GENERAL AGREEMENT

ON TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

CONSULTATION UNDER ARTICLE XII:4(a) WITH THE SLOVAK REPUBLIC

Background paper by the Secretariat

I. General

1. This paper is prepared pursuant to paragraph 7 of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes.[1]

2. The Slovak Republic has notified, in document L/7428, the introduction of an import surcharge of 10 per cent on consumer goods and foodstuffs under Article XII:(a) of the GATT with effect on 3 March 1994. In its notification Slovakia states that it has introduced the measure "to prevent the worsening of the situation and to reach the necessary stabilization of the country's monetary reserves... The measure is considered as a short-term supplementary element within the framework of the economic policy aimed at the improvement of the country's external equilibrium." Slovakia expressed its readiness to consult on the measure.

3. Slovakia has now invoked for the first time the balance-of-payments provisions of the GATT. Previously, the Czech and Slovak Federal Republic (CSFR), to which Slovakia is a successor state, introduced a surcharge on imports of consumer goods under Article XII:4(a) in December 1990.[2] This surcharge was abolished at the end of 1992, as announced in the Committee meeting of 8-9 October 1992 (BOP/R/203). The Czech and Slovak Federal Republic split into two independent states on 1 January 1993, the Czech Republic and the Slovak Republic; Slovakia became a contracting party to the GATT, as a successor state to the Czech and Slovak Republic, in April 1993.

II. Slovakia's Trade and Exchange System

4. Slovakia's transition from central planning to a market economy was started in 1990 within the framework of the Czech and Slovak Federation. These reforms included a substantial degree of trade liberalization and internal convertibility of the domestic currency.[3] The basic laws, regulations and economic and trade institutions of the former Czech and Slovak Federal Republic have been maintained in force by Slovakia.[4] Slovakia and the Czech Republic have formed a customs union.[5]

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[1]BISD 26S/205

[2]BOP/R/193

[3]BOP/W/140

[4]Document L/7253 provides information on the Slovak economic and trade regime.

(a) Import and export licensing

5. Slovakia has maintained in force the large scale import liberalization which was introduced as part of the reforms by Czechoslovakia in 1990. Import licences are required on the imports of crude oil, natural gas, firearms and ammunition and narcotics. Imports of some commodities such as uranium ores and concentrates, natural and enriched uranium and their compounds, black coal, and waste and scrap are subject to quotas. Any other goods may be imported freely by registered companies. According to the Slovak authorities, the quantitative restrictions are used for environmental reasons (waste and scrap) or protection of the domestic production.

6. Export licences are required for the export of some sensitive goods (arms, weapons and explosives); export of selected essential inputs for domestic production (meat, cereals, sugar, cement, energy, wood etc.) and exports of goods subject to quantitative restriction imposed by foreign partners.

(b) Import duties

7. Slovakia continues to apply the tariff rates introduced by the former Czechoslovakia. At present, the average simple tariff in Slovakia is 6 per cent, with 97 per cent of all tariffs bound under the GATT. The low level of tariff protection is due to the fact that most of the current rates were adopted in the planned economy period of Czechoslovakia, when tariffs did not influence substantially the flow of imports.[6]

(c) Regional agreements

8. Slovakia, as a successor state to the CSFR, has free trade agreement with the EFTA states and is a party to an Association Agreement with the European Union. The Association Agreement, however, is not yet in force, instead the Interim Agreement on Trade and Trade-Related Matters of the Association Agreement is applied. Slovakia is also a member of the CEFTA (Central European Free Trade Agreement) and it concluded a free trade agreement with Slovenia. In October 1992, the Czech Republic and Slovakia signed a Customs Union Agreement. All these agreements are under examination in different GATT Working Parties.

(d) Exchange policy and exchange controls

9. Slovakia has established its own independent monetary system, following the currency separation on 1 January 1993. Slovakia has maintained the policy of fixed exchange rate as a nominal anchor, which was introduced by Czechoslovakia. The Slovak koruna is pegged to a basket of currencies (US$, DEM, ATS, CHF and FRF). The Slovak koruna was devalued by 10 per cent in July 1993 to sustain foreign currency reserves and current account convertibility. Since February 1993, transactions with the Czech Republic are conducted through a clearing system at a different exchange rate.

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[5](...continued)

[5]L/7212. A GATT Working Party has been established for the examination of the Agreement on the Customs Union.

