

*INSTITUTE OF SLOVAK AND WORLD ECONOMY
SLOVAK ACADEMY OF SCIENCES*

*Economic Development of Slovakia
in 2002*

**(Study Prepared on Behalf of the United Nations Economic
Commission for Europe)**

Ivan Okáli et al.

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Authors:

Ing. Ivan Okáli, DrSc.

Ing. Herta Gabrielová, CSc.

Ing. Egon Hlavatý, DrSc.

Ing. Karol Morvay, PhD.

Ing. Richard Outrata, CSc.

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1. Overall economic development in the year 2002 as a basis of trends expected in 2003

In the year 2002, economic development of Slovakia was closely connected to its political development. After the autumn Parliamentary elections, the power has remained in the hands of an old/new right-oriented government. A continuity in execution of the governmental power oriented on onward reforms has strengthened the political credibility of the Slovak Republic. Also thanks to this, Slovakia received the invitation to the European Union and NATO at the end of 2002, at the parallel enhancing of the rating valuation of its economy to the investment level.

The economic policy made during the final phase of the political cycle influenced directly - partly in a negative way - the development of the economy.

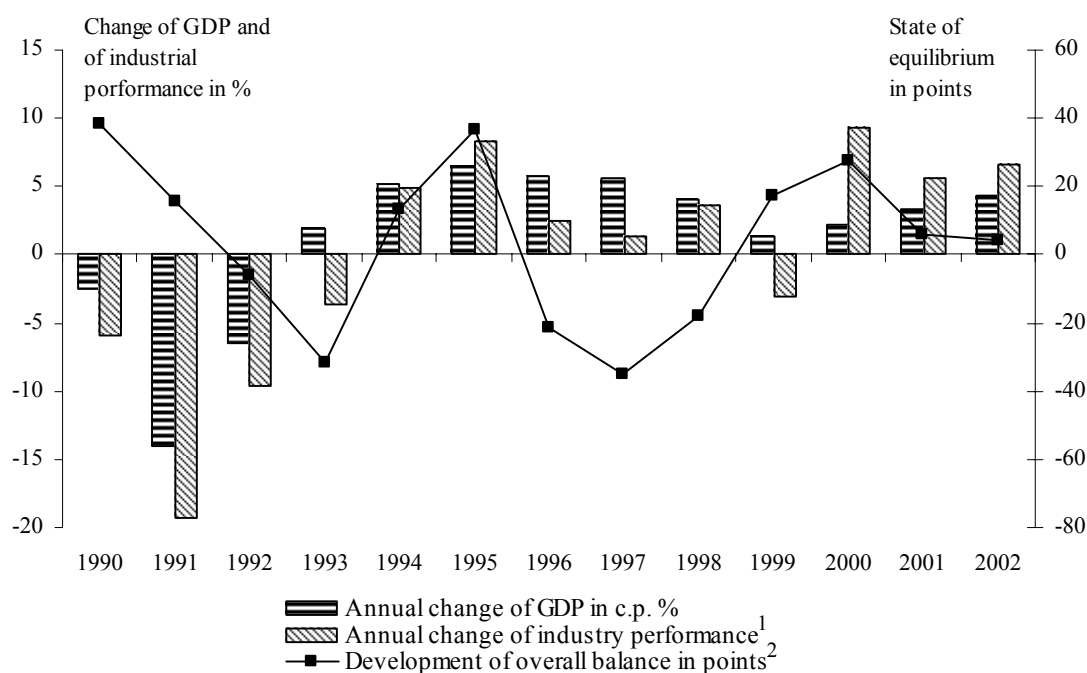
The restrictions in household consumption caused by the effort to restore the balance during the years 1999-2000 have been tried to be compensated by the government at least partially by a temporary stop of the price deregulation in the year 2002. However, not the actual decreased inflation rate was taken as an orientation point for the development in nominal wages, but a considerably higher inflation rate recorded in previous periods. As a result of that, during the year 2002 real wages were rising much faster than the labour productivity.

A relatively fast growth in household consumption, together with almost identical speed of the growth in public consumption (connected with an ongoing absence of reforms of high cost demanding sectors of public services) caused in 2002 a repetitive creation of high deficit in the trade balance and the current account. As a final result, the deficit was reflected as a further deterioration of the overall balance. This is compared with the changes in the economic performance in the chart 1.

The results of the year 2002 bear signs of the final period of the transformation cycle which has started at the end of the year 1998 with replacing of a fixed SKK exchange rate by a floating rate. Stabilizing economic-political measures taken in the year 1999 and in the first half of 2000 together with several steps in price deregulation improved the

status of macro-balance with a direct impact on a decline in the rate of growth and on its gradual recovery which continued also throughout the year 2002.

Chart 1
Main trends in the development of Slovak economy between 1990 – 2002



¹ In the years 1991-1998 change in goods production; in the years 1999-2002 change in industrial production (according to its index).

² The trend of overall balance summarises development of its following partial elements (indicators): year-to-year inflation rate, interest rate from drawn loans, ratio of state budget to GDP, the share of net exports on GDP and difference between the increase in labour productivity and the increase in real wages. Annual values accounted separately for each partial indicator are figured in the points (at intervals of +100 to -100 points) according to its ratio to a mid value of the span between the max-value and min-value of certain indicator in the whole period (time series). An average from the sum of points gained in particular years by partial indicators is considered as an *annual value of overall balance*.

The average state of overall balance in the SR for respective period (years 1990-2002) is identified in the graph as its zero value. Positive (plus) values represent its above-average level, and negative (minus) values represent its below-average level.

The overall balance and the performance development presented in the chart 1 indicates, that the transformation cycle running in the years 1999-2002 was not so strong if compared to the previous cycle (years 1994-1998). This can be explained by the fact that the Slovak economy is getting closer to development trends typical for standard market economies. When regarding that transition cycles were running at the same time as political cycles, it proves also a weakening of a political pressure on the development of the economy.

As it is obvious from the chart 1, overall macroeconomic balance was in the year 2002 (and even as early as in the year 2001) compared with the year 2000 notably worse, but still remained at the level slightly exceeding average values recorded in the whole transition period of the years 1990-2002. This way the Slovak economy will enter the next development stage from a better starting position than at the beginning of all previous transition cycles running so far, and if continuing in all structural reforms, it will be done with some prospects for a substantial elimination of accompanying impacts. This might be contributonal for a better balanced and thus much faster growth in the economic performance. From the point of view of the above described status of the overall macro-balance in the year 2002, the decline in the GDP growth rate envisaged for the year 2003 should be understood only as a temporary and less dramatic than the decline in the years 1999 and 2000.

The economic growth rate of the SR in the year 2002 progressed much faster despite of an unfavourable situation in the prosperity of the world economy and especially that of the EU member countries. This resulted from several factors. It should be noted that it was mainly due to competitiveness based on low wage costs, on the restructuring of the banking sector and also the restructuring of enterprises which was concluded during the years 1999-2001 (it was reflected in the improved financial situation of enterprises as well as in growing strength of the tradesman sector and of small and medium enterprises¹), the monetary policy oriented for sustaining the pro-export exchange rate of SKK (Slovak crown) and on decreasing of interest rates, growing investment activities in major export oriented industries in the years 2000 – 2002, territorial diversification of the exports.²

For a more detailed view of the movements, which were introduced in the year 2002 regarding the economic and also the closely related social development in Slovakia, the data in table 1 can be used.

¹ The share of tradesman sector and of companies up to 250 employees on the value added formation in the national economy increased from 55 % in the year 1998 to 60 % in the year 2002.

² The share of the exports to Germany, Czech Rep, Austria and Poland on the total exports from the SR declined from 57,6 % in the year 2001 to 54,2 % in the year 2002, while the total of the portion held by Italy, France, Spain and Japan in the same period increased from 14 % to 17,7 %.

Table 1
Social-economic development in the years 1990–2002

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	A. Development of the economy performance									
Index of GDP ¹ Previous year = 100 1989=100	1.9 79.4	5.2 83.5	6.5 88.9	5.8 94.1	5.6 99.4	4.0 103.4	1.3 104.7	2.2 107.0	3.3 110.5	4.4 115.4
Index of industrial production ^{1,2} Previous year = 100 1989=100	-3.7 62.5	4.6 66.8	8.3 72.3	2.5 74.1	1.3 75.3	3.6 78.1	-2.6 76.0	8.8 82.6	6.7 88.1	6.6 93.9
Index of labour productivity in the national economy 1989 = 100	92.3	98.9	103.5	105.7	112.6	117.4	122.7	127.2	130.1	135.6
Index of labour productivity in the industry 1989 = 100	83.0	94.0	100.8	105.0	108.8	117.6	118.0	132.4	139.6	148.5
Profitability of costs in non-financial corporations. in % ³	3.2	3.4	4.2	2.8	2.5	0.4	1.4	2.7	4.6	5.0 ^o
Profitability of costs in processing indust. in % ³	-0.2	0.3	1.8	-0.1	-0.1	-1.4	0.8	3.0	5.0	4.5 ^o
	B. Indicators of the balance									
Inflation rate % ⁴	23.2	13.4	9.9	5.8	6.1	6.7	10.5	12.0	6.7	3.3
Of it: rate of core inflation in %	.	.	.	.	.	6.1	6.0	5.7	4.3	2.1
φ interest rate from loans in % ⁵	14.4	14.6	13.3	13.4	18.4	19.4	16.9	11.8	9.4	9.1
State budget balance / GDP in % ⁶	-6.2	-5.2	-1.5	-4.2	-5.4	-2.6	-1.8	-3.1	-4.5	-4.7
Annual Δ productivity ⁷ – annual Δ of real wages in national economy, in percentage points	-1.3	3.7	0.9	-4.6	0.5	1.7	8.2	8.6	4.0	-1.5
Net exports/GDP in % ⁶	-5.0	4.6	1.7	-11.2	-9.6	-10.6	-4.3	-2.4	-8.5	-6.8
	C. Social development									
Index of employment, previous year = 100 ⁸	99.2	98.1	101.7	103.6	99.1	99.7	97.0	98.6	101.0	100.2
Unemployment rate in % ⁸	12.7	13.7	13.1	11.3	11.8	12.5	16.2	18.6	19.2	18.6
Annual change in real wages in %	-3.9	3.2	4.0	7.1	6.6	2.7	-3.1	-4.9	0.8	5.8
Index of real wages , 1989 = 100	72.8	75.0	78.3	83.8	89.2	90.8	88.3	84.2	84.9	89.8

¹ In constant prices.

² In 1998 the methodology of measurement of the output in the industry changed. Instead of measuring the production of goods the index of industrial production is being calculated.

³ In the years 1993-96 in companies with 25 < employees, in the year 1997 – 2002 in companies with 20 < employees.

⁴ In consumer prices, in average per year.

⁵ From loans drawn from commercial banks in average per year.

⁶ In current prices.

⁷ Productivity from GDP in constant prices.

⁸ According labour force survey, in average per year.

^o Estimate.

Table 1 shows that a remarkable increase in its performance proved to be the most important phenomenon in the development of the SR economy in the year 2002.

This was seen, on the contrary to the years 1994 – 1998, not only on macro-level, but also on micro-level in the form of good economic results of enterprises. Especially the start of a substantial turn, which began in the year 1999, and which reshaped the development of economic results in the manufacturing industry enterprises, is really remarkable.

The rate, by which the faster growth of labour productivity contributed to a faster GDP growth in the year 2002, eased the pressure of growing wages on worsening of the overall balance. This was done directly through its impact on a decline in the unit labour costs, but also indirectly through its positive impacts on exports and the foreign trade balance as well as by improvement in economic results of enterprises plus respective expansion of the tax base which allows the growth in incomes in public budgets.

However, the development of balance indicators is warning that there might be a danger of some overvaluation of the positive moments in the economic development in Slovakia in the year 2002. The rate, in which the state budget deficit and also the public finance deficit increase, will be - in relation to the achieved GDP growth - inevitably transferred into an increasing ratio of the government debt to GDP. The worsening of the situation in the public finance is still stronger calling forth the necessity to continue in the implementation of structural reforms which have already started.

