UNICE TASK FORCE ON ENLARGEMENT

2002 REPORT ON CANDIDATE COUNTRIES' PROGRESS TOWARDS EU ACCESSION

SLOVAKIA

June 2002

Table of contents

Executive Summary

Slovakia has been able to catch up with the frontrunners in the enlargement negotiations in a very short time. This has been possible through the very high commitment of all parties to the country's accession to the EU.
This has also been due to several concessions Slovakia has made during the negotiating process, in order to reduce the conflicting areas (especially transition periods).

However this race for accession has also meant a tremendous effort for the local authorities and problems are arising with the effective capacity of the official bodies to implement the new rules and proceedings.

Therefore the EU instruments have to be applied with special care in order to ensure that the funds and policies are suited to the country's needs and administrative capacity. There have been several corruption scandals related to EU funds in the recent past and complaints about corruption and public mismanagement were also common in the companies' feedback. It would be extremely undesirable to spoil the image of enlargement and the country in general because of deficiencies in funding procedures, which make mismanagement and misappropriations of EU funds all too easy.

Actions recommended

There has been positive feedback from companies engaged in Slovakia about the country's preparedness for enlargement.
The message is that, for political an economic reasons but also for public morale, accession should be carried through as early as possible. However special attention should be drawn to particularly sensitive areas such as:

- Improvements of the functioning of the judicial system, including enhanced training and creation of special incentives for the court staff and judges.
- Efficient implementation of the Acquis, requiring enhanced training of civil servants, and improving the consistency in the interpretation of related secondary legislation.
- Application of the Protocol to the Europe Agreement on conformity assessment and acceptance of industrial products (PECA) and harmonisation in standards and norms.
- Revision of the tax code and more business-friendly interpretation of the fiscal Acquis.
- Improvement of creditors' rights.
- Simplification of customs procedures.

Foreword

Slovakia fulfils the Copenhagen criteria: it has a stable democracy and an open market economy. Slovakia has had intense relations with the EU from the date of its independence in 1994, and the European Union is the most important economic partner. Slovakia has made significant progress in catching up with the leading Candidate Countries, as negotiations have moved well ahead with the majority of chapters having been closed, specifically 24 out of 30.

Due to the forthcoming elections on 22 September 2002, for the time being it is difficult to draw a picture on specific political issues after that date, although all the different parties agree on the common objective of EU accession.

From the EU side there is extensive cooperation with Slovak authorities through "Twinning – Projects". Especially with the ministries of justice and finance there are several twinning partnerships with EU countries.

At bilateral level, there is also a good cooperation in sensitive areas such as nuclear safety.

The fluent approximation of Slovakia, especially in the terms of acquis adoption has been an important political signal to underline the country's willingness for EU membership.

However the successful negotiating process is not always accompanied by equally far-reaching successes in implementation of the newly adopted rules.

The task of this report is to define the areas with major deficits on the country's route towards EU approximation.

To that end, an inquiry among European firms affiliated to UNICE Member Federations was carried out, in tandem with a series of personal interviews with expatriates belonging to the executive staff of foreign companies investing in Slovakia. There has also been an interview with a "Twinning Long-term Expert" in the field of Justice and Home Affairs as one of the crucial chapters for enlargement.

Inquiry Results and Points for Discussion

Authorities, official bodies

Slovakia is carrying through several "Twinning Projects" with EU countries; most partnerships are carried out with German and Austrian authorities.

In general terms the participation of the Slovak experts in the Twinning Projects was highly regarded. Especially the personal commitment and also time engagement to the project was highlighted.

Deficits in the realisation of common aims were mainly contributed to the low level of technical and infrastructure equipment.

That means that the increasing demands on administrative staff are not fully compensated by relief through computerisation or newly created positions.

The problem of corruption was mentioned especially referring to the lower levels of the administrative bodies. Work overload on the one side, poor remuneration and incentives on the other side make the system susceptible to corruption.

Civil servants earn relatively little - even in important positions. An average wage is around SKK 12,000. In the industrial field it is around SKK 13,500, whereas a civil servant earns some SKK 14-15,000. In comparison an employee in the private banking sector easily earns SKK 20,000.

And income pressure, especially among university graduates, is around 15-20% increase yearly!

That means that the salary level among people in comparable positions in the private and official sector is increasingly divergent.

Corruption is one consequence of this development, high fluctuation of experts in the state sector another. This is also claimed as a decisive cause for delays and uncertainties in the justice system: the staff turnover negatively influences the stock of knowledge and experience.