(e) The import surcharge

10. As stated by the Slovak notification, the 10 per cent surcharge on the imports of consumer goods and agricultural products was introduced against the background of the destabilizing influence of the transformation process, deterioration of terms of trade as well as the negative impact of macroeconomic developments in the last three years which have led to a further decline of economic output and a growing foreign trade deficit.

11. The import surcharge is applied to items specified by HS categories in the notification and to all sources of imports including the Czech Republic and countries who have free trade agreements with Slovakia. The basis of the surcharge is the customs value. The surcharge has been introduced as a provisional measure, the intention of the Government is to apply it until the end of this year.

III. Macroeconomic and Trade Developments

12. In recent years the Slovak economy has seen a sharp decline in output and a rapid increase in unemployment, leading to a significant decline in living standards. The economy's weak performance is in part attributable to the disintegration of the CMEA markets towards which it was heavily oriented. While the process of reform is expected to continue, much will depend on the Government's ability to control the budget deficit and to maintain its stocks of international reserves.

(i) Macroeconomic developments

(a) Output, prices, and employment

13. The Slovak economy grew slowly in the 1980s but 1990 marked the beginning of a downturn which deepened in 1991. The volume of gross domestic product declined by nearly 15 per cent in 1991, and preliminary estimates suggest that there were further declines of 7 per cent in 1992 and 4.1 per cent in 1993 (Chart 1).[7] Even though all the sectors of economy have witnessed a decline in output, the private sector has performed relatively well, increasing its share to 39 per cent of GDP in 1993 - an increase of 7 percentage points over the previous year. The recession in the economy is in large part attributable to the collapse of exports to the former USSR and other East European countries and to the inflation control policy of the Government which cut purchasing power in real terms.

14. In the planned economy period, open inflation was virtually non-existent as most prices were fixed. In 1990, consumer prices rose by 10.4 per cent and then, in 1991, by 61.2 per cent after the federal Government liberalized the prices of most goods (Chart 2). Inflation was brought down to 10.1 per cent in 1992 by contractionary monetary and fiscal policies. However, there has been a resurgence in inflation to 23.1 per cent in 1993 which has been attributed in part to the introduction of a value added tax in January 1993 and to a devaluation of the of the currency by 10 per cent in July 1993.

15. The recent sharp decline in output has led to an increase in unemployment to 11 per cent of the labour force in 1992 and to almost 13 per cent in 1993 (Chart 3). The economic decline has also resulted in a shift of workers out of manufacturing and into services. Recorded real wages declined by almost 30 per cent in 1991 but recovered partially in 1992 by about 9 per cent and in 1993 by 3.5 per cent.

