

# WORLD TRADE ORGANIZATION

RESTRICTED

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## **Committee on Balance-of-Payments Restrictions**

### REPORT ON THE CONSULTATIONS WITH THE SLOVAK REPUBLIC

1. The Committee on Balance-of-Payments Restrictions consulted with the Slovak Republic on 9 October and 17 December 1997. The consultations were held under the Chairmanship of Mr. Peter R. Jenkins (United Kingdom) in accordance with the terms of reference of Article XII:4(a) of the GATT 1994 and the Understanding on the Balance-of-Payments Provisions of the GATT 1994. The International Monetary Fund was invited to participate in the consultations in accordance with Article XV:2 of GATT 1994.

2. The Committee had before it the following documents:

WT/BOP/S/5	Background Paper prepared by the Secretariat
WT/BOP/G/5	Basic Document supplied by the Slovak Republic
WT/BOP/N/21 and Corrs. 1 and 2	Notification from the Slovak Republic
WT/BOP/N/28	Notification from the Slovak Republic

IMF                      Slovak Republic, Recent Economic Developments, 3 March 1997.

#### Opening Statement by the Representative of the Slovak Republic

3. The opening statements are attached as Annexes I and II.

#### Statement by the Representative of the International Monetary Fund

4. The statements are attached as Annexes III and IV.

#### Discussion in the Committee

(i) Balance of payments position and prospects; alternative measures to restore equilibrium

5. Members recognized that the Slovak Republic faced a serious balance-of-payments problem, in that a current account deficit approaching 10 per cent of GDP was unsustainable and reserves were at a low level. However, members noted that appropriate macroeconomic policies and in particular, fiscal tightening, as recommended by the IMF, were desirable and would bring about lasting relief. In this context, members also urged an acceleration of reform in the banking and commercial sectors. Following the suspension, in December, members welcomed the parliamentary approval of the 1998 Budget, which raised taxes aimed at lowering the fiscal deficit, and the new bankruptcy law which would allow for needed restructuring.

(ii) System, method and effects of restriction

6. The Committee welcomed the prompt notification of the import surcharge and the fact that it was price-based, generally applied and a time table for phase out had been provided. It was pointed out that the surcharge, which had replaced the import deposit scheme, applied to more products than the latter restriction had, thus increasing protection. Some members questioned whether the level of the surcharge was proportional to the problem. Some members suggested that the measure was not appropriate to address the balance-of-payments problem, others that the measure was in conformity with Article XII. Members suggested that the phase out schedule be accelerated with some calling for an elimination of the surcharge by the end of the year.

Replies by the Slovak Republic

7. The representative acknowledged that the import surcharge was not a substitute for macroeconomic policies but was rather a short-term corrective measure until reform policies could have their stabilizing effect. With respect to the rate of the surcharge, the authorities had determined that a higher level would affect competitiveness and ignite inflationary tendencies, and he added there was less selectivity in its application than had been the case under the import deposit scheme.

8. In December, the representative presented a revised phase out schedule which would accelerate the reduction of the surcharge and eliminate it by 1 October 1998.

Conclusions

9. The Committee recognized that the Slovak Republic was facing balance-of-payments difficulties, with a low level of reserves, as noted by the IMF. The Committee welcomed the prompt notification of the import surcharge and the accompanying schedule for its phase out. Members also welcomed that the measure was price-based and generally applied.

10. Some Members questioned whether the measure was an appropriate response to the balance-of-payments problem confronting the Slovak Republic; they suggested that structural reform and macroeconomic adjustment were more likely to bring lasting relief. They called for fiscal tightening and an acceleration of the phase out plan.

11. After a short suspension of the consultation, the Slovak delegation reported that the Slovak parliament had adopted a budget for 1998 which provided for a reduction in the fiscal deficit; the bankruptcy law had been amended; and a modification to the phase out plan which would result in the elimination of the measure by 1 October 1998 would be notified formally.

12. On that basis, the Committee agreed to recommend that, pursuant to paragraph 13 of the Understanding, the Slovak Republic should be deemed in compliance with its obligations under GATT 1994, provided it adhered to its modified time-schedule. It was understood that any departure from the time-schedule would be notified promptly so that the Committee could meet.

