Statement by Philippe Peeters  
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**Slovak Republic: Country Assistance Strategy**

The government that took office during the second half of 1998 launched a strong macro stabilization program, followed by a comprehensive program of reforms. One of the most important elements of the reform program will be the Enterprise and Financial Sector Structural Adjustment Loan. The Fund will treat this Bank supported program as one element of its own Staff Monitored Program, which will enhance the confidence in Slovakia's commitment to macroeconomic stability.

The basic goal of the program is to complete Slovakia's economic transformation and prepare its economy for competition as required for membership in the European Union, while at the same time raising the living standard for Slovak citizens. The proposed CAS has been designed to support these three objectives.

**Macroeconomic Stabilization**

On coming to power in late 1998, the present government inherited an economy in a weakened condition, which was extremely vulnerable to external shocks. At that time, the economy was growing by around 6 percent of GDP, with unsustainable high fixed investments of around 38 percent of GDP, a growing fiscal deficit, a current account deficit that grew by 10 percent of GDP, and deepening external indebtedness.

The most important steps taken by the government to restore macroeconomic balance were to reestablish fiscal discipline and lower the current account deficit to a sustainable level. The record for the first year was quite impressive: The past year has seen these macroeconomic successes continue. In 2000, the general government deficit reached 3.5 percent of GDP. And it is expected that last year's strong output performance, led by exports, will be shown to have reduced the current account deficit to around 4 percent of GDP.

The Slovak authorities have worked with the EU Commission to prepare a medium-term policy framework. This document represents a road map to guide the authorities in preparing for EU accession. It assumes that, between now and 2004, Slovakia will gradually reduce its fiscal deficit to between 1-1.5 percent and its current account deficits to 2.5-3 percent of GDP.

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Economic Sector Reforms

The improvement in Slovakia's macroeconomic indicators during the past year have created favorable conditions for sectoral reforms, and ambitious deregulation and liberalization policies are being implemented in the financial, public expenditure, social, health, transportation, and telecommunication sectors. As part of this change, several independent regulatory bodies have been established and more are on the way. The Bank's broad technical assistance has established a solid basis for beginning soon with adjustment lending under structural conditionality. Since investment lending is available from other institutions, mainly of the European Union, the Bank Group has rightly chosen to concentrate on adjustment lending in support to restructuring and privatization, and in preparation for FDI and infrastructure financing. An appropriate division of labor has indeed been agreed upon between these European institutions, the IMF, and the Bank.

Financial Sector Reform

Major steps have been taken in the financial sector. In the banking sector, the principal reforms were the restructuring and privatization of the three biggest state-owned banks and the launching of a strategy for small- and medium-size banks. Last year saw significant progress in all these areas, and the reforms undertaken up to now have succeeded in stabilizing the banking sector. The share of non-performing loans in the banking sector portfolios has decreased significantly, and they have been removed to a special agency.

The restructuring of the three biggest state-owned banks has been successfully concluded last June. In December, the biggest of these state-owned banks was sold to foreign investors and the other two major state-owned banks will be sold in the course of this year. IFC will participate in the privatization of one of these banks.

In order to improve the efficiency of banking supervision, the Slovak authorities have modified the legal framework. An amendment of the new Banking Act is being readied for government discussion. Passage of this legislation will promote transparency, efficiency, and competitiveness, and improve the corporate functioning of the banking sector. Many features of this amendment originated in recommendations by the Bank.

Privatization and Restructuring

Banking sector restructuring goes hand in hand with the restructuring of the enterprise sector. The newly approved bankruptcy law will speed up the process of restructuring and help combat corruption and improve corporate governance. The most controversial law, the Strategic Enterprise Act, has been replaced by the Privatization Act. The government has made plans to sell stakes in telecommunication, financial institutions, and several utilities. Several larger companies have already been privatized.

Another key objective of the medium-term development program is to achieve sustainable economic growth. The principal reason why Slovakia's development has lagged behind that of its neighbors is the lack of foreign direct investment (FDI). FIAS has been preparing a
comprehensive set of policy measures aimed at attracting foreign capital to Slovakia. MIGA will play a crucial role in increasing FDI, and IFC in stimulating the investment of both domestic and foreign capital. The authorities have approved an ambitious agenda for attracting FDI. New capital will be sought not only for restructuring, but also for green-field investment. And to ensure the transparency of the capital market, the authorities have established a new legal and institutional framework for financial market supervision.

Public Finance Reform

Reforms in the management of public finance will focus on the state budget, on fiscal decentralization, establishment of a state treasury and on a medium-term financial plan. To increase the transparency and efficiency of spending controls, 10 of all the present 12 special state funds will be brought under the budget at the end of this year. The establishment of the rest of the Treasury system is scheduled for next year. As a next step in the strategy of medium-term development, the Slovak authorities have already prepared a medium-term financial plan.

Because Slovakia is a newly independent country, it has experienced serious problems of administrative capacity, even more than other transition countries in the region. The CAS rightly mentioned this weak institutional capacity as one risk to a satisfactory achievement of its objectives. As part of its support to accession countries, the European Union is providing finance and assistance to various key departments, such as Agriculture, Environment, Finance, Health, and Justice.

Social reforms

The CAS also identifies the need for social reforms. Social sectors are one of the biggest burdens on public expenditures. Just as in other transition countries, major problems are runaway costs and untargeted coverage. The government is preparing measures for improving the efficiency of the health care system and for avoiding increased indebtedness of health facilities and health insurance companies. The pay-as-you-go pension system will also be supplemented by a capitalization-based, fully funded system. The government is preparing a reduction of spending in the social sector and improving the control of social benefits.

In addition, Slovakia has also to face problems of extremely low-income groups, including very vulnerable ethnic minorities that have extremely high rates of unemployment. Specific programs will target these extremely well defined pockets of poverty.

In conclusion, my Slovak authorities are committed to their reform programs. They are nonetheless aware of the challenges that lie ahead. They agree that the proposed base case scenario is the right one in the current circumstances, and they are implementing the reforms that are attached to it. They are also confident that with a rapid agreement on a SMP program with the IMF, and with help of the EFSAL, they will be able to implement the measures that have been identified as triggers for the high case scenario.