

GUIDELINES

Socially-Sensitive Labour force Restructuring in South Eastern Europe

SLOVAKIA

Restructuring of the Mechanical Engineering Industry

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1. Introduction

Economic indicators show that the restructuring of the Slovakian economy, especially industry, has achieved positive results, although its sustainability remains questionable.

Before we consider the success story of the mechanical engineering industry in Slovakia a number of important facts should be addressed:

- Restructuring of the industry started in 1990 – and according to some indicators was completed in 2006–2007 – on a compulsory basis, mainly as a consequence of the transformation of the political and economic system from a centrally planned to a market oriented one.
- There was no single plan for restructuring but several, often independent, even controversial, stages. Particularly good examples are the timing of government measures to deal with unemployment (commenced 1991), the introduction of bankruptcy legislation (in practical terms at the end of 1994) and above all a series of legislative acts – on VAT, social contributions, corporate taxation, and so on – that dramatically increased costs, thereby leading to an increase in unemployment.
- The statistical data are often inconsistent because of changes in the system¹ and the division of Czechoslovakia in 1993.
- The mechanical engineering industry includes steel construction, machinery manufacturing and the automotive industry, including suppliers.
- There was no direct² exporting before 1990 – today, direct exports account for around 95 per cent of production in the industry. The companies concerned had to acquire the relevant experience and know-how before engaging in exports.

The mechanical engineering industry has been an important part of Slovak industry since the late 1930s. Up until 1990 heavy industry (heavy steel construction, castings, and so on), arms manufacturing and semi-finished products dominated, mainly for Czech industry. At the end of the Communist era the industry employed more than 200,000 workers, out of a workforce of 2,500,000, and accounted for more than 20 per cent of all industrial production (see Figure 1).

¹ The statistical system was changed in 1992 and 2007. The differences are mainly in terms of definitions, for example, the grouping of different branches under the title 'mechanical engineering industry'.

² All foreign trade, including to COMECON countries, was strongly centralised up until 1990. Only 20–30 foreign trade companies were allowed to conclude export contracts.

