 80 per cent majority in Slovak parliament. However, none of these parties has a socialist profile, and they all have been inclined to a pragmatic muddling-through. To trace the origins of fiscal problems it should be recalled that in the Czechoslovak federation Slovakia used to receive fiscal transfers in the range of 5 – 7 per cent of its GDP. When the federation broke up these transfers seized and the currency crisis imminent in 1993 forced the Slovak government into sharp expenditure cuts to balance its budget. After 1994, expenditure quickly bounced back to the accustomed level although tax revenue did not increase accordingly.

The unpleasant side-effects which expedients such as statutory liens cause in the medium and long run became particularly obvious in the case of large state owned banks. They had been carrying a huge bulk of non-performing loans until their recapitalization in 2000/2001. Ultimately, they were the primary victims of statutory liens. Some 35 – 40 per cent of their non-performing loans were collateralized, but since their debtors ran tax arrears collateral often became subject to a statutory lien and was auctioned off by the collection department of the internal revenue service. Thus, more often than not super priority of statutory liens frustrated bankers’ attempts to secure their loans. In the end this backfired against the fisc because it greatly increased the fiscal costs of bank rehabilitation.

In 2003 the problems discussed in this section started to vanish. The super priority of statutory liens was abandoned, all liens were required to be recorded in public registers and their priority made dependent on the time of recording. Unrecorded liens are now always lowest in the priority ranking. The rate of the ownership transfer tax was reduced to three percent flat and later it was completely abolished, this becomes effective in 2006.

**2.2. A PECULIAR EFFECT OF BANKING REGULATIONS**

In the 1990s banks were not permitted to take a mortgage on a home in the course of construction. This prevented financing home construction by mortgage loans except if the client owned other real estate of sufficient value which he could offer as additional security. This regulation was justified with the argu-

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23 At the time of separation a large part of the Slovak public including some academic economists (see e.g. Mihálik 1994) blamed much of Slovak worries on Prague which was accused of either „bureaucratic centralism“ or „ultraliberalism“ and by some even of both. As a result parties such as HZDS (Mečiar’s party) and SNS (Slovak National Party) which were among the most outspoken proponents of Slovak independence found it difficult to tell their voters after independence that they should endure a decline of their living standard.
24 See Trend February 3, 1999 p. 8A.
25 See Trend May 2, 2001 p. 20A
ment that lending on unfinished construction would expose banks to excessive risk. This reasoning is unconvincing. Throughout the 1990s state-owned banks were often encouraged to lend liberally to well-connected businessmen who offered far more dubious security. Although the issue was raised by housing market experts and NBS (National Bank of Slovakia) as early as 1994, the regulations were changed only in 1999. As a result, mortgage financed home construction essentially started only in 2000\(^{26}\). The reason for the delay was not that government opposed home construction as a matter of principle. Rather, other potential uses of bank credit were considered more important, neither were Mečiar-led governments very concerned about advancing the development of a civil law society. They were not alarmed at such sideeffects of banking regulation.

3. THE JUDICIARY

3.1. CAPACITY PROBLEMS

In communist Czechoslovakia judges were relatively few in numbers, divorce suits formed the bulk of their case load. Judges had to carry out much of the clerical and organizational work involved in running a court by themselves. This consumed the greatest amount of their time. The most advanced type of technical equipment courts used to possess was an unwieldy typewriter made in GDR. As Cepl (1995) put it, judges were in an unappealing profession which an ambitious young man was unlikely to choose.

After 1990, the Slovak judiciary for years continued to be severely underfunded. As in other post-communist countries, the case load grew enormously, which may be illustrated by figures from the court district of Košice. Until 1989 the Košice district, which then covered about a third of the Slovak republic, witnessed a yearly case load of 5000 – 6000 commercial disputes\(^{27}\). In 1991 the resp. figure was 30000, in 1992 it exceeded 100000\(^{28}\). The number of judges also increased until the late 1990s, but by very much less. In 2000 it was 1142, in 2004 1145\(^{29}\). As far as the number of judges per capita of the population is concerned, the Slovak republic surpassed the French, Dutch or Austrian ratios in 1994, but

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\(^{26}\) The overall amount of mortgage loans granted until the end of 2000 was only 1,9 billion SKK. In 2001 lendings jumped to 4,4 billion SKK and continued to grow rapidly in subsequent years.

\(^{27}\) In those days commercial disputes were not decided by ordinary courts but by arbitráž, a quasi-judicial specialty of Soviet type socialism. It was abolished in 1992 and its personnel transferred to ordinary courts.


\(^{29}\) Trend May 12, 2005 p. 21.
has remained some 20 per cent below Czech or German ratios until today. Judges
would have been able to handle more cases if the supporting staff and the tech-
nical endowment of courts had been augmented more significantly and allowed
judges to concentrate their efforts on adjudication\textsuperscript{30}. However, such improve-
ment has been a painfully slow process, computers for instance were nearly totally-
ly unavailable until 1995. In 1996 computers started to arrive and a gradual
process of upgrading set in, but for a number of years the greatest amount of
equipment remained fairly primitive. Many courts continued to be located in
shabby and overcrowded offices. Only since 2000 has state-of-the-art technology
been arriving on a scale which should enable the judiciary to increase its speed
significantly and only after 2002 computing facilities were connected in a sys-
tematic way to build a system of electronic file management. In 2001, more than
ten years after the onset of judicial reform, judges were still reported to spend 45
– 70 per cent of their working hours on duties which could just as well be han-
dled by clerks, legal executives or computers\textsuperscript{31}.

Considering these circumstances, an enormous degree of court congestion is
not surprising. The situation was described as „close to collapse“ already in
1993\textsuperscript{32}. Then it was estimated that an average commercial dispute was likely to be
abjudicated after four years provided that it is did not go to appeal. More com-
licated procedures like e.g. bankruptcies have frequently taken more than eight
years. According to observers, after the midnineties courts speeded up a little
bit\textsuperscript{33}. However, this progress had its limits as can be illustrated at the example of
Devin Banka, which sued the minister of finance for 2,5 billion SKK (about 130
mill USD) in 1999. In fall 2001, when the bank failed, the court had not yet start-
ed to consider the petition\textsuperscript{34}. Delays of several years have remained common to
this very day even if the decision is not appealed against. In 2004 the average
commercial dispute took 22 months to be resolved, in Bratislava the average
duration was even 26 months\textsuperscript{35}. In between 2000 and 2004 court delays even
tended to increase again. Some claim that the tide has been turning in 2004 and
an acceleration is on the way. In 2003 critics still argued that the real change
which has occured in Slovak business disputes has not been due to the improved

\textsuperscript{30} The case load per capita of the population is not higher than in most of Western Europa. Since
1998 it has often been less than in Germany which nevertheless continues to be able to assure a
relatively rapid adjudication of civil law disputes.

\textsuperscript{31} 45 per cent is the lower bound of a host of figures reported in the press, for this estimate see
\textit{Trend} May 15, 2002 p. 3A. For higher figures see e.g.\textit{Trend} January 31, 2001.

\textsuperscript{32} See \textit{Trend} December 8, 1993 p. 9.

\textsuperscript{33} See \textit{Trend} April 7, 1999 p. 9A.

\textsuperscript{34} \textit{Trend} October 17, 2001.

\textsuperscript{35} \textit{Trend} May 12, 2005 p. 20
efficiency of courts but rather to the growing sophistication of businessmen who increasingly have learnt to avoid potential disputes and write contracts which are largely self-enforcing\textsuperscript{36} or can be enforced without court-involvement.

After 2003 the minister of justice undertook a major initiative to solve the problem of the inadequate support staff. He created a layer of legal executives similar to a German \textit{Rechtspfleger}. Legal executives are required to hold a bachelor of law issued by an academic institution and thus should be capable of releasing judges of much routine work and decision-making. Once legal executives will have become acquainted with their work, judges will be able to concentrate their efforts on making the difficult decisions. Appointment of legal executives started in 2003, in summer 2005 their number already reached 800.

As in all post-communist countries a key issue for enlarging capacity and securing adequate quality has been the small court problem. Slovakia had numerous courts in rather small towns. This causes two problems. First, in these small courts judges are required to solve a broad variety of cases and remain underspecialized, which is detrimental both to the quality and the quantity of their output. Second, in the small courts the local caseload tends to be subject to significant random fluctuations and it is not rare that in some places judges have rather little to do while everywhere else the workload is plainly unmanageable. This may seem an obvious and easy to solve problem, but really it takes considerable courage to attack it. The problem can only be solved by closing down quite a number of courts, and the towns which lose their local court invariably are going to put up opposition. Only in 2003 the minister of justice dared to tackle this issue, but before parliament actually adopted his scheme in 2004 he was forced to accept quite a number of uneasy compromises.

Another common problem of post-communist countries was tackled in 2003 as well. In communist law, civil procedure was based on the inquisition principle. Thus, the judge was required to undertake a possibly far-ranging investigation and discover the socalled objective truth. If taken seriously, this often amounts to an unbearable burden. The 1991 reform of civil procedure had taken only some initial steps towards reintroducing the disposition principle. Only the 2003 reform of civil procedure rendered the trial basically adversarial leaving it up to the parties to provide all relevant information. In effect, this reduces the workload of the judge and increases the capacity of the judicial system. Procedural law has been changed in other respects as well, but unfortunately this was done by a large number of small amendments. E.g. in between 1999 and 2004 the code of civil procedure was amended 23 times. This makes life more difficult for judges because as a rule a case must be completed under the procedural

\footnote{Trend Nov 6, 2003 p. 27}
law under which it was filed. Thus, in civil litigation judges are currently required to apply 23 somewhat different procedural laws.

