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Policy Interdependence during Economic Transition: The Case of Slovakia 1999-2000

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ABSTRACT/RÉSUMÉ

This paper sets out a framework to analyse the interdependence of reforms in different policy areas during the transition process. It identifies four broad policy blocks related to liberalisation, stabilisation, exit and entry. The transition process in Slovakia is a case study of the striking interdependence between these different policies. Along these lines, the paper analyses the reform programme that was implemented in the Slovak Republic during 1999-2000, focusing on macroeconomic stabilisation and structural reforms in the banking and enterprise sectors. It appears that success in making up for a period where economic reform had stagnated and even been reversed depends on being able to reform on a broad front. In particular, this means addressing the difficult situation of financial deadlock between all major players in the economy and the large costs associated with restructuring. Fostering deep restructuring in the large enterprise sector is the main structural challenge in the Slovak economy. This must be faced if the economy is to promote sustainable growth that results in the job creation necessary to bring down high levels of unemployment. During the transition, the many pressures from restructuring are likely to converge on the budget, which will become an indicator of strain in the economy.

JEL Classification: P21; P27
Keywords: Transition; policy-interdependence; structural reform; Slovak Republic.

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Cet article propose un cadre d'analyse sur l'interdépendance des réformes économiques au cours du processus de transition. Quatre grands blocs de politiques sont identifiés : libéralisation des prix, stabilisation de l'économie, cadre économique pour la sortie et l'entrée de firmes. Le processus de transition en Slovaquie est un cas d'étude intéressant de cette interdépendance des politiques économiques. L'étude analyse le programme de stabilisation macroéconomique et les réformes structurelles dans les secteurs bancaire et des entreprises, mis en œuvre en République Slovaque pendant la période 1999-2000. Pour rattraper avec succès le retard accumulé dans le passé, il serait nécessaire que ces réformes soient effectuées sur un front assez large. Il est notamment indispensable de surmonter les blocages financiers entre les principaux agents de l'économie et d'assumer les coûts liés à la restructuration. Le défi majeur est l'accélération de la restructuration en profondeur du secteur des grandes entreprises. C'est la réalisation de ce défi qui permettra de promouvoir une croissance économique soutenable génératrice d'un nombre d'emplois suffisants pour faire baisser le chômage. Pendant la période de transition, il est probable que les comptes publics devront supporter un grand nombre de contraintes liées à la restructuration et qu'ils seront, par conséquent, un indicateur de la *pression* sur l'économie.

Classification JEL: P21; P27
Mots-clés: Transition; interdépendance des politiques économiques; reformes structurelles; République Slovaque.

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POLICY INTERDEPENDENCE DURING ECONOMIC TRANSITION: THE CASE OF SLOVAKIA 1999-2000

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1. Introduction

1. The transition process in central and eastern Europe has provided strong evidence of the links between macroeconomic developments and structural reforms. After early debates between ‘gradualists’ and those advocating ‘shock therapy’, and on the optimal speed of reforms (Aghion and Blanchard, 1993), it has become increasingly evident that reforms are strongly interdependent. The success of any individual policy depends on being able to reform on a broad front. A certain uncompressible time is also needed to build up institutions to support market mechanisms. Thus the focus of the debate has shifted from the speed to the scope and coherence of reform (Stiglitz, 1999).

2. The current stage of transition in the Slovak Republic well illustrates these policy links. The structural underpinning of transition was neglected in the early stages of reform and latterly the macroeconomic position had started to deteriorate. Between 1996 and 1998 the Slovak economy had accumulated substantial external and fiscal deficits, along with an unsustainable level of public investment and expenditure. Although economic growth had been maintained, it was not soundly based (OECD, 1999a). Policy changes quickly followed the parliamentary elections in September 1998. Shortly after, the National Bank of Slovakia (NBS) had to abandon the fixed exchange regime that had been in place since independence in 1993. An initial economic programme was approved in December by the new government. But the measures were not enough, and a second austerity package was implemented in May 1999.

3. Policy during 1999 was targeted at macroeconomic stabilisation. The state budget deficit was contained and the austerity measures to slow down domestic demand induced a substantial reduction in the current account deficit, which nearly halved compared with 1998. The government further liberalised controlled prices of energy and public utilities which increased headline inflation significantly, even though inflationary pressure remained subdued. While a recession might have been expected, Slovakia in fact grew by nearly 2 per cent in 1999. This moderate growth was not enough to prevent unemployment rising to nearly 20 per cent.

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4. Together with this restrictive stabilisation programme, the government initiated a number of measures intended to improve the situation in the financial sector and pave the way for hardening budget constraints in the enterprise sector. The first microeconomic reform was the adoption of a bank restructuring programme that began in December 1999. The large state banks were recapitalised and a tranche of their bad loans transferred to a new bank restructuring agency. These steps were intended to prepare the banks for rapid privatisation. The problems in the banking sector are linked to those in the enterprise sector. In the absence of enterprise reform the benefits of bank restructuring cannot fully materialise. This is a typical example of the interactions amongst reforms that are the focus of this paper.

5. The paper starts by setting out a framework enabling to identify the main linkages between macroeconomic policies and microeconomic reforms. It moves on to the immediate macroeconomic stabilisation measures adopted in Slovakia and their impact on the real economy.[2] It then considers the two main areas of structural reform, the financial and enterprise sectors, and their interaction. In turn, structural changes will make themselves felt at the macroeconomic level. The circle is closed in the final section by analysing the impact of these reforms on the macroeconomic position. Given the limited scope for monetary policy, the budget is the primary gauge of strain in the economy. Along these lines, the paper highlights the challenges that lie ahead in reducing public sector expenditure and debt creation. It ends with a summary.

2. Interdependence of policies

6. Observations from a decade of transition provide evidence to explore the linkages between different economic policies. At the outset, all transition countries were offered roughly the same liberal policy package designed to make use of market mechanisms to obtain the best possible allocation of resources, which in turn creates the conditions for sustainable growth and an improvement of living standards. In retrospect, one aspect perhaps overlooked at the time was that such a package needs to be internally coherent. In order to reap the full benefits from this approach to reform, policies in the different areas of the reform programme must, as far as possible, be implemented in parallel.

7. Precisely because reforms are interdependent, the direction of causality between different policies can often not be disentangled. Ideally, in order to analyse these simultaneous interactions a general equilibrium formulation would be required. In reality, providing evidence and specifying structural interactions would not be straightforward as the environment during transition is very volatile and many aspects are difficult to quantify.

8. A more pragmatic approach was adopted here, which is summarised in Figure 1. It sets out the most important policy areas and their links in the sequence they were typically observed in Central and Eastern European transition countries. This sequence may reflect not only policy choices but can also result from the relative ease of implementation or different political pressures. In the first place, most transition countries liberalised trade and a large basket of prices.[3] As a result, the true pattern of demand is revealed as relative prices adjust. This was followed by stabilisation, but if the right macroeconomic policy mix is not in place, notably when a budget deficit is financed through monetary creation, price liberalisation is quickly followed by high and accelerating inflation. In turn, macroeconomic stabilisation can only be sustained and lead to economic recovery if significant and steady progress is achieved in the

2. Additional information, which is not used in this paper but that may be useful as background information for the reader, can be found in OECD(2000a).

3. Typically prices of energy, housing and transport lagged the liberalisation in other areas.

area of structural reform.[4] For example, efforts to achieve and maintain budget discipline are undermined where enterprises face weak budget constraints and draw resources from the public sector. The channel for this is often not direct subsidy from the budget, but instead over-easy access to credit from the banking system, often itself in full or partial state ownership. Another example of indirect support is where the state maintains an artificially overvalued exchange rate in order to facilitate imports of raw materials or energy to unrestructured heavy industries (OECD, 1998). This situation persists until firms that fail to add value are forced out of the market. During transition, privatisation and restructuring have all been used to encourage this outcome. But often this process has been held back by insufficient use of liquidation, the result of ineffective bankruptcy procedures and weak creditor rights (Malle, 1999).

Figure 1. Policy interdependence: a framework for transition

9. Lack of progress in one area affects other structural reforms. For example, large enterprise restructuring is undermined in the absence of external financial discipline, typically imposed by the banking sector. Either banks do not lend, regardless of companies' creditworthiness, to prevent a new accumulation of bad debts, thus reinforcing existing credit constraints. Or else, under pressure to resume the flow of lending to unrestructured enterprises, financial problems in the banking sector re-emerge. Likewise, if bankruptcy proceedings are not effective, banks cannot both provide credits and impose financial discipline. More generally, positive structural interactions do not necessarily follow policy implementation. The problem is not only to solve the question of *stocks*, such as bad debts, but also to ensure that the *flows* are right, namely exit and entry of firms, new financing and investment. When the flow problems have not been solved, the stock problems tend to re-emerge, with the risk that their resolution becomes even more costly. Where exit mechanisms are enforced and induce enterprise liquidations but where the conditions for entry of new enterprises are not in place, the pace of restructuring may become politically unsustainable as unemployment rises and the economy fail to recover rapidly.

10. These policy linkages have been the focus of the OECD approach towards transition countries. A recent comparative study of the three Baltic States (OECD, 2000b) concluded that it was more important to get the *links* right rather than pushing reform in any single area. These links should also incorporate institutional development (Havrylyshyn and van Rooden, 2000).

11. The initial reform programme approved by the Slovak government in December 1998, outlined in Table 1, reflects growing awareness of the interdependence of structural reforms. However, decisions on the actual implementation of policy were slow to emerge. The government had to develop a *modus operandi* within the different parties that comprise the coalition, an illustration of the interaction between economic policies and the political system. Nonetheless, the reform programme finally gained momentum during 1999. Key measures were adopted in fiscal policy, price liberalisation and bank restructuring. However, progress on enterprise restructuring and financial discipline requires a higher degree of political consensus, which has proved difficult to achieve.

Table 1. Slovak reform programme and policy implementation, 1999-2000

4. Evidence on this point is provided in several OECD Surveys of transition economies (OECD, 1996, 1997, 1998, 1999a,b and 2000)

3. The macroeconomic stabilisation package

3.1 Adjustment measures

12. By the end of 1998 the macroeconomic situation in the Slovak Republic had become unsustainable. During 1998 the Slovak Republic recorded a current account deficit of 10.4 per cent of GDP and a fiscal deficit of 4.8 per cent of GDP (Table 2). The government was also faced with the risk of collapse in vital public services such as healthcare and education. The coalition government which took office in late 1998 focussed its initial programme on macroeconomic stabilisation. Policy aimed to reduce the fiscal deficit, slowing domestic demand and in this way bringing down the current account deficit. After some months it became apparent that these measures were not sufficient to stabilise the fiscal position (IMF, 1999a-b). It was politically difficult for the government to adopt firmer measures in advance of a presidential election that took place in May 1999. But it also took time for the four coalition partners[5] to reach an agreement on a mechanism for taking decisions, and indeed on the extent of economic adjustment required. In fact, a second package of austerity measures was announced just prior to elections at the end of May and implemented immediately afterwards.

Table 2. Macroeconomic performance, 1995-1999

13. The state fiscal deficit was brought under 2 per cent of GDP by government action to both increase revenue and reduce expenditure. The State budget came close to balance for the months August to November, having already reached more than three-quarters of its planned total before the end of July. The government was able to cut the budget deficit without implementing its plan to reduce the numbers of civil servants by twenty thousand; government employment actually rose during 1999. The most important revenue measures were the imposition of a temporary import surcharge (at 7 per cent), and increases in the lower rate of VAT and in certain excises. There was also a first round of increases in the price of energy and public utilities and a reduction in proposed improvements to welfare benefits. The consolidated budget deficit[6] was also reduced, though at 3.6 per cent it remained nearly double the state budget deficit.

14. The major achievement of the adjustment package, however, was a dramatic reduction in the current account deficit. In Slovakia the trade balance effectively determines the current account balance, given that the high service revenues from energy transportation approximately cover the invisible trade deficit in other areas. Weak domestic demand combined with the import surcharge imposed half way through the year led to a considerable reduction in the demand for imports, which fell by some 14 per cent in US dollar terms. After three years of double-digit deficits the current account for 1999 fell to 5.8 per cent of GDP. This moved Slovakia's external position back onto a sustainable footing. This point is illustrated in Figure 2, which relates the level of the current account deficit, nominal GDP growth and the debt to GDP ratio.[7]

Figure 2. Sustainability of the current account deficit

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5. The coalition comprises the Slovak Democratic Coalition (SDK), Party of Democratic Left (SDL), Civic Reconciliation Party (SOP) and the Hungarian Coalition Party (SMK). The SDK is itself a coalition of five separate parties that remain independently registered: the Christian Democratic Movement (KDH), Democratic Union (DU), Democratic Party (DS), Slovak Social Democratic Party (SDSS) and the Slovak Green Party (SZS). In January 2000, the Prime Minister formed a new party, the Slovak Democratic and Christian Union (SDKU).

