EXHIBIT 12

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International Trade Administration
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Investigation
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MEMORANDUM FOR: Robert S. LaRussa
Assistant Secretary
for Import Administration

FROM: Bernard Carreau
Deputy Assistant Secretary
AD/CVD Enforcement Group II

DATE: October 13, 1999

SUBJECT: Antidumping Duty Determinations on Cold-Rolled Carbon-Quality Steel Products from the Slovak Republic – Market vs. Non-Market Economy Analysis.

SUMMARY

Since its emergence as an independent, democratic state, the Slovak Republic ("Slovakia") has made significant progress in its transformation into a market economy country. The Slovak currency is now fully convertible. Wages in Slovakia are largely determined by free bargaining between labor and management. Trade has been liberalized and tariffs reduced, and the Slovak government is actively promoting foreign investment and business ventures. Industry, agriculture and services have all been privatized, and the power to make decisions related to the allocation of resources, and over pricing and output decisions, now rests with the private sector. Based on the preponderance of evidence related to economic reforms in Slovakia, analyzed as required under section 771(18)(B) of the Act, the Department should revoke Slovakia's non-market economy ("NME") country status, effective January 1, 1998.

BACKGROUND

On June 21, 1999, the Department announced the initiation of an antidumping ("AD") duty investigation on certain cold-rolled flat-rolled carbon-quality steel products from Slovakia. On June 25, 1999, the Department received a letter from counsel for the sole Slovak respondent, VSZ, requesting, on behalf of the Government of Slovakia, that the Department revoke the NME

status of Slovakia under section 771(18)(A) of the Act. On July 2, 1999, the Department initiated a formal inquiry into Slovakia's NME status.

On July 2, 1999, the Department issued a letter soliciting information and comments relevant to the NME status inquiry from all interested parties. The Department asked that any submissions made in response to this solicitation be made by October 1, 1999. VSZ submitted comments on August 20, 1999. The petitioners in the above-captioned case ("the petitioners") submitted comments on September 30, 1999. No other interested parties have responded to the Department's solicitation.

VSZ maintains that Slovakia's NME status should be revoked for the following reasons:

- The Slovak koruna is freely convertible for both domestic and current account transactions.
- Wages in the Slovak Republic are now largely determined by the interplay of negotiation and market forces.
- Slovakia is generally open to foreign investment. Foreign entities may establish joint ventures or wholly-owned companies in Slovakia, and the Slovak Commercial Code provides that foreign persons may conduct business under the same conditions as domestic enterprises.
- Private ownership dominates the Slovak economy, as privatization has led to an explosion of new private enterprises.
- Resource allocation and price and output decisions are controlled primarily by market forces, not government direction.
- Slovakia maintains an open trade policy with relatively low MFN tariffs and other market-based policies.
- Slovakia's openness to foreign trade and record of price stability underscores its transformation into a market economy.
- In comparison to other countries, Slovakia is a market economy and more market-oriented than other former centrally planned economies.

The petitioners assert that Slovakia's NME status should not be revoked for the following reasons:

- Slovakia has become less open to foreign joint ventures and other investments.
- The level of government control over Slovak enterprises remains high.
- The Slovak government continues to exercise significant control over the pricing decisions of Slovak enterprises.
- Some currency exchange restrictions remain in place with respect to capital account transactions involving conversion for foreign investments and loans.
- The extent to which the Slovak currency will remain freely convertible is in serious doubt.
- Wages are still subject to significant regulation in Slovakia.

APPLICABLE STATUTE

In making a NME-country determination under section 771(18)(A) of the Act, the Department must take into account the following factors under section 771(18)(B): (1) the extent to which the currency of the foreign country is convertible into the currency of other countries; (2) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management; (3) the extent to which ventures or other investments by firms of other foreign countries are permitted in the foreign country; (4) the extent of government ownership or control of the means of production; (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises; and (6) such other factors as the administrating authority considers appropriate.

OVERVIEW OF ECONOMIC REFORMS

Following the "velvet revolution" of 1989 (the peaceful removal of the Communist Party from power), Czechoslovakia embarked on an economic reform program intended to create a full-fledged market economy, reintegrated with Western Europe. The government quickly ruled out a "mixed economy," in which State management efforts would dictate activities and [illegible] and the profit maximizing initiatives of private economic agents would dictate activities and outcomes in the "market" part. The reform leaders believed that the contradictions inherent in such a mixed economy would pose serious macroeconomic management and coordination problems and would generate costs that would far outweigh any possible benefits.[1]

As a result, Czechoslovakia quickly liberalized prices and trade and implemented a comprehensive national privatization program to transfer the means of production back into private hands as quickly as possible, wanting to achieve a ratio of state property to private property similar to that in fully developed market economies. The government passed a law on private enterprise allowing private sector participation in virtually any economic activity, abolished the monopoly of foreign trade corporations (or "state trading enterprises") on external trade and significantly reduced average tariff levels, and amended the joint venture law to allow for 100 percent foreign participation. A two-tier banking system was created by breaking up the former state monobank, leaving an independent central bank to formulate and implement [illegible] and exchange rate policies. The government also began the arduous task of rebuilding

[1] Zecchini, Salvatore, ed. Lessons from the Economic Transition: Central and Eastern Europe in the 1990s. Boston: Kluwer Academic, 1997: 9.