3.2. JUDICIAL INDEPENDENCE

Institutional safeguards for judicial independence remained relatively weak until the judicial reform enacted in 2000. Life tenure of judges was the most effective safeguard which the system provided. Life tenure was to be granted by parliament after the judge had served on a four-year probationary period. In principle probationary periods may be considered good policy, but they had the side effect of leaving the judiciary exposed throughout the 1990s. During that decade the proportion of judges who were serving on four-year contracts remained high. The problem started to be debated in the massmedia in 1997. Then 14 judges who had completed their probationary period failed to get lifetime tenure for purely political reasons. Fortunately, in the early 1990s selection procedures had not been so politized, they became so only during Mečiar’s third term in government 1994 – 1998 which witnessed a much stronger turn towards an autocratic style of ruling than his second (1992-1993). By 1994 most positions had been filled at least on four year appointments. Only after 1994 did loyalty to one of the parties of the Mečiar-led coalition become a key criterion for appointment, granting of tenure as well as promotion. In the pursuit of this policy the minister of justice frequently transgressed the Judiciary Act and either failed to ask for the recommendations of the Judicial Council or ignored them. In 1995, an organized group of pro-Mečiar judges started to form which however in 1998 had not yet become large enough to take a decisive influence on the judiciary. As it turned out, the years of relatively liberal government (1990 to 1994) had provided the judiciary with a valuable opportunity to stabilize and get prepared before the battle which broke out in 1995 and lasted until the elections in 1998. Since 1998, politicians have respected judicial independence.

During the conflicts of the years 1995 - 1998 the constitutional court stood in the lime-light but other courts were part of the battle as well. As early as 1995 the government declared that it would ignore court rulings which were not to its liking and on several occasions, it spelt out what ruling it wanted to see. When courts failed to deliver, judges were insulted as „an unhealthy element of the Slovak political scene“, they were accused of being agents either of the CIA or the Libyan intelligence service who should be „kicked out“. The minister of justice

called judges „urchins, as stupid as a stick“\textsuperscript{41}. Judges‘ ability to offer resistance enhanced their reputation considerably, and the constitutional court became one of the few institutions of government in which a majority of the population trusted, its reputation being second only to the army\textsuperscript{42}. In view of prior developments this stance of courts was a somewhat surprising turn to the positive. As Holländer and Valko (1993, p. 129) pointed out they did not seem well prepared for such challenges. The first president of the Slovak constitutional court after the enactment of the constitution in 1992 was a fairly unsuitable person, a former minister of justice who had served before 1989. In 1993, none of the constitutional judges could be considered an expert in constitutional law. The choice of president was rather typical for the second Mečiar government which reappointed ex-communists to key positions and removed anti-communists appointed under the short-lived Čarnogurský government (1991 – 1992). Application of the federal lustration law was discontinued. Because of this turn Szomolányi (1993) pointed out that a persistent predominance of communist elites in politics and public administration distinguished the Slovak republic from East Central Europe and likened it to Eastern Europe\textsuperscript{43}. Examples like the aforementioned minister of justice notwithstanding, this characterization should not however be extended to (most) judges and other legal professionals. This is, first, because in all Soviet type systems judges were few in numbers, and second, because most judges and legal professionals, except state prosecutors, held subordinate rather than elite positions\textsuperscript{44}.

The courage which judges showed when they resisted the Mečiar regime deserves great praise and its significance for the defense of democracy was enormous. These proud achievements notwithstanding, the Slovak judiciary still needs to undergo substantial development before it can claim to live up to the requirements of a Rechtsstaat. In Slovakia as well as other post-communist countries legal professionals have tended to stick to a sort of legal positivism, one of its consequences being a hesitation to fill gaps in the law and interpret indefinite legal terms in a meaningful way. Moreover, while in Hungary and the Czech republic constitutional courts have broken away from this tradition\textsuperscript{45} and by doing so have set an important example for the legal professions, the same cannot be said about the Slovak constitutional court which chose to act more cautiously. The Slovak constitution circumscribes its authority more narrowly than

\textsuperscript{41} Slovensko 2000 p. 149.
\textsuperscript{42} Slovensko 2000 ibidem.
\textsuperscript{43} Leško (2000) argues the same point.
\textsuperscript{44} Those who are unaware of this may consult e. g. Pauer (1999)
\textsuperscript{45} The pathbreaking work of the Hungarian constitutional court is reviewed in Pfaff (2000).
the Hungarian or the Czech, but according to some observers the Slovak constitutional court has been too hesitant to exercise even this limited authority. They criticize the interpretation of the Slovak constitution by the constitutional court as „pure positivism“\textsuperscript{46}. Considering the immense pressure to which the court was exposed for years such cautiousness perhaps was an act of wisdom but it has caused problems as well. Statute law is always incomplete and needs to be amplified by caselaw. If judicial rule-making however fails to occur actual judicial decision-making must either be avoided e.g. by overemphasizing formalities or it remains highly unpredictable and erratic. Slovak judicial decision-making has suffered from both aberrations.

\section*{3.3. THE DECLINING REPUTATION OF THE JUDICIARY AND CORRUPTION}

The reputation of local and district courts has been increasingly impaired by rumours about corruption. According to well-informed observers corruption started to become widespread in 1996\textsuperscript{47}. An event of 1999 indicated that such suspicions were not at all unwarranted. Then several judges of the district court of Žilina, including its president, were sentenced for corruption by a Czech court which had jurisdiction because the crime was committed during a trip to the Czech republic. Unfortunately, more often than not disciplinary action taken by the Slovak judiciary itself appeared weak and undecisive\textsuperscript{48}. Bribes are believed to be mostly in the nature of „speed-money“\textsuperscript{49} but since the late 1990s suspicious decisions have become more frequent as well. After 1999 the minister of justice of the first Dzurinda government initiated procedures against several judges who were suspected of having accepted bribes. His initiative however was not strong enough to prevent corruption from being perceived as more and more of a problem. After 2000 the reputation of the judiciary thus quickly declined, by 2003 it had become one of the most disreputable institutions of Slovak government\textsuperscript{50}. Apart from bribery the public has minded that court behaviour often has been unpredictable and erratic, in particular if “new” fields of law like bankruptcy law are concerned. Some judges also have been perceived as intolerably arrogant. Reputable law firms strongly assert that they know about quite a number of court decisions which are so obviously wrong that they are explainable only by either carelessness or corruption.

\textsuperscript{46} Slovensko 2000 p. 148.
\textsuperscript{47} See Slovensko 1997 p 126. See also the inquiry summarized in Trend June 13, 2001 p.5A. In 2002 the Slovak police for the first time managed to catch a judge in the act. See SME August 30, 2002. He was taking a bribe of 100000 SKK.
\textsuperscript{48} Stav a perspektívy súdnictva (2000, p. 651)
\textsuperscript{49} ibidem p. 660
\textsuperscript{50} See Beblavá and Zemanovičová (2003).
Unpredictability of court decisions has been mostly due not to corruption but to the aforementioned slow development of judge-made law i.e. judicial rule-making. As a matter of principle, court decisions and opinions are not kept secret, but apart from supreme court decisions and decisions of the constitutional court they so far have not been published in a systematic way. Court decisions are often lacking in terms of consistency and if they were to approximate a *stare decisis* standard a bit more legal uncertainty would decline considerably. Some improvement may be around the corner, the minister of justice intends to publish nearly all (final) judgements and judicial opinions issued by Slovak courts (except divorces) in the internet soon. The system is expected to be launched in 2006. It is hoped that this will induce judges to write better and more convincing opinions, so far the quality of opinions often has been rather mediocre. There is reason to hope for that. If court decisions and opinions become easily accessible to the public they are likely to be criticized more often than in the past. The main defense which judges can muster in such debates is that they have decided according to the rules. This creates a demand for judicial rule-making since decision according to the rules is possible only if such rules actually exist.

The minister of justice of the second Dzurinda government also took tougher measures against court corruption than his predecessor. This was made possible by the decline of judges’ reputation, which rendered their opposition politically ineffective. There is indication that since 2003 court corruption is being fought more effectively and that it is actually declining. The minister initiated several major investigations which resulted in disciplinary action against a number of judges. E.g. in 2004 he demoted six judges of the Bratislava district court and suspended two. All of them had been specialized in bankruptcy proceedings. The ultimate decision on these disciplinary actions is still pending at the time of writing. Since 2003 disciplinary action against judges has become both more frequent and more effective, before it usually came to nothing. The sort of “solidarity” among judges which produced this unfortunate result appears to be in decline. The second Dzurinda however not only increased the pressure on judges, it also increased their salaries. The judges’ scale now runs from 95 per cent to 130 per cent of the salary paid to a deputy of the Slovak parliament. In addition judges receive some lumpsum payments and additional old age benefits. Together this makes for a rather comfortable income in terms of Slovak standards, this may be expected to render judges less susceptible to corruption. In addition the ministry of justice also took some other preventive measures against corruption. One of them was building a system which provides for randomized case allocation. Randomization is expected to curb corruption, because in the past case allocation more often than not was manipulated in
favour of certain interests which thus managed to get a “friendly” judge. As another preventive measure against corruption judges are now required to file an inventory of their property (majetkový priznanie). This inventory is to be published in the internet.

The reputation of the judiciary has also been impaired by factors which are beyond judges’ control. The services of lawyers are widely perceived as over-priced and lacking in quality. Lawyers have tended to be underspecialized, in addition regulations have hindered them from advertising their specialization. Finding the real specialist has been quite difficult for potential clients. Lawyers have played a major role in court corruption. Since bribes paid to judges are usually intermediated by lawyers it may happen that a lawyer suggests to his client to give him money for bribing a judge but the client cannot be sure that the money is really passed on. Thus, certain lawyers may actually profit from spreading rumours about court corruption. For this reason, the perception that courts were for a while the most corrupt part of Slovak government may have been mistaken. The view that the public perception of court corruption is considerably exaggerated was endorsed by insightful observers even when court corruption was at its climax. It is almost certain that a considerable majority of judges always has been honest.