6 The consolidated budget deficit includes the expenditures of local authorities and, importantly, extra-budgetary funds such as the welfare and road building funds. The welfare funds in particular have continued to incur considerable cash deficits (see Section 6 below)

7. See the technical annex for a definition of current account sustainability.

15. In aggregate terms, the most important factor behind the reduction in final domestic demand was the sharp contraction of investment (Figure 3), after the peaks of 1996-97. The seemingly excessive ratio of investment to GDP in Slovakia (OECD, 1999a) suggested a degree of over-investment not justified on economic grounds, and so pointed towards the need for the adjustment recorded in 1999. The government reduced its capital expenditure by 20 per cent during the year. Another element of the adjustment was the reduction in real wages. Average real wages were stagnant during the first half of 1999, and fell by 6 per cent during the third quarter. For the year as a whole real wages fell by 3.1 per cent compared with 1998. The fall in real wages was mainly due to increased headline inflation as the government moved to liberalise controlled prices and froze public sector wages.

16. These austerity measures were widely expected to produce a significant slowdown in growth. However, their impact was mitigated by a persistent upswing in exports during the year. Overall, the slowdown in growth left room for a 1.9 per cent increase in GDP during 1999.

Figure 3. Contribution to GDP growth of final demand, 1993-99

3.2 Social impact

17. The cost of both internal and external adjustment has been quickly reflected in higher unemployment. Registered unemployment increased from 16 per cent at the beginning of the 1999 to more than 19 per cent by the year-end. This measure is typically higher than those that are based on a labour force survey (LFS). But even LFS unemployment rose to more than 17 per cent by the end of 1999. This singles out the Slovak Republic from other transition economies as peak unemployment in the neighbouring transition economies of Poland, Hungary and the Czech Republic never reached these levels.

18. In part, increasing unemployment could be seen as a result of restructuring, given that between 1998 and 1999 roughly half the increase in unemployment (of 100,000) was due to net destruction of jobs. This particularly affected traditional sectors such as agriculture and heavy industry (machinery, basic metals and mining). At the same time, employment increased in the service sector and in some manufacturing industries such as textiles, but not by enough to offset job losses in other sectors. This sectoral reallocation is evidence of structural change (see Table 3).

Table 3. Labour market changes, 1998-99

19. But a large part of the rise in unemployment was due to demographic factors. Indeed, over 1998-99 the labour force increased by roughly 50,000, largely due to the number of young people joining the labour market. This is reflected in the substantial increase in unemployment amongst the youngest cohorts in the labour force that can be seen from the strong cyclical component of monthly unemployment, which peaks at the end of the school year in July (Figure 4). Actually, the rising trend in registered unemployment had already started before 1999, showing that previous growth in the economy had failed to generate sufficient new jobs. Nevertheless, the slowdown in growth that followed the austerity measures was a contributory factor to the increase in unemployment. Stronger growth was needed to absorb the natural increase in the labour force. Despite this continuing pressure from labour force growth, the rising trend in unemployment seems to have levelled off towards the end of 1999. However, this only emphasised the need to press on with structural reforms, especially since yet greater pressure on unemployment could be expected as restructuring progressed, not least as new bankruptcy procedures began to affect hitherto unrestructured parts of the enterprise sector.

Figure 4. Monthly change in registered unemployment, 1997-2000

20. The government took some measures to reduce the registered rate of unemployment by tightening the qualification criteria for unemployment benefit. It also sought to develop active labour market measures to alleviate youth unemployment in particular, and to increase the degree of labour mobility within Slovakia. This latter measure was designed to help reduce quite strong and persistent regional differences in unemployment. However, the social pressure associated with rising unemployment and tightening benefits inevitably interacts with, and complicates, the political process. This is a crucial aspect of reform (see Fidrmuc, 1996), which is not covered further in this paper.

3.3 Continued nominal convergence

21. Despite the increase in 'headline' consumer prices (CPI), underlying inflation remained subdued. Monthly CPI inflation shows clearly the level adjustments that followed three increases in regulated prices without raising the trend (Figure 5). The effectiveness of the austerity programme was enhanced by a consistently prudent monetary policy. The latter was gradually relaxed as the focus of economic policy shifted to the fiscal account, and the National Bank of the Slovak Republic (NBS) succeeded in stabilising and reducing the level of interest rates.[8]

Figure 5. Monthly consumer price inflation, 1997-2000

22. The reduction in interest rates did not lead to downward pressure on the exchange rate. On the contrary. During December 1999 the NBS intervened several times to prevent Koruna appreciation.[9] The real effective exchange rate, a broader measure using consumer prices (CPI) weighted by trade share, shows the Slovak crown appreciated by some 10 per cent during 1999 (Figure 6). The appreciation was rather less using producer prices, reflecting that the rising CPI stemmed mainly from price deregulation. Over the medium term, as a result of the EU accession process, monetary policy may place greater weight on stability of the exchange rate against the Euro. This does not pose a threat to the continued improvement in the trade and current account balances whilst it is matched by productivity gains. For this external constraint to be effective, however, the enterprise sector will need to restructure rapidly in order to increase the quality and variety of Slovak exports (see Section 5 below).

Figure 6. Real effective exchange rate, 1996-2000

4. The first step of restructuring: the financial sector

4.1 The banking system was deeply implicated in widespread indebtedness

23. There was agreement within the government that bank restructuring was the first step needed to re-establish financial discipline in the Slovak Republic. In line with OECD recommendations (OECD, 1999a), the government's Medium Term Economic Policy Priorities (European Commission, 2000)

8. At the beginning of 2000 the NBS introduced repurchase ("repo") contracts in order to reduce interest rate volatility. Initially it offered an overnight rate, with plans to move gradually to a two-week contract. This facility supported monetary stability by allowing banks to manage their liquidity much more actively. It had an immediate impact on interest rates in Bratislava: overnight BRIBOR rates in January 2000 were some 10 per cent less than a year earlier, and by April 2000 they had fallen below 8 per cent.

9. The NBS has publicly stated that it has a target corridor for the exchange rate, without revealing the upper and lower rates of the band.

emphasised that restructuring in the enterprise sector cannot succeed where the banking system either fails to extend credit, or extends credit without proper attention to creditworthiness.

24. By the time bank restructuring was launched in Slovakia, towards the end of 1999, more than 40 per cent of gross loans were classified as substandard or below. Most fell into the bottom 'bad' category. This proportion was subsequently reduced to 18 per cent following the first steps in the government's bank restructuring programme. Provisioning by the commercial banks had been strengthened, and the shortfall from NBS standards at the end of 1999 was about 2 per cent of GDP. It is noticeable that the level of bad loans climbed during 1999, and was concentrated not only in the troubled large banks (Group 1), but more widely in the banking sector. The fall in economic activity was one factor, but it seems likely that other factors were also at play: supervisors at the NBS had gained in experience, and the central bank had put more effort into on-site supervision. The incentives to declare non-performing loans also increased once banks sensed that the government was about to embark on a state-funded clean-up of the sector, and indeed the NBS encouraged banks to reveal non-performing loans.

4.2 The first phase of banking sector restructuring

25. The centrepiece of the bank restructuring plan[10] was the creation of a new bank restructuring agency, a joint stock company called Slovenská konsolidacná (SKA), to operate alongside the existing consolidation bank, Konsolidacná banka (KAB). No explicit justification has been given for establishing a new bank restructuring vehicle. However, it seems that a new institution, with new management, better trained staff and operating under different rules, was expected to break up the relationships between the state, large banks and enterprises that contributed to the original problem. The new structure is also designed to allow more active management of the loan portfolio than would have been the case under the KAB. Indeed, the government has systematically allocated different clients to the two consolidation institutions. The KAB's portfolio includes those loans where the state, or its agencies, were directly or indirectly involved as both creditor and debtor, e.g. state subsidised loans for housing. Thus, the KAB in effect became a vehicle for consolidating lending and borrowing that falls inside a boundary round the wider public sector, whereas the SKA has taken on bad loans from the enterprise sector.

26. While it seems likely that the KAB's asset portfolio will continue to be managed only passively, this is not expected to have a major impact on restructuring in the enterprise sector. The KAB holds few direct loans to enterprise, although these do include liabilities of the state armaments group, DMD Holding. Moreover, the KAB is small compared with the SKA, with total assets of some SKK 40 billion, of which half represents loans acquired before restructuring. By contrast, the SKA has total assets of some SKK 130 billion.

27. The SKA was designed to create the conditions for rapid privatisation of three largest banks Vseobecná úverová banka (VUB), Slovenská sporitel'ná (SLSP) and Investicná a Rozvojová banka (IRB). The process of restructuring has proceeded along the following steps:

a) The NBS transferred profits of SKK 21 billion to the Ministry of Finance that it made in writing back unused provisions created in December 1997, when it originally took IRB into administration. This was used to recapitalise the three largest banks (IRB, VUB, SLSP) and the Slovak Insurance Company (SLPO).

10. The plan had been developed in co-operation with the World Bank, the EU (through its PHARE programme) and USAID.

b) VUB, SLSP and SLPO lent the IRB SKK 8 billion under state guarantee. IRB used its capital increase plus these additional resources to meet its obligations (around SKK 13.5 billion) towards the central bank and, in this way, was released from NBS ‘conservatorship’ (administration).

At this stage, the capital adequacy ratio of VUB and SLSP had been increased and the IRB could be put up for sale. In net terms, the central bank had injected SKK 7.5 billion into the rest of the banking system.

c) The SKA was established with a minimal amount of equity capital (SKK 1 million) jointly owned by the three banks and the KAB (19 per cent each), and the Ministry of Finance (24 per cent).[11]

d) In order to give the SKA the means to buy the bad loan portfolio from the commercial banks, the commercial banks themselves lent around SKK 63 billion to the SKA under state guarantee. This was then used by the SKA to buy an equivalent amount of bad loans in VUB, SPSP and IRB. Only SKK 11 billion of bad loans were transferred to the KAB at the same time. The total of SKK 74 billion represented a little over 40 per cent of total classified loans.

e) In March 2000, the Slovak Ministry of Finance made a Euro Bond issue of EUR 500 million (around SKK 200 billion). Part of these resources were used to increase the state’s equity stake in the SKA, which in turn used its capital to repay the loans it had taken out from the commercial banks.

f) In June 2000, the Ministry of Finance severed the last link between the SKA and the banks when it bought back their residual equity holding in the SKA.

In summary, the commercial banks have been recapitalised with money from issuing state bonds, using the SKA as a transfer vehicle. A further transfer of bad assets to the value of SKK 34 billion took place in June 2000.

28. This process reduced the volume of classified claims (see Table 4) and prepared banks for privatisation. In February 2000 the government decided to sell all of its remaining stake (85 per cent) in VUB, and either 64 or 87 per cent in SLSP, along with its stake[12] in IRB. The government also recognised that the banks, in particular IRB, would probably not be saleable as going concerns, and so allowed for separate sale of specified bank assets.

Table 4. Selected banking sector indicators

29. Contrary to the approach adopted in the Czech Republic (see below), the SKA was designed to act principally as a vehicle for bank restructuring. Nonetheless, the Slovak government intends that the SKA promote a more active approach to collecting loans. Indeed the agency itself consists of only a small number of staff, answerable directly to the government. The SKA’s function is to sell parcels of assets to third parties who will then have strong incentives to maximise their yield, providing the sales had taken place at arm’s length on commercial terms. In this way, the SKA may in practice become integrally involved in enterprise restructuring, although it is impossible at this stage to assess whether it will be effective in managing and disposing of its portfolio of bad enterprise loans. But the government seems to have realised that in the absence of decisive action these companies would act as a dead-weight in the enterprise sector, a source of delayed or non-payment. Even when they are unable to obtain direct credit

11. The 19 per cent figure is carefully chosen. Where a parent holds more than or equal to 20 per cent in an entity, the entity has to be consolidated into the parent(s)’ balance sheet. In this case negating the whole purpose of the exercise.

12. Held through the National Property Fund and indirectly through state-owned financial institutions, banks and the State Insurance company; the overall state stake is some 70 per cent of the bank’s capital.

from the banks, the quasi-protected position of some companies would have allowed them to exploit indirect financing, such as by increasing arrears to suppliers, public utilities (transport and electricity), tax authorities and the social funds. The likely rate of recovery on the bad loans is low: about 80 per cent of the clients in both portfolios, as they stood in April 2000, were in bankruptcy.