Evaluation of social consequences of the economic development in the year 2002 itself sounds very impressive both from the point of view of employment/ (unemployment) development and also from the point of view of wages development. However, in the context of a long term development it is highly probable, that after the year 2002 the average social status of the SR population is further worse to compare with the situation prior the transition process. Regarding expected trends of the economic development in the year 2003, certain improvements can be expected in relation to the situation on labour market, but not much as for incomes.

2. Production development

The growth rate of the gross domestic product (GDP) during quarters of the year 2002 gradually went up (3.9 %, 4.0 %, 4.3 % and 5.4 %) and achieved in total 4.4 % (by 1.1 p. p. more than in the year 2001). The GDP growth was supported by the growth in value added 3.9 p. p., by the growth of other components of the GDP³ 0.5 p. p. The share of value added on the gross production reached 38.9 % that is by 0.2 p. p. less than in the year 2001. An overview of the GDP formation development in the years 1998 – 2002 is presented in the table 2.

Table 2

Development of GDP formation in the years 1998–2002 (at constant prices 1995)

	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
	year/year changes in %					Contribution to GDP growth in p. p.				
Gross Domestic Product	4.0	1.3	2.2	3.3	4.4	.	.	.	.	.
of it										
agriculture	0.6	-2.8	7.9	1.0	12.3	0.0	-0.1	0.3	0.0	0.5
industry in total	3.2	5.1	-5.5	3.6	4.0	0.9	1.4	-1.5	0.9	1.0
manufacturing industry	5.2	2.9	-2.0	10.2	2.6	1.2	0.7	-0.5	2.3	0.6
construction	-15.6	-29.9	2.7	-1.5	11.0	-1.0	-1.5	0.1	-0.1	0.4
services in total	4.6	1.2	7.6	4.6	4.2	2.4	0.7	4.1	2.6	2.4
trade, hotels and restaurants	3.8	3.5	6.6	1.9	-2.2	0.6	0.5	1.0	0.3	-0.3
transport, postal services, telecommunication	-4.6	9.4	2.2	13.5	-3.5	-0.4	0.8	0.2	1.3	-0.4
other services	8.1	-2.3	10.0	3.2	10.0	2.3	-0.7	2.9	1.0	3.1

Regarding industries, the top growth in value added in the year 2002 was recorded in the manufacture of electricity, gas and water supply (by 33.4 %), in construction (11 %) and in other services (10.0 %).⁴

A considerable slowdown in the value added growth, which occurred in the year 2002 in the manufacturing industry, was mainly influenced by unfavourable development of value added in the manufacture of basic metals and fabricated metal products (-12.1 %) and also by a slowdown in the growth in its other sectors (see chart 2).

³ Difference between taxes and subsidies and imputed production of banking services.

⁴ Service sector without trade, hotels and restaurants, transportation, post and telecommunications.

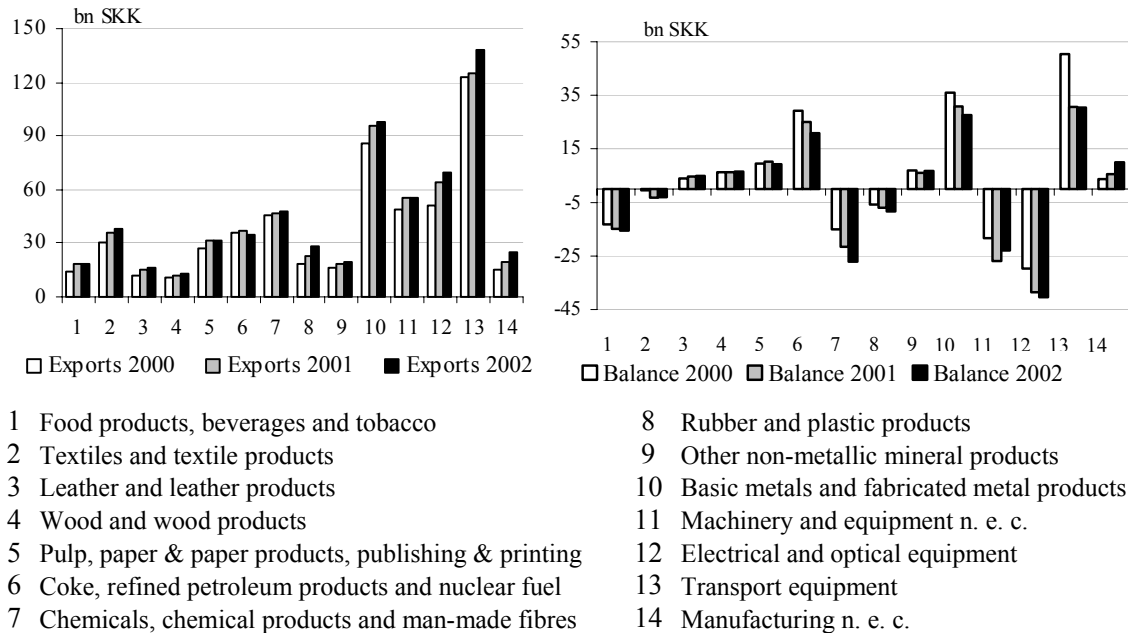
In comparison with the growth of industrial production, receipts for own output and goods in the industry (considering all activities of enterprises) in the year 2002 increased in real values only by 3.3 % (in the year 2001 by 6.2 %); in the manufacturing industry by 3.6 % to compare 8.1 % in the previous year. A higher growth in receipts to compare with the year 2001 was actually reached only in the manufacture of transport equipment (17.4 % to compare 7.4 %). Despite a slowdown in the rate of growth, the above average real growth in receipts was reached especially in electrotechnical and furniture industry. Receipts dropped both in nominal and real values in the manufacture of pulp and paper products, petroleum products, chemical products and of machinery and equipment.

Development in the manufacturing industry performance was influenced in the year 2002 by an unfavourable development in the external demand. This impact was reflected on a total worsening in foreign trade balance in the manufacturing industry – while in the years 1999 - 2001 exports were higher than imports (by 3.9 %, 13.4 % and 1.2 %), in the year 2002 exports covered only 99.9 % of the imports. The decline or stagnation in the exports was obvious mainly in the manufacture of basic products, but also in the manufacture groups which have long lasting problems (for instance manufacture of other transport equipment). In some technologic and labour intensive production, however, the exports substantially increased. The position of certain sectors within the manufacturing industry analysed from this point of view is presented in the chart 3.

As regards the *construction*, in the year 2002 a more visible recovery was seen for the first time since the year 1997. Construction production increased in real values by 4.1 % (while in the year 2001 only by 0.8 %); after a decline or stagnation recorded in several consecutive years, in the year 2002 the employment went up by 1.6 %.

Chart 3

Development in the exports and foreign trade balance in manufacturing sectors



Receipts from sales of *agricultural products* in the year 2002 in real values rose by 6.4 % (in the previous year by 9.7 %). A positive tendency starting in this industry is confirmed by a real growth in the value added, by the continuity in the profit increase in the agricultural enterprises, and also by the growth which appeared again considering the sale of animals to be slaughtered in the year 2002 which came after a long lasting period of a decline since the year 1998.

Corporate financial results in the year 2002 did not reach an extremely good level of the previous year. A considerable decline was recorded in financial corporations (5.5 bn loss to compare with almost 13 bn SKK profit in the year 2001). In the sector of non-financial corporations the profit/loss increased by 17 bn SKK and this was especially thanks to it substantial increase in the manufacture of electricity, gas and water supply (by 14 bn SKK), in construction (by 4 bn SKK) and in trade (by 9 bn SKK). A total profit/loss in the sector of non-financial corporations negatively influenced the decline in profit/loss

earned by the sector of transportation and telecommunications (by 9 bn) and partially also in the manufacturing industry. A total overview is displayed in the table 3.

In the year 2002, the majority of sectors in the manufacturing industry increased their volume of profit/loss, as well as cost profitability; the exception is seen in manufacture of coke and refined petroleum products, manufacture of chemical products and man-made fibres, but mainly in manufacture of basic metals and fabricated metal products – decline profit/loss from 12 bn SKK to less than 4 bn SKK and costs profitability from 8.9 % to 2.8 %.

Table 3

Development of the financial position of corporations in the years 1998 – 2002

	1998	1999	2000	2001	2002
	Profit/loss in bn SKK				
Non-financial and financial corporations in total	31.2	73.8	88.0	134.8	133.7
Financial corporations	8.4	26.7	8.8	12.8	-5.5
Non-financial corporations (NFC)	22.8	47.1	79.2	122.0	139.1
of it:					
Agriculture	-1.6	-2.0	-0.3	1.2	1.9
Manufacturing industry	-5.2	6.4	26.3	44.7	42.6
Construction	3.2	1.5	3.3	4.9	8.9
Services total	13.5	23.1	36.2	55.0	56.0
NFC with 20 and more employees	6.5	21.6	49.4	86.2	95.3
in it: profitable	86.8	75.6	81.3	112.3	127.4
loosing	-80.3	-54.1	-32.0	-26.0	-32.2
	Cost Profitability in %				
Non-financial corporations	1.2	2.3	3.5	5.2	5.7
Agriculture	-2.7	-3.6	-0.5	1.7	2.7
Manufacturing industry	-0.8	0.9	3.4	5.2	4.7
Construction	3.0	1.8	3.2	4.8	8.6
Services in total	1.5	2.2	3.3	5.2	5.0

The share of loosing enterprises on a total number of non-financial corporations with 20 and more employees dropped in the year 2002 to 27.8 %, even the overall reported loss of those enterprises has increased to compare with the previous year.

We can summarise, that in the year 2002 there was an ongoing process of a gradual improvement of business results in non-financial corporations, which have started in the year 1998. This happened despite the fact that some industries did not reached the level of

the year 2001. Even in industries, as for instance in manufacturing industry, where the profit/loss earned in the year 2002 to compare with 2001 declined, the results of the year 2002 significantly exceed the level recorded in 2000.

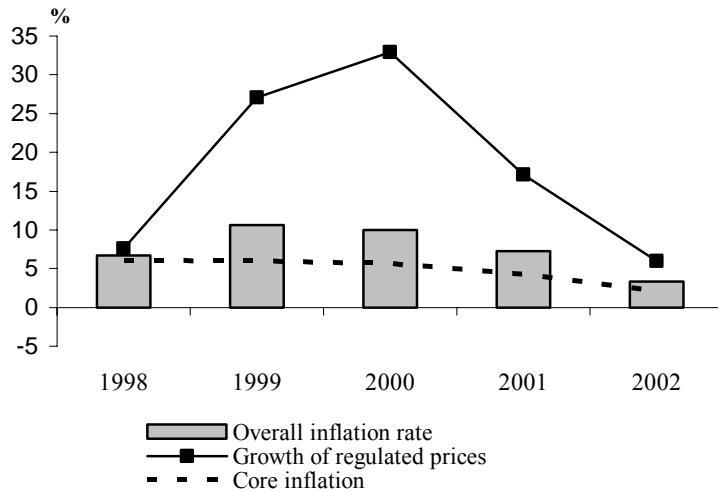
3. Price level development in the year 2002 and prediction of changes in the year 2003

In the year 2002, the growth in consumer prices recorded the slowest rate so far during the process of the economic transition.

The fact, that an average inflation rate reached only 3.3 % (chart 4), could be considered as a contribution to the macro-economic stability. However, this interpretation is not totally correct, if we consider the fact that this inflation rate was reached also with the help of a postponement of the originally planned changes in regulated prices. Short-term constriction of the price level growth will therefore be subsequently exchanged by a much faster inflation rate in the future years. From the point of view of a medium-term shaping of the economic environment, this was more or less an mistake. Instead of a gradual decrease of the inflation rate during the anticipated cycles of regulated prices adjustment, there was a deceptive signal in the form of an almost stopped inflation, followed subsequently by hikes chasing missed steps which had to be taken with the trims in regulated prices. This development complicates the formation of entrepreneurial and investment activities calculations.