4. SOME OTHER INSTITUTIONS INVOLVED IN DEBT COLLECTION

4.1. LAND REGISTERS

All over the world land registers are a key institution for collateralizing loans. They are even more so in Slovakia since until the aforementioned 2001 reform of secured transaction law few other assets were registered and suitable for being pledged without physical transfer of possession. Up to 2002 real estate was about the only sort of collateral which was usable in practice and thus land registers have been of paramount importance. But they also have been a problem spot since their post-communist reinstatement. As elsewhere, land transactions which occurred under communist rule frequently remained unrecorded. This greatly reduced the value of the information which registers could provide and entailed an enormous load as soon as they started to work this backlog off.

51 See e.g. the debate reported in Trend July 31, 2003 p. 18
52 In a poll more than 20 per cent of participating businessmen who had been involved in lawsuits in between 1998 and 2002 reported that they paid to their lawyers not only the usual fees but “something” in addition. See Trend April 24, 2003 p. 36
Slovak registers began this task in 1990 and ambitious targets were set: completion of the job was scheduled for 2000. Only about a quarter of all districts managed to reach this target. In 2004 it was estimated that about a third of all Slovak real estate was not yet properly recorded, for about a quarter of the agricultural land (about 580000 hectares) ownership was not yet determined. Mistaken records were not only due to the neglect of land registers under communist rule, but in particular in between 1996 and 2001 also a large number of new registrations contained mistakes. An investigation undertaken in 2001 found that 35 per cent of all information contained in the land register is seriously defective or plainly wrong. After 2001 this rate however started to decline.

Considering the enormous challenges which registers were facing, most observers were inclined to judge their performance as passable until 1996. Then land registers were transferred to the authority of regional administrations (okresné a krajské úrady), which were ruled by government-appointed prefects. At the time regional administrations were undergoing a reorganization which was meant to provide employment opportunities to partisans of the Mečiar government and tighten its control over local self-government. Already then critics doubted the wisdom of moving land registers to regional administrations, pointing to the severe lack of funds under which most of them suffered. Contingent on the financial health of the resp. regional administration and the views of its prefect, some registers continued to function in an acceptable way, while most others failed to keep up. As a result of decentralization compliance of local land register clerks with the methodological instructions issued by the Bratislava-based central office frequently was no longer controlled and actually deteriorated considerably. This resulted in numerous mistakes and wrong records. In the second half of the 1990s the volume of land transactions increased greatly; consequently the workload on land registers grew by some 250 per cent, while their resources declined. In some cases they even ran out of paper and had to tell applicants that their petitions could be processed only if they provided paper and stamps themselves. In 2001 filings could take up to three years. Since numerous applicants were unready or unable to wait that long, corruption started to become a major problem. According to a confidential survey made in 2000, one
out of seven applicants confessed to having corrupted land register officials; bribes were in the range of 5000 – 9000 SKK (125 – 225 USD) and thus came close to a monthly salary of an average Slovak employee. In 2001 government undertook a major effort to solve the problem. Land registers returned to central government. In 2002 and subsequent years budgetary allocations to land registers were increased considerably. Filings accelerated a lot. It is hoped that corruption will fade away once that land registers are able to effect all recordings within 30 days as is actually required by law. In 2005 59 out of the 79 land register districts of Slovakia had reached this goal. In nearly all of the others a filing rarely took longer than three months. In all of Slovakia about 80 per cent of all filings were completed within the required 30 days period. All in all backlogs have been declining nearly continuously since 1999.

\textbf{4.2. BAILIFFS}

Hayek (1994, p. 139) considered bailiffs (Serbian: \textit{sudski izvršitelj}) a key institution of „a competitive system“, referring to them as its „last resort“. Judging from their disregard for bailiffs, most economists seem to disagree. In contrast, prominent jurists like Cepl (1995) argue that the bailiff is the weakest link in post-communist justice.

In the early 1990s Slovak bailiffs were badly salaried court officers. They were few in numbers, and neither prepared nor eager to face the challenges of the new era which increased the quantity as well as the difficulties of their work enormously. This had serious consequences, because neither a lien nor an enforceable title nor a clausula exequendi authorize a creditor to satisfy himself by realisation of debtor’s assets; instead he must depend on the actions of a bailiff. The major exceptions to this rule are the internal revenue service and social security administrations which possess their own collection departments. The latter were considerably more effective than the bailiffs on which banks and private creditors had to rely. In the first half of the 1990s, according to some observers, bailiffs’ collection rate was about 0,1 per cent. This rate refers to the collection of claims for which the creditor held an enforceable title, which except if he had a \textit{zápisnica} could be acquired only through a lengthy and tedious procedure. Forced sales of valuable real estate were so rare that they made for headline news when they occurred. In sum, suing a defaulting debtor was a fairly hopeless undertaking.

\textsuperscript{61} \textit{Trend} August 22, 2001 p. 5A
\textsuperscript{62} \textit{Trend} May 26, 2005 p. 44.
\textsuperscript{63} In a very restricted set of circumstances businessmen are also entitled to collect without relying on a bailiff but this is of little practical relevance. See \v{C}entěš (2000, p. 18).
\textsuperscript{64} \textit{Trend} June 9, 1999 p. 7A
this predicament creditors could have recourse to two substitutes. First, they
could file bankruptcy petitions. This sometimes helped if the delinquent debtor
was in fact able to pay and only tried to take advantage of his creditor. More
often than not, such debtors thought of the prospect of being brought before a
bankruptcy court as unpleasant enough to change their attitude. When this hap-
pened, the petition was withdrawn. This use of bankruptcy as a substitute for
other means of debt collection is discernible in table 1 infra, it actually has
enjoyed lasting popularity up to now. The second substitute was hiring tough
guys who would threaten the debtor with base bats and other hard items.
Although this seemed to come into use in those years, it was never a really wide-
spread occurrence.

In 1995 Slovak parliament took a major step towards solving the problem
and passed the Exekučný poriadok (EP, Enforcement Act). The main source of
inspiration for the súdny exekútor which EP created was the French huissier. A
historical digression is illustrative at this point. In eighteenth century mainland
Europa execution of ius commune (general law) judgements tended to be similar-
ly court-centered and tedious as it has been in post-communism. Legal reforms
following the French revolution were meant to improve on this state of affairs,
and inventend the huissier. The huissier is a civil servant, but he does not earn a
fixed salary and is instead remunerated like an enterpreneur engaging in debt
collection. The details of his remuneration are determined in a civil law contract
concluded with the creditor who appoints him. In order to be licenced as a
huissier an applicant needs to have a master’s degree (maitrîse) from law school;
his authority and duties are in correspondence with this advanced stage of legal
training. This innovation has been a very successful one and was imitated later by
numerous other countries.

The Slovak exekútor resembles the French huissier. Accordingly, he is
required to have completed a thorough legal education, his authority is rather
broadly defined, and the relevant regulations enable him to earn a high income if
he is successful in collecting debts. The EP also contains some safeguards to pre-
vent abuses, e.g. before the exekútor sells seized assets in an auction he is required
to have them valued by a licenced appraiser. In a number of circumstances which
as a jurist he should be able to appreciate he is required to suspend execution and
relegate the issue to a court.

It is surprising that such great a step towards a private law society was under-
taken under the third Mečiar government who otherwise cared little about civil
law and tended towards paternalism. Even more astonishing, Slovakia was in this
regard ahead of all other post-communist countries. Slovenia followed in 1998,
Poland, Hungary and the Czech Republic in 2001, Bulgaria in 2005, while Croatia keeps debating the issue. When the author of this paper tried to solve the puzzle of Slovak leadership, one of his findings was a striking lack of a public debate before the enactment of the EP. The event was hardly noticed. Apparently, most deputies of the Slovak parliament had only a vague idea of what they were doing, when they nearly unanimously voted for this act. The EP had been drafted under the shortlived liberal Moravčík government (1994) as part of a policy package which was supposed to strengthen „financial discipline“. In the lively public discussion of this policy package the EP was hardly ever mentioned because it was considered as its least important and most technical component. This lack of public attention probably was the reason why, after Moravčík’s electoral defeat the succeeding Mečiar government decided to continue work on the EP even though most other parts of the policy package were scrapped. To fully appreciate the paradox which public disinterest in the EP poses it is worth noting that in 1995 debt arrears had been among the most hotly debated topics for years and numerous reasonable as well as nonsensical ideas had been voiced how this seemingly overwhelming problem could be solved. Nevertheless, the task, the incentives and performance of bailiffs were not discussed except within the narrow circle of experts who actually participated in the preparation of EP and met for some seminars behind closed doors.

The public started to become interested in the topic only when the first exekútori were licensed and began collecting, which was in fall 1995. By 1999 the number of licensed exekútori had climbed to 161, which might appear as little considering the proportions of the Slovak payment arrears problem\textsuperscript{66}. Some observers thought that this was due to restrictions on the number of licenses issued but when restrictions were lifted in 2000 it turned out that they had not been a significant constraint. The number of exekútori increased only slowly, in 2004 it was 260 and among these 260 there are quite a number who complain that the profession is overcrowded and competition too tough\textsuperscript{67}. In the late 1990s the real problem was that a large fraction of the overdue claims reported in the payment arrears statistics had long been close to worthless and even the most skillful and ruthless exekútor cannot earn a living from collecting them\textsuperscript{68}. When there was a real chance at collecting exekútori usually found a way to do it, as is indicated by the embarrassment and the complaints of numerous companies, cities, public agencies etc., whose assets were seized surprisingly quickly when

\textsuperscript{66} Trend June 9, 1999 p.7A. France has more than 3000 huissiers and they do not suffer from underemployment.

\textsuperscript{67} See Trend February 26, 2004 p. 30

\textsuperscript{68} For evidence see section 6 below.
they were running debt arrears. The efficiency of *exekútori* is also illustrated by the fact that since 1995 the internal revenue service has resorted to their services whenever its own collection units gave up because they found collection too difficult or too dangerous. This resort frequently helped, as is evidenced by the fact that about a third of all claims collected by *exekútori* between 1995 and 1999 were claims of the internal revenue service.

