

STRATEGY FOR SLOVAK REPUBLIC 1994-95

SUMMARY

SYNOPSIS

The EBRD's principal operational objectives in the Slovak Republic are as follows:

- **Support for privatisation and restructuring.** To accelerate the privatisation process while concurrently assisting the restructuring of enterprises. In this the Bank will not neglect suitable foreign partners for participation in its activities with the aim of encouraging export-oriented companies and stimulating the interest of foreign capital in the country's economy. It will also consider initiatives to alleviate the problems of corporate governance of existing enterprises by setting up investment funds.
- **Financial sector and banking reform.** To support the growth of private sector banks while upgrading banking skills and fostering competition among them. The Bank will also support the establishment of financial institutions that provide new ranges of services.
- **Support for small and medium-sized enterprises.** To pursue the task of SME development through a variety of initiatives, such as increasing the involvement of local banks in SME financing and sustaining the establishment of financial vehicles to facilitate trade. In this context, the Bank is considering a Special Restructuring Programme. It will also support where necessary the creation of new specialised financial institutions, e.g. investment funds, venture capital and leasing companies.
- **Support for public infrastructure and environment.** The efficient and environmentally acceptable supply of energy is a high priority. Also, the Bank will seek opportunities to facilitate the privatisation of public utilities. The country's strategic position in Europe will provide the Bank with the opportunity to support the upgrade and modernisation of transport and telecommunications.
- **Other initiatives.** These will consist of very selective activities in tourism, agriculture, forestry and agribusiness.

This document is based on the EBRD's Strategy for Slovak Republic, approved on 25 January 1994, which is for official use only.

STRATEGY

1 SUPPORT FOR PRIVATISATION AND RESTRUCTURING

With the indispensable support and cooperation of the government, the Bank will contribute to accelerating the privatisation process while simultaneously assisting the restructuring of Slovak enterprises. At the same time, in order to catalyse the inflow of foreign capital into the Slovak economy and to promote export-oriented companies, the Bank will not neglect suitable foreign partners for participation in its operations.

The government has committed SKK 500 million in the 1993 budget for the conversion of military industries to civilian use. This is an immensely difficult task, considering the level of specialisation of the various enterprises. The Bank, in turn, will focus its attention on a few well-selected heavy industrial plants and target them for modernisation and privatisation.

The Bank will also explore, where feasible, the possibility of participating in the conversion of a few select military industries to civilian use. Furthermore, the Bank will consider a full range of debt, equity and guarantee instruments, including the provision of construction facilities for manufacturers of heavy capital goods.

The Special Restructuring Programme (SRP) is a top priority for the Bank. The SRP is a fund with a 5-7 year life designed to provide cash and turnaround assistance and ultimately privatise up to 15 medium-sized enterprises currently in difficulties but with long-term potential. A preliminary structure for the SRP, which contemplates a cooperative effort between the Bank and the NPF, has been defined. The cooperation of the Slovak authorities is high and a preliminary framework agreement is being discussed.

2 FINANCIAL SECTOR AND BANKING

The principal objective of EBRD initiatives in this sector will be to assist in the development of sound private sector banks and to increase competition among the banks. Support for the creation of essential specialised financial institutions, management training and increasing banking skills will also continue to be among the first priorities.

In the financial sector, apart from the regional projects and agency lines available to the Slovak Republic, the Bank has recently approved an equity investment of ECU 6 million for the Slovenska Polnohospodarska Banka (SPB) and another equity investment of ECU 3 million for a JV private bank (Tatra Bank) to strengthen its capital base and increase competition among commercial banks. The EBRD has also provided technical cooperation for various institution-building projects involving the stock exchange, an export guarantee agency and a bank.

Future attention in the financial sector will mostly focus on institution building and assistance to selected commercial banks. The EBRD will participate in transactions and instruments that promote primary and secondary capital markets (via equity or debt). Cash funds for investors will be pursued and future opportunities to create equity funds will be explored. The Bank will also examine possibilities of assisting in the start-up operations for institutions such as mortgage banks, leasing and forfeiting companies, and export guarantee and insurance companies.