ANNEX IStatement by the Representative of the Slovak Republic  
at the BOP Meeting of 9 October 1997

It is a privilege for me to have an opportunity to participate on behalf of the Slovak Republic on consultations in the WTO Committee on Balance-of-Payments Restrictions.

Before my intervention explaining the reasons for application of restrictive import measure, pursuant to respective provisions of Article XII of the GATT 1994, I would like to express my appreciation to the WTO Secretariat and IMF for presenting of respective documents and constructive cooperation in preparatory process.

Allow me now to turn to the substance of our consultations. Since the detailed information on macroeconomic development, current account, foreign exchange reserves and other indicators, is available in the respective documents, I would like briefly to inform about the latest figures and developments in these aggregates.

After satisfactory developments in previous three years, again, positive results are being registered in **GDP**, where 6 per cent growth in constant prices in the first half of this year has been recorded. **Inflation rate** reached 6.1 per cent and has been kept relatively low during the third consecutive year. Stability of the currency has been maintained in the same period due to anti-inflationary policy and measures undertaken by National Bank of Slovakia which are in detail contained in Basic Document. However, intensified pressures on exchange rate of Slovak crown have appeared during several last months caused by both internal and external factors.

After relatively favourable results in **foreign trade** achieved in the years 1994 and 1995 reflected in balance of trade and services, negative developments in 1996 have been recorded. As a result of the accelerated growth in imports (28.5 per cent increase on year-on-year basis) and the considerably reduced growth in exports (increase 6.1 per cent only), huge trade deficit amounting US\$2.3 billion has been registered. This strongly negative development continued in the first half of this year and trade balance deficit amounted US\$986 million, which is higher figure in comparison with the same period of the last year. Unofficial figures for August show that deficit reached amount US\$1.1 billion. Additionally, rather unfavourable development was recorded in the services balance which has been a key factor in the generation of current account surpluses in the previous years.

In territorial structure of Slovakia's foreign trade, there are several weak points negatively influencing its development, namely inadequately diversified exports and dependence upon raw material, semi-finished products and energy imports. High share of Czech Republic and Germany in exports of Slovakia is a sensitive element in export performance and any negative development is reacting accordingly. Also commodity structure of Slovak exports dominated by semi-finished products is not favourable and thus sensitive to real and possible swings.

Trade balance deficit in 1996, consequently influenced the Slovak Republic's **current account** deficit amounting US\$2 billion and this unfavourable trend has been continuing during this year. In absolute terms deficit of current account totalled US\$1 billion in June 1997. According to available data share on GDP increased from 8.6 per cent up to almost 11 per cent of GDP in relative terms.

**Capital account** in its structure is not developing positively either. As our Basic Document indicates, there is very low level of foreign direct investment amounting US\$181 million in 1996, while short-term capital dramatically increased to roughly 70 per cent of overall capital inflow. This

speculative capital sharply increased in first four months of this year, but to the broader extent outflowed in May, which consequently led to reduction of foreign exchange reserves to the amount lower than three months coverage of imports of goods and services. Other types of capital inflow have been negatively influencing external indebtedness of Slovakia, where **foreign debt** in four years more than doubled from less than US\$3 billion in 1993 up to US\$9 billion registered in June 1997. The most rapid increase in foreign debt has been registered during first half of this year, where overall debt growth accelerated and expanded by US\$1.2 billion, in this period. While foreign debt in absolute terms would not seem to be alarming, per capita debt may be currently a matter of concern. Per capita debt increased from US\$562 in the beginning of 1993 up to US\$1,705 in June 1997. Taking into account current development in borrowing activities of the Government, enterprises and commercial banks, it is high probability that gross indebtedness will exceed amount of US\$10 billion in the end of this year, which will increase per capita debt up to US\$1,950 in given period. In this context, debt service will be growing, as a consequence to above mentioned development, what will mean an additional burden and thus pressure to balance-of-payments.

While in previous years overall **balance-of payments** has recorded modest surpluses, this trend has been reversed in recent period. Balance-of payments figures available in June 1997 show deficit amounting US\$253 million for the first time of existence of Slovakia.

