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FOREIGN EXCHANGE POLICY IN SLOVAK REPUBLIC

1. CREATION OF CONVERTIBILITY OF CZECHOSLOVAK CROWN

The Creation of convertibility of Czechoslovak crown and later the creation of convertibility of detached Slovak crown started immediately after the admission of Czechoslovak Federal Republic (CSFR) into the International Monetary Fund (IMF) in accordance with certain engagements which resulted from the completion of Agreement about IMF. Continual removing of foreign exchange restrictions and forming of foreign exchange market as well as forming of united, one-tier foreign exchange rate lead to the liberalization of foreign exchange policy and to establishment of internal convertibility of Slovak crown.

After the separation of CSFR and also the separation of Czechoslovak crown into Czech and Slovak crown, independent management of foreign exchange policy begun in both successive states. External convertibility of Slovak crown for current account of balance of payment was established on 1. October, 1995, which meant that the requirements of IMF on the convertibility of currencies in the member states were met. IMF requires external convertibility for current transactions, but not for capital transactions from its members.

Slovak Republic continued further in gradual liberalization of foreign exchange economy which is legally provided in the foreign exchange act. With respect to the formation of market environment, integrative objectives, and with respect to the level of monetary and fiscal instruments, Slovak

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Republic proceeded in system of liberalization of long-term financial relations at first and then short-term capital flows and consequently financial derivates will also be gradually liberated.

Presently the covertibility of Slovak crown is adapted by the act num. 202/95 of Statute-book, its amendation num. 45/98 of Statute-book, act num. 388/99 of Statute-book and other decrees and measures of National Bank of Slovakia and the ministry of finance. The goal of these amendations was to harmonize our foreign exchange act with the conditions in OECD countries and to approach the legal regulation in the European Union.

The philosophy of foreign exchange act generally allows in-landers and foreigners to engage themselves to the abroad, fulfill the liabilities that come from these engagements, acquire foreign exchange values and property in the abroad, acquire fixed assets, import and export finances in Slovak and in foreign currencies, if this act does not state differently. And this act just does state differently in the next 12 paragraphs. To explain, this act states the cases in which foreign exchange allowance (foreign exchange licence) and concessionary licence are needed.

Foreign exchange restrictions mainly refer to the obligation of transfer of finances to in-land which the in-lander obtained in abroad. It is so called transfer obligation. Furthermore, foreign exchange restrictions also refer to trading with foreign exchange values, operations with internal securities, operations with financial derivates, accepting and providing of financial credits from and to abroad, acquiring of fixed assets by foreigners in in-land, acquiring of fixed assets by in-landers in abroad, investing in abroad, securing liabilities of in-landers in abroad.

In order to establish full convertibility of Slovak crown, in accordance with the requirements of the European Union, it will be necessary to carry out further liberalizing steps, particularly:

a) providing of financial credits to foreigners by in-landers:
   - with the period of expiry longer than 1 year but shorter than 5 years,
   - with the period of expiry shorter than 1 year.
b) accepting of financial credits from foreigners by in-landers:
   - with the period of expiry longer than 1 year but shorter than 3 years,
   - with the period of expiry shorter than 1 year.
c) obtaining of fixed assets by non-residents in Slovak Republic (some exceptions are already allowed nowadays) and other way round-obtaining of fixed assets by in-landers in abroad.
d) freeing investment in abroad, including indirect investment (except direct investment in OECD, which have already been freed).
e) liberalizing of the operations with in-land securities in abroad.

f) liberalizing of the terminable operations with financial derivates.
g) disestablishment of transfer obligation and other foreign exchange restrictions in trading with foreign exchange values (foreign currencies, foreign securities, gold, and their derivates).

Concerning the "on the stocks" admission of Slovak Republic into the European Union, it will be very difficult to liberalize capital flows completely, especially to enable purchase of fixed assets by foreigners in in-land. The government contemplates a continual liberalization of purchase of fixed assets by foreigners in in-land so that the purchase of flats and other fixed assets will be liberalized within 5 years and the purchase of woods and agricultural ground within 10 years. Their immediate liberalization might lead to an extreme rise in the price of fixed assets, which will negatively affect home subjects. Therefore, Slovak Republic will ask the European Union for an exception.

Slovak Republic is facing a current task of gradual establishment of external convertibility on financial and capital account of balance of payment, which will remove foreign exchange restrictions as the result. It will also expand the environment for undertaking of Slovak economic subjects in abroad and for undertaking of foreign economic subjects in Slovakia. Therefore, Slovak Republic is considering another adjustment of foreign exchange act.

2. FORMATION OF FOREIGN EXCHANGE RATE OF SLOVAK CROWN

One of the conditions in order to introduce full convertibility of crown is most of all an appropriate system of foreign exchange rate, satisfactory international liquidity (foreign exchange reserves), and successful macroeconomic policy.

Macroeconomic policy should provide price stability and competitive revenues in domestic currency to prevent massive monetary substitution. So that domestic economy is protected from waves of monetary substitution and from speculative pressures, a realistic foreign exchange rate and satisfactory international liquidity are inevitable.

In the international economy there were times, when exchange rate systems of particular countries were generally the same and the countries followed similar principles for formation and management of foreign exchange rates. During Brettonwood monetory system, IMF was using coercive measures to supervise currencies of its member states because its approval before any change of parity was absolutely inevitable. After the agreements in Kingston in 1976 and after the second amendment of statutes became valid, the member states were not subjected under the supervision of the fund in matters of their own foreign exchange policy.