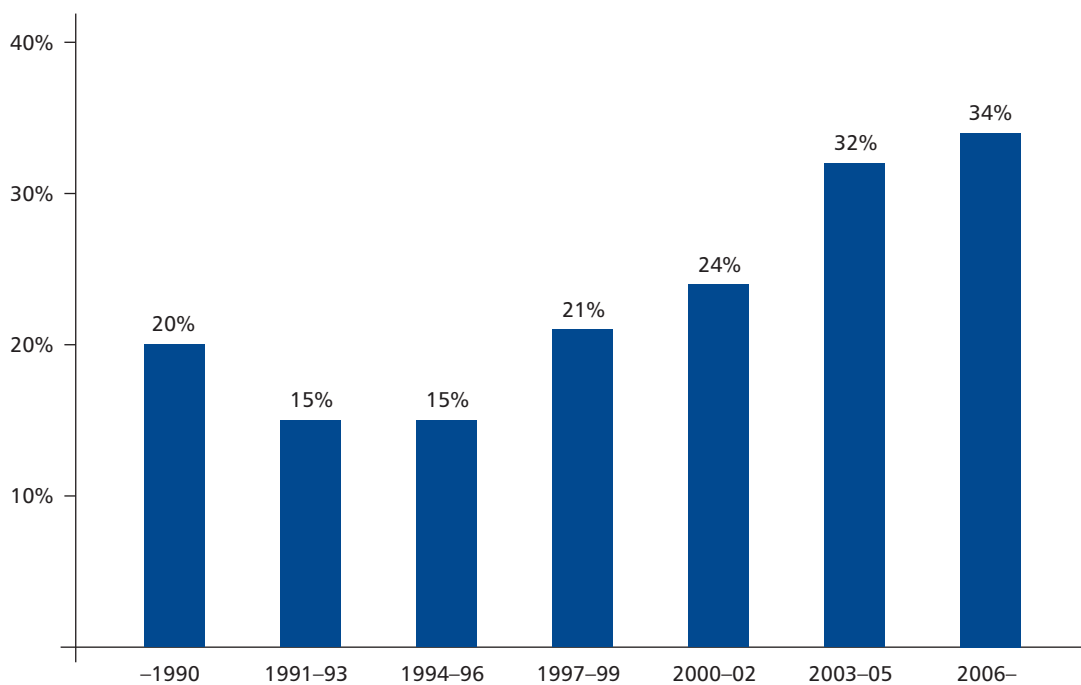
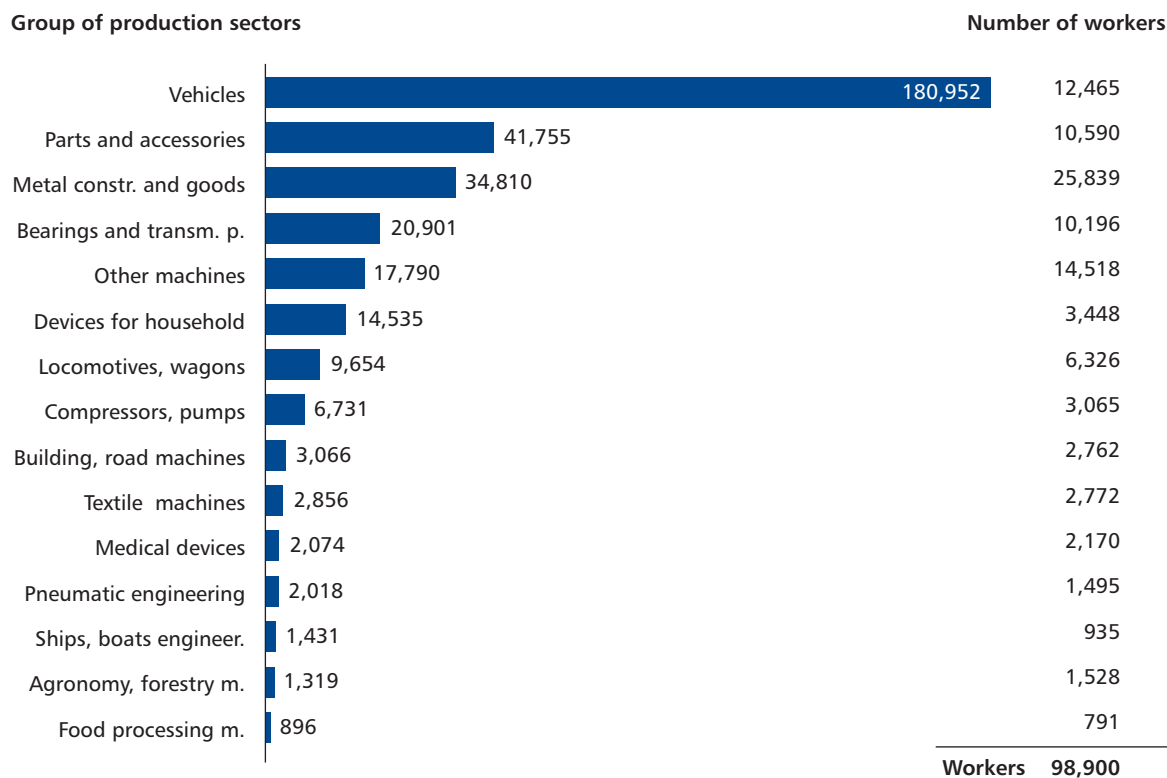
*Figure 1***Production in mechanical engineering industry as a proportion of total industrial production, Slovakia, 1990–2006**

Figure 2 depicts the various branches of the mechanical engineering industry and their share of overall production. The prominent role of the automotive industry – together with the production of parts – is clear, accounting for more than 70 per cent. Employment in the industry has declined significantly; there are now 45 per cent fewer employees in the industry than in 1989.

