

**Deloitte &
Touche**



***Ministry of the Economy of
the Slovak Republic***
Report of Elliot Berg's Meetings

**Delivery Order No. 15
Project No. 180-0014
Contract No. EUR-0014-I-00-1056-00
Eastern Europe Enterprise Restructuring and
Privatization Project**

**U.S. Agency for International Development
EUR/RME**

October 14, 1992



14 October, 1992

Dipl. Ing. Ľudovít Černák, CSc.
Minister
Ministry of Economy of the Slovak Republic
Mierová 19
827 15 Bratislava

Dear Mr. Minister,

The accompanying report has been prepared by Mr. Elliot Berg as a result of his recent meetings in Bratislava, during the period 29 September to 3 October 1992. Mr. Berg is the economist who came to Bratislava for a short but intensive series of interviews with representatives of your Ministry as well as various other people who are responsible for a broad range of economic and business oriented issues. A list of the people he met with is included as Appendix I to his report. Mr. Berg had hoped to meet personally with you to discuss the economic issues you have identified; unfortunately, such a meeting was not possible due to your conflicting travel commitments.

This work was conducted as the initial phase of the ad hoc economic advice requested by your Ministry, in your letter dated 12 August 1992 to US AID, Bratislava. The primary purpose of his meetings was to more clearly define and understand the nature of the economic advice being requested, based on his extensive experience in delivering such technical services throughout the world, and also to identify specific ways he felt such assistance could be most appropriately delivered, within the resources available under Delivery Order number 15.

The results of this initial phase is now being used to identify and recruit the best qualified economist to provide the additional assistance to the Ministry of Economy of the Slovak Republic, for the remainder of this project. We anticipate that this person will be available within the next few weeks, and will come to Bratislava for a period of at least

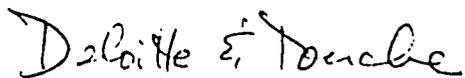
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four to six weeks. We will try to arrange a personal meeting with you early in his schedule.

After you have had an opportunity to read this report, please do not hesitate to contact Mr. Mel Mraz in Bratislava if you have any questions or would like to discuss this assignment. We are also delivering a copy of this report to Ms. Patricia Lerner, U.S. AID Representative in Slovakia.

On behalf of Mr. Berg and the Deloitte & Touche personnel working with him, we would like to take this opportunity to thank you, your staff and all the other individuals who they met with for the time and courtesies extended to them.

Sincerely,

A handwritten signature in cursive script that reads "Deloitte & Touche".

Deloitte & Touche

TO: Pat Lerner, USAID Representative, Bratislava
Mel Mraz, Deloitte and Touche, Bratislava

FROM: Elliot Berg, Development Alternatives, Inc.

DATE: October 3, 1992

REPORT OF MISSION FOR DELOITTE & TOUCHE
UNDER U.S. AID DELIVERY ORDER No. 15

1. According to an agreement between USAID and the Slovak Ministry of Economy, USAID is to provide, through the Deloitte & Touche IQC, 120 days of "ad hoc economic advice" to the Ministry of Economy. This was a successor agreement to one made with the previous government for 200 days of such technical assistance. My mission is undertaken as part of this agreement.

2. My terms of reference were to meet with officials in the Slovak Ministry of Economy and other economic agencies to determine what specific kinds of economic advice were being sought and how they could be most appropriately delivered. I interpreted my task to mean the identification of needs for macroeconomic or general economic policy advice. This is the way it was defined in early correspondence between Deloitte & Touche and DAI. And this was, in any case, what most of our Slovak interlocutors understood.

3. I was in Bratislava only from September 29 to October 3, 1992. Any observations based on so short a stay have to be tentative, to say the least. However, thanks to strong support by the local Deloitte & Touche office and help from USAID, I was able to meet a broad sample of officials in the economic agencies and others with relevant interests: the State Secretaries (the second in command) in the Ministries of Economy and Finance; most of the relevant department heads in these two ministries and key Section Heads; two vice-rectors and professors at the Economic University; the Director of the Economic Policy Department at the Prime Minister's Office and also a broad sample of the aid/technical assistance community in Bratislava. (A list of people met is appended as Appendix I). I benefitted also from a number of new studies and

reports that I found in Washington, at the World Bank and the Institute for International Economics -- one on trade policy in Czechoslovakia, for example, a second on a survey of small and medium enterprises, and a third which is a new book comparing reform experiences in Central and Eastern Europe. These documents are available for review at Deloitte & Touche's office in Bratislava; they can be provided to the Ministry if you would like them for your use.

