

## PRESS RELEASE

### **Slovakia: tensions mount ahead of the election**

The parliamentary elections in Slovakia will be held on June 12. Out of the 18 parties running in the election 8 parties have a chance to win seats in the parliament, as there is a 5% threshold. Immediately before these elections political tensions between Slovakia and neighbouring Hungary escalated again, this time because of the dual citizenship issue. The tensions peaked at the end of May as the new Hungarian Parliament passed the amendment that makes it easier for any ethnic Hungarian living outside Hungary to obtain Hungarian citizenship. The Slovak Parliament immediately responded with an Amendment Act of its own: Slovak citizens will lose their citizenship automatically on the same day that they acquire a second one.

This sticking point could affect election outcomes as Hungarians are the largest ethnic minority in Slovakia, numbering around 520 thousand people or accounting for 10% of total population. Although the voters preferences for the extreme-nationalist Slovak National Party (SNS - as part of the ruling coalition since 2006) has been falling in the last couple of months, the traditional so-called Hungarian card currently boosted by the dual citizenship issue could help the party to surpass again the 5-percent threshold for getting into parliament. The strongest ruling party Smer-SD led by Robert Fico will probably gain over 30% votes. Its second minor coalition partner, the LS-HZDS with Vladimir Meciar may also accomplish to get into parliament, although the famous and booming period of the HZDS more than ten years ago is definitely over.

The most recent opinion polls have shown a rising support for centre-right parties. Their chances have further risen, after the Czech parliamentary election two weeks ago clearly shifted that country to the centre-right. The strongest opposition Slovak Democratic and Christian Union – Democratic Party (SDKU-DS) would be the second strongest party supported by around 15 percent of the votes. The new liberal party Freedom and Solidarity (SaS) and the Christian Democrat Movement (KDH) have been somewhat less supported. If also both ethnic Hungarian parties, the Party of the Hungarian Coalition (SMK) and its rival called the Bridge (MOST-HID) surpassed the 5-percent threshold, the entire opposition centre-right block (SDKU-DS, SaS, KDH, SMK, MOST-HID) would be theoretically able to form a government. However, its stability would be questionable not least because of likely nationalist tensions. Anyway, both the game and the result are open.

On the eve of elections, the Slovak economy is recovering. The recovery seems fairly robust and comes earlier than expected. Slovakia is returning to a path of economic growth higher than other NMS. Economic expansion has been largely a function of the revival in external demand, the latter

supported by improved competitiveness. Like in other euro-zone countries, the weakening of euro is having a positive impact on Slovak exports especially related to its two important non-Euro trade partners (Czech Republic and Poland). Apart from the depreciation, the main reasons behind GDP growth have been a strong fall of unit labour costs coupled with rising labour productivity and falling producer prices. The outcome of this mix is raising competitiveness. The rising exports have encouraged industry and boosted GDP growth. In the course of the election campaign, the Fico government has interpreted the economic recovery as success of its own policy put into effect last year. The outgoing Slovak government adopted several anti-crisis measures in the course of the last year, targeted at the support of household consumption and employment. However, the recent revival has been exclusively export driven. Moreover, the Slovak labour market has significantly deteriorated, with the unemployment rate rising to above 14%. This is the shadow side of rising export competitiveness. About one fifth of industrial jobs, predominantly in the private FDI-dominated sectors, have been lost.

During the period of economic prosperity the government missed an opportunity to curb the budget deficit. Therefore public finances are facing serious structural problems. Apart from the current dynamics of the rising budget deficit there are other concerns like the absence of binding limits on budgetary expenditures, the long-term sustainability of the pension system, due to an ageing population and curbing of the second private pillar of pension system, as well as rising unemployment benefits. Past experience shows that only several years of strong GDP growth have an effect on employment. Therefore needs for public spending will remain for some time to come.

As for sustainable economic growth in the future, the crucial point is to avoid any measures that would threaten Slovakia's regained competitiveness and so might undermine its competitive position especially in the EU. If the euro remained weak and unit labour costs low, GDP growth could expand by above 3% in 2010. Later on, if the economies of the main trading partners should recover more strongly, Slovakia's GDP growth might even accelerate. The main challenges for the new government resulting from the parliamentary election relate to rising unemployment and an overflowing budget deficit.

After the election, the most important issue will be to form the new cabinet in due time in order to prepare a plausible austerity budget for 2011 and a credible program of medium-term fiscal stabilization. If not, the international rating of the country would decline and interest rates together with costs of debt service would be on the rise. As a result, the growth of public debt (currently at some 40% of GDP) and of gross external debt (about 70% of GDP) as well would accelerate. Whatever a new government may do with it, in all likelihood the next Slovak administration will be forced to cut public expenditures or increase the tax burden or both. The willingness to reform is depending on the economic policy of the future cabinet.

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