Figure 2

Production and employment in the mechanical engineering industry by branch, Slovakia

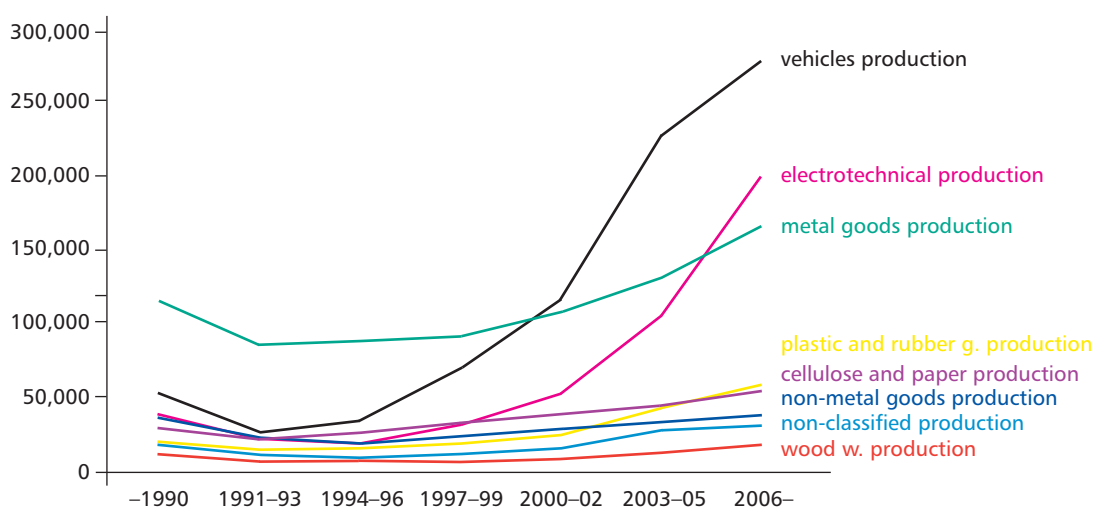
Income from goods production in bil. SK in year 2004



Total revenue in Slovak engineering in year 2004 – 340 787 bil. SK

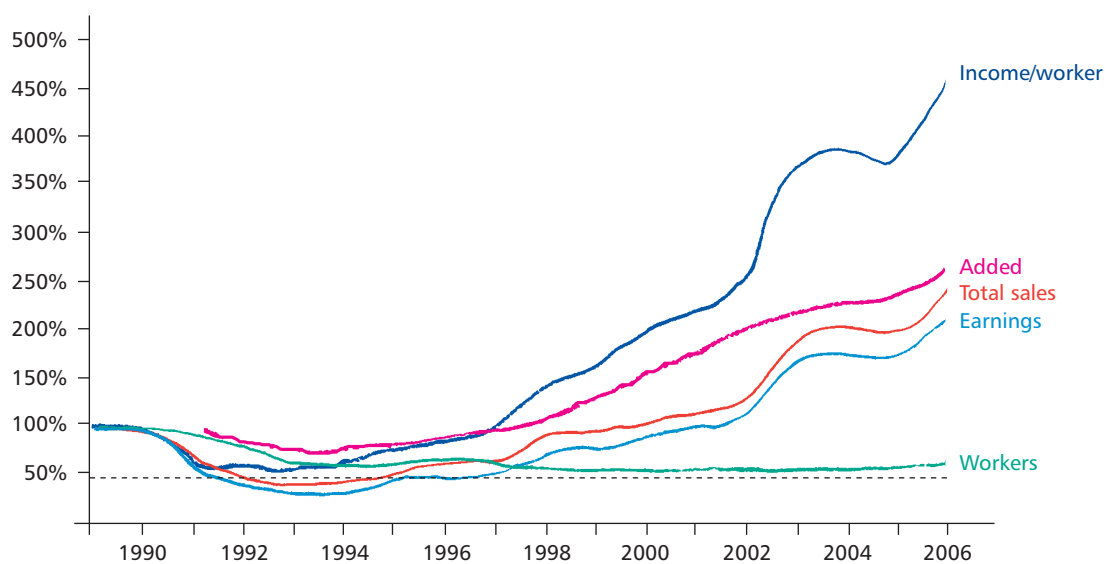
Figure 3

Production trend in mechanical engineering industry branches, Slovakia, 1990–2006



The impact of restructuring on the mechanical engineering industry and productivity is shown in Figure 4.