"Motivation" payments have become a common factor in Slovak everyday life. Corruption is a common topic also in the press, and it is not unusual to have to "motivate" the doctor if you want to be cured by him.

Inscription in the land register can take up to two years, with adequate "motivation" for the right official, you can have it in one day.

According to several testimonies, the problem of corruption among civil servants is increasing rather than diminishing. One reason may be that older employees still had other personal incentives, while the young staff is merely "money-oriented". So the generation change in this field is tending to aggravate the situation.

However managers feel that problems with authorities at a lower level often do not come from ignorance or out of malice, but from a lack of understanding for "western" or market-oriented business culture and needs.

Court proceedings

Several companies complained about the situation of court proceedings. In their experience there is no guarantee that decisions are taken according to Slovak laws. This counterproductive situation often provokes infringement of laws in business life because the law-breaker knows that there is little danger of being convicted, at least in the short term.

Managers confirmed that the country offers very interesting business opportunities and there are many success stories, but as soon as you get in trouble with a court proceeding you "realise you are in the Wild East".

It seems to be quite frequent that judges are put under pressure during proceedings, and "motivation" payments are also an important factor for a successful trial.

Again, the poor remuneration of civil servants and judges is thought to be a fundamental cause of the problems, but also the long duration of cases. That means that defending your rights by making a second appeal might easily take 3-5 years, which is too long for business operations. Thus, illegal verdicts are quite frequent and usually there are no consequences.

Time is one crucial point, the other was the "motivation" costs which usually have to be added to the cost of the legal action.
But also from the official side, too, there has been little commitment to fight corruption in the legal system –some examples should be made as a warning to the others. Thus confidence on the one side and respect on the other side could be signalled from the legal system

Self-administration of provinces, regional development

Since January eight provinces (VUC = Vyssì uzemný celok) have been introduced. They will have far-reaching self-administration possibilities.

However the process has just started, and for an extremely centralised country like Slovakia, where historically most attention went to the capital in its far west, this major change will take time until consolidation.

For the time being this administrative reform means an additional burden on administrative structures, which are already heavily engaged with acquis adoption.

The new regional division and enforced decentralisation may have a positive impact on disadvantaged areas. Until now, also under the Dzurinda administration there has not been a special programme for regional development, major investments still go to the Bratislava Region (which already reaches EU levels in PPP incomes) and in infrastructure projects oriented towards the west.

Also concerning Industrial Parks very few incentives have been created for underdeveloped areas, but existing parks have been enlarged.

However, companies are moving further eastwards with the passage of time. The wage pressure for academic graduates is about 15-20% a year, which means that many firms are already avoiding the western areas and moving eastwards. Nevertheless the bad infrastructure (sometimes there is no daily flight connection to the second largest city, Kosice) is delaying this process.

EU Funding for Development

Concerning EU funding there have not only been several cases of severe corruption, but often a lack of prepared specialists – and therefore adequate projects - making it difficult to obtain EU funding.

From the employer side an initiative has been started in order to create, in cooperation with the EU and the local authorities, a “Centre of Competence” in order to prepare and submit qualified projects, especially in view of the increasing budgetary ceilings which go hand in hand with accession. (They are determined to prevent the “Portuguese case”, where EU funding was lost because of the lack of valid projects upon accession.)

Adoption of the Acquis

Acquis adoption is carried through with great enthusiasm. Although the quality is suffering from the speed: there are uncertainties, contradictions and often the interpretation of the law is made on the wording, not on the sense – this practice leaves room for manoeuvre, which is highly counterproductive for a clear legal framework.

Bankruptcy law and practices

In Slovakia it is quite frequent that a company is declared bankrupt, and the former owner simply opens another firm with the same activity. Or, even worse, is the case where the assets of a company are simply transferred to a new company, the old one remains with the liabilities, and the creditors are confronted with an “empty” firm.

There is another criminal variety, where a creditor sells his liabilities to another company, this company then blackmails the Debtor to bring in a claim of bankruptcy ("motivating" the judge and using the easy laws). That way a preliminary administrator is called into the debtor companies, without the usual criteria (like insolvency (=Überschuldung) that are common in the EU.

Declaration of Bankruptcy is too simple, court proceedings last too long, execution takes even longer (if you can enforce it), and so business life is disturbed.

Pyramid funds (games)

Another example for the lack of a properly functioning juridical system is the existence of series of very dubious "Investment funds" and other "money-making schemes".