A creditor who appoints an *exekútor* must hold an enforcable title. To get such title, he usually needs to obtain a final judgement from a court and this may take many years. In contrast, the internal revenue service and social security can produce enforcable titles themselves and do not need to involve courts. All other creditors can avoid court involvement only by using the above-described procedure of creating a *zápisnica*. This device was rarely used until 1996, but it became popular in 1997. It is more than practical; in view of court congestion it is the only real chance for creditors other than the internal revenue service to foreclose in due time. The observation that up to 1997 even banks rarely made use of this device\(^{69}\), reveals that they considered execution as a hopeless undertaking. It was only the EP which turned execution into a matter of practical life which deserves to be thought about when negotiating a loan. Two other immediate effects of the EP were that bankruptcy petitions against solvent debtors started to become somewhat less frequent – creditors who had a *zápisnica* no longer needed to resort to this expedient to pressurize neglectful debtors. Second, according to some observers\(^{70}\), debt collection by violent means also became less frequent.

The positive effects of the EP are close to obvious. Nevertheless, it did not become popular with the Slovak public. In 1999 a major attempt was undertaken to pull the teeth of the *exekútor* and turn him into a harmless creature. Surprising as it may seem, this attempt was backed even by the Slovak chamber of commerce and industry (SOPK), which is supposed to represent entrepreneurs’ interests. However, the SOPK\(^{71}\) as well as the other major employers’ association had in 1996/97 been captured by large politically connected companies which as a rule were heavily indebted. As a result he failed to represent rank and file entrepreneurs, whose access to credit remained extremely limited until 2001. In those years the latter were grossly underrepresented in the public debate and this has changed only slowly in more recent times.

Paradoxically, the initiative to tame *exekútori* was part of a policy proposal which claimed to solve the debt arrears problem. Tackling this problem had been

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\(^{69}\) See *Trend* February 5, 1997 p. 18A

\(^{70}\) *Trend* June 6, 1999 p. 7A

\(^{71}\) Note that in contrast to other continental European countries by far not all entrepreneurs had joined SOPK because there was no compulsory membership.
one of the principal programme items of the Dzurinda government which came to power after Mečiar’s electoral defeat in 1998. The key policy paper complained at length about the lack of law enforcement but proposed to tame the exekútor even though he was one of the few levers of relatively effective law enforcement which Slovakia possesses. Among the numerous reasons given why the exekútor should be tamed one can claim to some legitimacy. The EP sometimes enabled junior creditors to seize assets which had been pledged to secured creditors and appropriate the sale proceeds. Under some circumstances, the details of which are beyond the realm of this paper, the impact of execution was tantamount to a revision of priority ordering and impaired secured creditor’s rights. This opportunity was exploited in multiple ways. Since banks typically have been secured creditors, junior creditors could use this loophole to inflict damage on banks. Ultimately the burden was shifted to taxpayers, who were required to recapitalize banks in 2001. In a number of cases bank managers themselves apparently encouraged junior creditors to proceed in this way. This was in the framework of asset-stripping schemes (tunelovanie), which were a frequent phenomenon in 1996 - 98. A somewhat different scheme was implemented e.g. in the widely publicized case of a copper forge indebted to several banks. In 1999 one of the creditor banks, VÚB, sought to gain an advantage over the others when it unexpectedly appointed an exekútor who managed to seize and sell assets pledged to these other banks.

Other critics of the EP pointed out that in a number of cases the authority of an exekútor had been misused to defraud government. As an illustration consider the following scheme: The manager of a state-owned company conspires with his crony fabricating payables to the latter. These payables do not really exist, they are counterfeited. The „contract“ which they fake instructs the notary to issue a zápisnica. Subsequently, the alleged „creditor“ reports to the notary that the „debtor“ has failed to service his „debt“ providing evidence that no payment has arrived. The notary inquires with the manager of the „debtor“-company who however does not respond. Subsequently, the notary issues the enforcement clause and the creditor appoints an exekútor to foreclose. The reader might conclude from this description that this is not at all a problem of the EP but rather one of holding managers liable for defrauding their principal. Slovak company law enjoins a duty of care upon managers and they can be held liable for violating this duty. However, in those times such managers were either not sued at all (e.g. because they were faithful adherents of the ruling party and hence their principal did not really mind) or, if proceedings were commenced by the next govern-

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72 See e.g. Trend June 27, 1998 p. 7A
73 Trend February 24, 1999 p.7A
ment they frequently got stuck (e.g. because relevant documents were „lost“ without a trace)\textsuperscript{74}. Even, if proceedings did not run into unsurmountable obstacles they took a long time, providing the culprit with ample opportunities to retreat to a Carribean island.

The dilemma encountered here is that the introduction of one relatively efficient procedure, i.e. execution, into an environment where most other judicial procedures do not function too well creates its own kinds of distortions. It is far from obvious that softening execution is the best way out of this dilemma, albeit that critical accounts in the Slovak press tended to suggest this. These abuses were not the only reason for unease about \textit{exekútori}. In addition, influential debtors were frightened by the observation that \textit{exekútori} had forced a number of overindebted companies to declare bankruptcy. In principle, the bankruptcy law amendment of 1998 obliged the management of a company to file for bankruptcy as soon as the company was overindebted or insolvent, and a manager who failed to comply could be punished but so far this has remained a dead letter. As a result, such companies hardly ever filed for bankruptcy except if they were under the threat of \textit{exekútori} who were about to seize assets essential for continuing operations. The opening of bankruptcy procedures suspends execution. The increasing number of bankruptcy procedures opened after 1996 (see table 1 \textit{infra}) was partly a sideeffect of the EP and the resulting job losses contributed to the unpopularity of the \textit{exekútor}, even though he generally seized essential assets only if attempts to find and seize others had been in vain. Consequently, one of the reforms of the EP debated in 1999 proposed that \textit{exekútori} should not be allowed to seize essential assets. In summary, the dismay about EP was due to lay-offs of workers and emotional reactions to a number of scandals. Whatever was published on the topic failed to offer a proper analysis of underlying problems, the political debate remained on a fairly superficial level.

Considering the broad support for proposals to tame \textit{exekútori}, the amendment passed by parliament in 1999 was remarkably moderate. Among the major changes was that creditors other than banks are no longer permitted to appoint an \textit{exekútor} if the enforcement title which they are holding is issued by a notary public. Since 1999, nonbanks thus often need to get a court order before appointing an \textit{exekútor}. This slows down the procedure, and it has been a blessing that banks are excluded from this requirement, even more so since banks tend to be more dependent on execution than trade creditors. Other changes provided by the amendment were a reduction of the fees which \textit{exekútori} are allowed to charge, government supervision over \textit{exekútori} was tightened and additional facilities to gain protection from enforcement were provided. The

\textsuperscript{74} See Trend July 22, 1998 p.2A
amendment also provided for one change to the better, the aforementioned possibility to reverse the priority ordering of claims was removed. Parliament passed this amendment nearly unanimously.

As more recent experience has shown, in spite of the amendment exekútori have remained a rather effective agent of law enforcement, and delinquent creditors continue to be more afraid of exekútori than of anything else. A particularly vivid illustration of the real progress towards the rule of law for which the exekútor should be given credit is the experience of Banská Bystrica, the fifth largest city of the Slovak republic. As a result of its lord mayor’s misguided ambitions Banská Bystrica became insolvent. Its creditors appointed exekútori who managed to seize real estate and other assets owned by the city. In the end Banská Bystrica had to seek the tutelage of a French (!) bank which made its help conditional on a disempowerment of the city council. In particular, the local budget becomes effective only if approved by the bank. This example in addition demonstrates another point: Slovak law lacks a bankruptcy procedure for cities. Because enforcement is assured, this gap could be filled by private contract.

Political attacks on exekútori subsided after 1999 and they became fully accepted as a legitimate component of the administration of justice. In 2005 their authority was even broadened again. As mentioned above, in a number of circumstances, in particular if the debtor raises certain objections, the exekútor is required to suspend enforcement and wait for the court to decide. This more often than not takes years and as a result may render enforcement impossible. The 2005 reform prescribed a two months period for most of these court decisions. If the court fails to meet the deadline the exekútor is authorized to continue enforcement.

5. TINKERING WITH BANKRUPTCY LAW

The bankruptcy law inherited from the former federation in principle took a pro-creditor stance. In 1993 Slovak public opinion strongly believed that legislators should limit its realm of application to a small number of hopeless cases while the bulk of distressed companies should be treated in some other way. Legislators should create obstacles against opening bankruptcy suits. The only group which advocated consistent application of bankruptcy law was an employers’ association which represented private entrepreneurs. Its voice was a lonely one. This antibankruptcy consensus broke down only in 1998 and, as a result, some crucial impediments to bankruptcy procedures were abandoned only then.

75 This view was shared by all parties then represented in parliament.
Table 1: Bankruptcy petitions filed and bankruptcy procedures opened

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<td>76</td>
<td>198</td>
<td>427</td>
<td>805</td>
<td>665</td>
<td>638</td>
<td>368</td>
</tr>
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Sources: Slovensko (2000 p. 461), Trend April 2, 2003, Trend June 23, 2001, Trend June 16, 1996. Official data are unavailable for 1992 – 1995, the 1995 figures have been compiled by journalists of Trend. The aggregate figures for 1992 – March 1996 reported in the table were compiled by a bankruptcy judge and are the only semi-official data ever published for this period. For 1996 – 2000 official figures are available. After 2000 the publication of official data was unfortunately discontinued, the 2002 figures were again compiled by journalists of Trend who asked both the ministry of justice and the bankruptcy courts. Composition procedures are not included in the data, they have been rare. According to Trend June 3, 1998 only about 5 petitions for composition were filed per year, none of them concerned a major company. Other sources claim that up to 1996 not a single composition procedure was launched. Trend May 29, 2003 contains data about the completed composition procedures. Their number was 4 in 1999 and 2000 each, 11 in 2001 and 26 in 2002. All of the procedures contained in the list concern companies, consumer bankruptcy has so far been only a theoretical possibility.