Figure 4
**Employment and productivity in the mechanical engineering industry,
Slovakia, 1989–2006**



2. Restructuring

Before describing the results of the restructuring of the mechanical engineering industry, with a focus on workforce restructuring, it is important to understand what this process entailed:

- Profound changes were needed in the structure and performance of the industry and its branches, involving: workforce downsizing, disinvestment, ownership change, settlement of debts, demerger, outsourcing, change of market orientation, change of management, new technology, training, and so on.
- The process can be forced or voluntary – restructuring in the mechanical engineering industry was forced due to the shrinking market, the unprecedented speed of privatisation and rising costs.
- Social changes, for example, structural unemployment, retraining, social tensions, reorientation of the social partners.
- Adequate legislation and financial system, as well as sufficient resources.
- The crucial role of the state as legislative body, and the state's willingness to forgo at least part of the taxes and social contributions owed by companies.
- Privatisation.

2.1 Impact of Privatisation on Restructuring

Political change at the end of 1989 created unique conditions for the privatisation of industry, services and the financial sector because it was all owned by the state. The politicians who came to power at that time emphasised privatisation in the following terms:

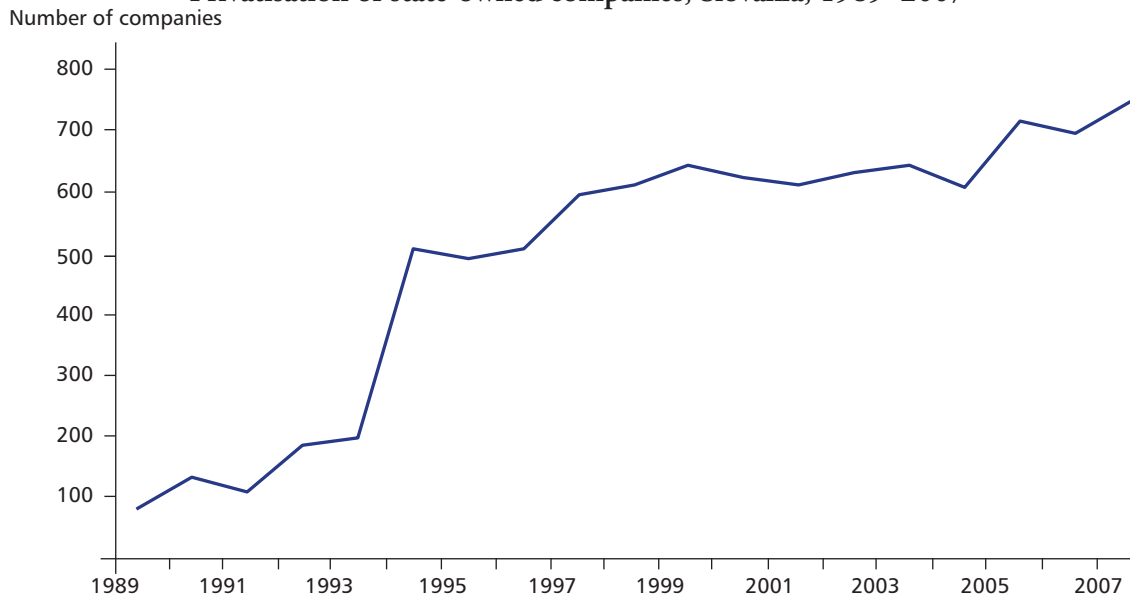
- democracy equals private ownership;
- the state is not an appropriate owner;
- the privatisation of industry will speed up restructuring;
- the 'invisible hand of the market' will bring about a change from a centrally planned economy to a market oriented one.