Comparison of the Slovak and Czech loan restructuring agencies

There are substantive differences between the Slovak and Czech loan restructuring agencies. The Czech Revitalisation Agency (RA) is wholly-owned by the (Czech) Konsolidacni Banka and intended to operate at arm's length from government. The RA's task is to restructure the debt, and where necessary the management, of large firms. Although it may select firms for revitalisation, the government exerts influence over the decision by 'pre-selecting' firms that meet four criteria (workforce must exceed 2000; annual purchases from domestic suppliers must exceed Kc 1 billion or some USD 28 million; debts to the three largest banks must exceed Kc 3 billion; and, they must make an operating profit).

In Slovakia no such filtering exists since the SKA is mainly targeted towards bank restructuring. By default, classified loans in the official programme are transferred to the SKA. In both countries, the agencies have a wide mandate to administer assets, implement cost cutting programmes, and formulate new business plans. The objective is to maximise their portfolio value through liquidations, restructuring and sale. The agencies' success will be determined by the ability of their managers to take decisions on the basis of objective economic and business assessments. This assumes the government will refrain from influencing the process. In both countries, weak bankruptcy legislation and poor protection of creditors could hamper the work of these agencies.

30. Since the SKA does not hold a banking license, it is supervised by the Ministry of Finance rather than the NBS. In principle this allows a better oversight of how the SKA's manages its portfolio of bad loans, but it may also leave it more exposed to political pressure. In any case, the government plans to terminate its involvement in the SKA by 2003, by which time the agency would be liquidated or sold; it seemed likely that the KAB will remain in existence for some time beyond this date.

31. Whilst there has been this positive progress in bank restructuring, further action is needed. The first phase of restructuring only included 'bad' loans. This was cautious, in that loans presently classified as 'standard' because they are covered by a state guarantee could prove to warrant a lower ranking. This would mean that guarantees amounting to some 16 per cent of GDP in total could begin to crystallise and become a cash charge on the state budget. Once the banks had been privatised, the government would no longer be able to control the rate at which these liabilities were released onto the budget. This feedback of bank restructuring into the fiscal position is discussed below.

4.3 Role of the banking sector in economic restructuring

32. Financial intermediation had reinforced existing economic structures. Dissolving the link between large enterprise and state banks is expected to free-up resources to the new private sector (e.g. small and medium sized enterprises) and to the rest of the financial sector. This is essential to improve the functioning of exit and entry mechanisms. After government action to restructure the sector, credit was no longer readily available, and lending was often tied to demands for sovereign guarantees. Bank lending to enterprise fell sharply in real terms, and the NBS acknowledged a 'credit crunch': only 3 per cent of lending to enterprise was long term. In addition, falling interest rates were not matched by falling spreads in the commercial market, which exceeded 10 per cent for long term loans, and 3 per cent for short term loans. The spread on short-term debt even rose quite significantly during the last quarter of 1999. Overall, nominal credit to households and enterprises rose by some 6 per cent during 1999, but this was substantially below the rate of growth of nominal GDP. In real terms credit fell.

33. This suggests that banks were responding to new incentives and enforcing tighter financial discipline. But the enterprise sector suffers until banks are able accurately to assess credit risk and

commence lending to viable enterprises and projects. For this to occur, the business environment must provide for secure credits and recourse to legal remedies such as workable bankruptcy procedures.

34. Domestic capital markets are not yet an alternative source of viable funds. The Bratislava stockmarket is small (only 46 listings by end-1999) and suffer from thin volumes, poor supervision and suspicions of insider trading. This lack of confidence was encouraged by weak securities legislation (e.g. even in early 2000, physical bearer shares were still permitted) and licensing requirements that resulted in large numbers of poorly capitalised brokerages. The lack of transparency in Slovak privatisation up to 1998, including the role played by insiders, also did much to undermine confidence in the market. Amongst large enterprises only few believed that listing would attract new capital. The market regulators and government started to introduce changes designed to attract new members. The most important was the creation of a new financial markets supervisor in June 2000. This office did not add to existing regulatory capacity, but drew together supervision of capital markets and insurance[13]. Although these institutional changes are important steps, the behavioural changes they are intended to promote will inevitably take time.

5. Deepening reform: restructuring the large enterprise sector

5.1 Financial deterioration in the enterprise sector

35. The limitations of the financial market and the lack of available bank credits emphasised the need for rapid enterprise restructuring. Previous studies of large enterprises in Slovakia concluded that some restructuring had taken place despite strong insider ownership and the absence of foreign capital (Djankov and Pohl, 1997). However, OECD (1999a) pointed out that the restructuring which had taken place was not sufficiently deep to put enterprises in a sustainable position over the long run. This has been confirmed by evidence on the deterioration of the financial discipline in the Slovak enterprise sector during 1997-99 (Table 5). Uncertainty during transition makes it difficult to discriminate between entities that face liquidity constraints and those that face a more fundamental problem of solvency. It is also difficult to disentangle what are the net debtor and creditor positions between enterprises and different parts of government. However, in Slovakia it was clear that in aggregate the financial situation in the enterprise sector had deteriorated. Profitability and return on assets fell, even though turnover rose.

Table 5. Selected indicators of enterprise financial performance

36. It is noticeable that an upturn in arrears occurred at a time when many other enterprise indicators were turning down (Tables 6). There was a strong increase in the level of inter-enterprise arrears during 1998, and by the end of the year these amounted to a little under 20 per cent of GDP. This trend intensified through 1999 as growth slowed and domestic demand fell sharply. An accumulation of arrears is not in itself conclusive evidence that insolvency has increased. Firms may face a genuine liquidity constraint if banks become too risk averse to lend; besides enterprises may face an incentive to obtain credit by late payment if this incurs penalties at a lower rate than that at which bank loans can be obtained. Increased inflation is also an incentive to delay payment. However, in Slovakia profits and returns in the financial

13. Banking supervision will remain with the NBS until at least 2002, though (as noted in the text) it does not have responsibility for the new SKA. The NBS itself opposed the proposed changes in the organisation of financial market supervision on the grounds that administrative effort and resources would be better placed in training regulators within existing organisational boundaries. There is also an ongoing debate about whether the Ministry will retain the power to veto changes to market rules. There is similarly a debate about how to guarantee the Office’s independence. The Office will be responsible for supervising market participants, issuing licenses and imposing sanctions.

and non-financial sectors fell sharply in 1998. This applied as much to the private as the state-owned sector. Turnover continued rising, but this only papered over the underlying accumulation of arrears and falling liquidity.

Table 6. Inter-enterprise and tax arrears, 1997-99

37. The most problematic aspect of poor enterprise performance is that it affects the balance sheet of the public sector at large. The development of arrears to the Social Insurance Agency (SIAG) and the policy measures adopted to collect outstanding debts are evidence of the vicious circle arising from the lack of structural reforms. The most immediate source of credit to the enterprise sector was the SIAG, along with other government welfare insurance funds (see below). Total debts to the SIAG at the end of 1999 amounted to some SKK 43 billion. Although the SIAG has the right to commit firms to bankruptcy to obtain payment, this option was almost never followed on the grounds that it yields little, and is not effective as it takes too long. Instead, the SIAG negotiated directly with enterprises, in particular on the timing of repayment. The agency is able to forgive any outstanding penalties and interest once firms have repaid the principal owed. Indeed, given the state of Slovak enterprises, there was a widespread expectation that the SIAG would not seek to collect interest and penalties, and firms built this expectation into their planning. This added to the lack of incentives to financial discipline. The SIAG acknowledge that a significant proportion of its debt may not have been collectible. It claimed, however, to have used the ability to forgive penalties once principal has been repaid as a powerful incentive to collect at least some of what it is owed. But the evidence does not support this. The actual amounts were small (SKK 200 million of collections followed by SKK 40 million of forgiveness). Along with arrears in social security payments, tax arrears also rose (Table 6). This accumulation of arrears further blunted the incentives to restructuring in large enterprises (EBRD, 1999, ch.9)

38. Another reason behind the increase in inter-enterprise arrears may have been that the authorities were beginning to tighten their policy on enterprise arrears to government in the second half of 1999 and on into 2000, with a corresponding increase in penalties. As an example, one of the regional electricity distributors had become more active in using disconnection as a way to procure payment and, by contrast, management in another was dismissed as a result of poor performance in this area. Enterprises also reported a tougher attitude on the part of government agencies in collecting their debts. This approach would reveal quite quickly which enterprises were fundamentally insolvent rather than just suffering a temporary cash flow shortage. Another source of potential credit was the state railway (ZSR). Although direct evidence of this is hard to come by, repayment terms are 15 days for freight and payment in advance for passenger traffic; but average repayment duration at the end of 1998 comfortably exceeded three months.

39. Therefore, although there was an element of genuine liquidity constraint amongst Slovak enterprises at the beginning of 2000, it seems likely there has also been a strong increase in insolvency. Existing bankruptcy rules had been inadequate to deal with this problem. A previous amendment to the bankruptcy law in 1998 did not have the expected impact. Although it simplified procedures and allowed much greater scope for creditors and debtors to reach a settlement, it did not in practice turn bankruptcy into a tool of restructuring. A large accumulation of bankruptcy petitions remained unprocessed during 1993-97. The situation did not improve much in the period to 1999 despite the 1998 changes, which placed debtors under a legal obligation to declare their insolvency. Declarations increased, but only added to the volume of outstanding cases. (Table 7).

Table 7. Bankruptcy, 1993-99

5.2 Enforcing exit mechanisms

40. According to the framework set out in section 2, reform typically progresses from enforcing exit mechanisms to promoting the conditions for enterprise creation. In this respect, the main steps taken in Slovakia were the improvement of bankruptcy legislation, the removal of protected status for some enterprises, and promotion of FDI. Possibly as a result of policies implemented after 1998, preliminary data for 1999 showed that profitability picked up from its low level (Table 5), supported by the increase in controlled prices and the growth in export revenues.

5.2.1 Enhancing bankruptcy

41. Changes to bankruptcy legislation mainly strengthened the position of creditors. Under the new rules, this group acquired the right to appoint the administrator and to approve restructuring plans. The system was also simplified, principally by reducing the number of creditor rankings, which worked to ensure that most creditors gain nothing when an enterprise is bankrupted. An important feature was the introduction of an exact test to establish bankruptcy: non-payment of a liability after 30 days would act as a trigger for bankruptcy. Whilst the changes left a few creditors worse off, mainly the state, it improved the position of the majority, giving them an incentive to use the system more actively. The most important objective was to make the system faster.

42. These amendments were a move in the right direction. Changes in the banking sector mean also that commercial banks had a stronger incentive to use the new procedures. But this type of reform can only take hold slowly. Judges and legal professionals have to be trained[14], and participants have to learn about the new procedures. In the particular circumstances of transition it also requires a more widespread understanding of bankruptcy as a means to re-organise business and as a way to recover assets. These changes will however take time to embed themselves in Slovakia's business and governmental environment. Although the time taken to adopt some transitional reforms may be compressed, institutional changes of this kind take longer to become effective. But neither could time be lost. In the absence either of new bank credit or the liquidation of insolvent enterprises, inter-enterprise arrears and arrears to the government would just continue to rise. A feature, as described above, of Slovakia in the recent past.

5.2.2 Restructuring large enterprises

43. Enforcing new standards of bankruptcy demands both political will and a degree of political consensus, particularly in the case of large enterprises. The changes are difficult to implement as they almost inevitably lead to increases in unemployment and restructuring or liquidation of firms that were at one time regarded as 'strategic enterprises'. Indeed these companies tend to be located in less dynamic economic areas, meaning there is less enterprise creation to compensate for loss of employment due to restructuring. In the past, the label 'strategic' was a sign that the government was convinced of an enterprise's future potential economic value, and wanted to buy time for gradual restructuring. Hence, these firms were typically also those that hoped to receive supplementary funding with less pressure to restructure. The situation was further aggravated by the previous government's Revitalisation Act, which created an expectation of 'easy' terms or forgiveness of past debts. This Act was repealed by the current administration soon after it took office. This was an important step towards re-establishing financial discipline.

14. An IBRD grant is being used to set up a training programme.

The case of a former 'strategic' company

As in other transition countries, enterprise performance in the Slovak Republic is heterogeneous (see OECD 1999a). Some companies are in an advanced stage of restructuring, but typically most problems are concentrated in large enterprises that are also big regional employers. For example, this is the case in the large machinery companies associated with the former armaments industry. The company described below illustrates well the problems government faces in resolving financial deadlock in the economy.