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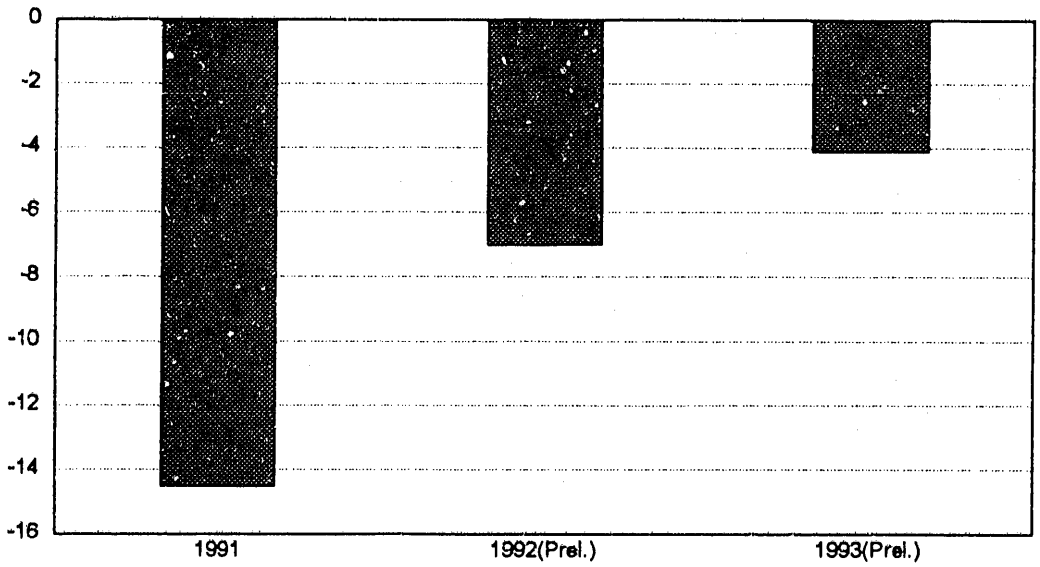
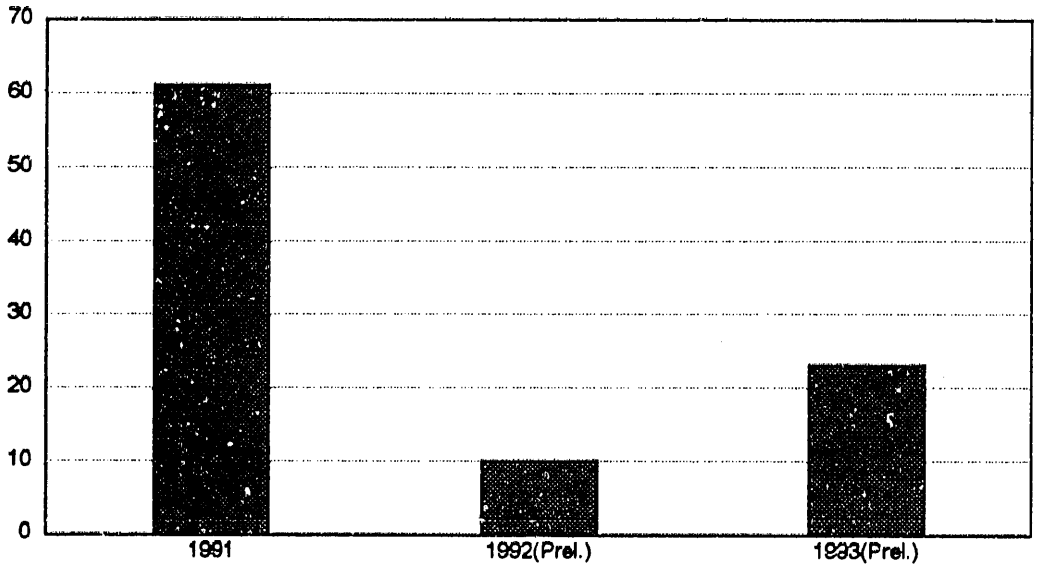
[7]All figures for 1992 and 1993 are based on preliminary estimates provided by the IMF.

Chart 1- Slovak Republic - GDP volume, 1991-93
(Percentage change)



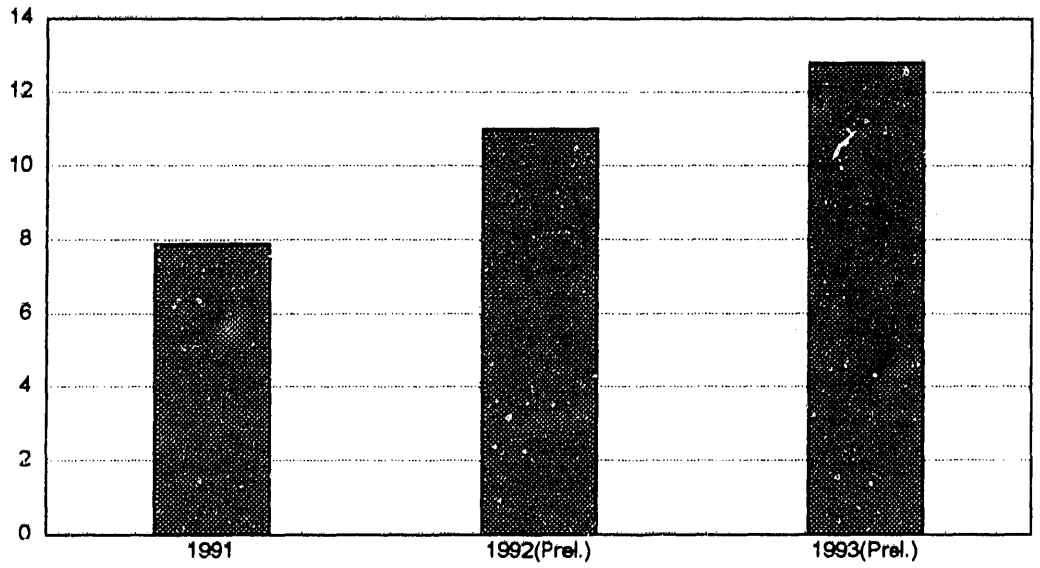
Source: IMF.