2 Aghevli, Bijan B., Borensztein, Eduardo and Tessa van der Willigen. Stabilization and Structural Reform in the Czech and Slovak Federal Republic: First Stage (Occasional paper No. 9). Washington, D.C.: International Monetary Fund, March 1992: 4.

Czechoslovakia managed the initial phase of the transition process quite well, employing tight fiscal and monetary policies, a pegged exchange rate as a nominal anchor for the economy, and a "voucher privatization" program that gave everyone a stake in the process. By the beginning of 1993, prices and the exchange rate had stabilized, and the drop in aggregate output had been arrested.[3]

It was at that point, at the beginning of 1993, that the Czech-Slovak Federation dissolved. Nevertheless, reforms continued in the newly established Slovak Republic. By 1998, (1) the vast majority of Slovak enterprises were in private hands--though many of the larger enterprises had been privatized *via* a process that lacked transparency and fairness, consequently discouraging foreign investment; (2) the relatively few price controls that remained--covering utilities, energy, and rents--were being phased out; (3) the Slovak koruna was convertible on both current and capital accounts; (4) budgetary subsidies had been reduced; (5) bankruptcy laws had been strengthened and enterprise budget constraints hardened; and (6) bank reserves and provisions had been built up to reduce the bad-debt problem in the banking sector.

Slovakia's reforms have been neither *ad hoc* nor incremental in nature, but have, instead, been part of a continuing, systematic and comprehensive effort by the Slovak Government to build a market economy and democratic state. The following section presents a discussion of each of the six statutory factors that the Department considered in determining whether Slovakia's NME country status under the U.S. AD law should be revoked at this time.

SECTION 771(18)(B) FACTORS

(1) *The extent to which the currency of the foreign country is convertible into the currency of other countries.*

The Slovak currency, the Slovak koruna, was pegged daily to a basket of five currencies up until July 1994, when the basket was reduced to the German mark (60 percent) and the U.S. dollar (40 percent).[4] The National Bank of Slovakia ("NBS") maintained the pegged rate within a target zone. Exchange controls were put in place to ensure exchange rate stability, which the government relied on as a nominal anchor for the economy. The exchange controls on current account transactions were gradually lifted and, in 1995, by amendment to the Foreign Exchange Act, Slovakia brought its exchange rate regime into compliance with Article VIII of the International Monetary Fund's Articles of Agreement. These obligations include (1) the avoidance of discriminatory currency practices and restrictions on trade-related payments; and (2) the convertibility of foreign-held balances. As a result, the koruna became fully convertible

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[3] Zecchini, Salvatore, ed. Lessons from the Economic Transition: Central and Eastern Europe in the 1990s. Boston: Kluwer Academic, 1997: 12-15.

[4] Economist Intelligence Unit. Country Profile: Slovakia. Mar. 22, 1999: 26.

for current account purposes.[5] Since then, Slovakia has further liberalized exchange controls as follows:[6]

(i) individuals and firms (domestic and foreign) in Slovakia can now maintain foreign exchange ("FOREX") accounts without prior government approval and no longer have to surrender their export earnings or other FOREX receipts to banks;

(ii) accounts in korunas are now fully convertible into foreign currencies for current account purposes and for many capital account transactions, including outward direct investment; and

(iii) permission is no longer needed to buy and sell foreign securities traded on the main stock exchange markets of OECD countries.