Official **foreign exchange reserves** of National Bank of Slovakia after relative stability in two previous years, where the level has been sufficient to cover imports of goods and services up to 4 months in 1995 and 3.4 months in 1996, declined in April and further in May 1997 below US\$3 billion in absolute figures and below 3 months of imports coverage. This situation prevailed in consecutive three months and July 1997 data confirmed this unfavourable development, where foreign exchange reserves reached the level covering 2.8 months of imports only. High share of short-term capital on total liabilities of capital and financial account may further endanger level of foreign exchange reserves.

**State Budget** in 1996 has deteriorated and deficit amounting SKK 25.6 billion representing 1.3 per cent of GDP in relative terms, was recorded. Situation in the first half of this year has not improved. Current figures available for June 1997 are indicating deficit of SKK 13.2 billion and fiscal deficit amounted SKK 5.5 billion in given period, overall real revenues reached 45.9 per cent and expenditures 44.1 per cent of annual budget plan. Reasons for lower level of revenues have been detected mainly in lower tax collection from legal entities and on expenditure side by extensive growth of capital expenditures which have exceeded the time framework of budget expenditure plan in the first half of this year. The main strategy of the Slovak authorities for this year is to keep fiscal deficit on the projected level or lower. External and internal imbalances led Slovak Government to adopt several measures necessary for correction of this development.

Now, let me briefly mention the set of measures adopted recently with the aim to respond to above-mentioned developments and imbalances in the area of:

**A. Budgetary, fiscal and tax policy:**

- (i) Tightened regulation of budgetary expenditures in the second half of the year with expected selective whole-year limitation of budgetary expenditures minimum volume of SKK 5 billion.
- (ii) Tax administration and collection through stricter control and penalization of violation of regulation with the aim to achieve better fiscal discipline in being introduced.

- (iii) In order to strengthen tax incomes and to influence consumption submit a draft of the Act amendment of excise duty on hydrocarbon fuels and lubricants has been effected. Excise tax has been increased by 5 per cent in average, product coverage has been expanded. Additional increase of revenues from this measure amounting to SKK 500 million is expected.
- (iv) Prices of energy for large-scale consumption in average by 10 per cent have been raised.
- (v) The water rate by SKK 1 and sewage rate by SKK 1 for households have been raised.
- (vi) The concession charges for TV and radio broadcasting have been raised by maximum 50 per cent.
- (vii) Public investment projects has been reduced by SKK 5 billion.

## **B. Wages**

There is a distortion between growth of labour productivity and real wages growth with difference of 1.8 per cent in the first half of the year. Therefore, Government has adopted amendment of the Law on Wages where adjustment of real wages in business entities should be in compliance with the labour productivity. The main goal of this measure is to slow down domestic demand and reverse further deepening of current account deficit.

Except of above mentioned package, there are further intentions of the Slovak Government to adopt measures in fiscal area with the aim to reach more balanced macroeconomic situation and to reverse unfavourable developments , for example:

- (a) to include the further taxation of personal consumption of the business sphere into the proposal of income tax.
- (b) to prepare a proposal of the Act for implementation of excise duties on some goods and services.
- (c) to reassess:
  - applying of heating subsidies in respect to the households incomes
  - measures for elimination of losses caused by transport of heating.
- (d) to prepare the proposal for different tariffs for over-consumption of energy, gas and transport by households since the beginning of 1998.
- (e) to consolidate maximum prices of heating and water heating.
- (f) to increase prices for railways for personal transport.
- (g) to amend Law on VAT where some items will move to the higher rate (from 6 to 23 per cent).

As far as projection of fiscal budget for 1998 is concerned, it is an expectation, that its deficit will be reduced to SKK 5 billion.

**Import surcharge** creates an integral part of broadly adopted package aimed at stabilization of the current situation and should be seen as corrective measure of temporary nature and does not substitute or deviate from open and liberal trade policy of Slovakia. It is characterized by low fully bound tariffs, very low number of non-tariff measures, as well as active participation in sectoral initiatives, for example ITA, and active approach in services sector with valuable contribution in basic telecom and financial services where additionally further liberalization steps are being currently undertaken on national level. Therefore, import surcharge has been introduced alternatively as transparent price-based measure having less disruptive effect on trade. It is applied on a non-discriminatory basis, almost across the board with some exceptions stipulated in negative list, covering more than 75 per cent of total imports.