In this political environment, priority was given to privatisation without the prior creation of adequate economic and legal instruments. The first 'surprise', of course, was the rapid growth of unemployment, from zero at the end of 1989 to almost 10 per cent at the end of 1992. The

measures taken by the state at that time were based on the idea that ‘privatisation will solve the problem of restructuring’, and attention was primarily directed towards supporting the unemployed rather than measures for saving jobs and creating new ones. Nevertheless, again unintentionally, the forced restructuring of corporations was initiated by the state, usually (at least to begin with) motivated by a wish to acquire or exploit existing ownership.

Figure 5

Privatisation of state-owned companies, Slovakia, 1989–2007



Privatisation in Slovakia went through the following stages:

- 1991–92 – voucher and ‘small’ privatisation;
- 1994–95 (after the division of Czechoslovakia) – privatisation in favour of predetermined owners;
- 1995 – introduction of bankruptcy law;
- 2000 – new wave of reforms (Labour Code, tax, social system, bank restructuring, and so on).

It is important to consider the sheer number of companies undergoing privatisation and its impact on social dialogue.

As far as methods of privatisation are concerned, it is worth quoting the World Bank report *Restructuring of Large Firms in Slovakia* (Simeon Djankov and Gerhard Pohl, 1996):

We find that privatization to insiders through management-employee buy-outs did not hamper firm restructuring as the new owners (old managers) invested heavily in new technology, laid off a substantial part of their workforce, sought foreign partnerships, and were prepared to sell controlling stakes to outsiders in return for fresh financial resources.

The evidence also suggests that the mass privatization program did not result in weak corporate governance since it was followed by a rapid consolidation of ownership. Our findings support the view that the main objective of privatization programs should be the speedy transformation of ownership, not the selection of perfect owners.

2.2 Workforce Restructuring

The workforce is strongly affected by restructuring, and in Slovakia the process is not yet over. This judgement is borne out by the fact that unemployment is still above 9 per cent and the employment rate is below 60 per cent. In Slovakia roughly 10 per cent of the population – that is, around 500,000 people of working age – depend on their monthly social benefit cheque. Workforce restructuring is required on both qualitative and quantitative grounds. The process involves the following stages and elements:

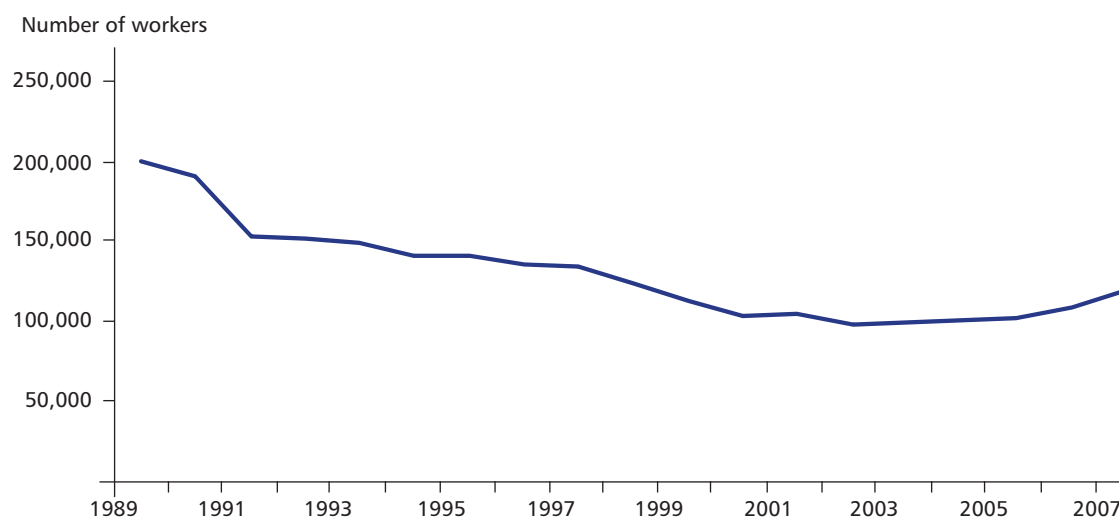
- needs evaluation;
- identification of available jobs in other industries;
- restructuring programme;
- restructuring instruments:
 - management of unemployment and workforce placement;
 - management of retraining – new skills;
 - vocational training and education;
- financial resources.