They are cause of public scandals every now and then, when a big fund goes bust.

Although there is a rigorous law on asset management, and the obligation to have a special licence, there are many funds that simply operate illegally. And not clandestinely, but with huge PR measures. This development started in 1993, yet no government has so far been willing to tackle these practices.

Business Representation

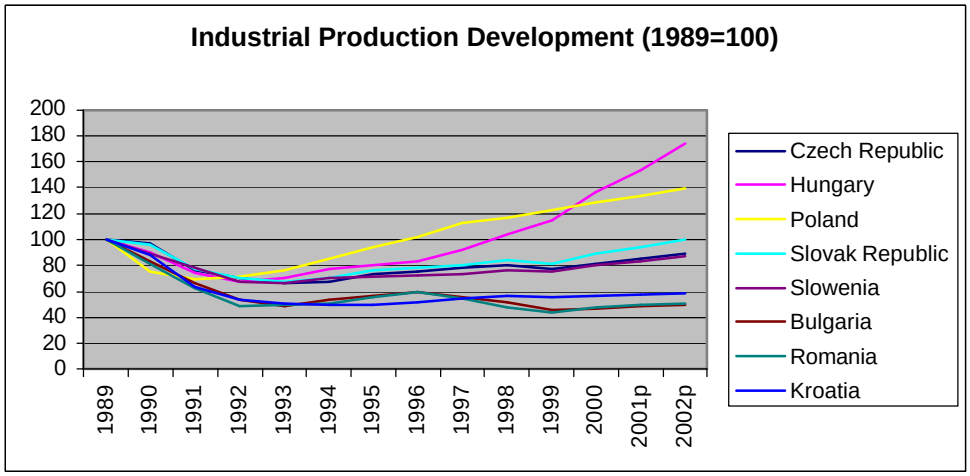
Employer organisations are quite centralised in the big cities (especially Bratislava), whereas in the further regions they are still in an establishing phase.

The worker associations, trade unions, on the other hand have a long tradition, so establishment of a productive Tripartite System is still in construction and employers are struggling to improve their say in the policy-making system.

Economic Context

Also in 2001 Slovakia had stable macroeconomic growth, which was sustained to a large extent by increasing exports. Figures from 2000 show a real growth in exports of 15.8%.

The private sector is already producing 80% of GDP, while 60% of GDP comes from SMEs.



Unemployment is still high, especially in the eastern provinces (up to 35%), although experts believe that about 25% are voluntarily unemployed, as illicit work is very widespread on the one side, and unemployment benefit (starting at around SKK 4,500 for 6 months) and minimum wages are at the same level on the other side.

	2000	**2001p**	**2002p**	**2003p**
GDP	2.2	3.1	3	4
Inflation	12.0	7.3	5	7
Unemployment	17.9	18.6	17	16
Balance of payment	-3.7	-7.6	-7.2	-4.8

WIIW, 2/2002

To help bring down the trade deficit there was pressure from the government side to urge especially the big department stores to increase the share of Slovak products on offer. The initiative failed however, because of a lack of quality Slovak goods.

Recommendations

In general the investment climate is improving in Slovakia. The gradual process of EU alignment and hence the enforced implementation of EU legislation is one of the most important factors for EU companies to engage in Slovakia.
European companies strongly believe that Slovakia's accession will significantly strengthen ties, supporting and facilitating expansion of business activities. The sample of companies interviewed come from a large variety of sectors. Specific recommendations from the business perspective for improvement could be summarised as follows:

- further reduction of public sector involvement in economic activities to the minimum necessary, and promotion of privatisation
- simplification of customs procedures
- promotion of standardisation and certification
- establishment of legal certainty
- training of civil servants
- special training and incentives for court staff
- improvement of creditor rights
- more business-friendly and realistic interpretation of fiscal Acquis

Annex on legal aspects
(Compiled by companies' experts on legal affairs)

Freedom to design business contracts.

Fiscal Laws: the interpretation of fiscal laws in some cases is very narrow. Not in general, but depending on the "willingness" of the civil servants involved.

Price discounts, for example, are only accepted if it is in cash, discounts in products are seen as a "gift" if they have a value over SKK 200.

This is only one example of unnecessary restrictions on the freedom to design business contracts. Other examples were already given in last year's report.

Securities – creditor's rights

A general problem of the Slovak legislation is (i) non-existent rules in respect of establishment of certain – in Western Europe relatively normal - securities, and (ii) very problematic, and from some aspects even non-existent possibility to enforce creditor's rights. In this connection, allow me to inform you about the following facts:

Current impossibility to create a pledge over movable assets.