The Slovak authorities are aware of the fact, that inevitable condition for sound growth is transformation in its complexity, restructuring of economy through effecting of systemic and rational measures supporting sectors with higher value added, which would lead to improvement of external position and reversing of current imbalances. Changes in GDP generation will require certain period, during which stable macroeconomic environment is necessary. This is, however, as we are aware, endangered by existence of foreign trade imbalance registered through deficit of trade balance and recorded from the second half of the 1995.

The Slovak Government reiterated in previous occasions that it feels fully to be bound by its international commitments for active and effective cooperation with all WTO Members. Reversed developments in some key elements of the balance-of-payments and of trade balance in particular, lead to consideration of reversing this situation. The Slovak Government is convinced that invocation of Article XII of GATT 1994, in order to safeguard its external position and balance-of-payments situation, to forestall the imminent threat of serious decline in its monetary reserves, is a legitimate step. The Slovak Government made its utmost effort to observe respective provisions of the Article XII of the GATT 1994 from the criteria as well as substance aspects and wishes to assure WTO partners that transparent timetable of phasing out contained in our Basic document will be respected.

We are prepared to consult with WTO Members in good faith and respond to questions which no doubt will be raised.

ANNEX IIStatement by the Representative of the Slovak Republic  
at the BOP Meeting of 17 December 1997

Mr. Chairman,

It is an honour for me to participate on behalf of the Slovak Government in resumed consultations in this Committee. In the context of previous consultations I wish to recall that detailed information on general macroeconomic developments, including developments on trade balance, current account of balance of payments, foreign exchange reserves and other relevant aggregates, being important for assessment for justification of invocation of Article XII of the GATT 1994, is available in document WTO/BOP/G/5. In today's intervention I would like to concentrate on the updating of figures and facts, which are important for further assessment of application of the import surcharge. The latest development in the period from mid-year up to the end of September and trade balance up to the end of this October will be presented briefly.

1. Economic development of Slovakia shows up to the end of September signs of stability in certain areas. Real GDP growth for this period reached 6 per cent, however, growth in comparison with last year has slowed down. The inflation rate based on current prices reached 6.1 per cent, which is 0.2 per cent higher than in the same period of the last year. Currency stability has been maintained by the anti-inflation monetary policy and by the corrective measures of the National Bank of Slovakia. However, pressures on the exchange rate of the Slovak currency, which have been recorded in the last months, will most probably continue, which is being caused by both internal and external factors. The average unemployment rate of 13 per cent has slightly increased in comparison with the same period of last year. There is long-term unemployment prevailing.

2. Development of the trade balance of Slovakia continues to be unfavourable. The negative balance in the third quarter has increased by US\$185 million and at the end of September reached in absolute terms US\$1,171 billion, which is however, in comparison with the same period of last year, less by US\$199 million. Main factors contributing to this relative improvement can be considered as follows: improved market situation in the EC, the most important trade partner of Slovakia, stabilization of prices for imported raw materials namely crude oil and natural gas, and last but not least introduction of the import surcharge. In absolute terms, a higher volume of exports than imports has not been recorded, but in relative terms export growth has been more dynamic than imports. The foreign trade turnover of Slovakia in the period from January up to October 1997 increased in comparison with the same period of last year by 8.4 per cent, where exports increased by 10.4 per cent and imports increased by 6.8 per cent. Dynamics of imports from this May has slowed down and this trend is recorded also in exports in the last two months. While average trade balance deficit January-April reached US\$189 million and in the period May-July (import deposit scheme) amounted to US\$101 million, trade deficit during August and October (import surcharge) reached US\$74 million. In the territorial as well as commodity structure there have not been recorded any fundamental changes.

3. Current account deficit in the year 1996 amounted to US\$2.1 billion. This trend has remained unchanged also during this year. In the period of nine months of the year 1997, current account of balance-of-payments deficit reached level of US\$1.2 billion (in fixed exchange rate 30.65 SKK/US\$). The level of the current account deficit on GDP is still high, approximately 8 per cent.