Chart 2 - Slovak Republic - Consumer prices, 1991-93
(Period average; percentage change)



Source: IMF.

Chart 3 - Slovak Republic - Unemployment, 1991-93
(Period average; percent of labour force)



Source: IMF.

(b) Public finance

16. The fiscal deficit declined from 13.1 per cent of GDP in 1992 to 7.5 per cent of GDP in 1993 (Table 1). Overall revenues declined slightly over the period from 50.7 per cent of GDP to 48 per cent, due primarily to a significant decline in direct tax collection. There was, however, a larger decline in overall expenditures from 63.8 per cent of GDP to 55.5 per cent, due to a decline in both current and capital expenditures. Social expenditures are the most significant item in current expenditures, accounting for almost 35 per cent of the total in 1993.

Table 1 - Slovak Republic - Fiscal developments in 1992-93[1]
(In percentage of GDP)[2]

	1992 Estimated Underlying[3]	1993 Outcome
Total revenue	50.7	48.0
Indirect taxes	13.4	13.8
Direct taxes	18.0	10.7
Social security contributions	10.0	12.6
Other taxes	2.0	2.4
Non-tax revenue	7.4	8.5
Total expenditure	63.8	55.5[4]
Current expenditures	55.6	49.4
Wages	5.1	4.7
Social expenditures	18.8	17.2
Health care	5.1	4.6
Subsidies	5.4	5.0
Debt service[5]	...	3.9
Other	...	14.0
Capital expenditures	8.2	6.1
Contingency reserve	...	...
Fiscal balance	-13.1	-7.5[4]

Source: IMF.

1 Consolidated general government.
2 Most recent estimate of GDP.
3B ased on an estimate of general government revenue and expenditure in the territory of the Slovak Republic (*i.e.*, including portions of federal revenues and expenditures).
4 Excluding military imports, equivalent to 1.6 percent of GDP, in exchange for a write-down of claims on Russia.
5 Interest, lending, and guarantees, excluding all amortization.

(c) Money and credit

17. The recent relaxation of monetary policy is revealed by the increase in the rate of growth of broad money from 4.7 per cent in 1992 to 16.2 per cent in 1993. Total domestic credit grew by 19.3 per cent in 1993. While the rate of growth of credit to enterprises and households was only 11. 1 per cent in 1993, net credit to the Government grew by almost 39 per cent.