According to the provisions of the Civil Code on pledge (§ 151a – 151l), a pledge over movable assets may be created (i) under a pledge agreement (the so-called *modus*) and (ii) upon satisfaction of any of the following conditions (the so-called *modus*): delivery to the pledgee or delivery to a third person/trustee or making designation in a document which is required for handling with the asset and proving the ownership title to the asset. Satisfaction of the above conditions for creation of a pledge set out in paragraphs (i) and (ii) is cumulative. From the above enumeration of the conditions representing the so-called *modus* for creation of a pledge it is clear that if the asset (e.g. technology) is to remain in the pledgor´s possession, there is only one option, namely designation in a document which is required for handling with the asset and proving the ownership title to the asset. In assessment of such requirements in respect of the relevant document and the statement that for acquisition of certain movable assets, except for some specific assets (ships, airplanes), the act of delivery is sufficient, I must state that no pledge may be created over movable assets without concurrent physical delivery thereof.

Legal non-enforcement of a mortgage over immovable assets, except for enforcement of a court decision or execution – non-existence of any auction regulation

Performance or realisation of a mortgage is connected, in case of civil law (Civil Code, § 151a – 151l), solely with enforcement of a Court decision or execution, i.e. the mortgager must "obtain" the execution title (mostly a Court decision or a costly Notaries deed). Obtaining an execution title in the form of a Court decision may last several years.

In the commercial law, even if there exists a formal legal possibility "...to sell in a public auction the object of mortgage which is in the mortgagers possession or which may be disposed of by the mortgager...", there exists no procedural regulation which would regulate the procedure in an out-of-court auction.

Non-existence of mortgage action

If there exists no other legal relation between the mortgagor and the mortgager, it is a problem to obtain an execution title which is inevitable in case of a mortgage over immovable assets as, according to the statutory provision (§ 151f of the Civil Code), the mortgager "is authorized to claim satisfaction from the collateral, in case the secured receivable is not fulfilled duly and in time". Such creditor's authorisation means exclusively the debtor's liability to suffer realisation of the mortgage, however not the obligation to pay any certain financial amount.

The obligation to pay certain financial amount means a liability which is required for acquisition of the execution title – inevitable in case of a mortgage over immovable assets for satisfaction of the creditor (in view of non-existence of an auction procedure in out-of-court enforcement). Based on the above , it is clear that in case of creation of a mortgage by a person other than the obligatory debtor and in a situation when the mortgagor as an obligatory debtor as a single person transfers the mortgaged immovable asset, the mortgager will be in distress and will not be able to enforce his rights in a legally safe manner, in spite of the existence of the mortgage.

Failure to accept the principle of time priority of a mortgage in some legal public execution procedure

In view of the existence of the character of the "preferential statutory pledge" applicable for any pledge created according to a decision of a tax office or a customs office (Law No. 511/ 1992 Coll., as amended, Law No. 238/2001 Coll., as amended), I must unfortunately state that tax and customs executions ignore any pledge having been created in favour of a private legal entity prior to the pledge created in favour of a tax or customs office.

Failure to accept the bona fide principle in registration in the Land Registry

The construction of the legislation of the Law on land Registry (No. 162/1995 Coll., as amended) does not protect the transferee's *bona fide*, and thus it may happen that the transferee-to-be or the pledgee-to-be will not become the actual owner or the pledgee, as the entry in the Land Registry means only a rebuttable presumption, i.e. unless something else is proved, the registered entry in the Land Registry applies. "Something else" may be proved e.g. as a result of termination of the agreement by the previous owner or as a result of invalidity of an agreement under which the seller or the pledgor had acquired the immovable asset. Thus it is clear that no third person may find out all circumstances, which may lead to challenge of the actual owner's ownership title, and thus such person is in a legally uncertain position and does not have available confirmed information that should be registered in a land book registry similar to the Land Registry.