In addition to the absence of deformed regulated prices adjustment, the second factor that pushed towards a decline in the inflation rate was the exchange rate development, which since the mid of the year 2002 strengthened and made imported commodities cheaper. Strengthening the exchange rate worked also as an anti-pressure against the growth of petroleum prices on the world market at the end of the year. A strong seasonal decline in the prices of food products (and also a favourable development of meat prices due to significant imports of cheaper goods) was further significant factor, which impacted the price level.

Chart 4
Year-to-year changes of the level of consumer prices



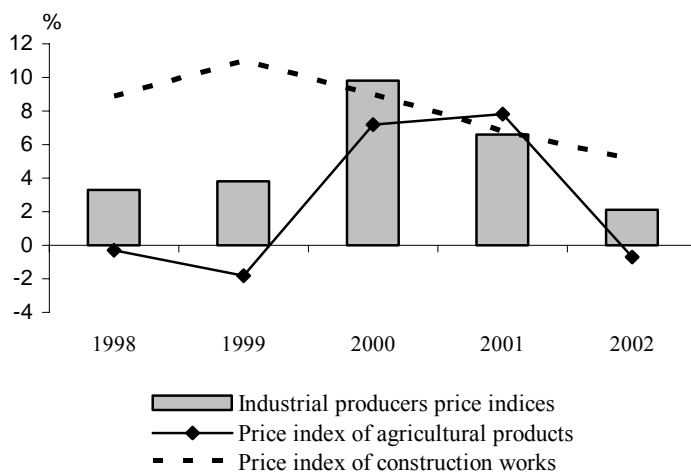
Pro-inflation factors included the increase of fees for mandatory third party liabilities for cars and the growth of telecommunication fees (they belong to administratively adjusted prices), a short-term notable hike in demand seen on tobacco products market (increase of the tobacco demand, together with a pressure on tobacco prices, was activated by information about the increase of the excise tax for tobacco from January 2003).

A low dynamism of the growth was characteristic also for the producer price indexes (chart 5). Also here, we could see the strongest reflection of the absence of a cost pressure (due to stop of regulated prices adjustment and due to appreciation of the local currency). Prices of industrial producers increased only by 2.1 % (of which prices for industrial manufacture products only by 0.7 %). More striking dynamism was recorded in price hikes for construction works (increase by 5.1 %). Prices for agricultural products even dropped down (by 0.7 %), and that influenced the above mentioned low growth in the consumer prices of food products.

Price development was for the last time allowed to be directly politically influenced (through adjustment of regulated prices) in the year 2002. A new qualitative feature in the field of prices is shifting the responsibility for the price policy of network sectors to an independent regulator. Despite the first activity of the regulation office seems to be

controversial⁸, it is likely, that the last phase of removing price deformations has started (and its accompanying features, for instance cross-subsidies, high energy intensity, non-profitability of core activities of the enterprises within the network industries etc.). This will probably cause a stronger pressure upon the industry restructuring and also upon changes in the structure of a household consumer basket.

Chart 5
Year-to-year changes of producers' prices



Our outlook on the inflation was built on a relatively stable exchange rate against EUR and USD (or on a slight, in the year 2002 less significant strengthening of the local currency), on the expectation of the absence of serious deviations in the development of prices for energy commodities on world markets. These factors should help in order the so called „imported“ inflation would remain at a non-significant level.

Analogous to the previous years, the cost inflation should dominate in the development of consumer prices also in the year 2003, the demand inflation pressures will also further be non-significant. A basic influence which will recover the cost inflation dwells in the increase of regulated prices, which (together with a changed

⁸ As controversial are considered the facts, that Regulation Office (ÚRSO) does not report to any authority (nor to any courts) and that there existed not enough transparent procedures regarding decision making about prices in the year 2003. We expect a pressure on a quality improvement and a better transparency of decision making process about prices in network industries.

VAT of the goods with regulated price) will probably directly impact the increase of an overall inflation approximately by 4.5 percentage point (according to NBS). Of them, the most important influence (1.4 percentage point) belongs to the increase of gas prices.

In the year 2003, also a considerably strong short-term inflation impulse resulting from the adjustment in indirect taxes will be working. An impact of new VAT rates (the difference of the influence of the increase of the lower rate from 10 % to 14 % and of base rate cut down from 23 % to 20 %) within the framework of non-regulated prices to the total inflation, is estimated by the NBS to reach about 0.3 percentage points. An impact on inflation should come from raising excise taxes (in total approximately by 0.5 percentage points, of which a substantial proportion will emerge as a result of the rise of excise taxes from tobacco products).

The consequence of the majority of the expected impacts to inflation was reflected at the very beginning of the year 2003, as a result of which consumer price in January increased month-to-month by 5.3 %. This is a month-to-month change of the price level which is comparable with July 1999 (5.8 %), when a strong adjustment of regulated prices was implemented within the frame of a set of stabilising macroeconomic measures.

Taking the above mentioned prerequisites into consideration, it can be assumed that the average rate of inflation could reach a level somewhere close to 8.5 %. The monetary program of the NBS for the year 2003 expects an average inflation rate to be somewhere between 8.2 % and 9.3 % (as of the end of the year the inflation could reach 7.7 % up 9.7 %). The end-of-the-year core inflation should - according to our estimate - oscillate close to the level of 3.2 %.

In case of industrial producer's prices, the adjustment of regulated prices of the producers of electricity, gas and heating will be the basic development factor. The growth rate of industrial producers' prices should - according to our estimates - get close to the value of 6 %.

After damping the growth of the price level in the year 2002, a considerable growth of the inflation rate will considerably influence development tendencies of several indicators: it is likely, that the growth dynamism of real wages will be constricted, a sharp slowdown will hit the growth of household consumption as well as the growth of a total GDP, the profitability in the industrial sectors, which are energy intensive, will probably worsen.

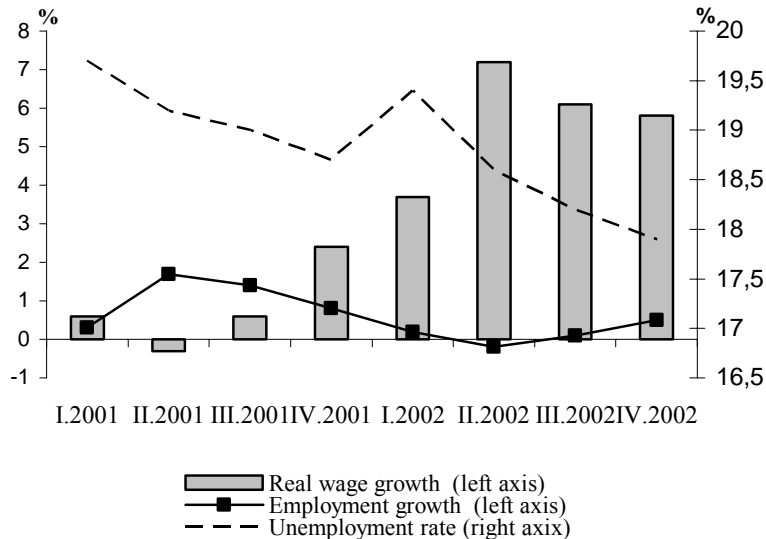
4. Situation on labour market in the year 2002 and changes expected in the year 2003

A turn in the development of demographic factors was a characteristic feature of the development of labour market in the year 2002. A considerable, even accelerating growth in the number of labour force typical for all previous years was replaced by shrinkage in the number of labour force. That has essentially changed development tendencies of unemployment. The collateral growth in both employment and unemployment was typical for the development of labour market in the year 2001. This apparent paradox was brought up by a strong growth on the side of supply – i.e. number of work force at labour market. The situation in the year 2002 was quite different: even the employment increased only moderately (by 0.2 %, according to labour force survey selective), thanks to the change in the development of the number or work force⁹ a decline of the unemployment rate was recorded.

Even if the unemployment rate during the year recorded a y/y decline from 19.2 % (in the year 2001) to 18.5 % (2002), the number of long term unemployed persons continued to increase (in the first 3Qs the y/y the number of unemployed longer than 2 years rose by 13.3 %).

⁹ According to labour force survey a y/y increase of the number of employed persons in the year 2001 by 22-thous., the number of unemployed by 22,8-thous. An overall growth of labour force thus represented 44,8-thous. persons. For comparison purposes: in the year 2000 the increase of labour force recorded 38-thous. persons, in the year 1999 it was 33-thous., in the year 1998 only 12-thous. persons. It means that a demographic factor in the years 1999 – 2001 rather complicated the situation on the labour market. Although in the year 2002 the number of labour force was falling down, and it represented y/y fall by 17,8 thousand persons.

Chart 6
Development of labour market parameters¹



¹ Figures on employment and unemployment according to a selective survey on the work force.

Next significant feature is a considerable strengthening of the growth of real wages. Real wages reached the top growth in the recent four years. In the condition of a remarkable slowdown in the growth of the price level, the growth in nominal wages was faster (from 8.2 % in the year 2001 to 9.3 % in the year 2002). The increase in real wages (by 5.8 %) was much stronger than the real growth in labour productivity. Vice versa, in the previous period (1999 – 2001), the productivity growth considerably exceeded the growth in real wages.

In comparison with the previous year, in 2002 the number of vacancies registered at labour offices increased (for instance at the end of the year 2002 the number of vacancies almost multiplied to compare with the similar period in the previous year). Due to that the number of registered unemployed people per 1 vacancy dropped (e.g. from 53 in December 2001 to 29 in December 2002).

The above mentioned moderate improvement of the characteristics of the labour market development should be understood more as a result of demographic factors and the employment policy measures, than the result of a better functioning labour market.

During the evaluated period, labour market was still marked by rigidity, which was influenced also by the newly passed laws (Law on Public Service, Law on State Service, new Labour Code, all effective as of 1st April 2002).

Thus, the labour market development influenced the overall balance in two ways (in an adverse way): On the one hand, it supported the overall balance because after 4 years of growth (1998 – 2001) the imbalance range on the labour market measured by the unemployment rate declined. On the other hand, despite the sharp slowdown in the growth of the living costs, the growth rate of nominal wages went up, and due to that the growth recorded in real wages was stronger than the labour productivity growth. Vice versa, if this tendency pertains, this could weaken the overall balance of the economy. However it is not likely, that this risk factor will continue.

Situation on labour market in the year 2003 should be influenced by an ongoing demographic trend associated with a low and probably negative dynamism of the number of labour force. This factor will bring a decline in the rate of unemployment even under conditions of a relatively low rate of employment growth and advised layouts in some big companies. The employment growth seems to reach the value somewhere close to 0.5 % (the production growth will be in the first place related with the productivity growth, not with the growth of employment).

The development of unemployment will be influenced by the amendment of the Law on Employment, which is more demanding in terms of communication between the labour office and the unemployed person (and also by other ways the law diminishes the motivation to be registered at labour offices). In January 2003 we could see an unusual drop in the number of unemployed person registered at labour offices.¹⁰ We assume that this change happened also thanks to the new enactment of the Law on Employment. Although, we still do not know how these steps will be reflected on the unemployment rate based on selective survey on the labour force (a part of those persons,

¹⁰ Even if in January is quite common to see a sharp seasonal swing upwards to a higher rate of unemployment measured according to the number of people registered at labour offices, the situation at the beginning of the year 2003 was totally different. The rate of unemployment to compare the previous months rose only moderately and to compare with the same month in the previous year there is a drop by 2 percentage points (from 19.7 % to 17.7 %). That is a decline by more than 62 one thousand registered available unemployed people (to actual 470 221 persons).

who will cancel their registration at labour offices, may in the survey further fill in, that they have no job, etc.). After a consideration on such impact, we assume that the rate of unemployment measured through the selective surveys will in the year 2003 drop down to the average of 17.5 %.