4. The coverage of this negative balance of the current account is followed by inadequate structure of capital and financial account of balance of payments. Above all, data available show a very low

share of foreign direct investments. In the year 1996 FDI reached almost US\$200 million (less than 1.4 per cent of GDP). In the year 1997 foreign direct investments are negative. During the period from January up to September 1997 FDI inflow amounted to US\$55.5 million (0.4 per cent of GDP only), while FDI outflow reached US\$58.2 million. Negative development is clear also in the area of disbursement of capital liabilities, where short-term capital share is higher than 50 per cent. Capital and financial account structure has direct impact on the increase of foreign debt. In absolute terms total gross foreign debt of Slovakia reached US\$9.4 billion (official data to the end of August 1997). In this context, debt service will be growing with evident consequences.

5. The balance-of-payments position has not changed from the last consultations. To be more precise, overall balance of payments during three quarters of 1997 has recorded a deficit amounting to US\$183.7 million. These figures are understandably a matter of concern.

6. Official foreign exchange reserves modestly improved during the last two months. However, coverage of imports of goods and services is still on critical level, not exceeding three months. This unfavourable level of foreign exchange reserves together with remarkable share of short-term capital, may cause various problems including possible exchange rate attacks.

7. The Slovak National Council approved on 12 December 1997 the state budget for the year 1998. General government deficit for 1998 is projected for 3 per cent of GDP, in comparison with 1997 for which deficit has been projected for 4.8 per cent of GDP. Fiscal budget deficit for 1998 has been approved at the level 0.7 per cent of GDP in comparison with 1.8 per cent of GDP in 1997. Slovak authorities consider from medium- and long-term strategy to keep fiscal balance. Based on the above-mentioned data, a tendency from expansionary fiscal policy towards a restrictive one is evident. However, real possibilities and limits in the economy have had to be taken into account.

8. In order to solve the problem of internal imbalances, in addition to the package indicated in more detailed fashion in the last statement, further measures have been adopted, namely: (i) amendment of the Law on VAT has been adopted, where some items moved to higher level, from 6 per cent up to 23 per cent; (ii) excise tax for tobacco and alcoholic beverages has been increased; and (iii) gradual liberalization of prices for heating, energy and gas are considered.

9. The Slovak Government realises that the fundamental precondition for further growth of the economy is its restructuring, above all in the industrial sectors. With the aim to reach more effective and transparent as well as accelerated restructuring of the economy, the amendment of bankruptcy law has been adopted by the Slovak National Council.

10. A liberal policy is a fundamental element in the Slovak overall policy. And I would like to stress, that Slovakia pursues this open and liberal policy. Lately, the Slovak Government joined ITA and will apply reduced tariff rates with effect from 1 January 1998, it has approved Fourth Protocol to GATS on basic telecom, and actively participated in negotiations on liberalization of financial services. By this approach I wish to indicate that the import surcharge currently applied is a temporary corrective measure to overall policy aimed at stabilization of current macroeconomic imbalances.

11. The Slovak Government would like to reiterate its binding to adopted international rules and commitments. It is, however, convinced that in the context of its macroeconomic situation an invocation of Article XII of the GATT 1994, in order to safeguard its external position, especially balance-of-payments position, to forestall the imminent threat of serious decline in its monetary reserves, is a justifiable step. Slovakia has presented an exact timetable for phasing out of the import surcharge pursuant to the respective paragraphs of Article XII of the GATT 1994. Taking into account concerns of WTO Members during previous consultations to the presented harmonogram and thorough assessment



of the latest macroeconomic developments after introduction of the import surcharge, the Slovak Government considered all aspects of further application of this measure. In addition, based on modestly improved balance-of-payments situation as well as foreign exchange reserves, despite still being fragile and volatile, the Slovak Government would like to submit the following amended timetable for the phasing-out of the import surcharge:

- As from 1 January 1998 the import surcharge will be reduced to 5 per cent. Decision on this reduction has been already adopted by Decree No. 339/1997 dated 13 December 1997.
- The import surcharge will be further reduced as follows: as from 1 April 1998 - 3 per cent, as from 1 October 1998 the import surcharge will be abolished, provided the balance of payments as well as foreign exchange reserves situation will be stabilized. This proposal means accelerated phasing-out harmonogram and effectively shortens the originally submitted timetable.