Based in central Slovakia, this firm is an important local employer. It was originally a strategic company producing military trucks and recovery vehicles, though since 1990 it has produced diesel engines and machines under license from various western partners. Their main customer, for large diesel engines, is in Belarus, and their other major market is for tractors in Bulgaria and Romania. The licenses have all now expired, and the company is in talks with a foreign engine maker who is exploring whether to buy part of the production facility.

The enterprise was established in 1996 as a joint stock company with 4800 employees. Production of forest equipment and military vehicles was transferred to another group company in 1997. Current employment is 1750, though management estimate that only 850 are needed for current production.

The company was one of the first for which a putative 'revitalisation' plan was prepared in 1996. In the expectation that the company would restart large scale production, between 1996 and 1999 about one-third of its employees were loaned to another large foreign investor with a production facility in Bratislava, who paid their wages and other non-wage labour costs. Half the workforce stayed at home, receiving 60 per cent of their wages.

The company plans a SKK 1 billion turnover with a zero profit. But it has no access to bank-financed working capital. The company has already reduced its debt burden by conducting a debt-equity swap with a large state-owned bank for a 25 per cent stake. There is still a very considerable debt to the state social funds, who have obtained court orders for mandatory invoice factoring in order to receive at least some of what they are owed. They owe an even greater amount to the state energy distribution company.

44. After an extended debate within the coalition, parliament passed an amendment to the Privatisation Act in September 1999 that cancelled the Strategic Enterprises Act. This change abolished the term 'strategic company' and liberalised the rules under which state enterprises can be privatised and restructured. The postal service, railways, forestry and water supply are deemed to be natural monopolies that must remain wholly state-owned even though many OECD countries have made other judgements and privatised all or part of these sectors. The state must retain a majority holding in the energy utilities; and the state is to keep a minority holding (34 per cent) in the fixed-line telecoms company, the main retail bank and the dominant insurer. Even after these changes the government remained influential in industry, through regulation, but also directly through its ownership of utility companies. However, it seemed likely that pressure on public finances could lead the government to explore whether there was further scope to privatise utilities. The government needed to develop adequate regulatory structures before further utility privatisation, and work in this area could accelerate as a way to improve service to consumers irrespective of future intentions with respect to ownership.

45. Restructuring large scale enterprises is always politically sensitive. For instance, when it negotiated the sale of its stake in Eastern Slovak Ironworks (VSZ) to a strategic investor, the government was not dealing simply with an enterprise. It was negotiating about a whole region's dominant employer at a time when unemployment was already at record breaking highs. It had the difficult job of weighing up long term prosperity (and employment) against negative developments in the short run, when electorates typically have a very short horizon when evaluating a government's performance. In general, the authorities need to consider the extent to which enterprises have accumulated not just financial debt but also what could be called 'social debt'. This latter obligation relates to the need for government to deliver a (low) minimum standard of living directly to the population in a region where this is no longer being done by state-owned firms, not least to prevent social unrest. One option open to government is to discharge this obligation through generous severance payments, but this would become yet another pressure on the public finances (see below). Moreover, evidence from other transition countries suggests that this policy is a palliative that does little to address the underlying social problems.

5.3 Creating the conditions for entry of new firms

46. The privatisation or liquidation of state-owned companies can help to break the cycle of accumulating debt in the enterprise sector. But this is not enough to promote the deep restructuring that is itself connected with the entry of new firms or the rebirth of existing firms through a change of ownership or management. There is evidence from other transition countries that FDI can play an important role in this respect.[15] Slovakia has had difficulties in attracting FDI, in part a result of a reluctance to involve foreign investors in the privatisation process (OECD, 1996). In the new government programme there is specific reference to the role of FDI in economic restructuring. Along these lines, some measures were introduced in 1999 such as widening the scope for branches of foreign financial institutions to buy land needed for their operations, and freely transfer capital. It seems foreign investors in Slovakia, as elsewhere, preferred to make greenfield investment as a way to reduce uncertainty about the contingent liabilities that may arise on purchasing a going-concern. It is also easier to employ workers of the right skills and temperament when starting afresh than trying to slim down an existing workforce. For these reasons there is also a reduced role, as discussed above, for the capital market as a route to enterprise take-over or merger.

47. However, FDI is not sufficient to bring down high levels of unemployment. Policies designed to foster entrepreneurship by facilitating the entry of new enterprises are critical. The small and medium-size enterprises (SMEs) have been the most important channel for job creation in Slovakia. In 1999, they accounted for 50-60 per cent of value-added and employment.[16] This matters since a high level of unemployment is corrosive socially and politically, but also because it puts pressure on the social spending and can undermine continuation of reform. In this respect 1999 was not an encouraging year. Total employment in firms of less than 20 employees combined with sole traders was some 650,000 at the beginning of 1999; roughly the same as total employment in firms employing more than 500. During 1999 employment in the former group contracted by more than 4 per cent, but increased by some 2½ per cent in the latter. However, the smaller firms were more than twice as profitable per head as were the larger firms. This result is magnified if firms of less than 10 employees are compared with firms employing more than 1000. All of this suggests that the economic incentives for the development of the new private sector were emerging, but that they had so far been blunted by the crowding out of resources by large unrestructured firms. Bureaucratic obstacles and corruption may also have played a part (EBRD, 1999).

48. Large enterprise restructuring was also expected to have a significant impact on the export potential of the economy. Slovakia is a small and very open economy, with the ratio of trade to GDP typically above 130 per cent. It needed a sustained growth of exports in order to relieve the external constraint. Slovakia's revealed comparative advantages did not much change apart from an important shift out of iron and steel towards motor vehicles, associated with substantial investment made by Volkswagen in a plant close to Bratislava (Left hand panel, Table 8). By 2000 the latter accounted for some 20 per cent of Slovak exports. With this notable exception, the export profile remained the same as that which showed itself in the past to be highly sensitive to fluctuations in demand, as well as prices. Unless Slovakia diversified its exports it would remain externally vulnerable, notably because of potential for real exchange appreciation noted above. However, further changes in the structure of supply were intimately related to effective enterprise sector reform, which had proceeded at a rather slower pace. In this context, it is noticeable that Slovakia reduced its dependence on energy imports as highlighted by the sharp fall in the revealed comparative disadvantage for these products (right hand panel, Table 8). In effect, for a given

15. For a fuller discussion, see Carlin and Landesmann (1997).

16. This includes an estimate of the number of tradesmen. The exact share of SMEs in value added is not known due to the presence of a residual category ("other enterprises") in the data supplied by the Statistical Office of the Slovak Republic.

level of exports, this gave the Slovak Republic more scope to import products with a higher technology content.

Table 8. Revealed comparative advantage, 1993-99

6. Closing the circle: the impact of restructuring on the budget

49. Given the reforms underway, it is likely that the fiscal account will be an indicator of strain in the economy.[17] The chain of interlocking financial relationships between large enterprises, banks and public funds described above is likely to converge in the budget. A schematic representation of these links is set out in Figure 7. The primary indebtedness within the enterprise sector started with the accumulation of arrears between the large enterprises and utilities (particularly electricity). As a result, these utilities became unable to meet their obligations towards social funds. Ultimately, this liability rests with the government which has to underwrite any shortfall in the social funds, in order to guaranty delivery of basic social services. Another link in the chain is the accumulated stock of bad and doubtful debts, owed both by large enterprises and public utilities. A large tranche of these debts has been transferred to restructuring agencies (KAB and SKA) in order to facilitate restructuring in the banking sector. The government has had to replace these assets in the banks' balance sheets, by issuing sovereign debt. Servicing is a charge on the budget. Taken together, restructuring leads to strong pressure on the budget.

Figure 7. Framework for interlocking financial relationships

6.1 Pressures on the budget

50. In 1999, the consolidated general government deficit for 1999 was contained at 3.6 per cent of GDP (Table 9). However, most of the adjustment was achieved through temporary measures. Notably, a temporary import surcharge[18] that alone represented more than 5 per cent of 1999 tax revenue, equivalent to more than 1 per cent of GDP. Over the next years, more structural measures are needed to face several fiscal pressures.

Table 9. Consolidated general government balance, 1997-2000

51. The biggest fiscal challenge is in the three welfare funds: the Social Insurance Agency (pensions), unemployment insurance and health insurance. These funds have been in financial difficulty for some time. Not only have they been haemorrhaging cash, SKK 56 billion since 1996, but budgeted projections were that they would become insolvent during 2000 (Figure 8). This was a benign reading of the situation. A more realistic assessment would have excluded amounts owed to the funds in respect of interest and penalties: more than half their receivables fell into this category. The discussion in the previous section suggests these may be largely uncollectable. The conclusion is that by the end of 2000 the combined funds would need an injection approaching SKK 30 billion just to lifted them out of insolvency, without taking any account of the actuarially accurate value of future liabilities.

Figure 8. Liquidity and solvency of combined social funds

17. For a discussion of the feedback between the macroeconomic policies and economic restructuring during transition see Coricelli (1998).

18. This surcharge was lowered to 5 per cent on 1 January 2000, and to 3 per cent on 1 July. It was planned to abolish this levy on 31 December 2000.

52. The government had commissioned task forces to develop policy to meet this challenge, but these could not have an impact in the short term, where the pressure would fall on the fiscal account. As an emergency measure the government assigned a large part of profit made on the sale of its stake in the Ceskoslovenská obchodní banka (CSOB) to providing the funds with liquid resources[19]. But these payments do not constitute a long-term solution. Moreover, further privatisation and enforcement of new bankruptcy legislation would probably only serve to crystallise as yet undeclared losses to the funds, which would have to be met from the budget.

53. Concerning bank restructuring, the cost was estimated at SKK 100-105 billion (some 12 per cent of 1999 GDP). This was initially to be financed by borrowing from the commercial banks, placing an immediate servicing burden on the budget. In the medium term, the government intended to issue more Euro denominated bonds to cover this expenditure. In March 2000, the government issued a EUR 500 million 10-year bond.

54. The government also faced fiscal pressures from developments in the domestic economy. As growth has slowed, unemployment rose to an all-time (see Section 3). The government tightened access to unemployment benefit by requiring claimants actively to seek work and by reducing the level of benefit, but strong regional differences mean the government's scope for reducing entitlements and structural income support for poverty alleviation was limited. There is a danger that a large proportion of the increase in unemployment will in fact be structural rather than cyclical, especially against a background where large enterprise restructuring accelerates while new activity fails to develop with sufficient dynamism in the regions in question.

55. In addition to these factors, the government faced an exceptional financial flow during 2000-01 from 5-year privatisation bonds issued in 1995 to the value of SKK 35 billion (about 4 per cent of GDP). The government chose to acknowledged the debt, refusing to countenance default or deferral[20]. This represents a substantial fiscal stimulus whose management requires careful co-ordination between the NBS and the government. Lastly, the government inherited a substantial volume of contingent liabilities in the form of state guarantees. At April 2000, the state had issued total guarantees of SKK 156 billion, of which SKK 122 billion (16 per cent of GDP) remained active.[21] Some SKK 26 billion of this outstanding debt fell due during 2000, and the Ministry of Finance in fact estimated that roughly half of it is non-performing and so would have to be met out of the budget.

6.3 Financing reform

56. In aggregate, expenditure pressures look set to require a financial commitment of some SKK 285 billion over the medium term (Table 10), equivalent to nearly USD 7 billion at April 2000 exchange rates. In order to face these challenges the government has several possible options. It has already stated its intention to sell 66 per cent of the shares in Slovak Telecom, 49 per cent of Transpetrol and SPP (the gas company), and nearly all its shares in the big three banks (VUB, IRB and SLSP) during 2000. This is expected to raise some SKK 32 billion. A similar amount of revenue from privatisation is expected in 2001 as a smaller bank, the insurance company and parts of the energy sector come up for sale.

19. Some SKK 3.5 billion will be paid to the SIAG in respect of arrears from the railway company (its biggest debtor), and some SKK 1.5 billion to the health fund in respect of staff working in hospitals and other state medical institutions whose contributions had not been paid over by the Ministry of Health.

20. One widely touted alternative was for the government to swap privatisation bonds for equity shares in currently state-owned enterprises.

21. As noted in Section 4, the chosen approach to bank restructuring considered loans covered by state guarantee as 'standard'.

Although this clearly helps with the financing, the pressure on the budget can ultimately only be relieved through stronger and more sustained growth. Given the financial scale of the policy challenges set out above, it seems that the government will need more resources than it will be able to attract through FDI and privatisation revenues.