Thus, by early 1998, the koruna was convertible on both current and capital accounts. The market consequences of convertibility soon became clear. Downward pressure on the koruna--due to growing fiscal and trade deficits--necessitated direct intervention by the NBS in FOREX markets. As pressures increased, FOREX reserves were drawn down to a point where, on October 1, 1998, the NBS abandoned the peg and let the koruna float.[7] As a result, the koruna immediately fell by about ten percent, but subsequently strengthened. Notably, the koruna has not experienced a prolonged period of currency turmoil that has characterized the experience of other emerging economies moving away from fixed-rate regimes, attesting to the well-established independence and strict monetary policies of the NBS.[8]

Like many Central Banks, the NBS has found it necessary to intervene directly in the FOREX market to support the koruna. For example, the koruna remained relatively stable in the first two months of 1999, reflecting the NBS's tight monetary policy. In late February 1999, however, pressure on the koruna increased, and in March, the currency suffered a significant drop, landing some 20 percent below its previous DM/$ basket value. This drop prompted the central bank to intervene in the FOREX market for the first time since the koruna was floated.[9]

(2) *The extent to which wage rates in the foreign country are determined by free bargaining between labor and management.*

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5 "The Slovak Republic - - Back on Track." European Business Journal. 12 Aug. 1999: 85.

6 International Monetary Fund, Exchange Arrangements and Exchange Restrictions, 1998: 797-802.

7 Organization for Economic Co-operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 42.

8 Id. at 63.

9 Economist Intelligence Unit. "Slovak Economy: Outlook to 2000." EIU ViewsWire. Apr. 9, 1999.

Trade union freedoms in Slovakia are guaranteed by Article 37 of the Slovak Constitution, which was ratified on September 3, 1992.[10] The right to strike is recognized by Article 37(4) of the Constitution for all but judges, prosecutors, members of the armed forces, and firemen. Although there have been relatively few strikes in Slovakia since 1989, the right to strike, when exercised, has encountered no particular obstacles.[11] Slovakia was largely free of strikes from the 1989 revolution through 1996.[12] Seven strikes were officially recorded in 1997.[13] The largest strike came in June, when Bratislava's mass transit company drivers--in an effort to secure wage increases--struck for four days, crippling city transportation services.[14]

There are currently four major trade union federations in Slovakia. The Trade Union Confederation (KOZ) is by far the largest. According to a 1998 report by the European Commission, nearly 80 percent of Slovak workers are members of a trade union.[15] The Law on Citizens' Associations prohibits discrimination by employers against union members and organizers. Complaints may be resolved either in collective negotiations or in court. If found guilty of anti-union discrimination, employers are required to reinstate workers fired for union activities.[16]

Like other Eastern European countries in transition, Slovakia relies on collective bargaining among the government, trade unions and employer associations to determine wage rates,[17] although this "tripartite arrangement" can become unhinged at times. For example, in 1997, the government, concerned about macroeconomic stability, inflationary expectations and the international competitiveness of Slovak enterprises, did not consult with unions or businesses before imposing wage controls designed to contain rapid real wage growth. These controls limited wage growth in firms to between six and 12 percent, depending on a firm's productivity and profitability. As a result, in the first half of 1998, average real wage growth in industry

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[10] European Commission. "Commission's Opinion on Slovakia's Application for Membership of the European Union." 1998. Available: http://europa.eu.int/comm/dg1a/enlarge/agenda2000_en/op_slovakia/b1.htm

[11] Id.

[12] Bureau of Democracy, Human Rights, and Labor. "Report on Human Rights Practices." Jan. 30, 1998. Available: http://www.geocities.com/CapitolHill/7502/1human.html

[13] Id.

[14] Bureau of Democracy, Human Rights, and Labor. "Report on Human Rights Practices." Jan. 30, 1998.

[15] European Commission. "Commission's Opinion on Slovakia's Application for Membership of the European Union." 1998.

[16] Bureau of Democracy, Human Rights, and Labor. "Report on Human Rights Practices." Jan. 30, 1998. Available: http://www.geocities.com/CapitolHill/7502/1human.html

[17] Id.

slowed down and--in contrast to 1997--fell short of labor productivity growth.[18] When the new government assumed office in 1998, it abolished these wage controls and affirmed its commitment to a dialogue with organized labor, reviving "tripartite negotiations" to address wages, working conditions, and the impact of government austerity and economic stabilization measures.[19]

(3) *The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country.*

The U.S. and Foreign Commercial Service reports that Slovak law permits foreign companies and individuals to establish and own business enterprises in Slovakia.[20] Foreign companies and individuals can establish branch offices, joint-stock companies, limited liability companies, limited partnerships, "unlimited partnerships," cooperatives, silent partnerships, and associations. All Slovak businesses can deal directly with foreign entities and are not subject to performance requirements concerning the establishment, maintenance or expansion of their investments. One hundred percent foreign ownership of Slovak business entities is permitted, as is 100 percent repatriation in hard currency of all post-tax profits. The government can expropriate foreign investments, in exceptional cases, where it is in the public interest. Such expropriations must be compensated. In the event of expropriation, the foreign investor has recourse to judicial appeal. To date, there have been no cases of expropriation in Slovakia.