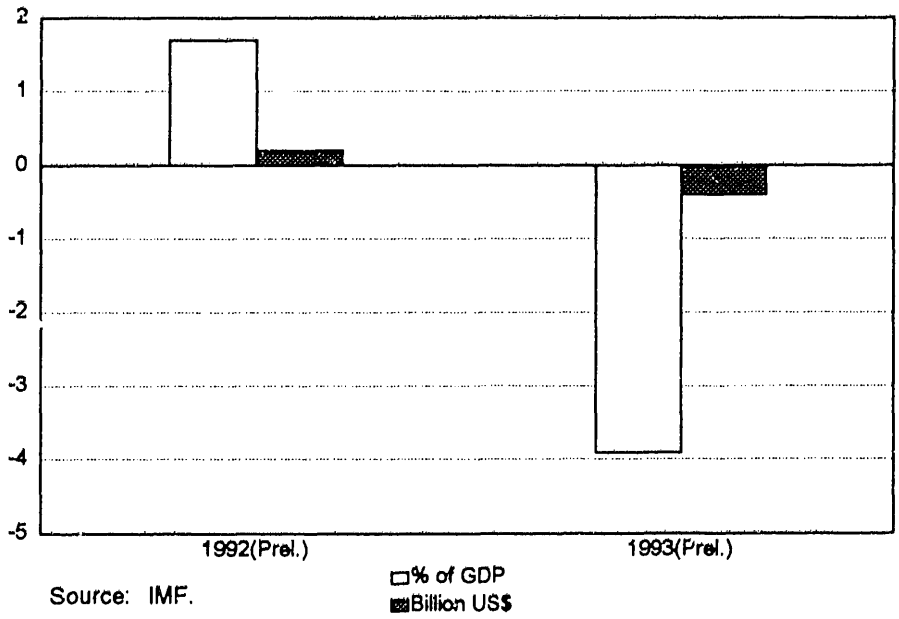
(d) Exchange rate

18. In July 1993, the devaluation of the Slovak koruna vis-a-vis the dollar formalised the de-linking of the Slovak koruna from the Czech koruna, which had been informally initiated with the creation of a clearing arrangement between the two countries. The exchange rate of the Slovak koruna declined from an annual average of Sk 29.5 per U.S. dollar in 1991 to an annual average of Sk 28.3 per U.S. dollar in 1992. At the end of 1993, the exchange rate was about Sk 33.2 per U.S. dollar. There was persistent pressure to devalue due to the need to maintain export competitiveness in the face of high inflation.

(ii) Balance of Payments

19. Slovakia's current account moved from a surplus in 1992 of 179 million dollars (1.7 per cent of GDP) to a deficit in 1993 of 436 million U.S. dollars (3.9 per cent of GDP) (Table 2 and Chart 4). Although the services balance moved from a deficit of $80 million in 1992 to a surplus of $379 million in 1993, during the same period the deficit on trade balance widened from $715 million to $915 million, and there was a significant decline in net current official transfers from $744 million to $4 million.

Chart 4 - Slovak Republic - Current account, 1992-93
(Billion dollars and percentage of GDP)



Source: IMF.

20. Merchandise exports were 16.7 per cent lower in 1993 than in 1992, while merchandise imports were 12.2 per cent lower. One fifth of Slovak exports consists of iron, steel, and related products (Chart 5a) and these products have encountered import barriers in important foreign markets. In non-ferrous metals, Slovak producers faced severe competition from the CIS republics. In bulk petrochemicals and similar products, the depression in the global markets has been complemented by strong competition from Russia and the Ukraine.

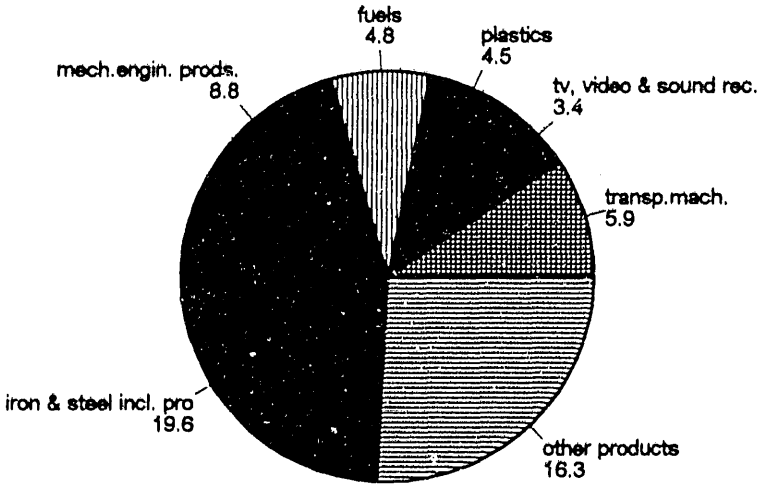
Table 2 - Slovak Republic - Balance of payments, 1992-93[1]
(US$ million)

	1992 Preliminary	1993 Preliminary
Current account		
Trade balance	-715	-913
Exports, f.o.b.	6,515	5,429
Imports, f.o.b.	7,229	6,344
Services balance	-80	379
Receipts	1,704	2,139
Transportation	412	458
Travel	200	390
Income	170	189
Other	921	1,101
Expenditures	1,624	1,760
Transportation	128	143
Travel	165	216
Income	205	228
Other	1,126	1,173
Current transfers	814	100
Private (net)	70	96
Official (net)	744	4
CURRENT ACCOUNT BALANCE	179	-436
Capital account		
Capital transfers (net)	...	529
Foreign investment (net)	100	-373[2]
Other long-term capital (net)	251	555
Credits received, net	196	306
Credits extended, net	55	249
Short-term capital (net)	-436	73
Clearing account balance (surplus, -)	...	189
CAPITAL ACCOUNT BALANCE	-85	973
Errors and omissions	-633	-182
OVERALL BALANCE	-539	356
Gross reserves (increase, -)	-95	-521
State Bank	5	-59
Commercial banks	-100	-462
IMF credit, net	94	90
Short-term liabilities (decrease, -)	540	75

Source : IMF.