The growth in real wages will sharply weaken, probably will be close to zero. This assumption is derived from a higher inflation rate (up to estimated 8.5 %) and at the same time from a slowdown in the growth of nominal wages (this is called forth by the freeze in the growth of wages in several segments of the public sector).

We can summarise, that the development on labour market in the year 2003 will much strongly contribute to the overall balance of the economy to compare the year 2002, but for the price of stagnation of real wages.

5. Balance of payments and foreign capital

5.1. Balance of payments

In the year 2002, the development of the trade balance and the current account bears the impacts of the world economy recession which started in the second half of 2001. However, the increased inflow of a foreign capital secured a favourable development of the overall balance of payments. An expected development during the last months of the year, which brought up a moderate recovery of the world economy, indicated reduced trade balance deficit and subsequently the current account deficit. The current account deficit represented 8.2 % of GDP (by 0.3 % less than in the year 2001) and it reflects approximately the level of the monetary program for the year 2002.

Revenues from the privatization of the Slovak Gas Industry and of the Energy Distributing Companies and also from the deblocation of the Russian debt on the capital and financial account allowed for an improvement of the overall balance of payments development.

Table 4

Development of balance of payments in the years 1998 – 2002 (in mil. USD)

	1998 ¹	1999 ²	2000 ³	2001 ⁴	2002 ⁵
Trade balance	-2 189	-1 103	-916.8	-2 134.7	-2 131.4
Services balance	19	149	439.4	479.5	455.5
Income balance	200	-128	-235.5	-100.7	-263.1
Current account	-1 970	-1 083	-713.0	-1 755.9	-1 938.9
Capital and financial account	1 728	1 823	1 413.0	1 719.0	5 175.3
Other items	-288	-19	120.2	180.2	409.3
Total balance	-530	721	923.7	140.4	3 645.7

¹ Used rate 36.913 SKK/USD.

² Used rate 41.417 SKK/USD.

³ Used rate 46.200 SKK/USD.

⁴ Used rate 48.347 SKK/USD.

⁵ Used rate 45.335 SKK/USD.

Foreign currency reserve of the NBS increased and at the end of the year amounted 9.2 bn USD what allows to cover the imports of goods and services approximately for 6.0 month in average.

5.2. Foreign capital

The position of foreign investment in regards of the balance of payments has in the year 2002 changed dramatically in comparison to the year 2001. While in 2001 the long-term foreign investment did not cover the current account deficit, in the year 2002 a net inflow of long-term foreign capital resources more than 3-times multiplied the current account deficit.

Together with the short-term resources, which by the way show an outflow from the Slovak economy, a total inflow of foreign capital (without capital account) in the year 2002 amounted 229.4 bn SKK (5.2 bn USD) and was by 150 bn SKK (3.5 bn USD) more than in the year 2001.

Among the long-term foreign capital resources, *the foreign direct investment (FDI)* further dominated and their position was considerably strengthened. Its positive balance achieved almost 182 bn SKK (4.0 bn USD), and in comparison with the year 2001 it was by 111 bn SKK (2.5 bn USD) higher. The inflow of FDI into the economy

in the year 2002 itself was accounted for 180 bn SKK (4.0 bn USD), while the FDI outflow to abroad shows insignificant values (0.1 bn SKK, i. e. 1.9 mil USD).

Table 5
Development of foreign investment in the SR from January through September 2002

Item PB	2001		2002		Difference	
	bn SKK	mil USD	bn SKK	mil USD	v bn SKK	mil USD
Balance of FDI in total	70.6	1 460.3	181.7	4 007.2	111.1	2 546.9
inflow ¹	57.0	1 179.1	179.7	3 964.9	122.7	2 785.8
outflow ¹	-2.0	-42.0	-0.1	-1.9	-1.9	-40.1
Balance of portfolio investment	-10.5	-217.2	25.1	554.2	35.6	771.4
inflow	13.9	287.3	12.8	281.5	-1.1	-5.8
outflow	-24.4	-504.5	12.3	272.7	36.7	777.2
Balance of other long-term investment	-10.6	-221.1	-5.0	-102.3	-5.6	-118.8
inflow	-10.1	-210.9	-17.4	-387.5	7.3	176.6
outflow	-0.5	-10.2	12.4	285.2	12.9	295.4
Balance of long-term foreign investment in total	49.5	1 022.0	201.8	4 561.4	152.3	3 539.4
inflow ¹	60.8	1 255.5	175.1	3 858.9	168.3	2 603.4
outflow ¹	-26.9	-556.7	24.5	580.5	51.4	1 137.2
Balance of short-term capital	29.9	619.3	27.6	608.8	-2.3	-10.5
inflow	28.4	588.1	7.8	171.3	-20.6	-416.8
outflow	1.5	31.2	19.8	437.5	18.3	406.3
Balance of foreign capital total (less capital account)	79.4	1 641.3	229.4	5 170.2	150.0	3 528.9

¹ FDI include only property stake + reinvested profit.

Source: Information base of the NBS.

Also in the year 2002 the FDI inflow was from the major portion generated by the privatisation and by purchases of stakes owned by the state. Foreign direct investment without privatisation activities (greenfield and joint-ventures) represented only less than 10 %.

In the last years, FDI inflow to *manufacturing*, where the investment is of the utmost importance because of necessary improvement on the level of technologies, productivity and quality of products, indicated a decline (not only in relative but also in absolute terms with the exception of the year 2000).

In addition, the biggest FDI volumes flowing into the manufacturing industry are mostly allocated to industries with semi-products manufacture (pulp and paper, refined

petroleum and petroleum products, manufacture of metals). When a sophisticated production regarded the FDI is low.

Table 6
FDI in the SR economy by major sectors

	FDI Inflow						FDI Status as of	
	1999	2000	1Q – 3Q 2001		1Q – 3Q 2002		30. 9. 2002	
	%	%	bn SKK	%	bn SKK	%	bn SKK	%
Manufacturing	48.3	45.8	4.6	16.0	2.3	1.4	101.0	40.6
Electricity, gas, water supply	–	–	–	–	132.8	8.3	0.5	0.2
Trade	30.3	2.7	3.3	11.5	6.1	3.8	31.1	12.5
Transport, telecommunication	2.4	46.3	1.4	4.9	0.6	0.4	32.1	12.9
Banking and insurance	6.1	3.4	17.7	61.7	17.2	10.7	70.0	28.2
Total SR	100.0	100.0	28.7	100.0	160.9	100.0	248.5	100.0

Source: Monetary review of the NBS, November, 2001, 2002; own calculations.

Thanks to the so called privatisation FDI, which especially in the years 2001 and 2002 recorded a tremendous increase, the position of Slovakia in *FDI per capita indicator* comparing it with other candidate countries has significantly improved (see Table 7).

Table 7
FDI development per capita in the SR and other Central Europe countries

Country	FDI per capita in USD			
	1998	1999	2000	2001
Slovak Republic	395	421	692	879
Czech Republic	1 396	1 707	2 107	2 618
Hungary	1 831	1 917	1 976	2 244
Poland	581	675	870	1 014 ¹
Slovenia	1 464	1 350	1 454	1 611

¹ Estimate, exact figures were not available.

Source: CESTAT (CANSTAT), Statistical Office of the SR, 1998 – 2002.

Germany (47.4 % of the total FDI inflow) and France (37.6 %) with orientation mainly to the enterprise level, belongs to the major *investor countries* in Slovakia for the year 2002. The next on the list are: Austria with its FDI orientation to banking, Great Britain for the enterprise level and Italy for banking. The biggest share on the FDI stock as of 30 September 2002 belongs to Germany (23 %) mostly at the enterprise level,

Austria (19 %) mostly in banking, Holland (18.6 %) at the enterprise level and Italy (10 %) in banking.

Regional orientation of the FDI inflow in the year 2002 proved to be even more dominating and far from a balanced position of the Bratislava region, when 99 % of new FDI went to this county. The share of Bratislava region on the of FDI stock as of 30 September 2002 to compare with the end of year 2001 increased from 63 % to 68 %. The second position was taken by Košice region where 13 % from the FDI stock volume was received, while the other regions got only about 2 – 4 %.

6. Foreign trade in the year 2002 and outlook for the year 2003

Despite unfavourable expectations during the year (high trade deficits in May and October) the SR foreign trade in the year 2002 in comparison with 2001 achieved much better *trade balance deficit*: –9 % GDP to compare with –10.4 % in the previous year. In 2002, differently from the year 2001, the nominal growth in exports exceeded the nominal growth in imports. Positive trends of the SR foreign trade development are presented in table 8.

Table 8
Development of basic indicators of the SR foreign trade

Indicator	1998	1999	2000	2001	2002
Exports , FCO, bn SKK, current p.	377.8	423.7	548.5	611.3	651.3
Annual change, current prices, %	+16.6	+12.1	+29.5	+11.4	+6.5
Imports , OP, bn SKK, current p.	460.7	468.9	590.3	714.1	747.9
Annual change, current prices, %	+16.9	+1.8	+25.9	+21.0	+4.7
Balance , bn SKK	-82.9	-45.2	-41.7	-102.7	-96.6
Balance/GDP, % ¹	-11.6	-5.5	-4.7	-10.4	-9.0
Export performance, % GDP ¹	52.7	52.0	61.8	61.8	61.1
Import intensity, % GDP ¹	64.2	57.5	66.6	72.2	70.1

¹ In the year 2002 according to the last estimate of the GDP (Updated prognosis of selected indicators on the SR economy in the year 2002 and a prognosis for 1Q 2003, Statistical Office of the SR, 12th December 2002).

Source: Statistics of the foreign trade for the year 1998, 1999, 2000, 2001, 2002, Statistical Office of the SR; web page of the Statistical Office of the SR – foreign trade 2003; own calculations.

Despite foreign trade in Slovakia in the year 2002 ended up with lower, although relatively still high deficit, the dynamism of foreign trade relations to compare the previous year has slowed. This happened due to several factors.

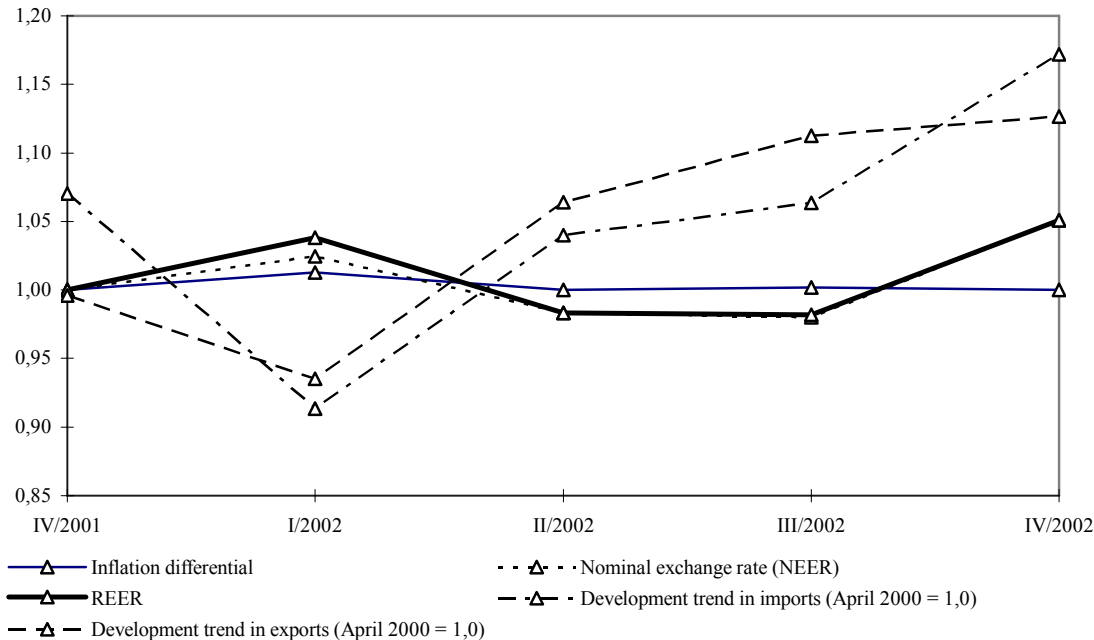
The most crucial impact on the decline in the external demand dynamism was the European Union influence (61 % of the exports from the SR), where the recovery of the economic growth lags behind other world regions (North America and newly industrialized Asian economies). The real growth of the EU economy declined from 1.6 % in the year 2001 to approx. 1.1 % in the year 2002. Domestic demand in the EU is running a slow recovery, household consumption is still pushed down, and a similar situation is found in the investment spending. Therefore also imports to EU countries since the year 2001 has experienced an overall decline.