Initially, there was no specific restructuring programme; the first government measures were introduced in late 1990 and the beginning of 1991, in response to unprecedented levels of unemployment (8 per cent – see also Figure 6).

The collapse of vocational training and education for political reasons should be strongly criticised, alongside the inadequate approach to the retraining of the unemployed. Unfortunately, most resources were spent on education in IT, bookkeeping, management, and so on, while most in demand today are steel processing machine operators and welders. This is not surprising, given the paucity of resources made available: one regional labour office stated in 2002 that average per capita expenditure on retraining over the previous 10 years had been less than SKK 8,000 (less than €265).

Decision-making errors at the outset of the restructuring process are understandable (beginning of 1990s), but much less forgivable in the later stages when much sought after foreign investors are suffering from a lack of skilled workers, while the inactivity rate is 10 per cent, higher than the EU average.

Figure 6
**Evolution of employment in the mechanical engineering industry,
 Slovakia, 1989–2007**



The most important developments as regards workforce restructuring in Slovakia are as follows:

- before 1993, mainly social assistance for the unemployed;
- 1993, creation of the Employment Fund, which financed the following:
 - state aid for the creation of ‘useful’ jobs;
 - public works;
 - promoting the employment of school leavers;
 - support programmes for employers creating new jobs;
 - support for job creation for the disabled;
- legal support – bankruptcy and restructuring law, revitalisation law, state aid law;
- state investment programme – railways, roads;
- restructuring of bad loans (1999–2001) – SKK 120 billion, 5-year state bonds, 8 per cent interest.

2.3 Corporate Restructuring

It is a common mistake in crises of the kind facing Slovakia to address only the social problems – for example, assistance to the unemployed – while neglecting the underlying cause, which is the failure of the economy to provide enough jobs: without well functioning companies social assistance is merely a band-aid. In economic terms, corporate restructuring at the beginning of a crisis is a ‘just in time’ measure, while social assistance to the unemployed is ‘just too late’. Incipient economic collapse could be recognised by the following:

- surplus assets as a consequence of market collapse; as a result the cost of depreciation³ and maintenance increased excessively;
- surplus stock of both finished and semi-finished products, which hit corporate cash-flow;
- bank credits and increasing financial costs – for example, interest rate,⁴ introduction of social contributions,⁵ introduction of VAT, inflation, and so on;
- secondary indebtedness – frozen finance among companies.

The main problem with these measures was their timing: financial pressures emerged together with the deepest economic crisis. As far as the development of government measures is concerned, the main characteristics were repeated efforts to develop a uniquely national approach and a profound misunderstanding of the roles of bankruptcy and enforced restructuring in improving the health of the economy.⁶ The keystone of bankruptcy-based solutions is that the market, represented by creditors – suppliers, banks, tax, social insurance and health insurance authorities – decides on the future of a company under the supervision of the court. The advantage is clear: less administration, less corruption and the risk is shared among all stakeholders, including the private sector.

In the early 1990s efforts were made to use state aid to promote ‘promising’ industries (all of which have since disappeared), to resolve bad debts administratively by means of a kind of forced ‘ringing up’ and selected revitalisation. It is now clear that corruption was rife in the whole process. The first draft of the bankruptcy law was prepared in 1993, but introduced only in 1995 because of extensive fears of a domino effect. A modern bankruptcy and restructuring law was introduced as late as 2005.

³ The possibility to suspend depreciation was introduced at the end of 1992.

⁴ The interest rate in 1989 was only 2 per cent – by 1995 it had reached 20 per cent or more.

⁵ Companies paid no social contributions before 1990 – now they amount to 34 per cent of gross wages.

⁶ With perhaps some exaggeration we can compare the role of bankruptcy administrators to the role of the scavenger beetle in nature or the grave digger in human society, while restructuring is comparable to medical treatment.