Some of these impediments mimiced Czech legislation, but Slovak legislators created more. Their common denominator is that they were designed to protect ailing companies from bankruptcy. Describing all of them would take us too far afield76 and the discussion will be confined to the most significant.

a. Companies deemed as strategic and some others were excluded from the realm of bankruptcy law. A variety of arguments were offered why nobody should be able to file bankruptcy petitions against these companies but these arguments did not add up to a sound and consistent concept. As a result, the choice of companies which appeared on the strategic list was rather arbitrary. Imuna, a medium-sized company, which processed blood conserves for medical treatment, found its way on the strategic list because it was thought that the notoriously underfunded Slovak health service should not have to depend on foreign suppliers who would insist on prompt payment of deliveries. While its strategic status afforded some protection in the early post-independence years it backfired later. Imuna

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became insolvent because the health service kept running arrears. Its operations came to a standstill in 1998 even though it lost strategic status only in 2000. Subsequently it was revealed that Imuna had been thoroughly decapitalized, and it went from strategic status to bankruptcy. Another reason why strategic status turned out to be a dubious blessing was that strategic enterprises were protected from bankruptcy but not from execution. As a result, they were frequently visited by exekútori. It can be inferred from various Slovak government documents that it was intended that the budget should at some point recapitalize these enterprises. Unfortunately, in view of the many other priorities which the minister of finance was supposed to fund, such aid did not come forth in the required quantity. Still, the overall assessment is not as clear-cut as is the case of Imuna. The former giants of armament industry located at Dubnica nad Váhom and Martin might be viewed as counterexamples. Ultimately, only minor parts of these companies managed to restructure successfully. Nevertheless, the strategic status of the largest local companies maybe helped Dubnica nad Váhom and Martin to stay industrial regions which have proved capable of attracting substantial investment after 1997. This success, however, came at high costs for the Slovak taxpayer and was thus of debatable merit.

b. An „innovative“ device invented in 1993 and abolished in 1997 was dohodovanie. Dohodovanie was a compulsory phase of bargaining which had to be completed before a bankruptcy procedure could be opened. It was hoped that this phase would lead to a settlement (work-out) between the defaulting debtor and his creditors. The 1993 amendment did set a narrow time limit for the dohodovanie phase, but it could be extended and frequently was. This facility was abused by debtors who were interested in dragging matters out for years. At the end of dohodovanie domestic creditors were required to vote on the proposed work-out. Foreign creditors were usually not invited to participate in the bargaining and the amendment explicitly excluded them from voting as well as from decision-making in the creditors’ committee formed during dohodovanie. At the time, Slovak companies often had Czech creditors who were disadvantaged by this procedure. In the decision on the proposed settlement, every participating domestic creditor irrespective of the size and priority of his claim had the same vote. Thus, depending on which creditors were able and

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77 See e.g. Trend February 23, 1994.
78 Similar ideas can be found in bankruptcy codes of other transition countries. E.g. the Bulgarian code enacted in 1994 has such a phase of bargaining.
ready to participate, the outcome could be a major surprise. During *dohodovanie* creditors were stayed (*zabrana prisilnog izvršenja*) and incumbent management usually remained in control of the company. It frequently abused this opportunity to engage in asset stripping\(^{79}\). *Dohodovanie* was another reason for the small number of bankruptcy procedures opened before 1996. Managers sometimes even managed to drag it out until remaining assets no longer covered the costs of a bankruptcy procedure. Such abuses hardly ever resulted in punishment neither was fraudulent conveyance law applied. If a settlement was adopted by a majority vote, it could not be subjected to a judicial review. Neither was it considered binding on anybody. So, after the alleged work-out was voted upon, displeased creditors could again sue the debtor for the amount owed according to the original credit contract. In summary, *dohodovanie* had little effect other than buying time for management. Unfortunately, this time often was not used to restructure the company. However, this does not hold universally. An exception which is worth reporting is a medium sized (670 workers in 2000) machine building plant located at Námestovo which was privatized in the voucher privatization in 1993. Before privatization it was insolvent and survived only because the bankruptcy law did not apply to such companies. Then investment companies gained control over the plant as a result of voucher privatization. It entered a *dohodovanie* and used the time gained to restructure. This was done successfully, in subsequent years it was running at a profit\(^{80}\).

c. By 1997 there was nearly universal agreement that *dohodovanie* had been a failure and should be phased out, so it was time to come up with another idea. This was the revitalization act of 1997, which was repealed only after Mečiar’s electoral defeat in fall 1998. According to this act, distressed companies could apply for revitalization. Their petition was scrutinized and decided upon by a so-called revitalization commission which consisted of representatives of several ministries including the ministry of finance, the governor of NBS (National Bank of Slovakia), the directors of three large state-owned banks and the director of the state-owned insurance company. The law failed to offer guidelines for their decision, and excluded creditors other than the aforementioned banks and the insurance company from participating in the decision. However, because these four entities were key creditors of most distressed companies and because of the inclusion of NBS which worried about the health of all banks, creditors’ inter-

\(^{79}\) See Kravec (1998, p.2).

\(^{80}\) See *Trend* January 24, 2001, p.2B
ests exerted an influence on the decision\textsuperscript{81}. After revitalization was ultimately approved by the commission, creditors were stayed and their claims written down, but before this approval they were not. The decision of the commission was final and could not be appealed to a court which constitutes a clear violation of the right to judicial review enshrined in the Slovak constitution. When the revitalization act was passed critics pointed out that it might be abused to help companies whose owners were close to the ruling coalition. Such fears seemed warranted because the entities represented on the commission were all (except NBS) controlled by partisans of the Mečiar government and thus potentially ready to help their cronies who owned or controlled distressed companies. However, matters turned out differently. More than one thousand companies applied for revitalization, but by September 1998, when the revitalization act was repealed, the revitalization commission had not yet managed to come to any decisions\textsuperscript{82}. All cases were still pending. The key obstacle was that by 1998 all state-owned banks were in a desperate situation themselves and felt unable to grant any concessions. The minister of finance and NBS felt the same. This was an unforeseen turn of events both for the authors of the revitalization act and the companies which had applied. They were actually worse off as a result of the act, first because creditors of companies which were suspected of aspiring to revitalization more often than not appointed an \textit{exekútor} as soon as they learnt about the act\textsuperscript{83}, and second because they found themselves cut off from credit since potential creditors feared they might be forced to write down their claims.

In summary, while none of the three devices was a convincing success the third was a total failure. In a few cases, obstacles a. and b. served a useful role.

In fall 1998 bankruptcy law finally became fully applicable to the whole sphere for which it had been designed in 1991. This, however, did not end the discussion about its reform. A major amendment became effective in 2001. According to official announcements, this amendment was regarded as an intermediate step towards a more fundamental reform. The reform envisaged among others was supposed to introduce a Slovak version of a reorganization procedure

\textsuperscript{81} Decisions required a qualified majority, which could not be reached without the consent of at least one bank.

\textsuperscript{82} See \textit{Trend} September 16, 1998.

\textsuperscript{83} E.g. the director of ZŤS Dubnica nad Váhom, a producer of armament, bitterly complained that the revitalization act seriously threatened his restructuring efforts. For three months \textit{exekútori} seized every single Koruna which arrived on the accounts of the company rendering it unable to pay wages or suppliers. See \textit{Trend} April 15, 1998
in the spirit of chapter 11 of US bankruptcy law. The details remained controver-
sial, and as a result, this intention was realized only in 2005, when a completely
new bankruptcy code was enacted which will become effective in 2006. In spite
of the enthusiasm for reorganization, the amendment enacted in 2000 strength-
ened the procreditor stance of the extant statute. This decision was prompted by
the special circumstances prevailing in 2000. Then the financial position of most
major banks was so weak that government feared a banking panic, at the same
time government itself was widely believed to be heading towards another
default. In this predicament government concluded that strengthening creditors
was unavoidable. In particular, the amendment enabled the creditor committee
to control the trustee (Serbian: stečajni upravitelj) more effectively and autho-
rized the creditor’s assembly to make a binding decision on the dismissal of a sit-
ting trustee and elect somebody else to be appointed as his successor. Up to 2001
the trustee essentially had been an agent of the court rather than of the creditors,
it was transformed into an agent of the creditors only by this reform.

Trustees have often been described as unreliable and catering to interests
other than those of creditors. Press comments even have claimed the existence of
a „trustee-mafia“. Evidence that such claims were not unfounded has accumulat-
ed since 2000, a number of trustees even have been going to jail84. The 2001
amendment was hoped to discipline trustees and make them more responsive to
creditors. There is indication that their behaviour in fact improved notably85 but
not sufficiently to prevent certain schemes which are described below.

Before the amendment went into effect there were widespread fears that the
number of bankruptcy suits might increase dramatically and a large fraction of
Slovak economy might be stuck in the court room. Such fears, however, proved
unfounded86. These observers seem to have overlooked the interplay between the
EP and bankruptcy law: Since the EP is in force, insolvent companies owning
enough assets to justify the attention of an exekútor usually have sought to pro-
tect these assets by filing for bankruptcy except if an out-of-court-settlement
could be reached.

84 The best known case of a trustee going to jail has been the bankruptcy of Devin banka. But it
has not been the only one, see e.g. Trend March 20, 2003 p. 6.
85 This was felt immediately. See e.g. Trend August 8, 2000 p.1A. This improvement also is the
only perceivable reason for the relatively good grades which Slovak bankruptcy procedures
received in the Doing Business Project of World Bank, in particular in comparison to the
Czech republic which otherwise continues to have a rather similar bankruptcy law.
86 Trend April 11, 2001 p.3A.
6. THE DEBT ARREARS CRISIS AND ITS END

Throughout the 1990s debt arrears were a key issue in the economy policy debate and, except the Čarnogursky government (1991/92), all governments as well as all major parties kept promising debt relief. A precedent had been set in 1991 when the Slovak government granted 12 billion KCS (about 400 mill USD) debt relief. This was mostly wasted on companies with poor prospects. Real interest rates were (at times strongly) negative from 1991 to 1994, providing another considerable reduction of real debt. In addition there were some smaller scale measures serving the same purpose. All of this was not enough to silence calls for further large-scale debt relief. However, this next cycle of relief was postponed year after year. In spite of reiterated promises government shied away from the enormous fiscal costs involved. This sort of policy continued until 2000. Then any further delays were considered too dangerous.