Table 10. Estimated future financial commitments

57. Slovakia is helped that it seems to be able to issue debt at very narrow spreads. These narrowed considerably during 1999. The gap had closed to around 200 basis points (Figure 9).[22] This is very favourable when compared with the prevailing situation in other emerging markets, such as in Latin America. Indeed, there appears to be an appetite for Slovak debt, probably reinforced by the EU's announcement at its Helsinki summit that the EU would start membership negotiations with the Slovak Republic.

Figure 9. Sovereign interest rate spread

58. Slovakia was also fortunate to start with a modest public debt to GDP ratio, although the quoted ratio of below 20 per cent GDP was flattering as it excluded debts on which the government had given a guarantee (IIF, 1999). Even taking this into account, the ratio rises only to perhaps 35 per cent of GDP. This suggests that the authorities have the scope to issue more sovereign debt, or sovereign guaranteed debt. This potential resource is another possibility to inject the fresh resources into the economy that will be necessary for Slovakia to build the foundation for future growth whilst avoiding a 'hard landing'. But if Slovakia borrows the resources to cover the one-off costs of restructuring, it will have to exercise great discipline in making sure that current expenditure does not add to the debt burden. The costs summarised in Table 10 would add 35 per cent to the 1999 public debt to GDP ratio, bringing it to 55 per cent.

59. However, if capital inflows are to end up in uses that promote growth and ultimately generate the foreign revenues that finance their servicing, then financial and enterprise sector transparency will have to be improved. This covers capital market rules as well as more mundane subjects such as accounting and auditing standards and the mechanisms for corporate governance. In the long run it would be as damaging for Slovakia if lenders were to extend credit too readily without some of these reforms being in place, as it would be to manage a capital shortage. The analogy is with the liberalisation of domestic credit in Slovakia after 1993. Unrestructured and large enterprises were able to borrow substantial sums. This contributed towards the banking sector problems and widespread enterprise insolvency that the current government is seeking to resolve. Slovakia's private foreign debt more than doubled between 1995 and 1998, and total debt reached nearly 60 per cent of GDP. Half of this stock was in the private non-financial sector (Table 11). Such indebtedness clearly generates risks that certain loans will be defaulted, as for instance happened in the case of VSZ. Even though this company was in majority private ownership, the government was obliged to meet the servicing obligations.

Table 11. Foreign debt and reserves, 1995-99

7. Summary

60. This paper set out a framework to analyse the interdependence of reforms in different policy areas during the transition process. We identified four broad policy blocks related to liberalisation, stabilisation, exit and entry. The success of the transition process seems to depend on benefiting from the

22. Spread is calculated as the difference in basis points (100 bp = 1 per cent) between yields on a long-term public bond and a comparable US Treasury bond.

positive feedback between all four areas, while avoiding the negative impact that results from lack of progress in any given area. The unsustainable growth path in the Slovak Republic towards the end of 1998 was a good illustration of how these interdependencies work. The lack of structural reform in the banking and enterprise sectors left the economy unable to respond to a strong push from domestic demand, arising mainly from public expenditure and investment. The result was a sharp increase in the budget deficit which crowded out substantial financial resources from the private sector and, under a tight monetary policy, increased interest rates. Without effective bankruptcy or liquidation procedures, mounting inter-enterprise and tax arrears were a way to diffuse the strain in the economy.[23] It resulted in a complicated financial deadlock between the banks, enterprises and public funds.

61. The reform programme of the new government that started to be implemented during 1999-2000 has been analysed against this background. We described the stabilisation measures and their impact on the real economy, the main policy actions taken in the two main areas of structural reform, and their interlinkages. The reform programme appears to have taken into account the need to reform on a broad front. But many challenges still lie ahead, in particular the creation of an environment supportive to the entry of new private enterprises and open to foreign investment. In the meantime, it is likely that the fiscal position will have to absorb the many pressures in the economy, from direct costs of structural reform to increased social expenditure. In order to manage this transitional strain in the economy, the Slovak Republic could use the option of issuing sovereign debt in a prudent way. The risks of private borrowing and lending, however, should not be underestimated until further large-scale enterprise restructuring has taken place. Over the long-run, the benefits from achieving coherence in the different policy areas should allow the economy to move onto a path of sustainable growth.

23. These mechanisms have been observed in other transition countries. See Daianu (1999) for a comprehensive analysis applied in the case of Romania.

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TECHNICAL ANNEX

This annex provides the details on the different indicators used in the text.

(i) Contribution to GDP growth of final demand

Final domestic demand is decomposed into private consumption, government consumption and gross fixed capital formation. Figure 3 exposes the contribution made by these different components of final demand in arriving at aggregate quarterly real GDP growth.

$$Contribution = \frac{D_{i,\,t} - D_{i,\,t-1}}{GDP_{t-1}} \cdot 100.$$

Where D_i is the relevant component of demand; *D* and *GDP* measured in real terms.

(ii) Sustainability of the current account

This analysis of sustainability of the current account deficit is based on a simple relationship between the growth of nominal GDP, interest rates and the level of the deficit (Howard, 1989), though more sophisticated extensions have been proposed. By definition:

$$\Delta\,\mathrm{ND} = -\mathrm{CA} \qquad (1)$$

where **ND** is net debt, and **CA** the current account balance. To be sustainable in the long run, net debt should not grow at a faster rate than nominal GDP in order to prevent the country falling into a debt trap where its ability to repay the debt rapidly decreases. Hence in the limit:

$$\frac{\Delta\,\mathrm{ND}}{\mathrm{ND}} = \frac{\Delta\,\mathrm{Y}}{\mathrm{Y}} \qquad (2)$$

where **Y** is nominal GDP. Using (1) and re-arranging:

$$\left(\frac{ND}{Y}\right) = \frac{1}{g} \cdot \left(\frac{-CA}{Y}\right) \quad \text{where} \quad g = \frac{\Delta Y}{Y} \qquad (3)$$

The relation above suggests the graphical representation that is used in the Figure 2 in the main text. All variables are expressed as a percentage of GDP. Rays from the origin, for two illustrative rates of GDP growth (5 and 10 per cent), show the level of current account deficit that holds constant a given share of net external debt in GDP. Hence, points to the right of the line give rise to an increasing ratio of debt in GDP that leads, in the long run, to an increase in external vulnerability.

(iii) Real effective exchange rate

The real effective exchange rate in Figure 6 was estimated using trade (exports + imports) weights for the OECD partner countries as follows:

$$REER = \frac{\sum_j \alpha_j \cdot \mathrm{E}_j}{\sum_j \alpha_j \cdot \mathrm{I}_j}, \quad where\ \alpha_j = \frac{X_j + M_j}{\sum_j (X_j + M_j)}.$$

Where ***X*** and ***M*** stand for exports and imports; **E** for the bilateral nominal exchange rate; and **I** for the relative bilateral price deflator of country *j* versus Slovakia.

(iv) Revealed comparative advantage

The index of revealed comparative advantage (RCA) is the difference between a sector's share in total exports and its share in total imports. This presentation follows Neven (1995). In OECD (1996, 1997, 1999, 2000) the reader can find comparable data for other countries. The revealed comparative advantage indicator is computed as follows:

$$RCA_i = \left(\frac{X_i}{\sum_n X_i} - \frac{M_i}{\sum_n M_i} \right) \cdot 100, \quad \text{and} \quad \sum_n RCA_i = 0.$$

Where ***X*** and ***M*** stand respectively for exports and imports, and ***i*** for the sector of activity, and ***n*** the number of sectors. The maximum and minimum values of the index are 100 and –100, attained in the case where there is complete trade specialisation and only two goods. In practice the value of the index rarely exceeds 10. Note that this is a *relative* measure. Hence, the comparative advantages are measured using the theoretical condition of balanced trade. The value of the indicator is also related to the intensity of intra-industry trade. The stronger that trade is within a classification, the lower the RCA index.

TABLES

Table 1. **Slovak reform programme and policy implementation, 1999-2000**

Programme of the new government	Implementation 1999-2000
Fiscal policy	
- The government decided a target of a 2 per cent deficit in 1999 (down from above 5-6 per cent in 1998)	- State budget deficit on target in 1999, but consolidated deficit 3.6 per cent of GDP
- Reduction of expenditure on infrastructure	- Infrastructure spending reduced by 18 per cent in real terms in 1999 - Public sector wage freeze implemented during 1999
- The government is planning to introduce a new Treasury system	- Government has started to provide consolidated accounts since Q3 1999; an IMF programme to improve the quality of the data is in place
- Strengthening supervision of the health Insurance companies and the Social Insurance Company	- Task Forces formed to develop strategy for welfare reform; tighter control by Ministry of Finance; strategy published as part of the government's Medium Term Policy Priorities
Bank restructuring and privatisation	
- Government policy paper on financial restructuring of banks and enterprises adopted August 1999	- Creation of new consolidation agency (SKA)
- Possibility of state financial participation in banks undergoing restructuring	- Capital injection of SKK 19 billion to 3 largest banks and transfer off their books of SKK 74 billion bad loans; banks now meet Basle minimum capital adequacy ratio - Legislation passed to make provisions allowable against tax - A new inter-agency steering committee has improved co-ordination
- Drawing in more foreign capital and expertise and creating conditions for the privatisation of banks - Government policy paper on bank privatisation adopted May 1999	- Government put bank privatisation as first priority - Government committed to privatisation of 3 large and 1 small bank in 2000 by international tender; financial adviser (JP Morgan) and lawyers have been appointed
Price liberalisation	
- Removal of general subsidies such as for heating; and adjustments in regulated prices of public utilities - The Price Act will be modified	- Price liberalisation has taken place in 3 steps (Jan, Jun 1999 and Feb 2000); to date average prices have increased by 135 per cent for electricity, 112 per cent for heating, 70 per cent for rents, 75 / 35 per cent for passenger rail / bus tariffs
Enterprise restructuring and financial discipline	
- Promote a favourable climate for FDI - Improve flexibility and enforceability of bankruptcy and settlement procedures	- New bankruptcy rules approved by Government and submitted to parliament in March 2000
- Use competitive methods for further privatisations; reduce the scope for owners to remain anonymous	- International tenders issued for privatisation of Slovak Telecom and for big 3 banks; partners now preparing final bids following initial selection - Termination of state holding in gas storage company
- Reassessment and redefinition of strategic enterprises - Strengthen competition policy, the Price Act will be modified, remove the monopoly of the Slovak Insurance Company - Prepare legislation allowing different methods to solve inter-enterprise arrears, including debt-equity swaps	- Strategic Enterprises Act cancelled in September 1999; Privatisation Act amended, reducing number of enterprises and utilities that must remain in state hands or with a state holding - Revitalisation Act cancelled before end-1998
Regional policies and the new private sector	
- Government policy paper on reform of administration adopted August 1999	- Audit of central government agencies carried out
- Support SME development, including improved legislative conditions and increasing the efficiency and co-operation between state institutions for SME development.	- Strategy published as part of the government's Medium Term Policy Priorities

Source: OECD (2000a)

Table 2. **Macroeconomic performance[1], 1995-1999**

	1995	1996	1997	1998	1999
Real GDP growth	6.9	6.6	6.5	4.4	1.9
Inflation	7.2	5.4	6.4	5.6	14.2
Unemployment (registered)	13.1	12.8	13.0	15.6	19.2
Unemployment (LFS)	12.4	10.9	11.8	12.5	17.1
Fiscal balance (% of GDP)[2]	0.1	-1.9	-5.3	-4.8	-3.6
Current account (US$ bn)	0.4	-2.1	-1.9	-2.0	-1.1
Current account balance (% of GDP)	2.3	-11.2	-10.0	-10.4	-5.8

1. The figures given for GDP are percentage changes from previous year. Inflation refers to the end-of-year consumer price index; unemployment to the year end rate.