4. I tried in these few days to explore the need for economic advice at two levels. The first is the most immediate and direct: what kind of ad hoc economic advice to provide, as requested under the Work Order. The second is related, but more fundamental: what is the present government capacity in economic policy analysis, economic policy making, and economic management, and what are broad medium and long-term needs in these areas?

5. These are obviously very large questions, and time constraints quickly forced my inquiries back to the urgent short-term issue of how to help in the next few months. Nonetheless, the short and longer-term issues often overlapped, and it's worth putting down some impressions about the broader issues.

6. First, in my opinion too little attention is being given to strengthening of policy analysis capacity and policy making procedures, and to overall national economic management. Relations with Prague on the one hand, and privatization programs on the other, have absorbed most analytic and public sector management energies. But like all new states, and especially like the new states to the East, Slovakia urgently needs to build capacity in public sector management -- for example in the management of foreign assistance, debt, and public expenditures (especially public investments). Civil service reform and rationalization of relationships between state enterprises and the state budget and between state enterprises also demand attention, economic policy-making procedures and agencies need to be rationalized, and training in policy analysis has to be speeded up, both in universities and on-the-job.

7. Without a lot of effort in these areas the country will easily fall victim to bad policies and massive failures in policy and program implementation, which will slow and distort the transition to a free market system. As everybody knows, a smooth and efficient transition to a market economy requires more informed and delicate government interventions, more reliance on prices and indirect market based instruments, not heavy-handed and ill-informed actions using direct controls.

8. Introduction of better policy analysis and policy making systems will be extremely difficult in the near term, even were it given more attention.

- There are few economists in the relevant economic agencies. Of 380 total staff in the Ministry of Economy, perhaps 40 are "economists". The Economic Strategy Department in the Ministry of Economy, the present center of economic analysis work in that ministry, has a staff of 10 people, two of whom stake a claim to being economists, and only one of whom has significant training in macroeconomics or market economics. And she is the director of the department hence not available for front-line analytic work.

- The salary structure in the public sector provides little incentive to hard work, acceptance of responsibility or job commitment. Professional economists and other analysts earn only a few hundred dollars a month. As the private sector and a donor presence expand, this will become increasingly uncompetitive, driving the best people from the civil service. The private sector will benefit, but government management of public resources and public policy making will be crippled. Training and technical assistance programs aimed at making things work better in the public sector will have little durable effect.

- The administrative agencies seem to be highly politicized.

- Big jurisdictional disputes are simmering, based on bureaucratic as well as political factors. The Ministry of Foreign Affairs, for example, is staking out claims to handle foreign assistance, foreign investment and trade policy and various other areas. All the economic ministries are setting up or beefing up privatization units with intent to exercise closer control over privatization decisions.

- Uncertainty about what will be the relationship with Prague will hold back action on some key fronts.

- In some ways most important of all, there is a great scarcity of sensitive and knowledgeable analysts of policy options in market economies. The economic administration of Slovakia is filled with many very able people, including many with strong training. But those who call themselves economists seem to be mainly engineers. The bulk of those over 30 were trained in the old Marxist, literary tradition. Market economics was taught as part of the history of economic thought. Even those who received the more modern, rigorous and practical quantitative training are not well-equipped by this training for policy-relevant analytic work in economics. The reason is

that they concentrated on such tools as input-output analysis and operations research. These are useful, even powerful techniques. But they that give little or no role to prices or price behavior. They encourage a "fixed coefficients" perspective. So, rather ironically, even the best trained graduates in economics and related fields may not be disposed by that training to do down-to-earth policy analysis relevant in a market economy.