Repeated announcements of debt relief must have caused incentive effects. If debt relief is in the air as it was for a decade aggressive collection is discouraged. Observers report that as late as 1998 most banks tended to take a „benevolent“ attitude towards some of their defaulting debtors and as a rule initiated collection only if they heard rumours that another creditor was about to appoint an exekútor. They changed their attitude only in fall 1998. At least up to 1995 even non-financial companies more often than not continued to supply some of their insolvent customers, because they expected to be recompensed by government. Such hopes seemed not at all unwarranted. Nevertheless, they were in vain. Contrary to Mečiar’s reputation as a resolute person, both his second and his third government were notoriously unable to set priorities and attempted to evade the hard choices required. Most of their undertakings suffered from chronic underfunding. Notwithstanding strenuous efforts to foster a fiscal illusion, Mečiar’s third government defaulted right at the eve of its electoral defeat in 1998.

In 1999 overall debt arrears were reported to exceed 50 per cent of the Slovak GDP while in 1992 they had been about 20 per cent. In reality, matters were probably even worse. According to presumably incomplete official statistics, debt arrears expressed as a percentage of GDP decreased somewhat in 1994 and 1995 and increased rapidly between 1996 and 1999. Inter-enterprise arrears participated relatively little in this growth spurt. By 1996 most companies had learnt

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87 See e.g. Trend March 18, 1998 p. 29A and Szomolányi (1993, p. 36).
88 Trend June 30, 1999, p. 11A.
89 Trend September 9, 1999 p. 8A.
90 For this view see e.g. Trend top 2000 p. 8
that it is unwise to supply insolvent customers and that promises of future reimbursement by government were to be taken with a grain of salt. This change of behaviour becomes even more evident, if arrears towards a few politicized entities such as the electricity company or the gas supply are deducted from overall interenterprise arrears\textsuperscript{91}. It was banks and social security budgets which were most strongly hit by the explosion of arrears. Tax arrears also increased dramatically after 1996, but from a comparatively low base.

The rapid growth of tax arrears must have been largely due to a selective nonapplication of tax law in favor of politically-connected companies. Tax authorities were in a better position to collect than anybody else. The explosion of non-performing bank loans was partly caused by a peculiar rule of Slovak tax accounting which was abolished only in 2000. According to this rule non-performing loans could be written off only after the debtor had been declared bankrupt or if an execution had ended unsuccessfully. In addition, the creditor was required to capitalize both overdue interest and default fines, so the book values of outstanding loans kept growing rapidly. In corporate income taxation this growth was considered as taxable revenue even if the debtor’s actual payments equalled zero. Since interest rates were high and reached 28 per cent in 1998 a non-performing loan granted in the early 1990s rapidly doubled and tripled in the books. This tax treatment rendered it virtually impossible for creditors to deal with the bad loans problem adequately except by appointing exekútori or filing bankruptcy petitions. While non-financial enterprises frequently did this and discontinued deliveries to their defaulting debtors, thus keeping the problem under control, most banks were neither willing nor able to adopt this strategy. This was first because of the aforementioned „benevolent“ attitude to some of their debtors, which frequently was assisted by political pressures, and second for the plain reason that their own capital position was too weak. One of the three large state banks, IRB, probably was overindebted already in 1993, while the others seem to have reached this state in 1995. Aggressive debt collection would have revealed this state of affair. This outcome was desired neither by government nor by bankers. The peculiar tax treatment of arrears which forced banks to show huge accounting profits when they were actually bankrupt, served fiscal interests only. Government needed the revenue for grand projects like the freeway system, the construction of which proceeded at a rapid pace from 1996 to 1998. Thus, the tax treatment of arrears allowed government to run a large hidden public deficit until 2000. Bankers went along with it because they did not want to rock the boat.

\textsuperscript{91} According to Trend September 1, 1999 p. 9A arrears towards the electricity company accounted for nearly half of all interenterprise arrears.
Enormous debt arrears should not be thought of as indicative that Slovak manufacturers were performing very poorly. This was not the case. Except in 1998/99 most manufacturing workers have been employed in companies reporting a profit. Clearly, manufacturing industry has been in a better shape than in most other post-communist countries. Apart from tax law, record levels of debt arrears and the deterioration of financial results in 1998/99 were caused by the boom in public investment which occurred in 1996 – 1999. This boom drove real interest rates to levels which far exceeded all expectations and induced a real appreciation of the Slovak Koruna. When public investment was cut in 1999, interest rates and exchange rate came down and the financial results of most companies recovered relatively quickly. Already in 2001 the IMF voiced the opinion that most Slovak companies had successfully concluded their post-communist restructuring.

Bank rehabilitation program was effected by a government agency named Slovenská konsolidačná assuming non-performing loans. After 2001, Slovenská konsolidačná and to a lesser extent also the internal revenue service attempted to auction off some of their non-performing loans. This has generated information on their market values. While several of these attempts ended up with a complete failure, the more successful auctions reached a price of up to about 5 per cent of nominal value. Bids exceeding 5 per cent of nominal value have been a rarity. These observations suggest that a large portion of arrears has been close to worthless since years. However, a skillful and energetic investor still could earn some money in this trade. The Penta group which has specialized in this business bought claims with a nominal value of 13 billion SKK from konsolidačná at the price of 431 million SKK. It actually collected more than 500 million. The prospect of a vigorous collection effort after a sale sometimes promoted a pronounced change of debtor behaviour. E.g. the social security agencies reported about cases in which the allegedly insolvent debtor paid his debt as soon as he learnt that it might be offered for sale. Complaints that more often than not both social security and internal revenue service are rather passive creditors have remained a recurrent issue. The upsurge of bankruptcy procedures after 1998 had the result, that by 2000 most of the arrears problem had arrived at the bank-

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92 See Okáli (1998) and the profit and loss statements reported in the yearly special issue of Trend on the largest Slovak companies. The precise share of profitable enterprises and the reliability of accounting data are difficult issues, but profits have been persistent enough to justify the overall assessment that performance was relatively good.


94 Trend Oct 30, 2003, p. 10

95 See Trend May 15, 2002 p. 4A.

96 See e.g. Trend Oct 2, 2003, p. 56
ruptcy courts. In 2003 nearly 85 per cent of the remaining portfolio of konsoli-
dacná were claims against companies which had entered a bankruptcy proce-
dure\textsuperscript{97}. Once these procedures will be completed the arrears problems inherited
from the 1980s\textsuperscript{98} and 1990s will be largely a matter of the past.

After 1999 the behaviour of the internal revenue service and most bankers
changed and they tried much harder to avoid further tax arrears resp. the issue of
more bad loans. Bankers actually became overly cautious. While in other coun-
tries the credit crunch which results from such change of behaviour may amount
to a major shock to the real economy, its impact was less than dramatic in
Slovakia. For most companies bank loans had become largely inaccessible
already in 1997/98, because the minister of finance who needed to fill the budget
deficit had crowded nearly everybody else out of the loanable funds market.
Moreover, the credit crunch did not last, credit gradually started to recover in
2001. By 2002 all major banks had been privatized, reputable foreign banks had
been the buyers. The new owners wanted to earn profits and were thus interested
in a more active lending business. Declining budget deficits reduced the possibil-
ities to earn low risk returns by lending to government and forced bankers to
solicit customers other than the fisc. Many of the major Slovak companies nowa-
days no longer ask Slovak banks for credits either, because they are owned by for-

die of these fields credit expansion since 2002 has been double digit every single year,
in 2004 it reached 40 percent. The share of these credits in GDP however still is
fairly small because the expansion started from an extremely low base. As a result
of the change in bankers’ behaviour the cash-in-advance constraints which had
seriously restrained small business, home construction and the acquisition of
consumers’ durables throughout the 1990s have lost most of their former impor-
tance. As of now most Slovak businessmen report that difficulties with gaining
access to credit are no longer a major impediment to the growth of their busi-
nesses\textsuperscript{99}. Another reason for this improvement is that in contrast to the 1990s
small and medium sized companies now often have track records which enable
banks to better assess their credit worthiness.

As a reaction to the rapidly growing number of debtors a credit register was
founded in 2004. By 2005 nearly all Slovak banks had joined this register. In the

\textsuperscript{97} See Trend Oct 30, 2003 p. 10
\textsuperscript{98} Part of this problem originated in the 1980s when the Czechoslovak government reacted to
decreasing tax revenues and mounting fiscal problems by decapitalizing state companies.
\textsuperscript{99} On this see e.g. Trend April 21, 2005 p. 4
1990s building a credit register had not appeared as urgent because credit business was in decline and largely limited to a relatively small number of corporate clients.

Debtors’ behaviour which had started to improve already in the late 1990s continued to improve in the new century. Households are the best debtors, mortgagors nearly always pay their debt and consumption loans are only moderately worse. According to polls Slovak businessmen typically record a very pronounced improvement of paying habits as well. A considerable majority of all business debts are now serviced in time. According to a common view among Slovak businessmen, this is not only due to improved collection facilities, but also to “natural selection”. Incompetent and dishonest businessmen often have been weeded out by competition. The improved quality of bankers’ loan portfolio and improved paying habits are most clearly reflected in a declining spread. The difference between the Bratislava Interbank Offer Rate and the interest rate on bank credit taken by Slovak corporations is now often less than one per cent.