The growth in the exports was not supported by any significant growth in competitiveness of the tradable sector, not even by a higher quality and productivity, nor by relatively lower costs. It was more likely the other way. As it is visible from the development of the *unit labour costs* in manufacturing, where the annual real growth in productivity (covering 1st – 9th month 2002 to compare 1st – 9th month 2001 based on value added) was by 3 % less than the growth in nominal wages (by 7.9 %). This pushed down the price competitiveness.

A certain influence which weakened the pace of the exports performance of the SR economy should be attributed to *strengthening of the koruna* in 1Q and especially in 4Q 2002 (see chart 7). It is obvious from the chart that the development in the exports quite adequately corresponds with the development in a real effective exchange rate of the koruna.

Regarding the value of the largest *commodities* of the exports a lower dynamism of growth in comparison with the year 2001 is seen predominantly in food products, chemical products, pulp and paper, textile products, manufacture of basic metals and fabricated metal products, machinery and equipment. On the other hand, a higher growth in the exports was marked only by rubber and plastic products and by transportation equipment. The unchanged high growth in the exports was kept by furniture and shoe product sector and also by non-metallic mineral products.

Chart 7
Development of real effective rate in the SR in the year 2002



Even bigger drop in the growth dynamism to compare the exports was made in imports – from 21 % to 4.7 % at current prices. The biggest decline in the dynamism occurred at food products, mineral products, pulp and paper, textile products and machinery and equipment. In contrary, a higher dynamism in the imports to compare the year 2001 was recorded in rubber and plastic products and transport equipment. Still high dynamism of imports with no changes has been preserved by manufacture of metals and metal products.

Even if prices of *mineral products* (petroleum, gas, non-petroleum mineral products) within the year 2002 indicated some swings, in average they kept the level (non-petroleum products) or fell slightly below the level of the year 2001, which is not a significant change regarding the value of imports.

The low dynamism of imports was more considerably influenced by a rapid *decline of USD value*, which has been systematically weakening since 2nd Q. This influence was mainly seen on the imports with mineral products.

The development of imports of other products was influenced especially by the development in *domestic demand*, which according to preliminary figures grew in real values less fast than in the year 2001. This was especially true regarding gross fixed capital formation, where there was a decline in real growth from 9.6 % in the year 2001 to zero growth in the year 2002 and this reflected mostly as a sharp drop in the growth of imports in machinery and equipment. Because the growth of final consumption and especially of household consumption in the year 2002 was even slightly higher than in the year 2001, the above said drop in the imports dynamism of consumer goods including food products indicated, that domestic producers started to be more dominating in this commodity segment

The territorial structure of foreign trade is basically consolidated and there were no significant changes in the year 2002 (table 9).

Table 9
Basic territorial structure of the SR foreign trade

Country, group of countries	2001			2002		
	The share in %		Balance in bn SKK	The share in %		Balance in bn SKK
	Exports	Imports		Exports	Imports	
Total	100.0	100.0	-103.2	100.0	100.0	-96.6
of it:						
EU	59.9	49.8	+10.2	60.5	50.3	+17.9
CEFTA ¹	30.0	22.5	+22.5	28.3	22.3	+17.8
of it:						
CR	16.6	15.1	-6.0	15.2	15.1	-14.3
CEFTA without CR	14.4	7.4	+28.5	13.1	7.9	+32.1
Russia	1.0	14.8	-99.1	1.0	12.5	-87.3
Asia	2.0	6.5	-34.6	3.1	7.7	-37.9
of it:						
China	0.1	1.6	-10.6	0.3	2.1	-13.8

¹ Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovenia, Slovakia.

Source: Foreign trade in the SR, 2001, web page of the Statistical Office of the SR, 2003.

The table 9 shows that in the year 2002 a rising trend of the SR trade proportion of the EU market has further continued reaching 60.5 % in exports and 50.3 % in imports. Slovakia also improved its trade balance with EU countries by almost 8 bn SKK which has so far been favourable.

The trade balance with Russia improved to a certain extent. That was not connected with a reduction of commodity and volume imbalances in this trade, but practically only with the impact of the weahening USD on the value of imported energy resources.

On the other hand, the trade with CEFTA countries to compare the year 2001 shows worsened parameters. The exports dynamism went down and the dynamism of imports went up. Due to that a trade surplus with these countries decreased almost by 5 bn SKK, which was mostly contributed by the increased trade deficit with the Czech Republic.

A trade deficit with Asian countries increased as well, with China and with newly industrialized countries as the most important business partners in this area. The dynamism was seen predominantly in imports, while exports still lags behind.

The SR foreign trade development in the year 2003 will be influenced by several factors. Most of all it will be the development of the world economy, especially within the European Union and the closely associated world trade development. For both developed economies and the EU, the year 2003 should bring a recovery of their development. The domestic demand development in the SR, in a close relationship with a real economic growth, will be the second most important factor.

Based on these assumptions, if other significant conditions do not change, regarding mainly the external environment, a *favourable development of the SR foreign trade with goods* can be *predicted for the year 2003*:

- dynamism of the exports growth at current prices to compare to 2002 will increase within the range of 10 – 12 %,
- dynamism of the imports growth at current prices to compare to 2002 will also increase, while in relation to the exports dynamism it will be lower, approx. 10 %,
- trade deficit at current prices will be probably lower, while its relative value should reach about 7 – 8 % of GDP.

7. Financial and monetary policy

7.1. Financial and budgetary policy

Preliminary figures on the public finance development indicate, that the deficit (including the costs for the restructuring of banks) in the year 2002 has also remained a key issue of the financial policy of the state and it will probably exceed its maximum level so far.

A considerably high deficit regarding the public finance in the year 2002, despite some unrepeatable factors (revenues from the privatization, deblocation of the Russian debt) was also influenced by the costs for restructuring of banks and by repayments for the state guaranties, and in addition by deficits which were caused by an unfavourable financial development in the healthcare sector.

A crucial role as for the growing deficit was played by the state budget deficit, that was exceeding a predefined level during the whole year, and at the end of the year recorded 5 % of the GDP. Therefore it is very difficult to reach the planned goal to gradually went on decreasing the public finance deficit till the year 2006 thus meeting the level of the Maastricht criteria.

Table 10
Development of the state budget deficit

	1999	2000	2001	2002 ¹	Difference between 2002 and 2001
State budget deficit including restructuring costs (in bn SKK)	14.8	27.6	44.4	51.6	+7.2
The share on GDP (in %)	1.8	3.1	4.6	5.0	.
State budget deficit without restructuring costs (in bn SKK)	14.8	19.1	36.4	37.0	+0.6
The share on GDP (in %)	1.8	2.2	3.9	3.9	.

¹ Preliminary estimate.

Despite the total budgetary revenues in the year 2002 in comparison with the previous year indicate an increase by 15.0 bn SKK (by 7.3 %), budgetary expenditures in

the same period increased by 22.3 bn SKK (by 8.9 %). In comparison to the previous year, non-tax revenues dramatically dropped (by 3.2 bn SKK) mostly from the NBS profit delivery. A more visible increase in tax incomes was recorded in collection of taxes from income and profits, and also from taxes on goods and services due to increased tax revenue from the value added tax.

Table 11
Development of state budget revenue and expenditure in 1998 – 2002¹

	Reality in bn SKK					Fulfilment of the budget 2002 in %	Index 2002/2001 in %
	1998	1999	2000	2001	2002 ²		
Total revenues	177.8	216.7	213.5	205.4	220.4	100.2	107.3
of it							
A. Tax revenues	153.0	160.4	173.8	165.1	188.8	104.5	114.4
In it:							
Taxes on income, profits, capital gains and property	61.7	62.3	60.0	57.5	73.2	108.0	127.3
Tax on goods and services	78.3	84.1	99.0	102.0	115.6	102.4	113.3
International trade and transactions taxes	11.6	12.5	13.1	3.9	4.0	133.6	102.6
in it: import duties	5.2	3.9	3.7	3.6	3.8	132.1	105.6
import surcharge	6.4	8.4	9.7	0.3	0.1	.	.
B. Non-tax revenues	12.9	41.7	19.9	24.8	21.6	68.5	87.1
C. Grants and transfers	.	.	18.4	13.7	10.2	94.2	74.5
Total expenditures	197.0	231.4	241.1	249.7	272.0	105.5	108.9
of it:							
A. Current expenditures	170.6	182.6	203.5	213.3	237.1	105.7	111.2
B. Capital expenditures	24.1	21.0	25.4	27.5	32.5	97.9	118.2
C. Property share and loans	2.1	27.8	12.2	8.9	2.4	.	27.0
Surplus (+) / deficit (-)	-19.2	-14.8	-27.6	-44.4	-51.6	135.9	116.2

¹Figures: Ministry of finance of the SR.

²Data from the year 2002 are preliminary till the „State final account for the year 2002“ is approved in the National Council of the SR.

Regarding a total state budget expenditures, which in the year 2002 amounted 272 bn SKK, in the comparison with a previous year the current expenditures went up by 11.2 % and capital expenditure increased by 18.2 %. The deficit regarding the public administration was therefore in a discrepancy with the program declaration of the government which promised to cut down the public finance deficit.

The costs for the recovery of banks became visible on the increased credit activity of banks and on the support of the enterprise sector at the end of the year. In the

situation when interest rates went down, raising charges for various banking services were the most important factor securing the rise of profit for banks.

Act on the State Budget in the year 2003 assumes a deficit of 56.0 bn SKK. An opened remained the question of the settlement for state guaranties for bank loans, which assuming possible risks could amount up to more than 7 bn SKK. Steps eliminating new cases or financing „hidden guaranties“ from the state budget, have to remain in place.

7.2. Monetary policy

The objective of the NBS monetary policy for the year 2002 was to create prerequisites for fulfilment of integration conditions for entry of the SR to the European Union. The monetary program in the year 2002 counted on the core inflation within the range 3.2 – 4.7 %, at the overall inflation 3.5 – 4.9 %, on reduction of deficit on the balance of payments current account from 8.6 % to 7.9 % and a faster growth of the NBS reserve. These intentions were later modified to be close to reality (based on achieved results) with the program goals updates, especially taking into account the external economic relations, or the deficit on the current account. The dynamism regarding money supply remained unchanged, loans to households and enterprises should have increased by 7.5 % recorded in the year 2001 to 12.2 % in 2002.

Fulfilment of the basic goals of the monetary program for the year 2002 in the key monetary aggregates could be evaluated as quite positive. The core inflation at the end of the year 2002 reached 2.1 % to compare 4.3 % in the year 2001. Consumer prices raised by 3.3 % compared to 7.3 % in the year 2001. However, the price measures adopted for the year 2003 will considerably increase these values.

In the year 2002, the loans policy of commercial banks started to be more active, which was proved by a higher volume of loans to households and enterprises (consolidated, cleaned by misleading items) by 13.5 % and by further acceleration of granting loans during the course of the year. Money supply M2 increased only by 7 %, while the monetary program assumed its growth by 11.4 %. Also in the year 2002, the

National Bank of Slovakia by managing its leading interest rates strived to eliminate the danger of an impact of growing domestic demand on imports or on the current account deficit.