2. Including central and local governments and other public funds.

Source: Statistical Office of the Slovak Republic and Ministry of Finance

Table 3. **Labour market changes, 1998-99**

Increase in the labour force		50 534
Add: Employment reduction		56 680
Agriculture, hunting, forestry	20 686	
Construction	14 305	
Machinery and equipment n.e.c.	7 228	
Basic metals and fabricated metal products	6 273	
Mining and quarrying	2 704	
Other	5 484	
Less: Employment creation		-17 117
Wholesale and retail trade; Repairs	9 977	
Hotels and restaurants	2 784	
Textiles and textiles products	1 293	
Other	3 063	
Other		13 548
Increase in unemployment Jan-Dec 1999		**103 645**

Source: Statistical Office of the Slovak Republic and OECD

Table 4. **Selected banking sector indicators**[1]
Year end, SKK billion

	1997	1998	Q3 1999	1999
Number of banks	30	27	27	26
of which: without foreign capital participation	11	10	11	11
Total assets	776.9	796.3	743.1	782.8
Total classified loans	119.2	141.6	169.3	118.1
Classified loans as % total assets	*15.3*	*17.8*	*22.8*	*15.1*
Provisions	35.2	41.6	46.9	46.4
Profit/loss	-1.3	-3.7	-9.5	-16.9
Memorandum: of which large banks (%)				
Total assets	*51*	*46*	*46*	*45*
Total classified claims	*70*	*69*	*67*	*49*
Provisions	*53*	*62*	*58*	*63*
Profit/loss	*224*	*223*	*65*	*88*
Domestic credit	467.8	519.5	558.3	554.1
Credit growth (%)	3.1	11.1	10.8	6.7
Short term deposit rate, (%)	13.4	15.7	13.9	13.7
Short term lending rate, (%)	21.6	18.9	16.8	17.0

1. Excluding Konsolidacná banka (KAB); Q3 1999 is before implementation of the first phase of the government's bank restructuring programme, year 1999 figures are for after the first phase.

Source: National Bank of Slovakia

Table 5. **Selected indicators of enterprise financial performance**

		1996	1997	1998	1999
Revenues[1]	SKK bn	1,841	2,008	2,263	2,483
Net profit[1]	%	3.5	3.0	1.2	3.0
Return on assets	%	0.0	0.0	-0.4	..
Wages in total cost	%	15.0	18.5	16.7	15.5
Real wage growth	%	7.1	6.6	2.7	-3.1
Average employees[2]	(workers/firm)	296	247	206	183
Acid ratio[3]	%	62	69	71	..
Gearing		2.0	3.7	3.4	..

1. 1996 for organisations with 25 and more employees, 1997 for organisations with 20 and more employees, since 1998 for all organisations.

2. Industrial employment in firms with more than 20 employees (25 employees for 1996).

3. The ratio of liquid current assets (current assets less stocks) to current liabilities.

Source: Statistical Office of the Slovak Republic and OECD

Table 6. **Inter-enterprise and tax arrears[1], 1997-99**
Year end, SKK billion

	1997	1998	1999
Total claims[2]	303.3	360.5	342.4
of which: Overdue claims	117.7	130.4	144.1
Overdue claims as % of total claims	*38.8*	*36.2*	*42.1*
Tax arrears			
State enterprises	2.3	2.0	1.9
Strategic enterprises[3]	0.3	..	..
Non-state enterprises	18.5	32.6	50.1
Tax arrears as % total liabilities	*4.9*	*7.5*	*11.2*
Tax arrears as % total government tax revenues	*14.5*	*22.6*	*32.4*
Memorandum			
Total liabilities	428.3	463.8	464.0
Total tax revenue	145.4	153.1	160.4

1. Inter-enterprise arrears are for the non-financial sector.

2. Claims are those relating to day-to-day operations.

3. This classification has been abolished by the current government, and so data will not collected for 1999 and beyond

Source: Statistical Office of the Slovak Republic and Ministry of Finance

Table 7. **Bankruptcy, 1993-99**
Number of cases

	1993	1994	1995	1996	1997	1998	1999
Bankruptcy proceedings started	538	1115	1530	1321	1755	1831	2161
Petition withdrawn	20	104	113	0	0	0	0
Cessation of proceedings	85	267	388	272	275	279	451
Cases passed to local authority	57	69	64	0	0	0	0
Case rejected (lack of assets)	7	26	26	66	100	219	425
Other	0	0	0	334	113	204	413
	169	**466**	**591**	**672**	**488**	**702**	**1289**
Unprocessed cases at year end	369	1018	1957	2606	3873	5025	5897
Memorandum item							
Bankruptcy declared in year	11	21	42	124	229	786	659

Source: Ministry of Justice

Table 8. **Revealed comparative advantage[1], 1993-99**

		1993	1996	1999	Export share 1993	Export share 1999	Cumulative export share 1999			1993	1996	1999	Import share 1993	Import share 1999	Cumulative import share 1999
87	Vehicles other than railway or tramway rolling-stock and parts thereof	1.0	-1.9	7.9	5.7	19.1	19.1	27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	-16.0	-11.8	-8.2	20.9	12.9	12.9
72	Iron and steel	12.7	11.3	5.9	15.3	8.0	27.1	84	Nuclear reactor, boilers, machinery and mechanical appliances	-7.2	-7.2	-5.0	15.9	15.3	28.2
62	Articles of apparel and clothing accessories, not knitted or crocheted	2.0	1.7	3.3	2.6	3.8	30.9	85	Electr. machinery & equipments and parts; TV image and sound recorders and reproducers and parts and accessories of such articles	-3.0	-2.1	-2.4	6.7	10.7	38.9
44	Wood and articles of wood; wood charcoal	2.0	2.4	1.9	2.6	2.7	33.6	30	Pharmaceutical products	-0.7	-1.6	-2.2	2.1	3.0	41.9
48	Paper and paperboard, articles of paper pulp	1.3	2.2	1.7	2.9	3.8	37.4	90	Optical,photographis,cinematographic,measuring, checking,precision, medical or surgical instruments and apparatus; parts and accessories thereof	-0.9	-1.5	-1.6	2.5	2.4	44.3
76	Aluminium and articles thereof	0.5	2.2	1.4	1.5	2.6	39.9	26	Ores, slag and ash	-2.1	-1.2	-1.0	2.4	1.0	45.3
64	Footwear, gaiters and the like; and parts of such	1.0	1.0	1.1	1.8	1.9	41.8	38	Miscellaneous chemical products	0.1	-0.4	-0.9	1.2	1.3	46.6
94	Furniture; bedding, mattresses; lamps and lighting fittings; prefabricated building	1.9	1.8	1.1	2.8	2.2	44.1	32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks	-0.6	-0.7	-0.8	0.9	0.9	47.5
25	Salt; sulphur; earths and stone; plastering materials, lime and cement	2.5	1.1	1.0	3.1	1.4	45.5	52	Cotton	-0.2	-0.2	-0.7	0.6	0.9	48.5
86	Railway, tramway locomotives; rolling-stock and track fixtures and parts thereof; mechanical traffic signalling equipment of all kinds	0.7	0.8	1.0	1.1	1.5	47.0	28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes	-0.2	-0.5	-0.6	1.0	1.1	49.6
54	Man-made filaments	2.6	2.2	0.9	2.8	1.5	48.5	08	Edible fruit and nuts; peel of citrus fruits or melons	-0.7	-0.8	-0.6	0.9	0.6	50.2
73	Articles of iron or steel	1.4	1.3	0.9	4.3	3.5	52.0	41	Raw hides and skins (other than furskins) and leather	0.2	0.0	-0.5	0.3	0.9	51.1
70	Glass and glassware	1.0	1.3	0.7	1.5	1.4	53.4	59	Impregnated, coated, covered or laminated textile fabrics	-0.5	-0.4	-0.5	0.6	0.6	51.7
61	Articles of apparel and clothing accessories, knitted or crocheted	0.2	0.5	0.6	0.9	1.3	54.8	33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	-0.5	-0.5	-0.5	0.7	0.6	52.3
40	Rubber and articles thereof	1.7	1.4	0.5	2.8	2.0	56.8	55	Man-made staple fibres	-0.2	0.0	-0.5	0.5	0.8	53.1
29	Organic chemicals	0.5	1.3	0.5	2.9	2.2	59.0	51	Wool; fine and coarse animal hair; horsehair yarn and woven fabric	-0.1	-0.1	-0.5	0.4	0.5	53.6
89	Ships, boats and floating structured	1.0	0.9	0.3	1.0	0.5	59.5	83	Miscellaneous articles of base metal	-0.4	-0.3	-0.4	0.6	0.7	54.4
11	Products of the milling industry; malt; starches; insulin; wheat gluten	0.3	0.5	0.3	0.4	0.3	59.9	24	Tobacco and manufactured tobacco substitutes	-0.4	-0.2	-0.4	0.7	0.7	55.1
31	Fertilizers	0.6	1.0	0.3	0.9	0.4	60.3	21	Miscellaneous edible preparations	-0.4	-0.3	-0.4	0.5	0.6	55.7
10	Cereals	-0.2	-0.3	0.2	0.7	0.4	60.7	60	Knitted or crocheted fabrics	-0.1	-0.1	-0.3	0.2	0.4	56.0

1. This indicator is defined as: $(X_i / \Sigma X_i) - (M_i / \Sigma M_i)$.

Source: National authorities and OECD.

Table 9. **Consolidated general government balance, 1997-2000**
Per cent of GDP

	1997	1998	1999[1]	2000 plan[2]
State budget	-2.6	-2.7	-1.8	-2.0
Rest of general government balance	-2.7	-2.1	-1.8	-1.1
Extrabudgetary funds balance	-1.8	-1.3	-0.3	-0.5
Social security funds balance	-0.8	-0.2	-1.1	-0.6
Local governments balance	0.1	-0.4	-0.3	0.0
Extrabudgetary projects and NPF	-0.2	-0.2	-0.1	0.0
Consolidated general government balance	-5.3	-4.8	-3.6[3]	-3.1

1. Figures for the state deficit are lower than those in Table 5 by the amount of loans to the Health Insurance fund, which are eliminated on consolidation.

2. Based on GDP growth of 2½ per cent and year end inflation of 10 per cent.

3. Preliminary figure; total does not sum due to rounding differences.

Source: Ministry of Finance

Table 10. **Estimated future financial commitments[1]**
SKK billion

Social funds	
Solvency requirement	30
Operating shortfall	75
Bank restructuring	105
Increase in structural unemployment	..
Redemption of privatisation bond	35
Contingent liabilities falling due	40
Total	**285**

1. Costs are estimated expenditure for 2000-2004.
Source: OECD

Table 11. Foreign debt and reserves, 1995-99

End of period, US dollars billion

	1995	1996	1997	1998	1999[2]
Total gross foreign debt	5.7	7.7	9.9[1]	11.9	10.5
of which: Enterprises	2.7	3.8	5.1	6.7	7.0
Commercial banks	0.9	2.2	2.9	2.7	0.7[3]
Official[4]	2.0	1.7	1.9	2.5	2.8[3]
Short term foreign debt	1.7	2.9	4.3	4.6	2.7
of which: Enterprises	1.3	1.5	1.9	2.5	2.4
Commercial banks	0.4	1.4	2.2	2.1	0.3[3]
Official[4]	0.0	0.0	0.2	0.0	0.0
Foreign reserves	5.0	5.7	6.5	6.0	4.4[3]
of which: Official reserves of NBS	3.4	3.5	3.3	2.9	3.4
Memorandum items:					
Total gross debt per capita (in USD)	1099	1473	1867	2191	1944
Total gross debt (in % of GDP)	33	42	51	58	56
Short term debt (as % gross total debt)	32	40	43	39	26[3]
Enterprise short term debt (as % total short term debt)	78	52	44	55	87
Enterprise short term debt (as % total enterprise debt)	49	40	37	38	34
Official reserves in months of import	4.7	3.8	3.4	2.7	3.1
Foreign reserves (in % of GDP)	29.0	30.3	33.4	29.3	23.2

1. At the end of December 1997, the actual level of foreign debt was higher by roughly USD 800 million. The level of foreign debt was reduced to USD 9.9 billion artificially, due to an accounting operator performed by a foreign bank based in the SR in December 1997.