7. SOME EMPIRICAL RESULTS ON THE EFFECTS OF BANKRUPTCY LAW

This section confronts the Slovak bankruptcy experience with two conjectures on bankruptcies in transition which are frequently rehearsed in the literature. The first proposition concerns the alleged liquidation bias of bankruptcy laws such as chapter 7 of US law or the statutes used in most of mainland Europe before it became fashionable to adopt a version of chapter 11 of US bankruptcy law. Central to chapter 7-type bankruptcy procedure is what Hart (1995) somewhat misleadingly refers to as a „cash auction“. Slovak bankruptcy is of such type. The objections usually raised against such procedures imply that in a post-communist environment the alleged bias towards premature liquidation should emerge a fortiori. Such propositions are often bolstered by the observation that composition (Slovak vyrovnaní, Serbian prisilna nagodba), the key rescue procedure offered e.g. by the Czechoslovak bankruptcy code, is rarely used. The second proposition re-examined in this section claims that rapid as opposed to slow privatization enhances asset stripping and looting (tunelovanie) which ruins numerous companies capable of restructuring and survival. If this is true it should show up in the bankruptcy record. Slovakia clearly has been a country of rapid privatization. After the voucher privatization which occured in 1993

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100 see eg. Trend July 1, 2004 p. 13
101 See e.g. Hart (1995, p. 162f.).
102 Åslund (2002, p. 104) dubbed this view full-fledged gradualism. Stiglitz is one of its most vocal proponents. See e.g. Stiglitz (1999).
there was a temporary slow-down but privatization speeded up again in 1995, when rigged deals in favor of Mečiar’s partisans became a matter of great importance.

To check on these propositions a sample of 80 bankruptcy procedures was constructed. On every single case of bankruptcy reported in the press as much published information as possible was collected. Only if this information was enough to provide a check on the aforementioned propositions the resp. case was included in the sample. Because the financial press is the main source of information, the sample contains medium and large companies only. Since in small companies neither the liquidation bias nor asset stripping is likely to pose as much of a problem for the overall economy, the selection of medium and large companies is desirable. Except for three cases all of the bankruptcies included in the sample occurred after 1997. On a whole, published information on bankruptcies opened before 1997 is too scarce to allow for any definite conclusions. The sample covers nearly all of the major bankruptcies occurring between 1997 and spring 2002. One notable exception is VSŽ, the steel plant in Košice, which was the largest manufacturing company of Slovakia before the rise of Volkswagen Bratislava. It is not in the sample, because the insolvency of VSŽ was not handled in the framework of a formal bankruptcy procedure even though strictly speaking bankruptcy law would have required this. It was disregarded because acting in accordance with legal requirements was thought of as too dangerous. The sample includes only formal bankruptcy procedures, and the companies covered are predominantly in manufacturing industry (58 manufacturing companies). This is likely to improve its aptitude for testing the aforementioned propositions because manufacturing companies usually possess substantial firm-specific know-how which might suffer during a bankruptcy procedure or be destroyed by looting.

The hypothesis of a liquidation bias may be considered disproved if after the opening of a bankruptcy procedure production continues on a substantial scale and for a considerable time – let us say for a year or more. Frequently, this may involve the transfer of activities to another company which serves the purpose of a rescue vehicle. In 42 out of the 80 cases contained in the sample production continued on a substantial scale in spite of bankruptcy. In only one out of these

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103 The main source was the weekly Trend and its supplement Trend top, but some other published sources were used in addition. In particular after 1997 the journalists of Trend have demonstrated remarkable skills in collecting relevant information. The other sources were Mihálik (1994), issues of Slovensko and various internet pages accessible through zoznam.sk

104 There may be asset stripping in small companies as well but note that stripping damages the overall economy only if it does not amount to a pure transfer i. e. only if actually destroys value. This seems less likely in small companies.
42 cases, the ship yard at Komárno, this was due to government supplying a rescue vehicle, in the other 41 cases government remained essentially uninvolved. This is a high survival rate by any standards. Out of the 42 surviving companies at least 15 were taken over (directly or indirectly) by foreign investors. This observation suggests that the favorable climate for foreign investment prevailing since 1999 contributed to the high survival rate. A closer look at the 38 non-survivors helps to put the survival rate in perspective. Among the non-survivors we can identify two groups of companies whose activities were unlikely to create value and thus should have been shut down. The first group comprises various financial companies (including banks) which primarily engaged in Ponzi schemes and other fraudulent business. This applies to ten companies in the sample. The second group comprises food-processing companies which formerly produced low-quality merchandise for CMEA markets. After the collapse of the CMEA Slovak food-processing industry had considerable excess capacity which was due to the high consumption of low quality food characteristic for late socialism. In the 1980s Slovakia had been a net food exporter. Scrapping such capacities is unlikely to destroy substantial value and five bankruptcies in the sample are readily explainable as due to this adjustment process. In sum, liquidation bias does not seem to have posed much of a problem in bankruptcies occurring after 1997, i.e. in a late phase of transition\textsuperscript{105}. Certainly, this observation does not prove that liquidation bias would have been similarly unimportant if bankruptcy had been applied on a more significant scale during early transition.

To check on the looting hypothesis we will assume that looting played a significant role whenever the investigations undertaken by Trend journalists uncovered evidence supporting this view. In the sample this applies to 26 cases; ten out of these 26 cases concerned the aforementioned dubious financial companies. Most of the remaining 16 cases (as well as the undeclared bankruptcy of VSŽ) featured the familiar picture of politically connected entrepreneurs prone to mismanagement and empire-building. In some cases, during privatization profitable companies were sold to well-connected domestic businessmen although a financially much stronger foreign investor was available. This frequently resulted in problems because the former often lacked the skills as well as the financial means to finance the major investments which were usually necessary to keep the company afloat. In nine out of the aforementioned 16 cases (and in addition in the case of VSŽ) it was found that post-privatization looting severely damaged a

\textsuperscript{105} Similar results were found by the research department of the journal Trend. Twenty out of the one hundred largest Slovak companies of the year 1998 entered a bankruptcy procedure in the subsequent five years and all of them survived this procedure as a going concern. See Trend May 29, 2003 p. 23.
company which, judging from their performance in the early 1990s, was likely to be viable. Most of the other companies which suffered from looting were in a difficult or even desperate situation already at the very moment of privatization. In these latter cases it is less than obvious that looting destroyed substantial values. Judging from these figures, the Slovak experience does not seem to support the claim that in a quickly privatizing country such as Slovakia looting was more of a problem than in slowly privatizing countries such as Bulgaria, Croatia, Rumania or Ukraina. Admittedly, such quantitative comparisons of looting are bound to be tentative. The case studies also reveal, that in most if not all cases of looting covered in the sample connections to high-ranking politicians played a role. Thus, these bankruptcies can hardly be said to support an unqualified claim for stronger government intervention. Government was part of the problem rather than the solution.

8. MORE RECENT DEVELOPMENTS OF BANKRUPTCY PRACTICES

Once bankruptcies had become a well-established part of business practices professionalization occurred rather rapidly, the major actors became sophisticated. This resulted in a number of advantages, but there was a dark side to this as well. Bankruptcy and restructuring became a core activity of a species of companies which in Slovak business jargon are referred to as “financial groups”. Some of them are engaging in honest business only, but this does not seem to hold for all of them. The best-known and wealthiest among these groups is the aforementioned Penta group, which in colloquial speech is sometimes referred to as the “lions of Bratislava”. The founders of Penta apparently were intelligent sons of former nomenklatura member. How they acquired their first few million crowns in the early 1990s is unknown. For these “financial groups” the opportunity to take a big leap forward came when Mečiar’s government launched a vigorous and ruthless attack on the investment companies which had been created during the voucher privatization program implemented in 1992. As a result of Mečiar’s attack most of their managers gave up and sold out, usually at low prices. E.g. Penta became big after it acquired the assets of VÚB Kupón, the largest voucher investment fund. Subsequently it multiplied its net asset value. Already then Penta’s specialty was buying undervalued assets and repackaging

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106 For an illuminating interview with a leading member of the Penta group see Trend Nov 7, 2002 p. 19 – 23.
107 Quite a number of the accusations against these funds resulted in court disputes which the fund managers usually won. This victory, however, usually came too late to save their companies. For an example see Trend April 6, 2004 p. 68.
and restructuring them to sell them at a profit. In the course of time Penta accumulated not only considerable legal know-how but also learnt a lot about turnarounds. The shares acquired from VÚB Kupón were minority holdings but Penta started to make a much more active use of stockholder rights than the former management of VÚB Kupón had used to. Frequently the key owners of these companies thought of this stockholder activism as so much of a nuisance that they were ready to offer Penta a good price for their stock. When this bonanza was over the Penta managers realized that collecting bad loans and restructuring bankrupt companies offered great opportunities. Whatever may have happened in Penta’s early years by the late 1990s it had become a company striving for a first-rated reputation. E.g. for buying claims against bankrupt firms it founded an investment company jointly with Credit Suisse First Boston. Penta was now so wealthy that it was able to invest large amounts in restructuring certain companies. E.g. it invested 200 million SKK in the restructuring of Ozeta, a bankrupt textile producer.