Mr. Chairman,

This initiative step of the Slovak Government will be hopefully taken positively as a concrete contribution to reach consensus and would lead to conclusive consultations.

We are prepared consult with the WTO Members in good faith and response questions which may be raised.

Thank you

### ANNEX III

#### Statement by the Representative of the International Monetary Fund at the BOP Meeting of 9 October 1997

1. The Slovak Republic has made impressive progress in its economic management and performance since its independence in 1993. Growth resumed in 1994 and accelerated in each of the following years, reaching almost 7 per cent in 1996, while inflation fell steadily from more than 20 per cent in 1993 to less than 6 per cent in 1996. The Slovak success with macroeconomic stabilization was supported by prudent fiscal policy and continuing enterprise restructuring. However, a very large external current account deficit emerged in 1996 which has persisted so far in 1997. Monetary policy has been tightened in response, but its effectiveness in slowing down domestic demand has been undermined by a fiscal policy that has turned more expansionary over the past two years.

#### Overview of Economic Developments

2. **1996** was the third year of strong growth and falling inflation. However, the current account registered a deterioration of 13 percentage points of GDP, to record a deficit of more than 11 per cent of GDP, as imports surged, fuelled by an increase of more than 20 per cent in domestic demand. Rapid credit growth through mid-year (with credit to enterprises growing at more than 20 per cent), a fiscal deterioration of 1½ percentage points of GDP and sizeable wage increases contributed to the rapid expansion of domestic demand. The temporary removal of the import duty on small cars was another factor behind the sharp increase in imports. In reaction to the growing external deficit, the National Bank of Slovakia (NBS) began to tighten monetary policy in mid-1996, pushing interbank rates up from 10 per cent to 16 per cent by December.

3. Preliminary data suggest that in **1997** the economy is growing at a more moderate pace of about 5 per cent, as private investment has slowed down in response to the tight monetary policy. Inflation, at 6 per cent (year-on-year) in July, is expected to pick up to about 7 per cent by year-end, following recent increases in indirect taxes. Export growth has rebounded, expanding by 13 per cent in Slovak crown terms (year-on-year) during the first half of 1997, compared with growth of only 6 per cent in 1996; import growth moderated during the first six months of the year to 14 per cent (year-on-year), down from 30 per cent during 1996. Nevertheless, the **external situation remains precarious**, as the current account deficit remains at about 10 per cent of GDP.

4. In May 1997, the Slovak crown faced a **speculative attack**, precipitated in part by contagion effects from the turmoil in the Czech exchange market, but also against the background of the large current account deficit. The crown briefly fell to the lower bound of its fluctuation band,<sup>1</sup> but pressures on the exchange rate subsided after the NBS choked off liquidity on the money market, pushing short-term interbank rates above 30 per cent.

5. These economic developments reflect the shortcomings of the prevailing **policy mix**. Despite the external imbalance, **fiscal policy** has become more expansionary, with the general government deficit planned to increase by 2½ percentage points of GDP to 3½ per cent in 1997, as the Government maintains its focus on infrastructure development, and on pursuing an industrial revitalization plan. Projections based on data through mid-1997 were even more worrisome, pointing to a deficit of over

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<sup>1</sup>The exchange rate is pegged within a band to a basket comprising the U.S. dollar and the German mark with weights of 0.4 and 0.6 respectively. To deter speculative capital inflows the NBS widened the band in several steps during 1996 from  $\pm 1\frac{1}{2}$  per cent to  $\pm 7$  per cent.

7 per cent of GDP due to a substantial shortfall in revenue collection and higher-than-anticipated interest payments.

6. In response to these projections, the authorities announced a package of measures in July 1997 that would reduce the deficit to about 4½ per cent of GDP in 1997. This fiscal deficit, together with the continued tight rein on **monetary policy**, have kept interbank interest rates above 20 per cent. The current policy mix could crowd out private investment, slow down economic restructuring, and still leave the economy vulnerable to external shocks. To avoid these risks, the Fund staff has urged further fiscal tightening aimed at achieving a balanced fiscal position in the second half of 1997, and a small surplus in 1998. In addition, the Fund Staff has cautioned the authorities not to involve the state in either the revitalization or the management of enterprises.