3 SUPPORT FOR SMALL AND MEDIUM-SIZED ENTERPRISES

Small and medium-sized enterprises are constrained due to lack of equity, capital and long-term credit for investment and growth. The Bank will address the task of SME development through a combination of initiatives, such as stimulating the involvement of local banks in SME financing and supporting the establishment of financial vehicles to facilitate trade.

The Bank will also support where appropriate the establishment of new specialised financial institutions, such as investment funds, venture capital and leasing companies.

The Bank is currently working on the identification of suitable projects, to be financed from the two regional credit lines and one regional close-end investment fund, to support SMEs in the region. The Bank is working on a further credit line facility to channel funds to SMEs through selected financial intermediaries.

4 PUBLIC INFRASTRUCTURE AND ENVIRONMENTAL SUPPORT

Transport

The Slovak Republic's strategic position in the centre of Europe provides the country with an opportunity to capitalise on the increasing international road traffic, which currently accounts for 12 per cent of total road traffic. The Bank has so far approved ECU 15 million for the rehabilitation and maintenance of E-roads. The Slovak authorities would wish future priorities for upgrading to include the east-west corridor in order to cope with the expected increase in freight traffic. Of significant economic importance will also be the upgrading of certain domestic routes, such as the road to the High Tatras tourist area and the tunnel under the industrial city of Kosice. Another bottleneck to be dealt with is the shortage of adequate reloading facilities to interlink road, water and rail transport.

The Bank is examining the possibility of investing in the construction of high priority motorway sections. It will also consider its support for the upgrading and modernisation of the railway sector in the country and is employing a consultant firm to develop a suitable project.

Energy

The Slovak Republic imports over 60 per cent of its primary energy needs. The Bank takes the view that the planning for future energy needs must be reviewed in the context of the strategy for heavy industry and in line with future energy efficiency programmes. Currently, nuclear power, as represented by the power station at Bohunice (4 x 440MW), provides half of the Slovak Republic's electricity generation, with two of the Bohunice reactors being considered "very unsafe" by the international community.

The Bank's activities in the energy sector focus primarily on the electricity subsector, particularly on improving efficiency both in supply and end-use, and on improving the environmental performance of generation facilities.

Electricity

The completion and upgrading to Western safety standards of the Mochovce nuclear power plant units 1 & 2 (2 x 440MW), which are of the Russian design type VVER 440/213, is high on the government's agenda. This project is currently under consideration within the Bank, while environmental groups and some neighbouring countries oppose it. However, other countries should support the project if the Bank's standard criteria are met. The Bank and other foreign financiers would see environmental merits and would support the project only on the condition that the two unsafe Bohunice reactors are closed down on completion of Mochovce 1 & 2. Clearly, this would be a complex project which would require an extensive analysis of many different factors including available alternatives and their cost, safety and environmental impact.

Even if the growth in electricity demand is assumed to be low as a result of tariff increases and other measures to improve end-use efficiency, there will be a need for additional generation capacity for the following reasons:

- part of the production resulting from Mochovce is likely to be exported
- the country wants to become more independent of power imports
- some inefficient and highly polluting coal-fired generation units are scheduled to be closed.

Therefore the Bank is considering its participation in financing the Bratislava 2 project, a 200MW combined-cycle gas turbine (CCGT). As this plant will not be operated by SEP, the utility which owns most of the country's generation capacity, the Bratislava 2 project fits into the Bank's strategy to create competition in power generation.

Other steps such as the increase in energy tariffs and the joining of the Vienna Convention on Nuclear Liability are strongly supported by the Bank. The creation of a regulatory framework in the energy sector will facilitate foreign investment and is therefore strongly recommended.

While it is recognised that tariffs reflecting economic costs are the best means to improve electricity end-use efficiency, the Bank is considering a line of credit for a demand-side management (DSM) programme in this subsector.