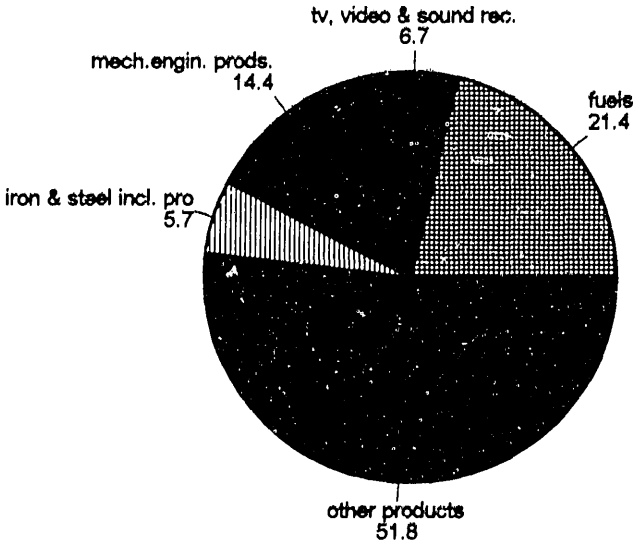
1 Including transactions with the Czech Republic.
2 Including US$529 million of Slovak shares in Czech companies acquired through the "first wave" of voucher privatization in the former CSFR. The counterpart is presented as a capital transfer.

Chart 5a - Slovak Republic - Composition of merchandise exports, January-July 1993



Source: "Plan Econ Report", volume IX, numbers 42-43, December 1993.

Chart 5b - Slovak Republic - Composition of merchandise imports, January-July 1993



Source: "Plan Econ Report", volume IX, numbers 42-43, December 1993.

21. There is evidence to suggest that while Slovak exports to the rest of the world declined by around 10 per cent, those to the Czech Republic fell by a quarter in 1993. The relative importance of the Czech Republic in total Slovak exports declined from an estimated 47.8 per cent for January-July 1992 to 42.5 per cent for the corresponding period in 1993 (Chart 6a). On the export side, Germany is now the second most important market, accounting for 15 per cent of total exports in the first seven months of 1993, which was significantly greater than the shares of Russia (4.4 per cent) and Ukraine (3 per cent).

22. On the import side, fuels and mechanical engineering products were the most important items, accounting for, respectively, 21.4 per cent and 14.4 per cent of total imports in the first seven months of 1993 (Chart 5b). There was a pronounced decline in the relative importance of the Czech Republic as a source of imports, from an estimated 48.5 per cent in 1992 to 37.8 per cent in 1993 (Chart 6b). Russia accounted for 17.4 per cent of total Slovak imports in 1993 while Germany accounted for 11.1 per cent. Russia is an important source of oil and gas, but the declining world energy prices and the growth of Slovak imports of German manufactures, may imply a shift in the relative importance of the two countries in the future.

23. On the services account, receipts for travel in 1993 were $390 million, an almost two-fold increase over the previous year. During the same period, the receipts from transportation increased 11 per cent to $458 million in 1993, while receipts from other services, which include inter alia insurance, engineering, construction, telecommunication, advertising and financial services increased by almost 20 per cent to $1,101 million in 1993. The expenditures on transportation and other services did not change significantly between the two years but the expenditure on travel increased by nearly 31 per cent to $216 million in 1993.

24. The capital account moved from a deficit of $85 million in 1992 to a surplus of 973 million in 1993. Net foreign investment was negative in 1993, which was attributable to the $529 million of Slovak shares in Czech companies acquired through the voucher privatization in the former CSFR.[8] The counterpart is presented as a capital transfer. Other net long term capital inflows more than doubled between 1992 and 1993, from $251 million to $555 million and there was also an increase in net short-term capital inflows. The clearing account balance reflected a current account deficit with the Czech Republic of $189 million.