The aforementioned transaction with konsolidačná turned Penta into the key creditor of more than 800 bankrupt companies. It thus can give reliable testimony about the actual problems of bankruptcy procedure like their susceptibility to dilatory tactics, and it has given testimony in numerous interviews with journalists. As an example for the relevance of dilatory tactics consider the bankruptcy of Slovenska kreditna banka (SKB) which occurred in 2000. Three years later the bankruptcy procedure was still at its very beginning, not even the initial oral hearing had occurred yet even though this is supposed to take place shortly after opening the procedure108. Proceedings were held up by a series of motions of challenge which various creditors brought against the judge, they claimed to mistrust his impartiality. One may wonder why creditors should be out for protracting proceedings – don’t they want to get their money back as soon as possible ? The resolution to the puzzle quite often is, that some creditors, who are holding claims of low priority and are thus unlikely to get a significant payout, are ready to sell to certain people or the frontmen of certain people, who either seek to cause delays109 or happen to be connected with the trustee and want him to be able to engage in certain abuses which would not be tolerated if he were subject to the effective supervision of the key creditors. The relevance of such connections is suggested by the observation that motions of challenge for suspicion of bias are quite frequently brought against the judge in the very moment in which he is about to replace the trustee (e.g. at the request of the creditor’s assembly). Motions of challenge against judges have been a frequent occurrence

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108 See Trend Dec 18, 2003
109 this may be e.g. because they are debtors of the bankrupt company
in bankruptcy suits since about 2000. They have been rarely successful, but turning them down always took a long time, because it is up to the supreme court to decide and there has always been a long queue in front of the supreme court. As long as the motion of challenge is stuck in the queue, the judge is barred from taking decisions and thus cannot hinder the trustee from engaging in activities favouring the debtor, certain creditors or his friends, who might e.g. get generously rewarded consulting contracts which drive up the costs of the bankruptcy procedure. Since 2001 the trustee can take numerous important decisions without seeking prior permission by the judge, including e.g. the decision whether and how to continue the business of the bankrupt company and the decision to sell certain assets. He is not required to sell by public auction, directed sales are permissible. He also decides whether fraudulent conveyance suits (pobijanje dužnikovih pravnih radnji) are to be brought, and whether the claims of certain creditors of the bankrupt company are considered fake or dubious or not. If he views a claim as dubious he may exclude the creditor from voting at the creditors’ assembly. As a matter of principle a creditor who is unhappy with the trustee’s decision can complain to the judge but this is of little help if the judge is barred from taking decisions because a motion of challenge is pending.

It has also become common that some low priority creditor who holds a small claim challenges the validity of the claims of the largest creditors. If the trustee happens to be connected with the former he may decide that the validity of these large claims is indeed dubious and bar the large creditors from voting at the creditor assembly. The large creditors may react by filing a suit, but the ultimate decision on this suit may be delayed considerably e.g. if somebody files a motion of challenge against the judge and if the low priority creditor subsequently appeals the trial court’s decision at the appellate court. As a result some small creditors may effectively rule the creditor’s assembly for years and reap substantial gains e.g. by directed sales made by the trustee. The trustee may also cause damage to certain creditors by failing to bring fraudulent conveyance suits in time. Suing for fraudulent conveyance (prikrata vjerovnika, alienatio in fraudem creditorum) later is unlikely to be successful because by then the conveyed assets often have been resold already several times and some of the companies involved in this chain of transfers even may have seized to exist. To void such transactions the petitioner must prove that the buyers acted in bad faith, proving this often is difficult. In actual fact most attempts to make fraudulent conveyances undone by taking legal action are in vain110. Another popular method to expropriate the major creditors is that shortly before the first meeting of the creditor’s assembly starts its proceedings all of sudden some hitherto unknown

claimants turn up who happen to raise huge claims. They may present e.g. forged bills of exchange. A “friendly” trustee nevertheless acknowledges the validity of their claims providing them with the majority of the votes on the creditors’ assembly even though no trace of these claims can be found in the accounts of the bankrupt company.

Employing such tricks in order to expropriate the key creditors of a company becomes even more effective if judges are venal. A “friendly” judge may be ready to appoint a “friendly” trustee who engages or supports various abuses. “Friendly” judges may be very unfriendly to the key creditors. It has actually happened that the judge hindered the genuine creditors from inspecting the documents provided by newly arrived alleged creditors claiming large amounts. Such behaviour of judges of course is quite suspicious. Observers consider it as close to obvious that after 2000 some bankruptcy courts turned into a hotspot of corruption. To illustrate the relevance of the abuses consider some examples. Shortly before the bankruptcy of the brewery Urpin was opened several hitherto unknown alleged creditors showed up. They happened to hold enforceable titles which concerned large amounts of money. Because they were non-banks court orders were required before exekútori could start to seize assets but these orders were issued at unusual speed. As a result, exekútori had sold a major part of the remaining assets of the company before the bankruptcy procedure was actually opened. Another example concerned Hydrostav, one of the largest construction companies in the country. It took the court one and a half years to decide about the petition to open a bankruptcy procedure. This delay was used to engage in fraudulent conveyances on such a scale that Hydrostav turned into an empty shell. A third example is that of the company Kžižík headquartered at Prešov. The trustee challenged the claims of the largest creditors and hindered them from voting in the creditors’ assemble. A supreme court decision was needed to correct for this, exhausting the chain of appeals took no less than two years.

The 2003 reform of civil procedure attempted to reduce the scope for dilatory tactics by imposing stricter requirements on motions of challenge brought against the judge. However, this was not enough to solve the problems. While the reform provided by the aforementioned amendment of bankruptcy law enacted in 2000 which enabled creditors to force an exchange of the trustee by voting

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111 E.g. in the Urpin case further discussed below at the day when the creditors’ assembly met for the first time the value of outstanding claims suddenly doubled because three hitherto unknown claimants showed up. All three had bills of exchange, none of them had ever been heard of before or was found in the accounts of the company.

112 Trend Oct 2, 1003 p. 56

113 Trend May 12, 2005 p. 23
against him on the creditors’ assembly and reduced the role of the judge in the bankruptcy procedure was appropriate in principle, it turned out as a major failure that too little had been done to professionalize trusteeship and keep dubious persons out of the profession. In 2004 Slovakia had some 1500 licenced trustees\textsuperscript{114} which surely is an enormous number. Institutions like Slovenská konsolidačna as well as management consulting companies do have lists of trustees whom they view as competent and reliable but these private devices turned out as insufficient to push the rascals out of the profession. When a bankruptcy procedure is opened appointing the first trustee is up to the court and the judge may appoint an unsuitable person who just happens to have passed the very moderate requirements for a license. This is even more likely if the judiciary is venal. On the first creditors’ assembly creditors can decide to get rid of this trustee, but this assembly may fail to be convened for a long time or it may be dominated by holders of fake claims or the judge may be hindered from putting the creditor’s decision into effect because a motion of challenge is pending. The genuine creditors even may find themselves excluded from the creditors’ assembly because the trustee declares their claims as dubious.

In 2006 a new bankruptcy code will become effective, it is hoped to solve many of these problems. A closer analysis of this reform is beyond the scope of this paper which focuses on the actual experience with law rather than speculating about the effects which a change of law may cause\textsuperscript{115}. To restrain many of the abuses discussed in this chapter licensing requirements for trustees are supposed to become much stricter in 2006. Among the new requirements is a state exam for trustees and periodic renewal of licenses. It is expected that as a result of tougher exams and some other requirements at least a quarter of the still extant licences will be revoked\textsuperscript{116}.

\section*{9. TENTATIVE CONCLUSIONS}

As was pointed out in the introduction this paper does not strive for theoretical generalization. However, a few conclusions appear as fairly straightforward.

First, the Slovak experience reconfirms the old wisdom that the path towards the rule of law is bound to be long and numerous obstacles need to be overcome,

\begin{itemize}
  \item \textsuperscript{114} \textit{Trend} May 6, 2004 p. 27
  \item \textsuperscript{115} These are some of the major innovations. In addition the new code is much longer and regulates matters in much more detail than its predecessor. It creates a Slovak version of a chapter 11 bankruptcy but under quite restrictive conditions. As a result observers predict that it will be used only in about one percent of all bankruptcy procedures. See \textit{Trend} May 6, 2004 p. 24.
  \item \textsuperscript{116} \textit{Trend} June 30, 2005 p. 15
\end{itemize}
and that such difficulties should be expected even if circumstances appear as relatively favourable. Compared with most other post-communist countries Slovakia had at least three major advantages. First of all, Slovakia had a long and well-established tradition of the rule of law. Roman law was adopted already in the sixteenth century. While at the eve of World War I Austria (including the Czech lands) had one of the most developed \textit{Rechtsstaat} to be found in mainland Europe, the kingdom of Hungary of which Slovakia was a part stayed somewhat behind. Nevertheless, with some delay most of the progress achieved in Austria spilt over to Hungary. This tradition continued until World War II. A second favorable circumstance was that after communism the ideas of the separation of power and judicial independence were strongly supported by the electorate. Otherwise judges hardly could have dared to resist the Mečiar regime and it certainly would not have earned them as much popularity as it actually did. And third, the fact that under Czech influence Slovakia embarked on rapid reform also should be viewed as a favorable circumstance for the development of the rule of law. The rapid retreat of government from the economy meant that judges turned into important decision makers who ever since have been in charge of deciding disputes involving huge amounts of resources. This is a major source of prestige for courts and stands in sharp contrast with their very limited role under communism when most judges decided only rather petty disputes. Courts thus quickly regained most of their traditional domain which was deciding disputes between citizens. If government largely refrains from interfering with the economy judicial decisions of business disputes are much less likely to result in clashes between courts and the executive branch of government than under interventionistic government, which renders such clashes virtually unavoidable. Such clashes are dangerous for the judiciary because it is likely to end up as the weaker power. If the executive branch of government displays contempt of court there is little that judges can do and this contemptuous attitude is likely to catch on.

Second the Slovak example suggests that prosperity can be achieved already a long time before the path towards the rule of law is passed through, taking a number of steps appears to be sufficient to provide for a good deal of economic progress.

Third after a while an improvement of business morals appears which reduces lawlessness considerably more than the rather gradual increase of judicial efficiency by itself could provide for. Competition seems to contribute towards this development. Slovakia has seen a large number of start-ups and the sphere of small and medium sized business has been highly competitive since the midnineties, since the end of the Mečiar-regime large companies have been fully
exposed to competition as well. Whether and under what circumstances competition can help to improve business morals has long been a point of contention in economic theory\textsuperscript{117}. The Slovak experience suggests a positive answer to the first part of the question.

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\textsuperscript{117} See e.g. Röpke's (1941) criticism of Say's (2003) Olbie ou Essai sur les moyens de réformer les mœurs d’une nation.
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