2. Preliminary figures; short term debt is at end-November.

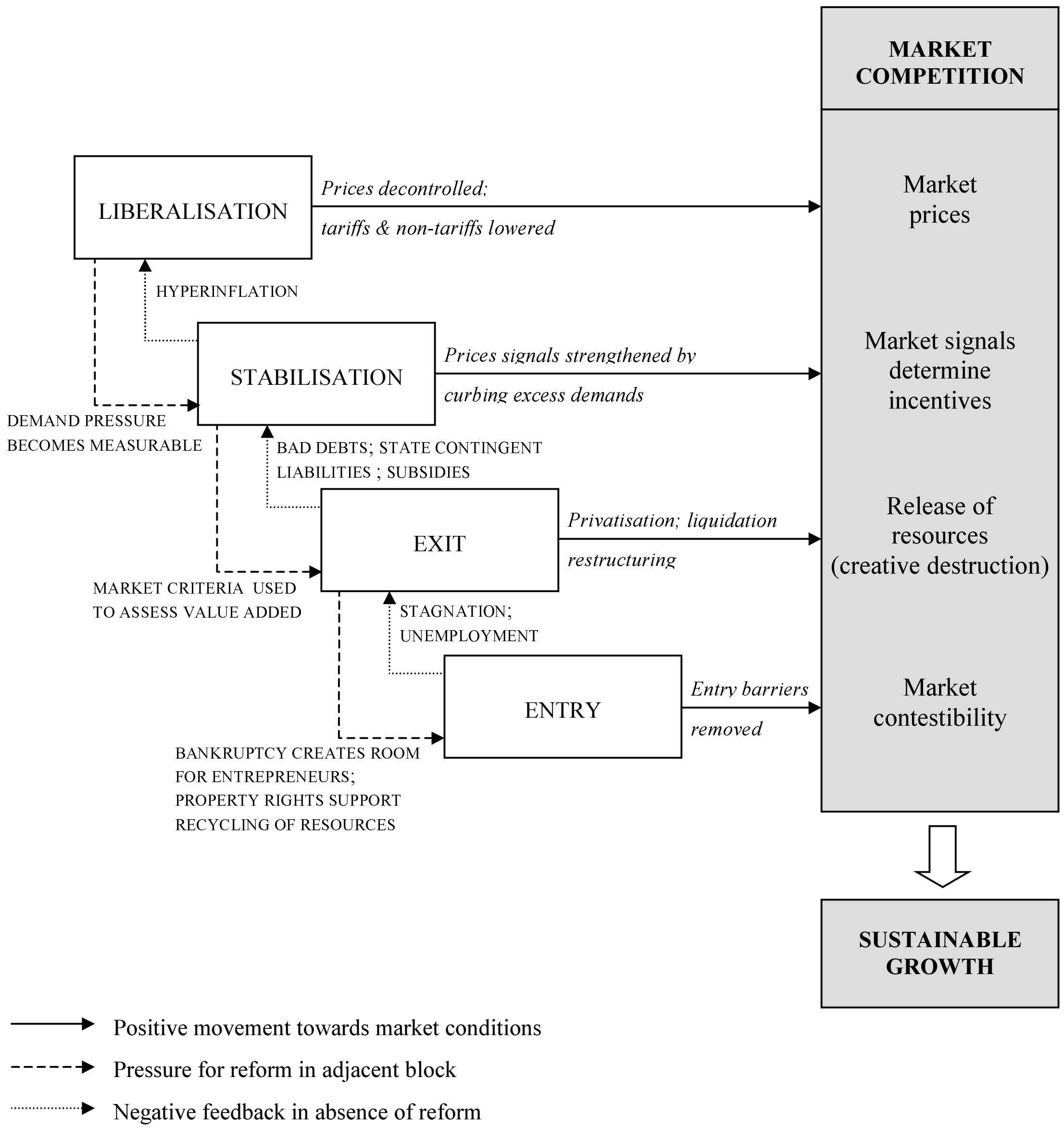
3. The simultaneous decrease in (short term) foreign debt of commercial banks and banks' foreign reserves between 1998 and 1999 is due to the abolition during 1999 of the NBS regulation imposing an 80 per cent deposit requirement on foreign borrowing by the banks.

4. Government, National Bank of Slovakia and municipalities.

Source: National Bank of Slovakia.

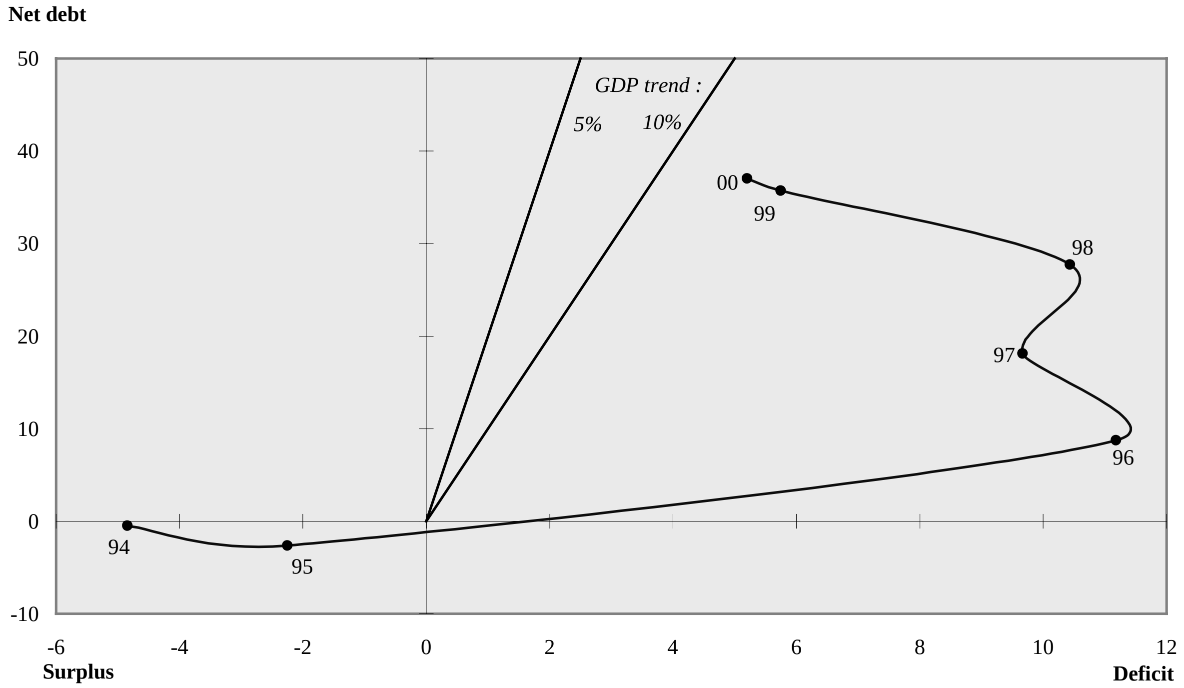
FIGURES

Figure 1. **Policy interdependence: a framework for transition**



Source: OECD

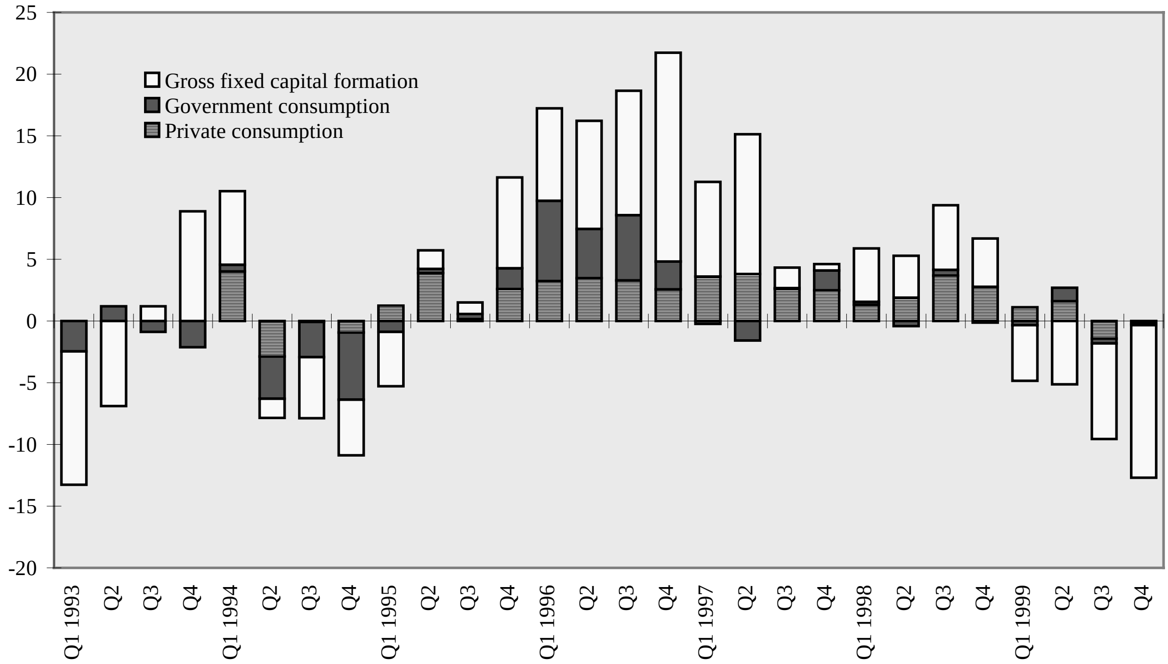
Figure 2. **Sustainability of the current account deficit**[1]
Per cent of GDP



1. See Technical Annex.
Source: Statistical Office of the Slovak Republic, National Bank of Slovakia and OECD

Figure 3. **Contribution to GDP growth of final demand[1], 1993-99**

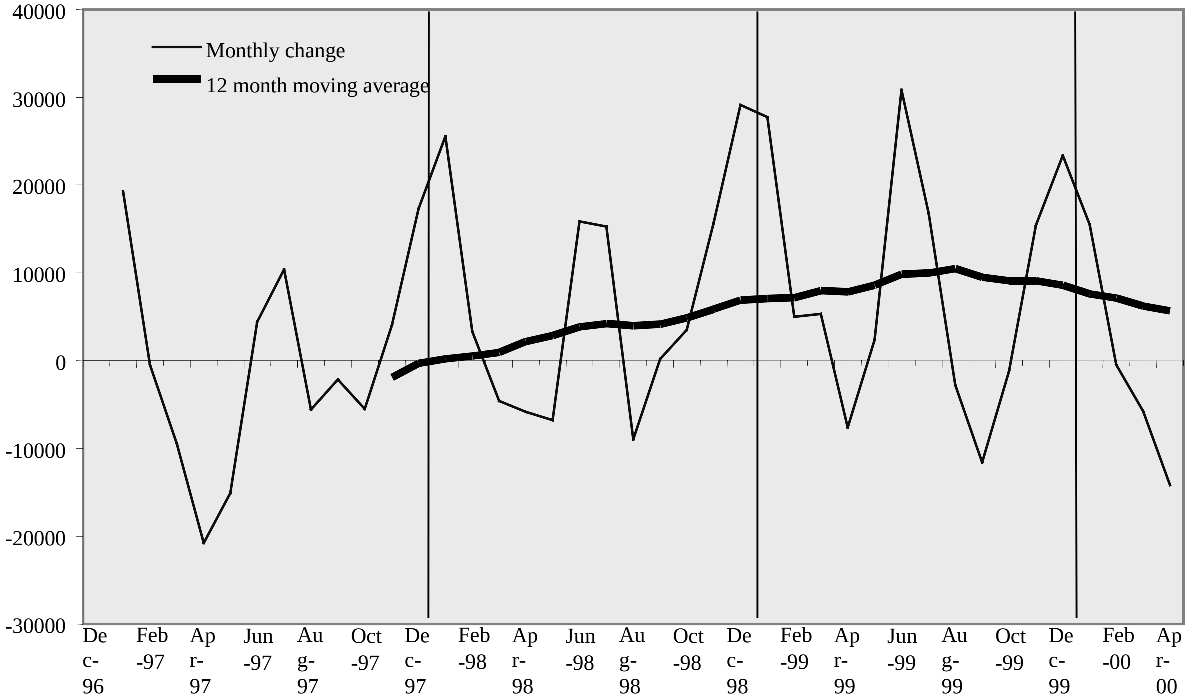
Per cent of GDP in the previous year



1. See Technical Annex

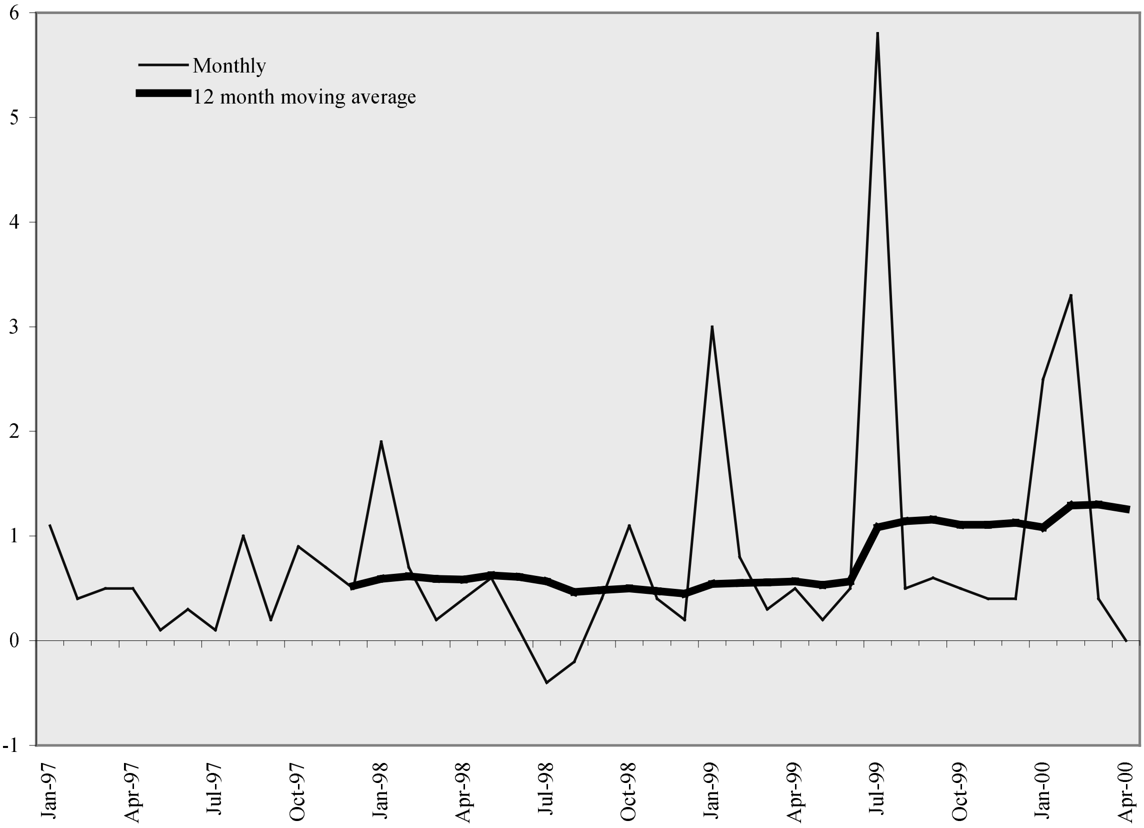
Source: Slovakia Statistical Office and OECD