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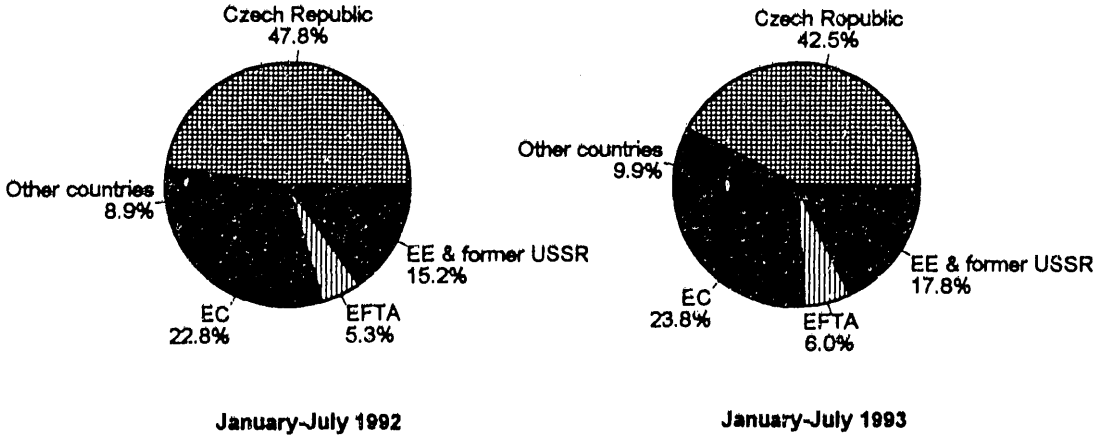
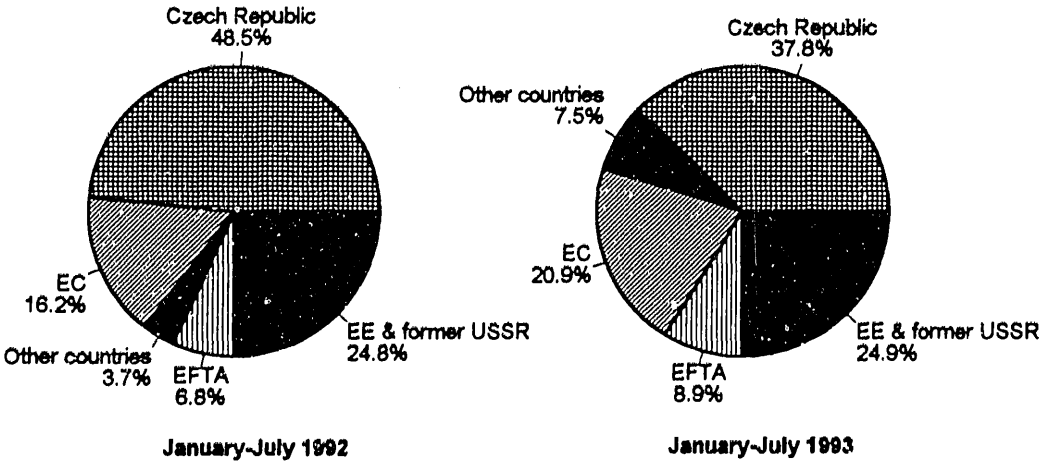
[8]The stock of foreign investment in the Slovak Republic at the end of December 1992 was reported to be around $230 million. The stock had increased to $366 million by the end of 1993. The three leading source countries for investments in Slovakia were Austria, with a share of 24.1 per cent, Germany, with 21.3 per cent, and the United States, with 12.9 per cent.

Chart 6a - Slovak Republic - Direction of exports by region, January-July 1992-93



Source: "Plan Econ Report", volume IX, numbers 42-43, December 1993.

Chart 6b - Slovak Republic - Direction of imports by region, January-July 1992-93



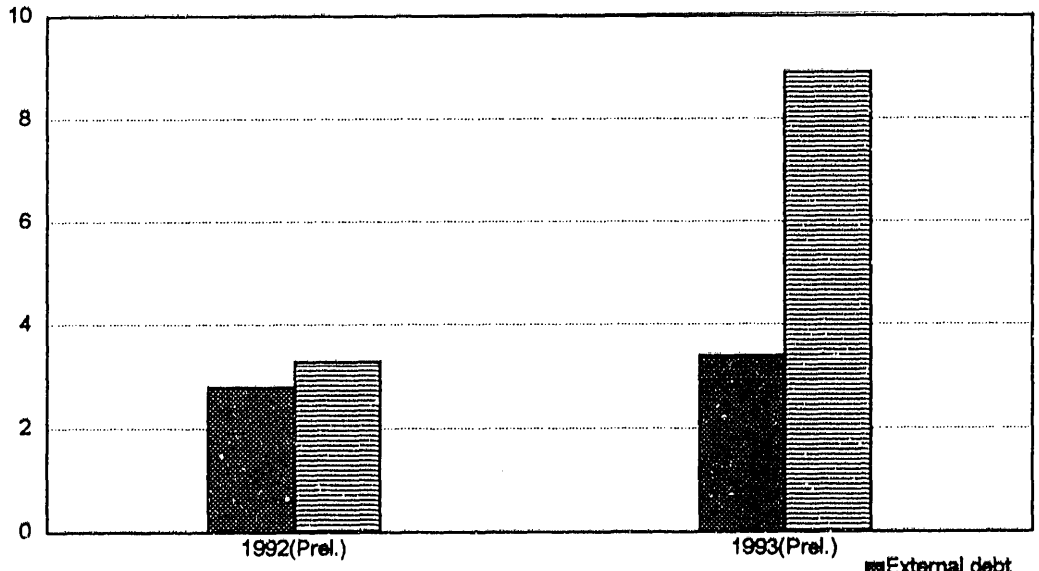
Source: "Plan Econ Report", volume IX, numbers 42-43, December 1993.