Absence of a regulation on priority for a mortgagee in execution in the form of collecting a receivable from account and collecting any other receivable

The Execution Code, in the provisions regulating execution performed in the form of collecting a receivable from account and collecting any other receivable, does not contain any provision which would provide for any preferential receivables. Although the provisions of § 99 and § 101 of the Execution Code expressly provide for performing execution in respect of typically preferential receivables, and the regime of preferential receivables is applied also in respect of § 112 of the Execution Code, from which it may follow that the provision of § 71(2) of the Execution Code should be applied also in execution by collecting a receivable. However, such provisions certainly do not cover those receivables which are secured by a mortgage over the executed receivable from an account or any other collected receivable, but they cover receivables representing allowance money, indemnification of damage resulting from injury of the damaged person, any receivable of damage resulting from wilful criminal acts, receivables in respect of taxes, fees and customs duties, receivables in respect of insurance benefits, etc.
As a consequence of such legislation, I may state that in case of existence of any execution proceedings performed in the form of collecting a receivable from an account in a bank or execution proceedings performed in the form of collecting any other financial receivable according to the Execution Code against the pledgor, in the process described above there exists no provision which would provide for priority for the mortgagee (in favour of which the executed receivables is mortgaged) which would prefer him to the claiming creditor.
Thus, the security may cease (subject to the amount of the claimed receivable) without the mortgagee´s receivable being satisfied.

Impossible mortgage over receivables due to limiting provisions in respect of enforcement or execution

In this respect, allow me to draw your attention to the anachronism of the relevant provision on execution proceedings, **which do not allow enforcement of a decision / execution in respect of:**

- any receivables for insurance benefits (according to § 317 of the Court Code of Civil Procedure) to be paid, according to the insurance policy, by the insurance company, provided such benefits are to be used for new construction or for repair of a building,
- any receivables for payment for a copyright **in the amount equal to four fifths** (according to the Court Code of Civil Procedure) or **three fifths** (according to the Execution Order).
- likewise (in the same system of "fifths" as in the preceding paragraph) also any receivables from any rights similar to the copyright **and any receivables of individuals earned in their business activities.**

In view of impossible enforcement of a decision of execution it is clear that, due to the fact that no mortgage may be created over the receivables in respect of which it is impossible to enforce a decision according to § 525(1) of the Civil Code, no mortgage may be established over the receivables mentioned above (or over a determined portion thereof).

Consequences of termination of execution proceedings by declaring bankruptcy, based on the provision of a newly introduced § 14a to the Law on Bankruptcy and Settlement for a mortgagee

According to the first paragraph of the above provision, the Court will decide on a knock-down declared in an auction of a real property in the execution proceedings according to § 146/1995 Coll., as amended - Execution Code, upon a proposal of the trustee or the bidder according to the above law, provided that in the execution performed in the form of sale of a real property, the knock-down was declared prior to declaring bankruptcy. Based on the above it is clear that in case of payment of the highest bid and filing a petition for granting the knock-down (it will be logical that the bidder will normally be interested in such an act), the bidder will acquire the ownership title to the real property sold in the auction. According to paragraph 2 of the above § 14a of the Law on Bankruptcy and Settlement it is clear that other than failure to pay the highest bid by the bidder on the date of approving the knock-down, at the latest, there exists no reason for refusal to approve the knock-down, and the executor will, upon approving the knock-down by the Court, deliver the proceeds to the trustee of the bankrupt estate.

The essence of the problem is that the mortgagees, after the entry into force of the Law No. 233/1995 Coll. - Execution Code, in order to avoid the risk of revocation of the authorisation to sell the mortgaged real property (which has been representing and still represents another appropriate way accepted by land registers from mortgages trying to proceed according to § 299 of the Commercial Code, i.e. selling the real property in the so-called other appropriate way), and thus to avoid the redundancy of the whole process of realisation of mortgage (at the moment of recalling the authorisation, the creditor is no more authorised, according to the opinion of the land register, to sell the real property), mostly used to file petitions for performing execution. In such process, and unless a petition was filed for performing execution (see cessation of mortgage in execution), the mortgagor had been satisfied immediately after the costs of the execution, acting in the position of a claiming creditor. It cannot be said that, according to the older legislation, the encounter of the execution (performed according to a petition for performance of execution by a pledgee) and the bankruptcy was non-problematic for the mortgagee, because when the final knock-down was allocated to the bidder, the bidder had paid the highest bid and the execution court approved the allocated knock-down, however no distribution schedule was approved by the Court, the mortgagee was in a similarly negative situation. *Such events are and have been negative in both cases* (the first case: under the previous legal provisions of the Law on Bankruptcy and Settlement, in a situation when the knock-down was allocated to the bidder, the bidder paid the highest bid, and the execution Court approved allocation of the knock-down, however, no distribution schedule was approved by the Court before the bankruptcy; and the second case arising from the current wording of the Law on Bankruptcy and Settlement - allocation of the knock-down, declaration of bankruptcy, proposal of the bidder or the trustee for approval of the knock-down, approval of the knock-down by the Court) **due to the fact that the mortgage has ceased to exist upon transfer of the**