7. **As regards the external outlook**, under present trends, the current account deficit in 1997 could remain in excess of 9 per cent of GDP. In the past, the deficit was mostly financed by medium- and long-term credits. There was, however, a marked increase in short-term credits in the first quarter of this year (the last quarter for which data are available). Reserve cover has fallen gradually to less than 3½ months of imports of goods and non-factor services from about 4½ months in 1995.

#### The Exchange and Trade System

8. The Slovak Republic accepted the obligations of Article VIII of the IMF's Articles of Agreement on 1 October 1995. It maintains a substantially liberalized **trade regime**, with import and export licences required for only a few items, and relatively low average import tariffs (8 per cent on an unweighted basis in 1996). Slovakia maintains a customs union with the Czech Republic and Association Agreement with the EU, free trade agreements with Visegrad and EFTA countries, and it anticipates becoming a member of the OECD before the end of the year. In 1996, to comply with OECD accession requirements, the Slovak authorities further liberalized **capital account** transactions, including credits from Slovak residents to OECD residents with maturity of five years or more; credits received by Slovak residents from abroad with a maturity of three years or more; and trade credits with respect to OECD members.

9. In consultation with the WTO, on 1 January 1997, Slovakia completed the phased removal of the import surcharge on consumer goods that it had imposed in March 1994 to deal with a temporary deterioration of the external accounts. On 1 May 1997, however, the authorities introduced an import deposit scheme, largely in reaction to a similar scheme which the Czech Republic had put in place but that was revoked in late August 1997. The import deposit scheme applied to consumer goods and footstuffs and required a six-month non-interest-bearing deposit equal to 20 per cent of import value. Effective 21 July 1997, the import deposit scheme was replaced with a 7 per cent **import surcharge** on about 80 per cent of imports, thus increasing the degree of protection. The authorities announced that the surcharge will be temporary and that it will be cut to 5 per cent at the beginning of 1998, lowered to 3 per cent in July 1998, and phased out by end-1998.

10. In its consultations with Slovakia, the Fund has urged the authorities not to impose trade restrictions and to rely instead on an appropriate mix of macroeconomic policies to deal with the large external imbalance. While recognizing the pressing need to deal with the persistently large current account deficit, the Fund regrets the imposition of the import surcharge whereas fiscal policy remains expansionary. The surcharge cannot be a substitute for appropriate fiscal tightening to reduce the external deficit to a sustainable level. To conclude, the Fund urges the authorities to immediately tighten fiscal policy and to initiate the phased removal of the surcharge, preferably ahead of the announced schedule.

ANNEX IV

Statement by the Representative of the International Monetary Fund  
at the BOP Meeting of 17 December 1997

1. The Fund's assessment and recommendations remain as in the statement presented during the October discussions (EBD/97/108; 9/24/97).
  2. An Article IV consultation mission visited the Slovak Republic during 30 October to 12 November 1997. Preliminary data for the first half of 1997 suggest that the economy, although moderating somewhat, has continued to grow at a rate of close to 6 per cent. Private investment has slowed in response to the tight monetary policy stance that remains in place. Since July, there has been a marked reduction in the monthly trade deficit. Through October 1997, exports grew by 10 per cent in Slovak crown terms (year-on-year), while import growth continued to decelerate to less than 7 per cent (year-on-year), down from 30 per cent during 1996. Nevertheless, the current account deficit is projected at between 8-9 per cent of GDP for 1997. Official foreign reserves now stand at their pre-May crisis level; this could deteriorate rapidly as the current account deficit remains high and turbulence in international capital markets has limited the access to external borrowing.
  3. On the fiscal front, the 1998 budget is currently being discussed in Parliament. The government proposal implies a general government deficit of 3 per cent of GDP for 1998, compared with budget plans of 3.5 per cent and a projected outcome of 4-5 per cent of GDP in 1997.
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