9. The seriousness of the problem of inadequate policy capacity is recognized, and according to Mr. Kozlik of the Prime Ministers's Office, they are planning to do something about it. In the present circumstances, he says (echoing others we talked to) there is no institutional home for policy thinking. Most of this thinking used to be done by the State Planning Commission, and it was done competently, whatever the faults of that agency. The MOE is too weak to carry that kind of activity forward. Mr. Kozlik says planning is underway to create a new organization, the Center for Strategy Studies of the Slovak Republic. This will be a think tank staffed by about 30 first-class analysts. He says it should be set up soon -- perhaps in a month, though it will be staffed gradually. It will be given contracting capacity, so some ability to self-finance, and will provide much better than civil service salaries. This seems like the right concept for a future policy analysis institution. It's a natural for USAID support at some stage.

10. Now to conclusions and recommendations about the short-term technical assistance to be provided. First of all, it's evident, as noted above, that there is a real need for economists' services, both in the government generally and in the Ministry of Economy in particular. The small numbers and uncertain training of the cadre of economists now available to the Slovak government has been noted. The output of analytic studies, reports or memoranda seems extremely slight. Everywhere we went I asked for examples of economic policy analysis or policy relevant studies. The university researchers said there were many such studies, but I did not see a list. And within the government the closest example cited was an Austrian government financed study in June 1992 that models the Slovak economy and does some output projections.

11. Everybody we talked with agreed that an economic adviser could be helpful and would be welcome. Enthusiasm for the idea varied, as might be expected, and numerous caveats or hesitations were expressed. Most enthusiastic was Mme. Sajtlavova, head of the Strategy Department in the MOE. She's the one most under the gun to produce a "Revitalization Strategy" and she expressed the most focussed set of needs that an economic adviser might meet -- notably in the areas of data generation and accessibility and in industrial policy. The Ministry of Finance people were also quite enthusiastic about the potentials of this kind of technical assistance, even though they are not directly involved at present.

12. More guarded was Mr. Lelovsky, the State Secretary and Section Head at the Ministry of Economy, who is probably the most senior official our adviser would have access to. Also, some officials expressed doubts about the efficacy of technical assistance in general. Many worried about language problems and consequent communications difficulties. Mr. Kozlik expressed skepticism based on his experience with advisers in the Anti-Monopoly agency, where he worked some time ago. He said the US advisers at that time (not those that are now in place, about whom he knows nothing) were too isolated, and not aggressive enough in proposing policy actions. (He cited a case of anti-trust policies in the energy sector which the Slovak officials learned about only during an internship in the US.)

13. To be effective, the work of any advisers would have to be "concrete". This idea came up all the time. The new State Secretary in the Ministry of Finance said several times that the problem with technical assistance/ advice is that it is usually too general. Perhaps they are worried that economic advice means production of abstract papers. Maybe they've been burned in the past. But at the same time they want the adviser to be technically competent, familiar with the modern analytic tools. Several people said it would help if he/she had some formal credentials to impress local skeptics - some articles published in journals for example. And the adviser will need sterling personal qualities to be effective in this setting: flexibility or adaptability, for example, because things are changing so much and so fast in Slovakia; and patience, accessibility, and enthusiasm. All this and the ability to write clear prose too.

14. The interviews revealed some confusion about what economists do and what economic policy advice is about. When I asked what they thought the proposed short-term economic adviser (we mostly used the term "macroeconomic adviser") should work on, the answers mostly entailed program definition more than economic analysis. For example, several people said he ought to work on industrial reconversion, others on programs to absorb the unemployed. I suggested that while these are legitimate tasks, the economist's special abilities lie more in defining appropriate policy environments than in developing program interventions. State Secretary Lelovsky clearly grasped this distinction, and he liked it.

15. The draft "scope of work" for the adviser, which was prepared by the Foreign Trade and Investment Department (or Service) of the MOE (Chief: Mme. Repcekova), reflects this confusion (attached as Appendix II). Three tasks are specified for "the US A.I.D. Financial Expert". The first is "Macroeconomic relations of the state economic policy", which consists of a long list of concepts or statistical notions like gross national product, industrial price index, unemployment, "aspects related to regional development" and so on. The second refers to "Government industrial policy" and sub-

lists some rather vague ideas (e.g., "process of industrial restructuring"). The third task is "Systems of government support of exports".