Table 12

Development of deposits (in bn SKK) and average interest rate (in %) in the year 2002¹

	Status in the year				
	1998	1999	2000	2001	2002
Deposits in SKK	386.9	424.7	505.6	554.7	649.7
of it: households	253.1	286.7	304.8	324.7	323.5
Deposits in foreign currency (calculated in SKK)	72.9	80.2	99.2	110.8	118.4
Total deposits	459.8	504.8	604.9	665.6	767.6
Interest rates from new loans in total	18.62	12.55	10.95	8.92	7.85
of it: enterprise sector	22.14	12.58	11.07	8.90	7.65
public sector	22.06	19.55	11.23	9.84	7.65
private sector	22.22	19.62	13.13	10.44	9.00
households	9.39	8.03	8.83	9.30	9.94

¹ NBS figures.

Interests from new loans in total and in enterprise sector went down, while interests for households' loans increased. Preliminary figures on the primary market development indicate, that an average interest rate for 1-year deposits in comparison with the situation at the end of the year 2001 when 6.62 % level was recorded fell down to 4.34 %. Interest rates for short-term loans during the same period declined from 11.24 % to 8.23 %.

The rate of inflation predicted for the year 2003 will again call forth a considerable difference between the development of interest rate from individual types of deposits and the average inflation rate. This will lead to a smaller interest of people for savings money in financial institutions. On the other hand it will boost capital market and increase prices for realties.

Positive results of the monetary policy were reflected also on the exchange rate development of Slovak koruna. It probably was a reflection of the improved political stability in Slovakia, continual trends in the local currency stability, policy of cut down of interest rates as well as other positive features of the economic development, especially of

a growing foreign capital inflow. Also in the year 2002 the central bank supported a stable position of the banking sector. At the same time, it made much stronger interventions on foreign exchange markets.

In order to secure the monetary policy objectives during the year 2002, more tools influencing interest rates movement were used, while supported by „verbal interventions“, and the changes of interest rates found their reflection on the inter-banks market.

8. GDP development in the year 2002 and outlook for the year 2003

8.1. GDP development and changes on the demand side of economy

The relation between the GDP development and the components of final demand are analysed in two variants. Variant A (in Chart 8) presents the exports as net exports and domestic demand (its components) is understood as a quantity not influenced by the imports. In the variant B (Chart 9) not only exports, but also domestic demand, or its components, are reduced by related (which they induced) volume of imports.

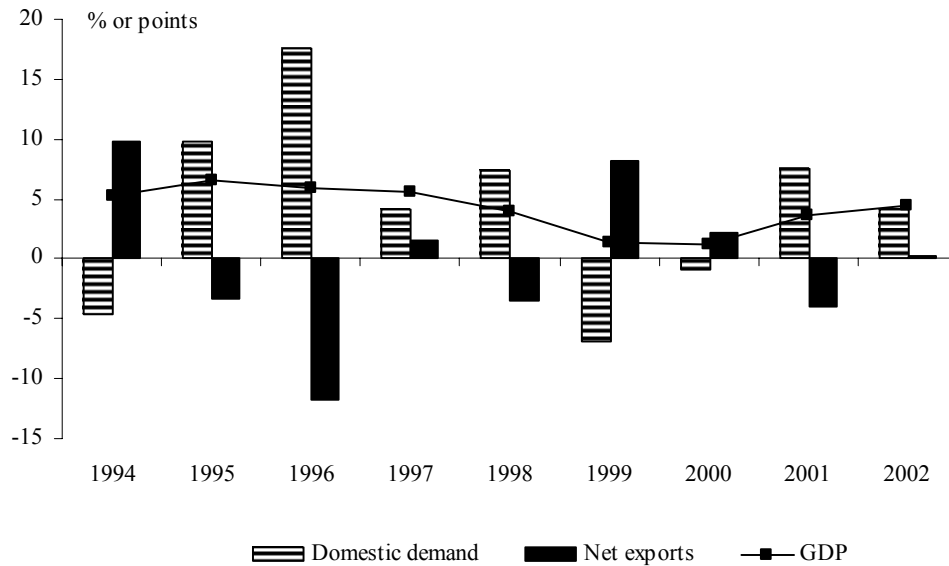
Variant A specifies the GDP development and structures of it use in the respective areas of demand. In the variant B demand components are cleaned from their imports intensity and therefore could be interpreted as factors which determinate the GDP development. In other way it can be stated, that the variant B is mapping the contribution of single components of demand in relation towards the changes in the economy performance.¹¹ In the both variants a special attention is given to the development of the total domestic demand, and separately the development of its components.

¹¹ The volumes of imports which in the variant B reduces the domestic demand and also the exports, were estimated according to Supply and use tables by commodities and industries (Statistical Office of the SR) and according to the structure of the imports.

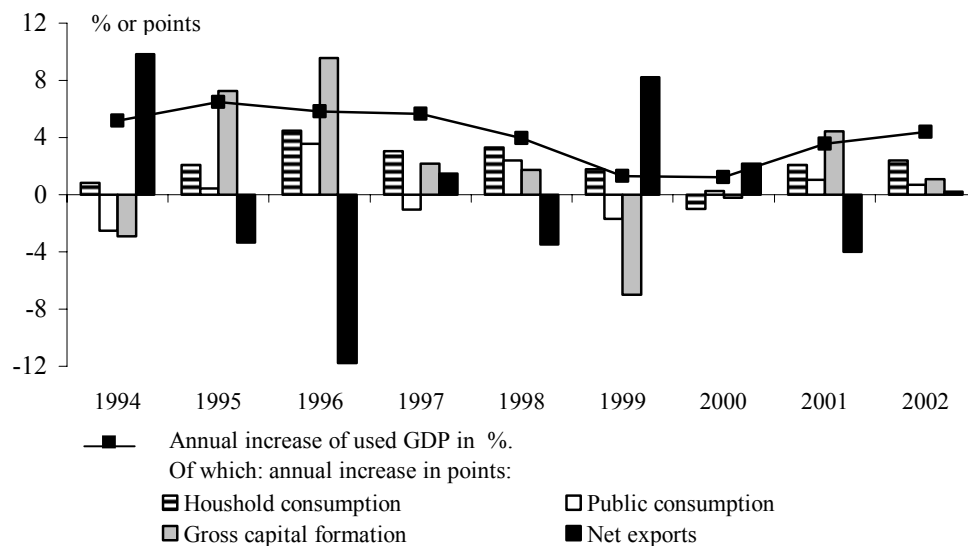
Chart 8

Development of GDP use and its components at constant prices (Variant A)

Domestic demand and net exports



Components of domestic demand and net exports



When the external demand is identified in one line with net exports, in the year 2002 (differently from preceding years, for the 1st time after the year 1997) the real increase of the GDP is associated with the growth of total domestic demand and also with net exports.

Even if the growth rate of the GDP use in domestic demand in the year 2002 was less than in the year 2001, but thanks to the positive development of the trade balance with goods and services, the total GDP use in the year 2002 increased more than in the year 2001.

The growth of overall domestic demand, regarding the above mentioned variant in the year 2002, was supported most of all by a speeded rate of the growth of household consumption, to a smaller degree also by higher public consumption. The overall growth of the domestic demand in the year 2002 was smaller by a moderate decline of the GDP use in gross fixed capital formation, but thanks to the growth of inventories the influence of the overall gross capital formation to GDP development was also positive.

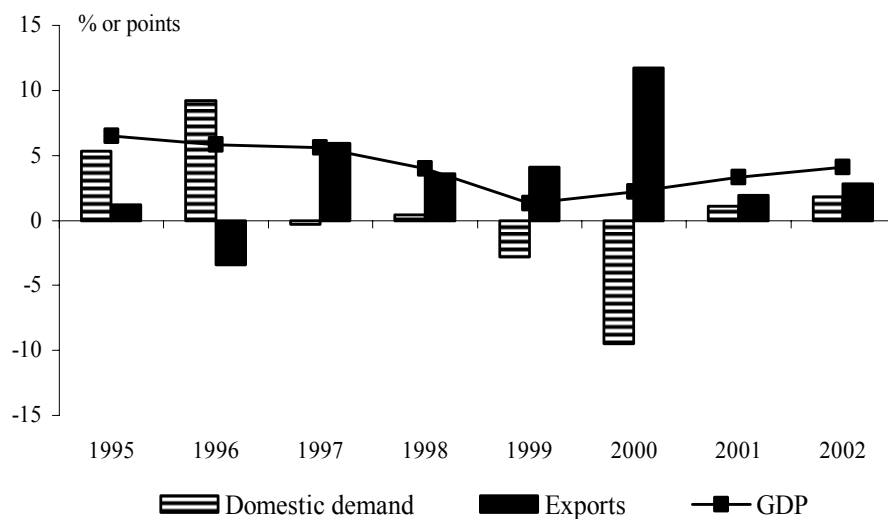
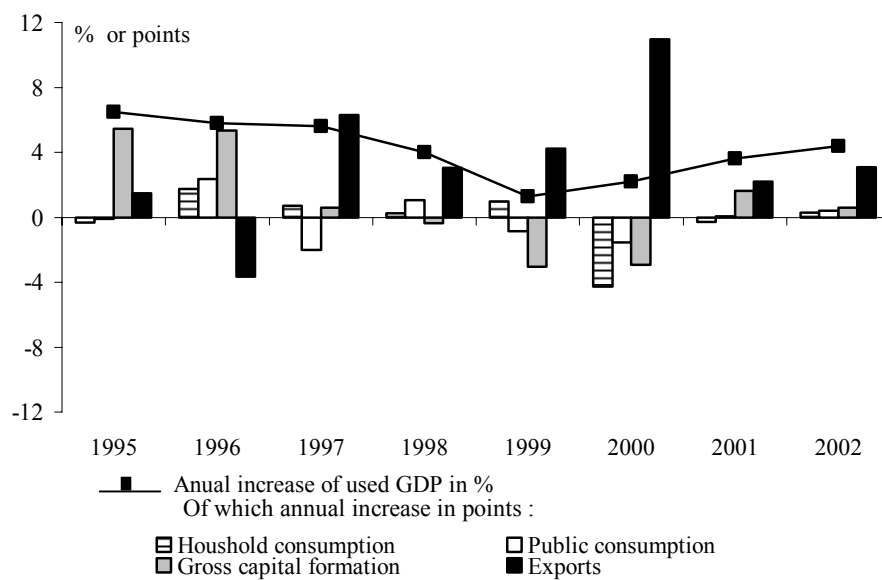
In difference from the year 1999, when especially government investment was constricted, the investment GDP use in the year 2002 was limited mainly by the unfavourable situation in the world economy.

Not only quantitative, but mainly in content, a different view on the relationship between the economy performance development and the changes in demand is received, when all of its components are reduced by their imports intensity. In that case (presented in the B variant - Chart 9) we are not searching for the way, or the area of demand, where GDP is used, but the influence of respective components of the final demand on GDP formation.

Chart 9 (variant B) is very convincing when pointing at export of goods and services considering them as the most important for the economic growth in the widely open and export oriented Slovak economy. The total points, that reflect the share of the components of demand on the GDP increases in the course of years 1995 through 2002 equals -1.0 for household consumption, -0.5 for public consumption, 7.3 for gross capital formation and 27.6 for exports. The contribution of exports to the real GDP formation was in the years 1995 – 2002 almost 5-times more than the contribution of the total domestic demand. A substantial portion of the GDP increase was ensured by the growth in exports also in the year 2002.

Chart 9

Development of GDP and of its components at constant prices (Variant B)

Domestic demand and exports (without the related imports)*Components of domestic demand and exports (without the related imports)*

A detailed analysis of the relationship between the development of GDP and components of the total demand will be connected with the prediction for the year 2003.

Domestic demand

Development of consumption or of demand of households in connection with the formation and use of incomes in the sector of households is presented in the table 13.