Foreign businesses and persons cannot directly own real estate in Slovakia. (Exceptions to this rule apply to real estate acquired *via* restitution or large-scale privatization.) However, foreign businesses and persons can indirectly own Slovak real estate through the establishment of legally registered Slovak companies. Foreign direct investment ("FDI") in Slovak banks is permitted, as there are now 14 banks that have foreign capital participation and four foreign bank branch offices in Slovakia. Foreign bank operations must be approved by the NBS, which screens applicants to ensure adequate capitalization and sufficient technical and managerial skills.[21] FDI is excluded from strategic sectors such as gas, electricity, telecommunications, and armaments production.[22]

Despite the relative openness of Slovakia to FDI, Slovakia accounted for just over two

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18 European Bank for Reconstruction and Development. Transition Report 1998. 1999: 188.

19 Economist Intelligence Unit. Country Report: Slovakia, Jun. 1, 1999: 23.

20 U.S.& Foreign Commercial Service. Slovakia: 1999 Country Commercial Guide. Jul. 1998: 30.

21 World of Information Country Report. Slovakia: Economy. Aug. 1999: 9. Available: http://www.datastarweb.com/32713ed6/WEBFORM/6001/30682a75/

22 Economist Intelligence Unit. Country Profile: Slovakia. Mar. 22, 1999: 25.

percent of total cumulative FDI in the region's transition economies, on a cumulative 1989-97 basis. On a per-capita cumulative basis, FDI in Slovakia is less than one-seventh of that in Hungary, and less than one-third of that in the Czech Republic. On the other hand, cumulative FDI in Slovakia compares somewhat favorably to that in Poland.[23] The OECD attributes the relatively modest flow of FDI into Slovakia to possible concerns over macroeconomic and political instability, and a perceived lack of transparency, consistency and predictability in the implementation of investment-related laws and regulations.[24] The scope of foreign investment opportunities has also been limited by problems associated with the privatization process, which are discussed below.

Recognizing the failings of past policies affecting foreign investment, the Slovak government is currently attempting to improve the investment climate in Slovakia. The government intends to actively promote FDI by using various incentives under the "Strategy for Promotion of the Entry of Foreign Investment into the Slovak Republic."[25] The government also hopes to increase foreign investors' investment opportunities by privatizing remaining state assets in a fair, transparent and predictable manner, in strict observance of national treatment and non-discrimination principles. In particular, foreign investors will be encouraged to participate in the privatization of State-owned banks.[26] Foreign investors will also have the opportunity to invest in Slovak enterprises heretofore excluded from large-scale privatization, pursuant to the "Strategic Enterprise Act." (See below.) Slovakia's stock of FDI reached approximately $1.7 billion in 1998, with the largest year-to-year increase coming in 1998.[27]

(4) *The extent of government ownership or control of the means of production.*

Privatization and restitution efforts began in Czechoslovakia in 1990 and continued in Slovakia after the breakup of the Federation in 1993. These privatization and restitution efforts encompassed land and other real estate (urban and rural), industrial enterprises, and small businesses (primarily service and retail establishments). The government effected the transfer of these properties and assets by one of following five means: (1) restitution (*i.e.*, the return of property that was illegally confiscated without compensation); (2) public auctions and direct [illegible] privatization of joint stock companies; (4) the "transformation" of

transfer to municipalities. Restitution was not limited to Slovak citizens and covered all types of property (land, housing, farms, forests and enterprises) and, along with voucher privatization,

23 European Bank for Reconstruction and Development. Transition Report 1998. 1998: 81.

24 Organization for Economic Co operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 73.

25 Ministry of the Economy of Slovakia. "Strategy of the Promotion of the Entry of Foreign Investment into the Slovak Republic." Kensington Publications. Aug. 1999. Available: http://www.kenpubs.co.uk/investguide/kenstaf.htm

26 Economist Intelligence Unit. Country Profile: Slovakia. Mar. 22, 1999: 21.

27 Economist Intelligence Unit. Country Report: Slovakia. Jun. 1, 1999: 33.

ensured that a large segment of the population would have a stake in the new economic and political order. The property transfers to municipalities (several thousand in total) involved such things as apartment buildings, land, sewer and water systems, and transit systems. The extent of the subsequent sale of these properties by the municipalities under the small-and large-enterprise restitution and privatization programs (discussed below) is not clear.