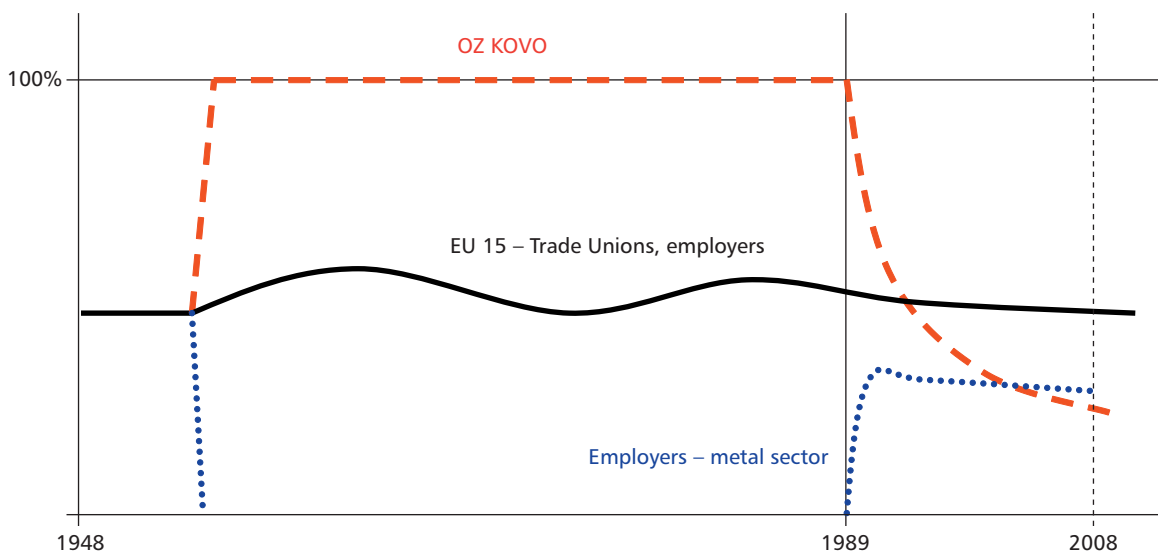
2.4 Social Dialogue

Motto: *Social dialogue is similar to a dam, protecting the land from flooding. The dam must be constructed during a dry period, when its protective function seems less important. If the dam is a good one, it seems that there is no need to worry about a flood. Once flooding occurs, however, it is too late to build a dam.*

Social dialogue in Slovakia is still a very sensitive issue, but very important in dealing with the upcoming difficulties.

Modern social dialogue started in 1990, but the position of the social partners at that time was very different from what it is today (see Figure 7).

Figure 7
Development of social dialogue, Slovakia, 1948–2008



While trade union membership (OZ KOVO is the metal industry trade union federation) was compulsory during the Communist era,⁷ there were of course no employers' organisations because the only employer was the state, with partial exceptions as regards cooperatives. Compared to the development of the social partners in the EU-15 Slovakia lags behind by about 40 years.

⁷ Trade union density during the Communist era was 99.5 per cent.

Since the transition got under way the trade unions have experienced heavy membership losses, having inherited their structure from the former, communist-controlled trade unions. Part of this inheritance, of course, was assets, mainly hotels and ‘cultural houses’ in the larger towns and cities. This potentially favourable legacy has to be set against the aforementioned loss of members, but above all the negative impact of restructuring (usually accompanied by the breaking up of companies) on grassroots trade union organisations. When companies were broken up, the trade unions lost members because formerly each company had its own trade union organisation.

In contrast, employers’ organisations were founded with enthusiasm, the main objective being to protect companies’ interests against the state rather than to engage in social dialogue with workers’ representatives. The founders, at the very beginning, were the managers of state-owned enterprises, and it was frequently the case that 80–90 per cent of representatives changed over a year.

The rapid creation of branch employers’ federations started, under the aegis of the Industry Association, succeeded in 1994 by AZZZ (Association of Employers’ Unions and Associations), which was closer to the government. AZZZ now represents mainly public sector associations, after the industrial associations left AZZZ in 2001 to create two organisations of their own.