ownership title and the proceeds from the execution performed in the form of an auction of the mortgaged immovable asset is/has been delivered by the executor to the trustee of the bankrupt estate, however, under the circumstance of non-existence of the mortgage, and thus no right for separate satisfaction (due to cessation of the mortgage and impossibility to use the proposed order for distribution of the proceeds according to the Law No. 233/1995 Coll. - Execution Order, according to which the mortgagee would be satisfied on preferential basis). The difference between the previous regulations and the current regulations of the Law on Bankruptcy and Settlement is clear, the time period of possible occurrence of the described negative situation is longer because, according to the previous legislation, the risk of occurrence of a negative situation for the mortgagee was narrowed between the moment of approval of the knock-down by the Court and approval of the schedule of distribution of the proceeds, and thus, according to the new regulations of the Law on Bankruptcy and Settlement, such time period is "spread" between the moment of allocation of the knock-down and the moment of approving the resolution on distribution schedule. At the end of this paragraph it should be said that the sole solution of the above problem accepting a mortgage is introduction of a new provision/new provisions to the Law on Bankruptcy and Settlement according to which the proceeds from the auction carried out in compliance with the execution regulations (particularly the Execution Order, the Court Code of Civil Procedure) would be distributed in a manner reflecting the existence of a mortgage over the sold real property, and thus on the basis of priority and immediately upon declaring bankruptcy, the persons receivable secured by the pledge over the sold real property will be satisfied.

Set-off Upon Declaring Bankruptcy

According to the new wording of the provision of § 14(1)(i) of the Law on Bankruptcy and Settlement, any receivable belonging to the bankrupt estate, which could otherwise be set-off, cannot be set-off. The original text of § 14(1)(i) of the Law on Bankruptcy and Settlement, until the effective date of the amendment adopted by the Law No. 238/2000, did not allow setting-off only in cases when any of the parties to the bankruptcy proceedings acquired the mutual receivable, which could otherwise be set-off (e.g. due and payable under a loan agreement), after declaring bankruptcy. Based on the above , it is clear that it was possible to set-off any receivable which could have been set-off against the receivable belonging to the bankrupt estate, provided such receivable had been acquired by the given party prior to declaring the bankruptcy. By applying the new provision of § 14(1)(i) of the Law on Bankruptcy and Settlement, it is clear that the banks are not entitled, after declaring bankruptcy of a debtor, to "use" the funds which are held in the accounts held with the creditor bank. In the manner described above, the creditor bank has been "deprived" of certain rights in satisfaction of its receivable in declared bankruptcy proceedings, because the funds "retained" in the accounts must be delivered by the bank to the bankrupt estate, without any right for separate settlement. The burdensome character of the new legislation may be seen also in the fact that the security assignment of receivables, in view of the very brief provision of § 554 of the Civil Code, was resolved as conditional assignment of receivables for a consideration, and subsequently the consideration was set-off against the secured receivable. **Based on the above , it is clear that the original text of the provision of § 14(1)(i) of the Law on Bankruptcy and Settlement was more "appropriate" for creditors**.

Lastly, allow me to state that a smaller part of the above problems (impossibility to create a pledge over movable assets, deletion of the priority statutory pledge in favour of tax offices) may be resolved by adopting amendments to the existing laws, as proposed by the Government according to the Resolution of the Slovak Government No. 338 of April 19. In this connection we should stress the fact that the final text and the resulting quality of such amendments will depend on how many proposals for modifications are submitted in the Parliament.

List of Rapporteurs of the UNICE Task Force on Enlargement 2002

Mr Erkki **Auvinen**, Partek Corporation

Mr Michael **Carbine**, International Computers Limited

Mr Werner **Freilinger**, MIBA Sintermetall AG

Mr Janis **Grins**, Freja

Mr Edi **Kraus**, Yulon d.d.

Mr Uwe **Krüger**, HOCHTIEF AG

Mr Willem-Jan **Laan**, UNILEVER NV

Mr Dominique **Meillassoux**, Mossley Group

Mrs Lucy **Neville-Rolfe**, Tesco

Mr Vincent **O'Doherty**, Superquinn

Mr Michael **Persson**, DANISCO A/S

Mr Andreas **Polycarpou**, Ideal Group

Mrs Bertrand **Vanden Abeele**, Suez