These efforts would have had little meaning without the concurrent establishment and protection of basic private property rights. The government therefore passed many laws governing the transfer of state assets into private hands (*e.g.*, the Small- and Large-Scale Restitution Acts, Law Nos. 403/90 and 87/91, respectively, and the Small- and Large-Enterprise--or "small- and large-scale"--Privatization Acts, Law Nos. 427/90 and 92/91, respectively).[28] Czechoslovak Law No. 23-91, which implemented the Council of Europe Provisions, recognized the right to own land as a basic right. Law No. 23-91 also protects private, collective and State ownership, and a 1992 amendment to the 1964 Civil Code abolished the preeminence of State ownership that had previously existed.[29]

Although the data are imprecise and the numbers are sketchy, roughly 100,000 properties in the whole of Czechoslovakia were returned to their original owners or heirs. Approximately 20,000 of these were small businesses/properties--mostly family-run rental houses, shops, restaurants and pubs–and the rest were pieces of real estate.[30] Of these 20,000 small businesses/properties, perhaps 3,000 were Slovak and 17,000 Czech.[31] In many cases, the original owners or their heirs had remained attached to the property in some manner, and it was recognized that auctioning the properties in these cases would be problematic. Small businesses that went unclaimed were auctioned off under a small-enterprise privatization program, beginning in February of 1991 and ending in early 1993. In this program, buyers made their bids over several rounds. Only Czechoslovak citizens could bid in the first round. However, subsequent bidding rounds were open to foreigners, but only if they had permanent residency status. Eventually, under this program, over 30,000 small enterprises were privatized (sold or leased[32]) for more than 45 billion Czechoslovak koruna.[33] More than 7,000 of these were Slovak

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28 NATO Colloquium. "Privatizing the Slovak Economy: Legislative Framework and Development." 1995. Available: http://www.nato.int/docu/colloq/1995/95-14.htm

29 Strong, Louise A., Reiner, Thomas A., and Janusz Szyrmer. Transitions in Land and Housing: Bulgaria, the Czech Republic and Poland. New York: St. Martin's Press, 1996: 95.

30 Organization for Economic Co-operation and Development. Economic Surveys: Czech Republic 1998. 1998: 50.

31 NATO Colloquium. "Privatizing the Slovak Economy: Legislative Framework and Development." 1995. Available: http://www.nato.int/docu/colloq/1995/95-14.htm

32 Organization for Economic Co-operation and Development. Economic Surveys: The Czech and Slovakia Republics 1994. 1994: 118.

The leased properties could be re-leased or sold at the end of the lease contract. The leases carried no special rights or privileges.

33 Organization for Economic Co-operation and Development. Economic Surveys: The Czech and Slovakia Republics 1994. 1994: 33.

enterprises.[34]

Small enterprises not claimed by their owners and not leased or sold under the small-enterprise privatization program were included in the large-enterprise privatization program. Just as with small enterprises, the government was committed to the restitution before sale of large enterprises. However, owners of many large enterprises did not qualify for restitution either because they had been compensated when their respective enterprises were nationalized, or because their enterprises were nationalized prior to 1948--the cut-off date for restitution claims. Therefore, restitution played a small role in the transfer of large enterprises. Large-enterprise privatization was supposed to have occurred in two waves. In the first wave, the largest share of enterprises, by value, was transferred by means of voucher privatization. The enterprises were converted into joint stock companies (sometimes several, in the case of some of the larger enterprises), and a large percentage of these shares was reserved for adult citizens to bid on. The remaining shares stayed with the government or were reserved for managers and workers.

Voucher privatization eliminated the wealth barriers that would have precluded many, if not most, Czechoslovak citizens from participating in privatization and having a stake in the privatization process. The first wave of voucher privatization was completed in 1993, after the Federation had dissolved. Out of 1,668 Slovak state-owned enterprises, 751 with a total book value of roughly 176 billion korunas (nearly US$6 billion) were privatized in this manner.[35]

In the second wave of large-enterprise privatization, the government abandoned the voucher approach and relied almost exclusively on direct sales. From 1996 to 1997, as the National Property Fund (the repository of state assets and privatization revenues) sold off its residual shareholdings, the book value of privatizable shares held by the Fund fell from about US$2 billion to US$ 0.7 billion. After further sales in 1998, the large scale privatization program was nearly complete, with the book value of total assets privatized amounting to almost US$10 billion. At the end of 1997, less than three percent of Slovak enterprises (by number) were publicly owned (by State or municipality) and the private sector accounted for 75 percent of GDP.[36] This three per cent comprises 32 percent of firms providing non-market services, *e.g.*, education, health and social services, three percent of firms engaged in market production (less than five percent in agriculture, less than three percent in industry), and one percent of firms providing market services.[37] Eighty percent (by number) of medium and large enterprises have been privatized (*i.e.*, 50 percent or more of the firm's equity is in private hands), and the share of

34 Strong, Louise A., Reiner, Thomas A., and Janusz Szyrmer. Transitions in Land and Housing: Bulgaria, the Czech Republic and Poland, New York: St. Martin's Press, 1996: 104.