Figure 4. **Monthly change in registered unemployment, 1997-2000**



Source: Statistical Office of the Slovak Republic and OECD.

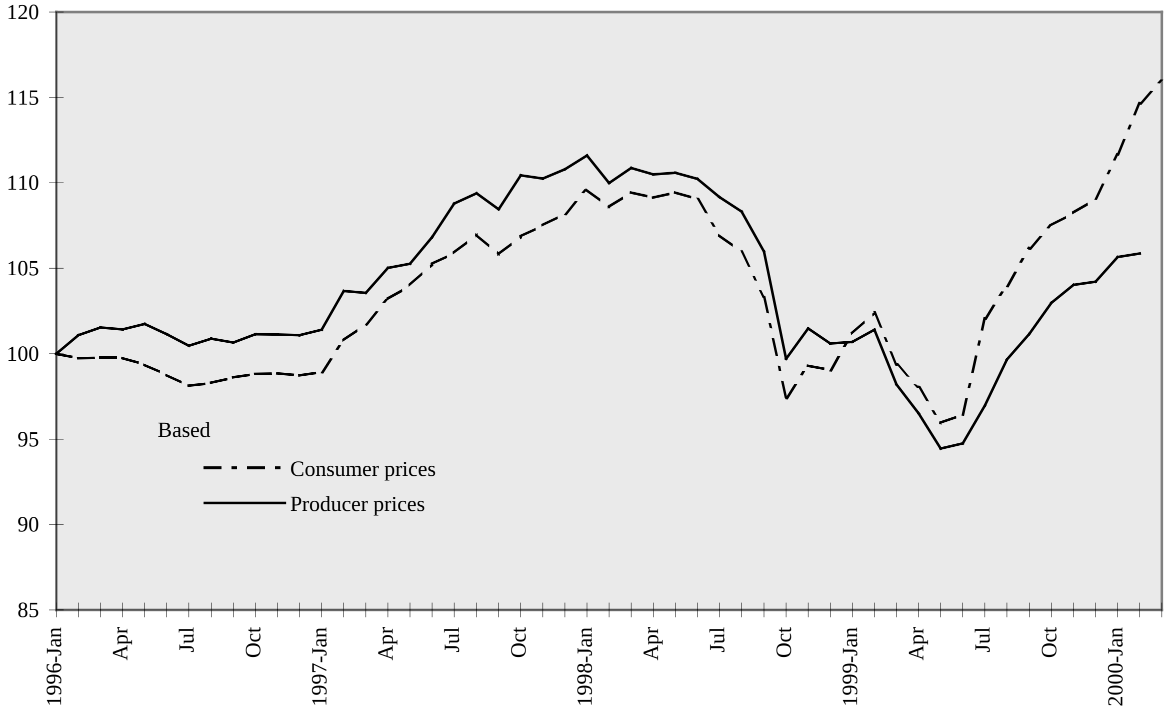
Figure 5. **Monthly consumer price inflation, 1997-2000**
Per cent



Source: Statistical office of Slovakia and National Bank of Slovakia

Figure 6. **Real effective exchange rate[1], 1996-2000**

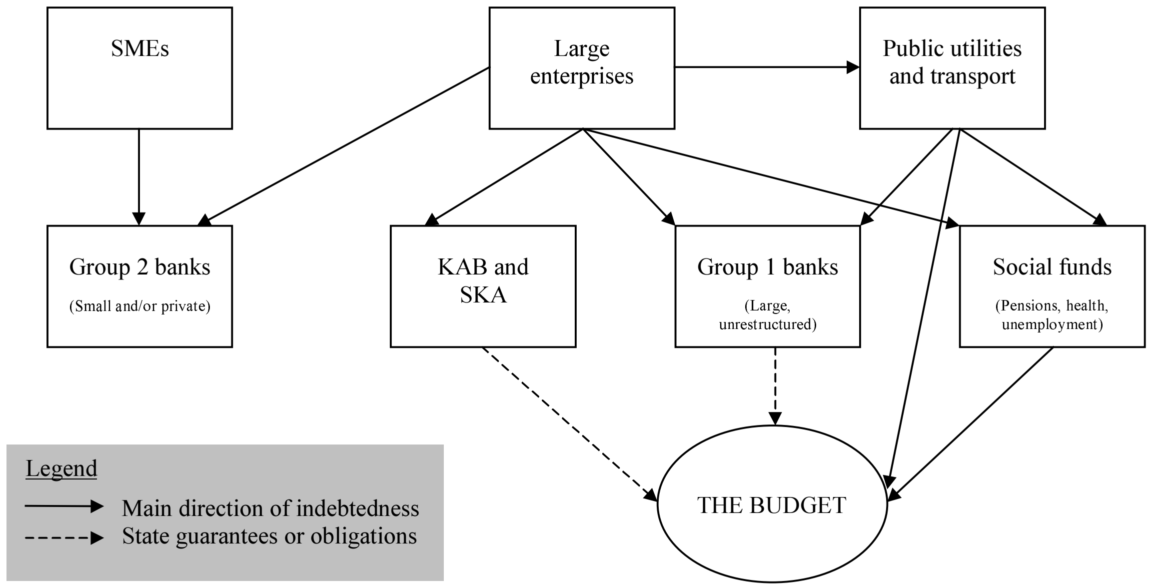
1996 January = 100



1. See Technical Annex. Growth in the index denotes an appreciation of the Slovak koruna.

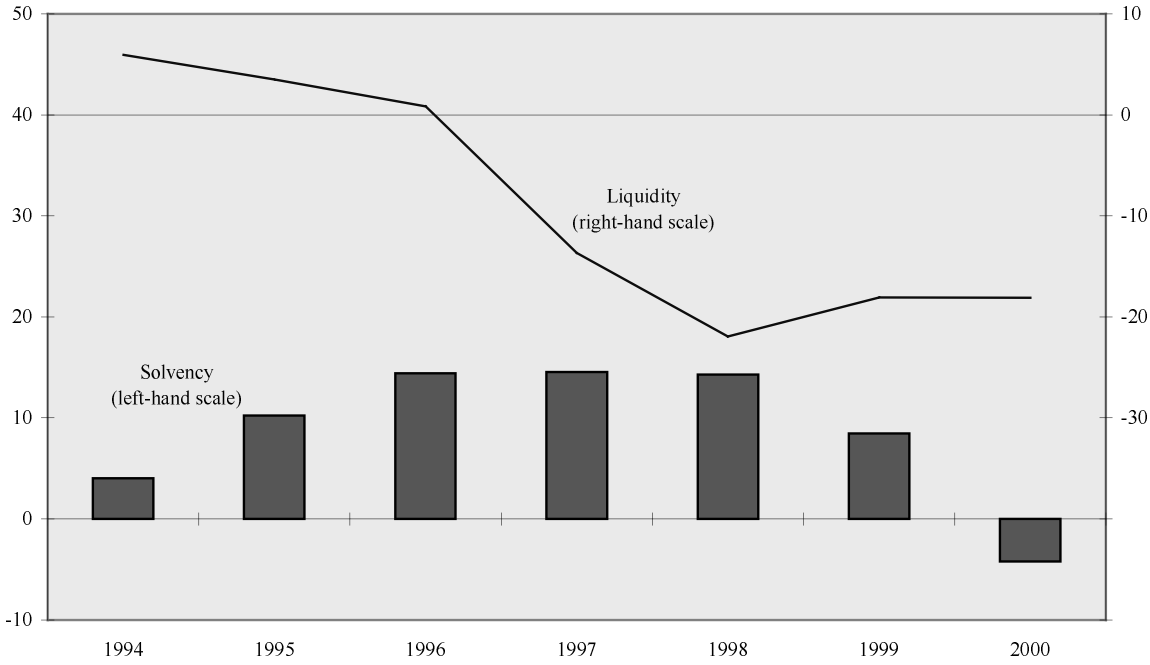
Source: Statistical Office of the Slovak Republic and OECD

Figure 7. **Framework for interlocking financial relationships**



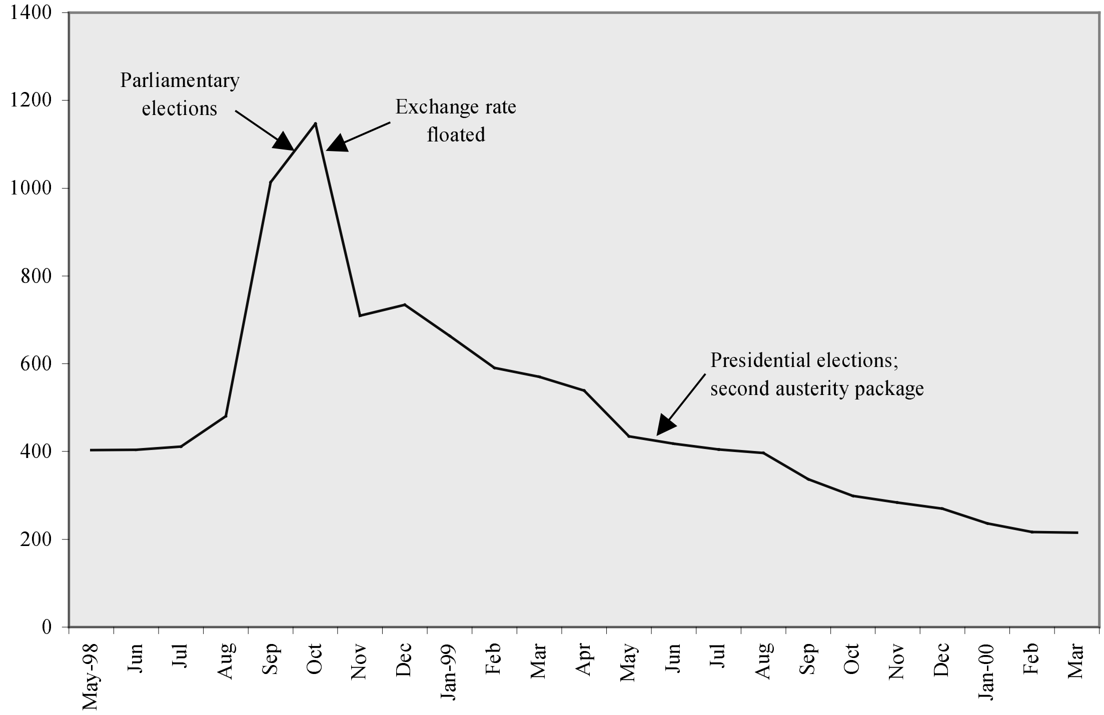
Source: OECD

Figure 8. **Liquidity and solvency of combined social funds**[1]
SKK billion



1. Social Insurance Agency, health and unemployment insurance funds.
Source: Ministry Finance and OECD

Figure 9. **Sovereign interest rate spread**[1]
Basis points



1. See Technical Annex.
Source: Bloomberg and OECD

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