Table 13
Impact of factors forming the household consumption on its annual changes in points¹

	On household consumption increase at current prices				On household consumption increase deflated by its price index			
	2000	2001	2002 ^o	2003 ^p	2000	2001	2002 ^o	2003 ^p
Current income in total	9.7	12.1	11.8	13.0	-6.9	3.6	8.0	0.3
Of it:								
compensation of employees	4.2	7.2	6.7	6.8	-4.3	2.8	4.6	0.1
gross mixed income	4.7	4.9	2.8	4.9	0.6	2.7	1.9	1.5
social benefits	1.4	1.1	1.9	0.9	-1.2	-0.2	1.3	-0.9
property income								
- revenues	-1.5	-1.6	-0.1	0.0	-2.3	-1.9	-0.2	-0.4
other current transfers								
- revenues	0.9	0.5	0.5	0.4	0.3	0.2	0.4	0.0
Current expenditure in total ²	-0.4	-3.7	-2.7	-3.4	3.6	-1.6	-1.7	-0.3
Of it:								
taxes and social allowances	0.0	-2.9	-2.1	-2.9	3.2	-1.2	-1.3	-0.4
other current expenditures	-0.4	-0.8	-0.6	-0.5	0.4	-0.4	-0.4	0.1
Gross available income	9.3	8.4	9.1	9.6	-3.3	2.0	6.3	0.0
Gross savings of households ³	-1.7	1.3	-1.3	1.1	-0.1	2.0	-1.0	2.0
Increase of final household consumption in %	7.6	9.7	7.8	10.7	-3.4	4.0	5.3	2.0

¹ Own calculations according to data from Statistical Office of the SR. Period before the year 2000 is neglected in the table due to lack of comparable data.

² Positive values of expenditure indicate their positive influence regarding the gross available income (and through that also on final consumption of households) based on reduction of their volume.

³ Positive values of the impact of changes in gross savings of households on their consumption increase occur when gross savings of households go down. The growth of gross savings of households reduces the increase in their final consumption.

^o Estimate according to data for 1Q – 3 Q.

^p Prognosis.

The growing trend in real household consumption which was recovered in the year 2001 continued also in the year 2002, although on different basis. While in the year 2001

the real increase of household consumption was to the same extent due to a higher income and lower savings, in the year 2002 the growth of household consumption was fully called forth by higher income (especially from increases of compensation of employees and mixed incomes) while their savings grew as well.

The prognosis of the development in real household consumption in the year 2003 assumes, that nominal wages will grow by 8.2 %, employment will increase by 0.5 % and inflation rate (in retail prices) will equal 8.5 %. Keeping up the relatively strong propensity to consume (supported by the inflation rate increase), which will, under a considerably slower growth in real income, be reflected as a decrease in savings of households is also counted for. If the above mentioned assumptions are met in the year 2003 we can expect a real household consumption growth by 2.0 %. Under these conditions the increase will fully come from the drop in savings of households.

Prognosis on public consumption in the year 2003 regards the development in current expenditure of the state budget without debt services to be the most important factor of public consumption change.¹² Under consideration was also the prediction of the inflation rate in retail prices in the year 2003 (8.5 %) together with a ratio between the inflation rate and the average value of the public consumption deflator in the years 1999 – 2002. If the above mentioned assumption materialize, the public consumption (at constant prices) will increase by 2.6 % in the year 2003.

Prognosis of gross fixed capital formation (GFCF): there were two approaches used in the year 2003. The first one is derived from the estimate of resources which can be used in respective sectors (non-financial and financial corporations, public administration and households) for gross fixed capital formation. The other one is supported by the prognosis on the exports in the year 2003 at constant prices and on average value of elasticity of GFCF change to reach 1 % in the change of exports at constant prices in the years 2000 – 2002. We use the average value of GFCF change detected in the both approaches in the prognosis of the GDP development in the year

¹² The elasticity of the public consumption per unit of change of the state budget current expenditures (without debt services) reach as an average of the years 1999 – 2002 the value of 0.98 %.

2003. It is expected that by this 3.0 % GFCF growth estimate in the national economy, the GFCF in the sector of non-financial corporations in the year 2003 will increase by 4.7 %.

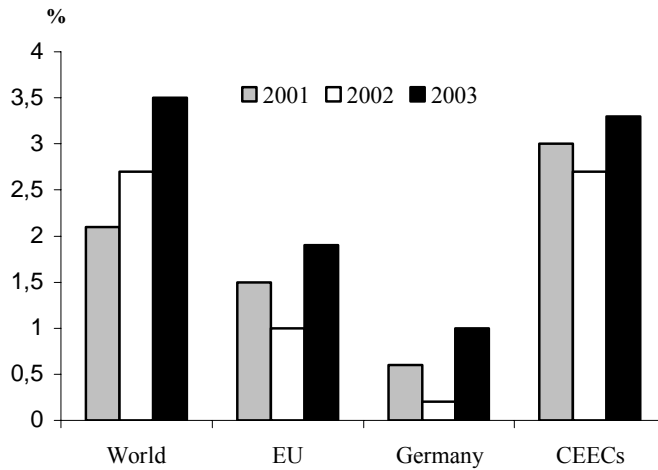
External demand – results achieved and chances of a development

According to available prognoses (OECD, Institute for World Economics, Kiel) the external environment should influence the SR exports more favourable as it was in the year 2002. A bottom turn point in the growth dynamism in EU and also a bottom turn point in the dynamism of the Slovak exports were reached in the first quarter of 2002. Since that period the growth dynamism in EU countries show a moderate speed up (however it is still rather low). In the year 2003, the growth dynamism should further speed up (chart 10), although we cannot count on levels above the long-term average. Even if the average rate of the economic growth in EU countries should equal about 2 %, at the same time the economic growth in Germany, the biggest buyer of the Slovak export production, will reach only approximately 1 % (even if this growth rate means an improvement).

A recovery of the growth in the EU member countries should come as a result of increased dynamism of final consumption and of investment, thus forming necessary prerequisites for the growth in imports to EU countries and through that likely increase the external demand from the point of view of the Slovak economy.

Among the parameters of the external environment, the development of exchange rate will be important. Our predictions are coming from the assumption that domestic currency will continue in appreciation process against the reference currency EUR. Besides that, it can be expected that especially due to the Iraq crisis USD will likely further weaken against EUR. At the same time this would mean also strengthening of SKK against USD. These assumptions imply reducing the chances for „imported inflation“ through prices of imported goods.

Chart 10
Expected changes in the rate of economic growth



Source: Institute for World Economics, Kiel.

Impact of changes in the external demand on the dynamism of GDP growth

Based on the above described assumptions, more favourable development of the foreign trade can be predicted to compare the years 2001 and 2002. As regards the impact on the GDP growth rate, net exports development plays a key role (the development of trade balance is therefore supplemented by exports and imports of services). We expect, that the improvement of the net exports result (if the exports at constant prices rise by 7.5 % and the imports increase by 6.1 %) will positively contribute towards the GDP growth approximately by 1 percentage point (contribution of net exports to the GDP growth in the year 2002 according to estimates was close about the value of 0.2 percentage point). That means that even if the result of the foreign trade balance and of net exports will be negative, the lower deficit will be relatively very important for the GDP growth.

8.2. An overall outlook on the development of the SR economy performance in the year 2003

The partial views on the development in demand and its impact upon the GDP development in the year 2003 are summarized in table 14.

Table 14
Prognosis of GDP development and its use structure for the year 2003¹

	In bn SKK ¹		Indices (previous year = 100) ¹		The share on GDP use in % ⁵	
	2002	2003	2002	2003	2002	2003
Households consumption ²	394.6	402.5	105.3	102.0	53.4	52.7
Public consumption	150.3	154.2	104.0	102.6	20.4	20.2
Gross capital formation ³	220.3	226.9	104.1	103.0	29.8	29.7
Domestic demand	765.2	783.6	104.7	102.4	103.6	102.6
Export of goods and services	585.6	629.5	105.9	107.5	.	.
Import of goods and services	612.4	649.8	105.3	106.1	.	.
Net export of goods and services	-26.8	-20.3	.	.	-3.6	-2.6
Gross domestic product ⁴	738.4	763.3	104.4	103.4	100.0	100.0
Final consumption	544.9	556.7	104.9	102.2	73.8	72.9
Gross savings	193.5	206.6	103.0	106.8	26.2	27.1

¹ At constant prices.

² Including consumption of non-profit institutions serving to households.

³ Presuming, that the status of inventories is changed proportionally to the gross fixed capital formation changes.

⁴ Without statistical difference between the used and the created GDP.

⁵ At current prices.

In the year 2003, we will see a moderate slowdown in the economic growth to compare with the previous year. The growth rate, however, will retain a higher level than in the years 1999 – 2001. It is also likely, that with the parallel improvement of the overall balance, the results of the year 2003 will become a starting point for the expansion of GDP growth in the next years.

A slowdown in GDP growth in the year 2003 will be a result of a reduced growth of all components of domestic demand presented in table 13. Within the framework of the development of the gross capital formation the growth rate of gross fixed capital in the year 2003 will however be higher than in the year 2002. Results regarding the foreign trade with goods and services in the year 2003 will be better than in the year 2002 and thus will positively influence the rate of GDP growth. A higher import intensity of the domestic demand over the exports will be accountable for the situation when the acceleration of the growth in exports related to the growth of domestic demand will extend the range between the growth rate in exports and imports. A positive feature of the economic growth in the prognoses for the year 2003 is a strong acceleration of the gross savings growth rate.

To provide a full picture of what is expected in the economic growth in the year 2003, we can use figures in table 15.

Table 15
The share of the demand components of on the percentage increase of GDP in points¹

	Variant A ²		Variant B ²	
	2002	2003	2002	2003
Households consumption	2.4	1.1	0.3	-0.6
Public consumption	0.7	0.5	0.4	-0.1
Gross capital formation	1.1	0.9	0.6	-0.0
Domestic demand	4.2	2.5	1.3	-0.7
Export of goods and services	.	.	3.1	4.1
Import of goods and services	.	.	.	.
Net exports of goods and services	0.2	0.9	.	.
Gross domestic product	4.4	3.4	4.4	3.4
Final consumption	3.1	1.6	0.7	-0.7
Gross savings	1.3	1.8	3.7	4.1

¹ At constant prices. See also other note to this table.

² See notes and comment to the chart 8.

In the variant A, where the contribution of the exports towards the GDP growth is expressed by real net exports – the exports is reduced by the total imports, it means also by imports belonging to some of the components of domestic demand. Therefore, as we had already commented regarding the chart 8, the information included in the variant A, table 15, indicate only the participation of components of demand on the GDP use. Participation of respective components of domestic demand on the use of GDP increase is getting notably lower, regarding the variant A in the year 2003 to compare the year 2002, although in a total figure (expressed as an overall domestic demand) it still remains higher than the share of (net) exports.

Substantially different view regarding the contribution of the overall demand components and their changes in the year 2003 is presented in the variant B which splits the imports among all demand components. Contribution of exports (of the external demand) to the GDP formation, as presented in table 15, already in the year 2002 exceeded the contribution of domestic demand. In the year 2003, the exports become the only factor supporting the GDP growth, and even the factor which by a part of its growth

effect will eliminate negative impacts of the development in domestic demand on the GDP growth. This is how the impacts of the economic-and-political measures targeting the improvement of the macroeconomic balance in a changed structure of the economic growth will be reflected in the year 2003.

9. A review of selected legislative and economic-and-political measures

The activity of the government and of the Parliament in the year 2002 was driven by a basic goal and that was the fulfilment of all necessary criteria for accession of Slovakia to the European Union and for obtaining the NATO invitation. In the both directions the several-year effort was concluded successfully. Slovakia got invitation to join NATO and it was included among the countries, which after a successful fulfilment of the ratification process should become the member states of the European Union as of 1st May 2004.