35 NATO Colloquium. "Privatizing the Slovak Economy: Legislative Framework and Development." 1995. Available: http://www.nato.int/docu/colloq/1995/95-14.htm

36 European Bank for Reconstruction and Development. Transition Report 1998. 1998: 189.

37 Organization for Economic Co-operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 88.

assets privatized at the end of 1997 exceeded 60 percent.[38] The National Property Fund and other Ministries still manage companies in those sectors excluded (so far) from the privatization process, including utilities, the postal service, telecom, railways, some agriculture enterprises, several large banks, and some large enterprises in the machinery sector--particularly those involved in armaments production.[39] It is likely that the scope of exemptions from the privatization process will be reduced significantly in the near term as the new government amends the 1995 "Strategic Enterprise Act" to cover only natural monopolies, *e.g.*, gas and electric utilities.[40]

We note that the second wave of large-enterprise privatization did not proceed without problems. The direct sales process suffered from a lack of transparency and fairness in the timing of sales, the choice of buyer, and the terms and conditions of sale. This effectively precluded foreign investor participation. The new government, having recognized the possible adverse effects on the industrial sector, is actively reviewing the terms and conditions of some of the privatizations that occurred under the previous government. Where a privatization is found to have been illegal, it may be reversed in part or whole.[41]

Land transfers into private hands and the privatization of agriculture essentially are complete. In urban areas, land conveyed with the property attached to it, as the property was either sold or returned to its rightful owner. In rural areas, collectives were transformed into cooperatives, as land owners, who had retained nominal title to, but not the right to use, their land during Communist rule, regained user rights over their land. The significant effect of these transformations was not so much a real one as it was a legal one--although many of the people actually farming the land remained the same, the transformations reestablished meaningful private property rights and in many cases changed the relationship between land owners and land users from a social one to a legal/contractual one.[42] These cooperatives and (private) individual farms now account for approximately 80 percent of cultivated land in the Slovak Republic, with State-owned firms (which the government intends to privatize) accounting for the remaining 20 percent.[43]

(5) *The extent of government control over the allocation of resources and over price and output*

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38 European Bank for Reconstruction and Development. Transition Report 1998. 1998: 189.

39 Id. at 188.

40 Economist Intelligence Unit. Country Profile: Slovakia. Mar. 22, 1999: 25.

41 European Bank for Reconstruction and Development. Transition Report Update. Apr. 1999: 43.

42 NATO Colloquium. "Privatizing the Slovak Economy: Legislative Framework and Development." 1995. Available: http://www.nato.int/docu/colloq/1995/95-14.htm

43 Economist Intelligence Unit. Country Profile: Slovakia. Mar. 22, 1999: 19.

decisions of enterprises.

In 1991, before the breakup of the Federation, the vast majority of prices in Slovakia were liberalized. At the end of 1997, there were price controls on a limited number of goods and services, primarily for household consumption, covering such items as energy products, utilities, rents, and some public services. These controls are being gradually phased out over time. For example, in early 1999, household electricity prices were increased 50 percent-100 percent; heating prices went up by 21 percent; water prices were increased by one-third; and gas prices were increased 50 percent-80 percent.[44] Interest rates have been fully liberalized[45] and are set by commercial banks on the basis of the discount rate and reserve requirements established by the NBS. The NBS has strictly adhered to a tight monetary policy that has served Slovakia well in dampening inflationary expectations and stabilizing the exchange rate during the transition process. The NBS has resisted efforts to weaken its authority and undermine its independence, having survived several attempts to "reign it in" by past governments not happy with its tight monetary policies.[46]

Land rights are fully transferable, except to foreigners.[47] Moreover, as discussed above, virtually all agricultural, service, and manufacturing enterprises are in private hands, and it is the private sector that now allocates resources throughout the economy. This is made evident by the increase in the number of Slovak enterprises, the reduction in average firm size, inter-sectoral changes in employment and output, and the relative growth of the services sector. The OECD reports that the total number of enterprises in Slovakia increased by about 50 percent between 1993 and 1997.[48] All sectors but non-market services (*e.g.*, education, health and social work) experienced an increase. The average size of Slovak enterprises decreased by roughly 50 percent between 1993 and 1997, falling to approximately 250 employees per firm, as the number of

increased and the number of medium and large firms (which tended to be [illegible] locus of lower value-added activity) decreased. Workers are moving out of large enterprises in all sectors, with a growing share of them moving into the market services sector (*e.g.*, wholesale and retail trade, repair shops, hotel and restaurants, transport). Consequently, the share of the market services sector in GDP is now approximately 45 percent and growing.[49]

While market entries in the industrial sector have been significant, market exits have not,

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[44] Economist Intelligence Unit. Country Report: Slovakia. Jun. 1, 1999: 20.