16. It was obvious, after a couple of hours' conversation with Mme. Repceková, that what she mainly wants from our economic adviser is help in designing more effective programs of export promotion. The head of the Economic Strategy Department (or Service), Mme. Sajtlavová, has something different in mind. While she also sees the adviser as helping on the economic statistics/data management problem, she wants to perfect the "revitalization policy" paper that is already in draft, and --most important-- help on industrial policy.

17. The senior official in the MOE (State Secretary Lelovsky) defines the adviser's task primarily in terms of industrial strategy. He would like to know in which sectors and subsectors Slovakia's industrial comparative advantage lies, what are its future niches in world markets. The Slovak industry produces too broad a range of outputs --too varied a mix of machinery for example. It has to specialize more. But in what?

18. This description of the adviser's task made me nervous, on several counts. It's too ambitious, even if it is regarded as the opening round of a more intense and longer term series of consultations. I don't know where we can find an analyst of such power and competence that he can satisfactorily meet such a challenge. And anyway, this definition of future comparative advantage is the job of entrepreneurs, local and foreign, and not bureaucrats and economists. Our job is to clear the path, to create the right policy environment and incentives and then get out of the way, allowing entrepreneurs and capitalists to discover opportunities we never dreamed existed. (When I said this to Mr. Lelovsky he replied rather drily that was so, but government had better access to information -- which may be true at this point.)

19. In any case, from these various expressions of need comes a fairly clear and consistent scope of work for our short-term economic adviser. Here's the way it looks.

1. The adviser should be a general economist with good command over macroeconomic and microeconomic analytic tools. Experience in advisory work in developing countries or Eastern and Central Europe would be highly desirable. Knowledge of Slovak or a related language (Polish, Russian) highly desirable; German competence useful. Experience or specialized knowledge of industrial policy or trade policy desirable.

2. The adviser will be resident in Bratislava for a period of approximately three months, starting as soon as a suitable candidate can be identified.

3. The adviser will undertake the following tasks:

(a) He/She will make a rapid assessment of the adequacy of existing arrangements for acquisition and dissemination of economic statistics and related information in the Ministry of Economy. If this quick review indicates the need for revision and strengthening of these arrangements, the adviser will draft terms of reference for a study by a specialist in economic statistics and information management. The study, if needed, should be action-oriented; it should include a detailed plan of action to remedy observed deficiencies.

(b) The adviser will assist the staff of the Foreign Trade and Investment Department of the Ministry should they decide to undertake an evaluation of existing policies and institutions for export and investment promotion. This evaluation would presumably be in the nature of a rapid assessment, aimed at synthesizing existing studies and reports, identifying major problem areas and providing a foundation for future analyses of greater depth.

(c) The adviser will examine existing data and analyses for the industrial sector, and determine what guidance they give for determining Slovakia's comparative advantage in industrial production. Some Slovak officials believe that the country's industrial sector produces too broad a range of outputs – too many types of machinery for example. It is therefore not sufficiently specialized to be competitive in world markets. The adviser will assess the validity of this and other prevailing views on industrial policy, defining the scope of work for any further studies that might be called for.

(d) The adviser will be available for consultation with staff of the Ministry of Economy, and will attempt to perform such ad hoc assignments as may be given by the Minister or the State Secretary. But given the adviser's heavy set of specific tasks, it is unlikely that time will be available for more than a few such assignments.

(e) The Minister of Economy will determine the specific unit within the Ministry to which the adviser will be attached. The most appropriate location would seem to be the State Secretary–Strategy Section Head's office (Mr. Lelovsky). Otherwise the Department of Strategy (Mme. Sajtlavova) would be a second choice.

(f) It is expected that the Ministry will provide office space, and adequate interpreter and translator assistance.

Ad hoc economic advise to Minister of
Economy of the Slovak Republic
Mr. L. Černák.
Eliott Berg and Pavol Lančarič
/US AID Delivery Order # 15, Sept. 29 to
Oct. 2/.