In the year 2002, the process of incorporation of the European legislation in SR culminated. A long list of legislation steps has been targeted to an implementation of EU technical and economic standards, or international standards into the Slovak legislation.

Among them the top importance belongs to the new act on accounting, on the payments system, on international assistance and cooperation in tax administration, on electronic signature and on the stock exchange. Based on the foreign exchange act amendment, on the act on collective investment and amendment of many other related acts, the constrictions on the capital and financial market are step-by-step moderated or removed. Basic parts of almost all legislative acts are therefore gradually coming into effect, some of them will come into force after the entry of Slovakia to the EU.

In connection with the act on international assistance and cooperation in tax administration, the act on income taxes was also amended. The amendment conditioned the provision of tax holidays by incorporating the clause specifying that the tax easement must be provided in accordance with the act on state aid (i. e. that the amount of the tax waived should not exceed the allowed intensity of a regional assistance and must be

defined as a one-off amount). This removed the obstacles preventing conclusion of negotiations with the EU on the chapter on Economic competition. This amendment (effective as of 1st September 2002) also codified, thus no taxes are to be paid from financial sources earned from grants which were provided on the basis of international agreements.

More transparent use of the public finance should be ensured by the act on state debt and state guaranties, which almost to its all extent became effective as of 18th July 2002. This law regulates the administration of government debt, administration of state guaranties, as well as conditions and procedures regarding the provision of state guaranties, and as of 1st January 2003 it also limits the maximum amount of state guaranties provided in one budgetary year. A similar objective is followed by the act on State Treasury, the first part of which came into effect during the year 2002, and gradually further parts will become effective from the beginning of the year 2003 and 2004. To make the administration of state property more efficient, the amendment of the act on state enterprise was approved effective as of 1st January 2003. This amendment defined rules how directors/presidents and members of supervisory boards in state enterprises should be selected, limits for their payroll, provisions regarding account balance statement and annual reports, etc.

Speculative splits and „tunnelling“ the property of business companies should be prevented by the amendment of Commercial Code, which as of 1st September 2002 stipulates, that once a business company was divided, each of the successor company will together guaranty by all its property without any difference regarding the liabilities which have passed from the exit company to other successors.

Act on the payments system (mostly into effect as of 1st January 2003) is to harmonize the SR legislative with the EU standards in the sphere of domestic and cross border payments, but it has an extra importance for the quality improvement of banking services in relation to their customers.

As of 1st April 2002 a new Labour Code and the act on public service and on state service came into effect. Implementation of these laws was calling forth a lot of problems,

which are currently being solved by partial amendments and a proposal for their complete amendment is going to be presented as a solution.

A certain legislative vacuum was filled in by passing a new act on the Slovak Academy of Sciences, the act on science and technologies and the new university act. However, several issues especially regarding financing the university/college study has remained unresolved.

In the social area, there were several regulations made during the pre-election period. Minimum wage in the year 2002 was increased twice. With regards to the provision included in the new Labour code on a shorter working week from 1st of April, the minimum wage rose from 26.60 SKK to 28.30 SKK per hour, and from 1st October to 32.00 SKK per hour and monthly to 5 570 SKK. As of 1st of July 2002 the rise in *living standard minimum* for individual groups of physical persons/individuals came into effect. Since 1st of July 2002 all main types of pensions raised basically by 5 % increase of the monthly amount of the approved pension; the top possible pension amount or a total amount of all provided pensions went up amounting currently 8 697 SKK monthly.

The act on social insurance was passed, that in a complexity regulates the basic social insurance (health insurance, pension insurance and accident insurance). The amendment of the act at the end of year postponed the date to become effective from 1st of July 2003 to 1st of January 2004; and at the same time postponed also deadlines for gradual adjustment to make old pension age for women and men equal, delayed deadlines of gradual transition from the current to a new model for calculation of pensions and all further associated deadlines.

In the year 2002, the act on children allowances and the supplement to the children allowances was amended twice. Since 1st of July 2002, children allowances were paid no matter the volume of a family income to which the allowances and supplement were paid. Basic monthly amount of children allowances was determined in the amount of 480 SKK, 590 SKK and 620 SKK according to the age of a child.

The amendment, which came into effect from 1st of January 2003, decreased the amount for the unlimited provision of children allowances by specifying a unified amount

of 270 SKK monthly no matter the child's age or an income amount per household (family). At the same time an income testing started again for the purposes of approval to pay the supplement to children allowances, and this is made in two income ranges. The amendment also adjusted the way that children allowances and supplement to children allowances are being provided by a municipality, where a child has a permanent or temporal residency, and this is related to child's truancy.

A new approach to the system for granting children allowances and a supplement to children allowances is clearly motivated by the effort of the government to reduce a total deficit of public budgets. This feature is also typical for several other legislation acts approved in the new legislation period. Among them, there is a reduction of the state bonus for housing savings from 25 % to 20 % of the annual deposit of the person engaged in a housing savings scheme, changes in the act on value added tax (VAT), which as of 1st of January 2003 introduced a new regulation regarding the VAT deduction and decreased the upper (basic) VAT rate from 23 % to 20 % , at the same time the bottom (preferential) VAT rate was increased from 10 % to 14 %, as well as a dramatic increase in each of excise taxes.

Special rigid measures started to be implemented regarding the unemployment. The amendment of the act on employment effective since 1st of January 2003 introduced much more tougher conditions for entering and further registering of unemployed persons in the labour office registry and for granting a financial support in unemployment; in addition this amendment also redefined the responsibility of municipalities regarding the resolution of employment of the registered unemployed persons in the municipality.

With the aim to reduce financial costs of the state for social support payments, the amendment of the act on the social support effective since 1st of January 2003 introduced strict limits for a maximum amount of social support benefits for needy people and broaden the difference between the payment of social support benefit for people who are needy due to their own purposes (maximum of 1 450 SKK monthly per one adult person) and the payment of social support benefits for people who are needy due to objective reasons (maximum 2 900 SKK monthly per one adult person), at the same time

a maximum amount of 10 500 SKK monthly was approved as a social support benefit for jointly appraisal persons who are found in a material need (a contribution for housing is not included in this amount).

In the year 2002 the system of decision making regarding regulated prices underwent essential changes. Actually, only decision on the net rent in rental flats was left in the competence of governmental bodies, further on selected types of medications and healthcare performance, on a bus transportation fare up to 100 km and on personal railway transportation fares; some prices are decided by local bodies. The competences in the main areas were by law given under the responsibility of independent regulatory office – Office for regulation of network industries, Telecommunication Office and Post Office. These institutions as of 1st of January 2003 according to previously defined rules decided on the price increase in respective areas under their responsibility. Prices for energy since 1st of January 2003 soared in all categories of buyers (it was due to the fact that deregulation of prices was not made in the year 2002). This price increase hit mostly the categories of households, which in the previous period paid lower prices thanks to a cross subsidy system. The price of gas increased from January 2003 in average by 32.7 % (by 43.7 % for households and by 30-36 % for bulk buyers), the price of electricity for all categories of final buyers went up by 19.8 %, for domestic buyers by 24.7 % and for bulk buyers by 24 %. The average price of heat will go up by 8 – 11 %, water and sewerage by 35 %, or by 30 %.

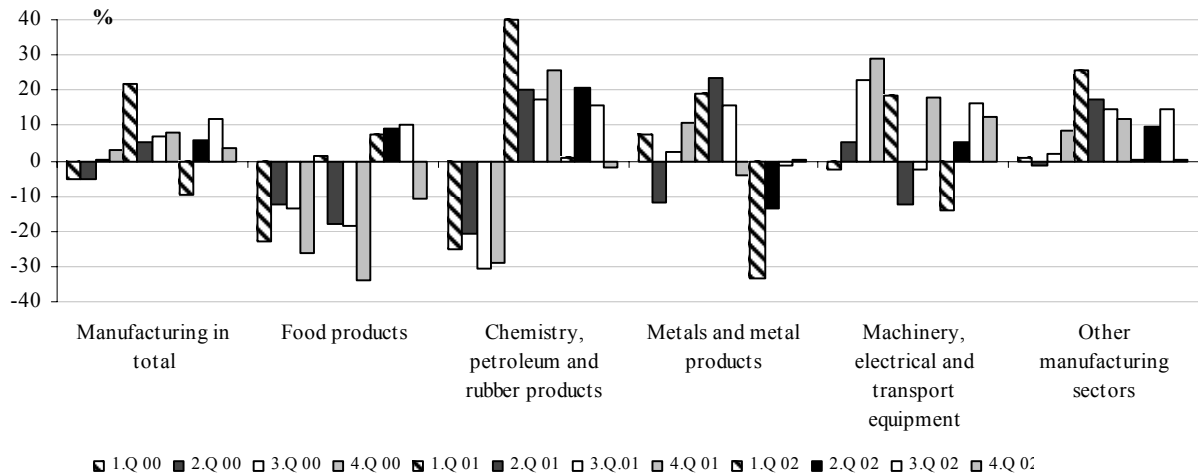
Privatisation process in the year 2002 continues especially in the energy sector. 49 % stake of the state held in the Slovak gas industry was sold to consortium of companies Gaz de France, Ruhrgas and Gazprom. Minority stakes in the three distributing energy companies were won by German concern E.ON Energie, French corporation Electricité de France and German firm RWE Plus.

By the sale of 66.79% of the stake in the Slovak insurance house to the German company Allianz and the sale of Istrobanka to the Austrian bank BAWAG, of the Banka Slovakia to the Austrian Meindl Bank, regarding some exceptions, the privatisation in the financial sector was concluded.

Chart 2

Development of value added in manufacturing industry sectors

(Percentage changes to compare the same quarter of a previous year, constant prices)



An uneven development in value added in the manufacturing industry in respective quarters of the year 2002 (-9.7 %, 6.0 %, 11.8 %, 3.4 %), especially a slowdown encountered again in 4Q quarter of the year 2002⁵, documented that there is still a strong sensitivity of this industry towards changes both in external and domestic demand, and this brings a relative uncertainty in the starting point of the development in the year 2003. At the same time, it should be expected, that the growth in value added regarding the energy intensive industries will also restrict the growth of energy costs.

Production *in the industry* increased⁶ in the year 2002 almost in the same pace like in the year 2001 – by 6.6 %; a total growth was reached along with the production growth in the manufacturing industry by 8.6 % (by 9.8 % in the year 2001⁷) and along with a decline in electricity, gas and water supply by 5.8 %. Regarding the manufacturing industry the top production growth was reached in furniture, leather and automotive industry, and also in the manufacture of rubber and plastic products; a drop was recorded in the wood and paper industry.

⁵ In 4Q the fast growth rate in the value added sustained only in the manufacture of machinery, electrical equipment and manufacture of transport equipment.

⁶ According to the index of industrial production (IIP) cleared from the influence of working days and in comparison with the same period in the previous year. IIP reflects the change in the volume of production in natural form.

⁷ Audited data.

In the year 2002, privatisation of 17 state enterprises of the Slovak bus transportation has started. On the sale through selection procedures is 49 % of the stocks of transformed stock companies, 34 % stocks are to be transferred to higher territorial units, and pre-defined investors will obtain the right to buy the remaining 17 % of the stocks after fulfilment of all determined conditions. The separation of healthcare premises from the state ownership was also being prepared (except for those, which should remain in the hands of the state), a no-payment transfer to the ownership of municipalities or a direct sale to a pre-defined interested buyer has been considered.

ECONOMIC DEVELOPMENT OF SLOVAKIA IN 2002

(Study Prepared on Behalf of the United Nations Economic
Commission for Europe)

**Authors: Ivan Okáli, Herta Gabrielová, Egon Hlavatý, Karol Morvay,
Richard Outrata**

**Institute of Slovak and World Economy, Slovak Academy of Sciences, Šancová
56, 811 05 Bratislava
Telephon: 42-1-2-52 49 54 80, Fax: 42-2-7-52 49 51 06
E-mail: sikula@savba.sk**