Foreign indebtedness and foreign exchange reserves

25. Slovakia assumed responsibility for $2.6 billion of the total CSFR debt of $9.5 billion when the federation split in December 1992. In addition, the Slovak Government is honouring its obligation of $225 million, or one-third of a loan extended to the CSFR by the World Bank in 1991. The outstanding external debt had increased to $3.4 billion at the end of 1993 from $2.8 billion at the end of 1992 (Chart 7). This did not include the disputed interbank liabilities to the Czech Republic. Debt service as a per cent of total exports had increased from 3.3 per cent in 1992 to 8.9 per cent in 1993.

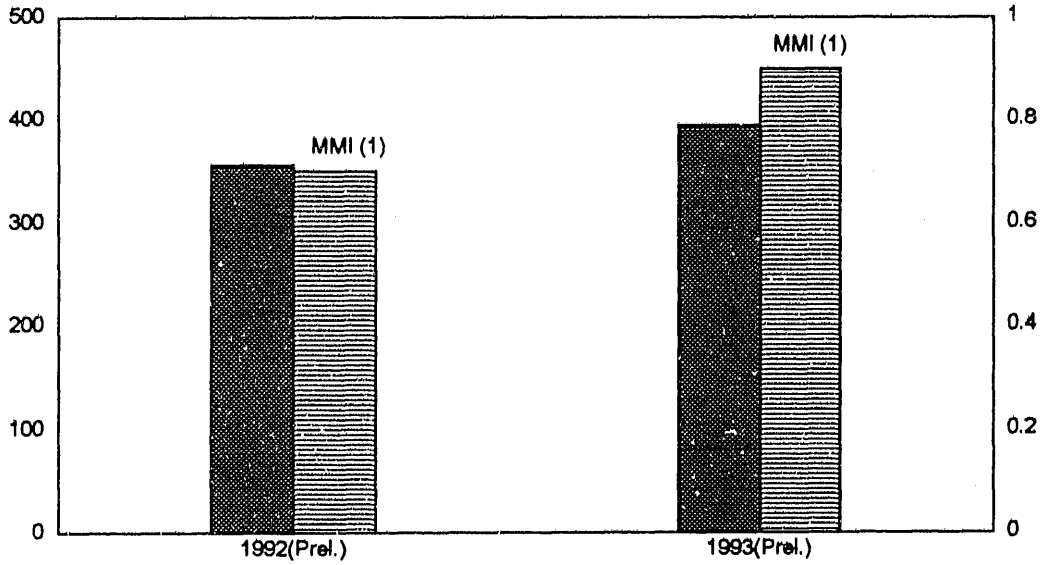
26. At the end of 1993, official reserves were $395 million, which was $39 million higher than at the end of 1992 but still not enough to cover even a month of imports (Chart 8). Gross reserves of the banking sector were at $1, 348 million at the end of 1993, which implied an increase of $465 million over the previous year.

Chart 7 - Slovak Republic - External debt (a), 1991-93
(End of period in billions of US dollars and
debt service as percentage of total exports)



(a) Excluding disputed interbank liabilities to the Czech Republic.
Source: IMF.

Chart 8 - Slovak Republic - Official reserves, 1992-93
(End of period; in millions of US dollars and months of imports)



(1) MMI refers to equivalent months of merchandise imports (right-hand scale).

Source: IMF.