[45] European Bank for Reconstruction and Development. Transition Report 1998. 1998: 189.

[46] Economist Intelligence Unit. Country Profile: Slovakia. Oct. 8, 1998: 8.

[47] European Bank for Reconstruction and Development. Transition Report 1998. 1998: 189.

[48] Organization for Economic Co-operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 88-92.

[49] Id. at 37.

despite the large number of money-losing or insolvent enterprises. These enterprises, which are insolvent primarily because of their inability to cover government tax payments and inter-firm debt, interfere with efficient resource allocation and use. Unfortunately, bankruptcy is not yet a sufficiently real threat that would harden budget constraints or improve corporate governance. Moreover, foreign investors--with their modern production, management, and marketing techniques--are not yet present in sufficient numbers to set an example. As a result, many insolvent enterprises have no incentive or motivation to restructure or reorient their operations. Slovakia has recently strengthened its bankruptcy laws. However, despite the fact that the number of bankruptcy filings rose sharply in 1998--to 805 from 427 in 1997--few proceedings have actually been concluded due to the lack of administrative capacity of the court system.[50]

There is no indication or evidence that the government is the primary allocator of capital in the economy. First, in Slovakia and in many other developing countries, corporate debt and equity markets are underdeveloped and illiquid and, thus, are not channels through which the [illegible]. Second, the NBS and state owned commercial banks are other possible channels through which the g[illegible] control and allocate bank credit, except that: (1) the NBS, as discussed above, sets monetary policy independently of the government; and (2) bank credit plays a relatively small role, on average, in financing the investment and operating needs of industry. The OECD reports that the share of bank loans in the assets of Slovak enterprises ranges, on average, from five percent to 25 percent, reflecting two important facts. First, much of the capital needs of Slovak enterprises apparently is being self-financed or financed through the use of supplier credits (*i.e.*, inter-firm loans). Second, banks are taking whatever deposits they can obtain and are investing them in high-yield, short-term government securities. Many Slovak citizens are electing to invest part or all of their savings not with the banks, but in new business ventures. The high yields reflect both the Central Bank's tight monetary policy and the government's fiscal deficit. The spread between these yields and the interest banks pay out on deposits is large and has allowed banks to build reserves and provisions to cover their bad debts.[51] Banks are willing to lend to Slovak enterprises, but there are not many takers at the high lending rates.

(6) *Such other factors as the administering authority considers appropriate.*

There are signs that a growing number of people in Slovakia realize that political freedoms and the rule of law are critically important for achieving long-term economic prosperity. Indeed, the most recent elections suggest that this realization is shared by the majority of the Slovak population. The consequent strengthening of political freedoms and the rule of law in Slovakia can only serve to deepen and bolster the economic freedoms that necessarily underlie a market

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50 Economist Intelligence Unit. Country Report: Slovakia. Jun. 1, 1999: 25.

51 Organization for Economic Co-operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 75.

economy.

The transition process ongoing in Slovakia has been aided by the existence of a compulsory, well-developed social security system, including health, unemployment, and pension benefits. Employees contribute 12 percent of their wages to social security, while employers contribute an additional 38 percent.[52] Such a safety net makes it easier to absorb the social adjustment costs of restructuring and transformation, which, in turn, reduces resistance to economic reforms that must be implemented.

Slovakia is a founding member of the World Trade Organization ("WTO") and has assumed all obligations and commitments that such membership requires. As a participant in the Uruguay Round of multilateral trade negotiations, Slovakia significantly reduced its trade-weighted average tariff rate and bound 100 percent of its industrial tariff lines, resulting in a post-Uruguay Round average tariff rate of just under four percent. The Uruguay Round helped to consolidate and institutionalize the broad range of trade reforms Slovakia had undertaken to date.[53]

The September 1998 elections put a four-party coalition government into power, as well as a new Prime Minister. This coalition government has demonstrated a strong commitment to economic and democratic reform. As a result, Slovakia appears again to be on the fast track to EU membership.[54] Likewise, the OECD has indicated that Slovakia may be ready for membership by the end of 1999, provided that Slovakia develops and implements sound macroeconomic policies that hold the promise of stable growth and development.[55]

Finally, all signs are that economic activity in Slovakia is predominantly price-based and money-based.