2.4.1 Basic Facts about Social Dialogue

The current phase of social dialogue started in 1990. It was significant that the trade unions were much better prepared than the inexperienced employers. Most of the trade union negotiators were professionals, while all the employers’ representatives acted on a voluntary basis, which remains the situation today.

The tripartite body, considered to be the ‘apex’ of social dialogue, was established in 1991. However, the government holds the power and therefore always has the decisive role in relation to both workers and employers. The social dialogue does not involve equal partners. The role of the tripartite body is really as an arena in which the government can consult with the social partners. Politicians in Slovakia have so far not made the best use of this possibility, however. The only effective social dialogue at national level is bipartite dialogue.

The basic legislation governing social dialogue was laid down in 1990–92. It created the legal background for collective bargaining, established the first regulations on strikes and amended the Labour Code. In the meantime there have been three fundamental revisions of the Labour Code and several small, so-called ‘technical’ changes.

To all appearances, basic legislation governing relations between employees and employers has become a political plaything, first for politicians and subsequently for the social partners. The destabilisation of industrial relations in favour of political ambitions is all too frequent, particularly among the new EU member states.

A two-tier system of collective bargaining was set up at the beginning of 1991 and remains in place, although there have been a number of attempts to reach a nationwide collective agreement (General Agreement). All attempts have failed so far because of the anti-corporatist views of most politicians and the idealistic belief that the tripartite body represents the dominant power in the social dialogue.

One sign of the low importance of social dialogue at present is the lack of regular statistics providing the necessary information. Currently, around 2.2 million people are in employment and roughly 200,000 (9 per cent) are unemployed. There are 95,600 employers (with legal personality) and around 500,000 sole traders. The trade unions have 450,000 members, most of them in the public sector. This yields an average trade union density of about 21 per cent – in the private sector the figure is around 10 per cent.

There are 38 collective agreements at branch level and around 3,500 collective agreements at enterprise level. Coverage is an estimated 30 per cent.

Trade union representativeness has long been disputed between employers and workers' representatives. Nevertheless, the Labour Code gives trade unions the right to represent 'all employees in the process of collective bargaining', which gives an advantage to trade union representatives. On the other hand, it is not entirely democratic.

The minimum wage is a very sensitive instrument both socially and economically; for example, it can strongly affect labour costs. It is unfortunate that this instrument is almost entirely in the hands of politicians. This is not so dangerous when the economy is growing, but during periods of economic difficulty the use of the minimum wage by politicians to increase their popularity can lead to disaster.

Compared to how things stood at the very beginning of restructuring, a number of negative tendencies can be discerned in collective bargaining – for example, the number of collective agreements and coverage.

The right to strike is guaranteed by the Constitution of 1990 and by the Collective bargaining law of 1991. There were only two strikes (railways) in the period 1990–2008 with a significant impact on the economy. There have been no lockouts (first introduced in 2001).

Although the Slovak economy has recently experienced a period of high growth – higher than in most other EU countries – social peace is a necessary condition for its sustainability and for facing the crisis which is now unfolding. The mechanical engineering industry is in this respect a particularly sensitive one because of the massive downsizing and restructuring it has undergone. Collective bargaining is a very important tool for resolving problems resulting from the difficult economic situation.

3. Lessons Learned from Restructuring

The main lessons learned from restructuring in Slovakia are as follows:

- The view that a rapid change of ownership would initiate change, often criticised from the very beginning of the restructuring process, proved to be correct.
- The mass privatisation programme did not result in weak corporate governance.
- Privatisation to insiders through management/employee buy-outs did not hamper firm restructuring; the new owners (former managers) invested heavily in new technology.
- Measures and legal instruments for corporate restructuring were missing at the beginning of the crisis.
- Social programmes – that is, effective support for the unemployed – must be introduced before or at the beginning of a crisis. In the case of Slovakia they were introduced late in the day.
- Social dialogue is a crucial instrument for the smooth implementation of restructuring.
- The most important legal instruments are:
 - bankruptcy and restructuring;
 - public procurement;
 - legislation on state aid.

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