Date: Tuesday, Sept. 29

10:30 Ministry of Economy, meeting with Mrs.
Repčeková, Head of the Department of Foreign
Trade Services.

Issues: Organizational structure of the Ministry of
Economy. Main problems the Foreign Invest-
ment Department faces. Foreign trade servi-
ces handling.

13:00 Ministry of Finance, meeting with Sector
Chief Magula, Department Directors Bónová,
Melicher, Malovec and Pichoňsky

Issues: Need of assistance in setting up National
Bank of SR, new institutions dedicated to
strategic analysis and macroeconomic policy.

16:00 EC PHARE Office, meeting with
Mr. A. Farauo, D. Coleman

Issues: Structure and scope of work done by the
EC PHARE Office, experience of EC PHARE
staff with governmental officers, main plans
for future. Main orientation of EC PHARE for
enterprises restructuring.

19:30 Dinner with Ms. Patricia Lerner, U.S. AID
Representative for Slovakia

Date: Wednesday, Sept. 30

8:00 Meeting with Colin Adlam, EC PHARE advisor
to Slovak National Agency for Foreign
Investment and Development

10:00 Meeting with Mrs. Šajtlavová /Head of
Strategic Dept./, Mr. Mišík - MOE SR

Issues: Main steps of the new government, competence
problems with the Foreign Affairs Ministry
regarding the role in foreign economic

affairs management. Need of assistance in establishing of information center, transformation of the Ministry, economic and industrial policy analysis.

16:00 Meeting with Roderick Marshall, SS&D attorney in Bratislava.

Issues: Experience in legal affairs advising to Slovak companies with western partners.

Date: Thursday, Oct. 1

7:30 Meeting with Leighton Klevana, representative of Czech & Slovak American Enterprise Fund in Bratislava.

10:00 Meeting with Mr. Lelovsky canceled. Discussion with Mrs. Šajtlavová and Mr. Zaťko.

13:00 Meeting with Jeff Silverberg, Head of The Entrepreneurship Center, Bratislava.

14:30 Meeting with M. J. Moltenbrey, foreign adviser at the Slovak Anti-Monopoly Office, from U.S. Department of Justice

Date: Friday, Oct. 2

8:30 State Secretary at the MOE Mr. Lelovský.

Issues: Need of assistance with setting up new strategic center of the government to replace the existing Governmental Commission for Economic Strategy. Need to change existing, very large assortment of the industry branches in Slovakia.

10:30 Vice-rectors of Economic University J. Stern and Mr. Husár, prof. Sojka.

Issues: Recent stage of economic research in Slovakia, particularly at the University. Foreign cooperation of EU.

12:00 State Secretary at the MOF Mr. Masár.

Issues: Hectic situation in Slovakia. Economically best solutions may not be always acceptable.

Federal parliament refused Act on forms of CSFR division into two sovereign republics, problems in continuing necessary works.

14:00 Head of Government Office Economic Dept.
Sergej Kozlík

Issues: New center for strategic studies. Education of governmental advisers in foreign countries. Scope of work and approach of the Department. Use of analytic advise and assistance from Austria. Coordination of activities of the Slovak economic ministries.

MINISTRY OF ECONOMY
OF THE SLOVAK REPUBLIC

Foreign Trade Service and Investment

Špitálska 8
811 02 B r a t i s l a v a

Program Proposal for US A.I.D. Financial Expert

We propose following subjects and themes to discuss:

1. Macroeconomic relations of the state economic policy

- identification of basic characteristics of Slovak economic policy and defining how they should be monitored using software program from developed countries;
- gross national product;
- gross domestic product;
- industrial price-index;
- retail price-index;
- retail sales: (consumption)
- investment; (capital investment);
- unemployment;
- process of revitalizing the economy situation particularly the method;
- aspects related to regional development;
- measures of central economic policy and measures for regional development;
- strategic planning of regional development;

2. Government industrial policy

- process of industrial restructuring;
- relationship with regional and economic policy;
- measures and methods of government industrial policy;
- process of privatization and its effect on industrial restructuring

3. System of government support of exports

- aspects of export support.
- process of selection; criteria for selection, export development policies.