ANALYSIS AND ASSESSMENT

Section 771(18)(B) of the Act enumerates six factors that the Department must consider in determining whether a country operates on market principles of cost or pricing structures, within the meaning of section 771(18)(A). However, the statute provides no direction or guidance with respect to the relative weight that should be placed on each factor in assessing the overall state of the economy, which implies that the Department may use discretion in its evaluation, based upon unique facts in each case. We note at the outset that each of the six statutory factors discussed is framed in terms of the *extent* of government intervention, and not in terms of absolutes,

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52 U.S.& Foreign Commercial Service. Slovakia: 1999 Country Commercial Guide. Jul. 1998: 36.

53 Organization for Economic Co-operation and Development. Trade Policy and the Transition Process. 1996: 33.

54 Economist Intelligence Unit. Country Report: Slovakia. Jun. 1, 1999: 7.

55 Czech News Agency. "Slovakia May be Ready for the OECD This Year." May 26, 1999. Available: http://www.globalarchive.ft.com

suggesting that complete *laissez faire* and a perfectly competitive market economy is not the applicable standard.

As the discussion above makes clear, Slovakia has made the transition to a market economy, despite the occasional slow-downs and setbacks. First, the vast majority of prices have been liberalized and are market-determined, and tariff reductions and the convertibility of the exchange on both current and capital accounts have linked Slovak markets and prices to international markets. Second, Slovakia is open to foreign direct investment, and wages are not set arbitrarily by the government, but by the market and through a process of the collective bargaining among workers, enterprises and the government. Third, there was no large-scale devolution of control over state-owned enterprises from the central government to local governments, and Slovakia avoided the problems inherent with a "mixed economy". Instead, virtually all agricultural, service and manufacturing enterprises are now in private hands, and it is they, and not the government, that allocate resources throughout the economy. Labor is on the move, with large firms and heavy industry shrinking and the light manufacturing and services sectors growing, as individuals and firms struggle to find the best use for Slovakia's scarce resources. Finally, Slovakia has successfully integrated itself into the global community. It is a founding member of the WTO, and is close to membership in the EU and the OECD. While membership in the WTO and integration into the world economy are not themselves dispositive of a successful transition to a market-based economy, they are significant steps.

Despite the extensive privatization that has occurred to date there remain problems in Slovakia's industrial and banking sectors, such as insolvency, weak corporate governance and weak bankruptcy laws, as well as bad debts, which are hindering restructuring and efficient resource allocation and use. Nonetheless, we note that these problems are certainly not unique to transition economies. Furthermore, more than 80 percent of the bad-debt exposure of the banking sector is covered by reserves and provisions. Thus, the uncovered bad debt loss is relatively small and limited to state-owned banks, which collectively account for roughly half of banking sector assets (a share that has been falling continuously over time). Therefore, while the bad-debt problem is serious and requires attention, it arguably is of manageable proportions and does not, therefore, constitute an uncontainable threat to the system at large.[56] Similarly, although many Slovak enterprises are insolvent and losing money, many others are profitable. In fact, industry as a whole is profitable and aggregate output is increasing,[57] and, as noted above, average employment levels and average enterprise size are falling and labor productivity and exports are increasing. Slovak enterprises as a whole have reoriented themselves, diversifying away from large-scale, heavy industrial production into smaller-scale, higher value-added manufacturing and services. Although insolvency is undoubtedly an impediment to the market reform process, it does not pose a threat to the system at large. In this regard, we note that the [illegible] of bank loans in the total assets of Slovak enterprises is relatively low, ranging from five

56 Organization for Economic Co-operation and Development. Economic Surveys: Slovak Republic 1999. 1999: 81.

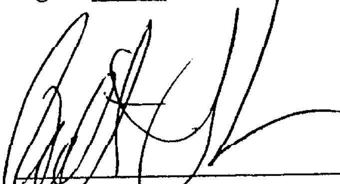
58 Id. at 94.

percent to 25 percent. This relatively small dependency of the industrial sector on bank loans suggests that the banking sector and industrial sectors problems discussed above are somewhat independent of each other.

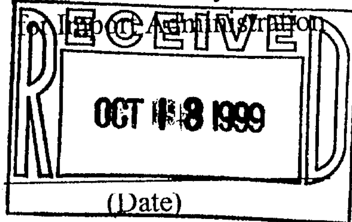
RECOMMENDATION

Based on the preponderance of evidence on economic reforms in Slovakia to date, analyzed as required under section 771(18)(B) of the Act, the Department should determine that revocation of Slovakia's non-market economy status under section 771(18(A) is warranted and that such revocation should be effective January 1, 1998.

Agree ✓ _____ Disagree _____



Robert S. LaRussa
Assistant Secretary
for Import Administration



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