Natural gas and oil

The Bank is currently supporting World Bank initiatives for studying the upgrading and rehabilitation of the SPP pipeline (Brotherhood) system. Similarly, the Bank is liaising with Transpetrol (trans-Slovakia oil pipeline) as to its rehabilitation needs in 1994.

Telecommunications

Aware of the critical importance of telecommunications for overall economic development, the government aims, by the year 2000, to achieve quality of service levels roughly comparable with west European countries and to double the penetration rate.

In order to achieve these targets, the government has embarked on an ECU 430 million modernisation and expansion programme for the period 1993-95. Part of this investment programme is financed by the EBRD (ECU 44 million), the World Bank and the European Investment Bank. The Bank has also financed an ECU 6 million private

investment (joint venture) project (Eurotel Bratislava) for a mobile telephone system. The Bank's intervention in this sector will be provided primarily through the support of privatisation.

The Bank intends to carry out the following initiatives:

- investment in local telecommunications networks by way of limited-recourse financing techniques. The Bank would arrange a syndicate of lenders and other investors and take direct participation.
- investment in ST (the fully state-owned main provider of telecommunications services in the Slovak Republic) in the form of convertible preference shares, equity warehousing or other hybrid instruments. This investment would be conditional upon the government going forward with the privatisation of ST through the sale of an equity stake to a strategic investor, and adopting a regulatory and tariff-setting mechanism. This investment would improve the accessibility and quality of telecommunications services, improve ST's capital structure and financial situation, and promote privatisation by enhancing the attractiveness of the company to potential investors.
- investment in private telecommunications projects involving the development of value added services.

Environment

Considering the priority given to the environmental situation in the Slovak Republic, the Bank will consider a few fundamental projects for possible financing. Consequently, the Bank is developing a project to finance the upgrade of safety measures at Mochovce Nuclear Power Plant and bring it up to Western standards.

In the environment sector, the Bank has identified a project as potentially viable: a loan for the financing of the renovation and expansion of a waste-water treatment plant for Istrochem, a leading state-owned chemical enterprise. Together with USAID the Bank will participate in project preparation and later possibly in co-financing.

The Bank is also working on the Danube River Basin Environmental Programme, which may result in a possible loan to the Slovak Republic and neighbouring countries.

Other environmentally related activities will be conducted together with the municipalities.

5 OTHER INITIATIVES

Tourism

The Bank will thoroughly evaluate the possibility of participating in the financing of a business hotel after considering, among the usual elements, present and future volume of business travellers as well as availability of suitable lodging. In addition, the Bank should consider the indirect support of small-scale initiatives via credit line facilities and explore possible involvement in real estate development, in Bratislava, for the newly established expatriate community (i.e. diplomats and businessmen).

Agriculture, forestry and agribusiness

The World Bank is currently appraising a forestry project which would aim at ensuring optimal management of forest resources in the Slovak Republic. The feasibility study undertaken by the World Bank has identified a number of investments in wood processing enterprises. A feasibility study would need to be undertaken to complete the information already collected by the World Bank and the EBRD could eventually envisage an operation to support investment in the sector. This study could also help in identifying potential investors.

COOPERATION WITH OTHER IFIs

World Bank

The World Bank approved a US\$ 55 million loan to finance part of the 1993-95 telecommunications development programme. This project is co-financed with an ECU 45 million loan from the EIB and an ECU 44 million loan from the EBRD.

European Investment Bank (EIB)

In April 1993, the EIB advanced ECU 10 million to improve the European E-road network with the Slovak Republic while the EBRD assumed a parallel loan. In June 1993, the EIB approved a loan for ECU 45 million to Slovenske Telekomunikacie to finance the expansion and modernisation of the Slovak telecommunications network. This loan is a part of the 1993-95 joint investment programme of the EIB, the World Bank and the EBRD.

European Community (EC)

For private sector development financing, there are plans for the creation of a special restructuring investment fund with the participation of other IFIs (such as the EBRD). The PHARE programme, through its agreement with the EBRD (Bangkok Agreement), also finances some of the Bank's technical assistance projects.

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