Countries can more or less make their own decision whether they will apply fixed system of foreign exchange rate or floating system of foreign exchange rate. The return to certain unification in international standard is improbable in the foreseeable future. But we can still encounter opinions that call for renewal of fixed foreign exchange rates.

In addition, the countries can choose the method of derivation of exchange rate from another national currency, from national monetary basket, from SDR, from ECU, from the demand and supply of certain currency. Statutes of IMF forbid the derivation of foreign exchange rates from gold parity.

Slovak Republic was using the system of fixed foreign exchange rate (pegged regime), the method of derivation of the exchange rate from national monetary basket, which consisted of DEM 60% and USD 40% and the zone oscillation was ±7%. This was also related to the applied monetary policy of National Bank of Slovakia (NBS) which used a monetarist transmission mechanism. NBS targeted the increase of aggregate M2 as the monetary subobjective through affecting currency base and monetary multiplicator. In practical realisation of targeting of monetary supply through selected currency aggregate, NBS targeted demanded height of nominal income (GDP) in semi-long-term and inflation in long-term. At once, NBS tried to fix nominal foreign exchange rate through foreign exchange interventions.

Bringing the European Monetary Union into function and establishing of common currency euro by 11 states on 1. January, 1999 also influenced our policy of currency exchange rate. NBS originally approved only the change in currency basket which was represented through replacing DEM by euro with identical share of 60% and maintaing USD share of 40%. Second more radical solution was disestablishment of fixed system of currency exchange rate and its replacement by managed floating. It was difficult to make decision because NBS was not definitely determined to carry out this radical step.

If Slovak Republic becomes the member state of the European Union, it will most probably enter into the European mechanism of exchange rates II (ERM-exchange rate mechanism II), which will contain those member states that will not participate on EMU (Economic and Monetary Union). Supposingly the fluctuation zone in EMU will stay the same, consequently ±15%; this system might only be tenable after forming a more objective level of foreign exchange rate.

Because it is assumed that countries in middle and eastern Europe will try out for membership to the Economic and Monetary Union, member states have to monitor the pursuance of EMU criteria, so called Maastrich criteria, even though these criteria might be changed in the future. One of the criteria is avoiding the realisation of devaluation of currency exchange rate 2 years before the admission to EMU.

Monetary stability of Slovak crown and also stability of foreign exchange rate were jeopardised by external disequilibrium, shortage of foreign direct investment, high government expenditures, foreign debt, and high interest rates on monetary market. The external disequilibrium has mostly been solved by administrative measures which limit import of goods from abroad, for example establishment of importing deposits, the establishment of importing mark-up and other measures which trace the protection of internal market, such as the Act about protective measures in import and the Act about subsidies and counterbalancing measures. The export efficiency was supported by two measures:

1. setting up of Export-import bank,
2. setting up of Fund for supporting foreign trade in the beginning of 1997.

Accepted administrative measures to limit imports have only a short-term character and at the same time they worsen competitive environment on domestic market. The effect of proexport measures will be more dramatically manifested in next years.

The solution of external disequilibrium by changing the system of currency exchange rate was long considered as inappropriate due to the narrow connection between export and imported goods or possible inflation impacts. Even though this situation needed to be solved in a wider context of measures, such as structural changes in Slovak economy, modernization of production, rise of share of technological imports, increase of foreign investments, support of domestic innovative policy, complete solution of privatization, *etc*. Of course, questions of suitability of applied system of foreign exchange rate of Slovak crown were not negligible.

Concerning the fact that foreign exchange policy in Slovak Republic is not yet completely liberalized, there is no conception about real foreign exchange demand and about real foreign exchange supply. Furthermore, there is no conception about the equilibrium of currency exchange rate of Slovak crown, which would be formed on the basis of foreign exchange demand and supply. This way, one can understand the careful approach of NBS to the change of applied system of fixed foreign exchange rate which has slowly brought more disadvantages than advantages. Slovak Republic prefered stability to objectivity of foreign exchange rate. The veracity of this statement is proved by the development of currency exchange rate of Slovak crown after the introduction of floating. NBS changed the applied system of currency exchange rate and introduced a new, more flexible system of currency exchange rate on 2. October, 1998.

The new system of currency exchange rate is placed in the category called managed floating according to IMF. NBS decided for euro as the reference currency.

The new system of currency exchange rate, so called managed floating, means that the level of exchange rate of Slovak crown is fully dependent on the demand and the supply of Slovak crown on domestic as well as on foreign exchange markets. The exchange rate can relatively reach unrestrained limits because there are no oscillation limits set for the exchange rate. NBS is not responsible for intervening in order to maintain its level within certain artificially stated oscillation limits as it was in the previous system. However, it does not mean that it will not ever intervene. If the currency exchange rate of Slovak crown develops in direction which is not considered to be proper for achieving objectives of monetary policy, NBS can intervene in order to revalue or devalue the exchange rate of Slovak crown either by decreasing or increasing of foreign exchange reserves. Other possibilities of influencing of foreign exchange supply and demand are also in the expansion of convertibility of Slovak crown, especially in elimination of existing foreign exchange measures.

After changing the system of currency exchange rate, there was a devaluation of Slovak crown, which moved from the maximum of 31.2% to almost 19% of previous central parity (maximal devaluation of 48.10 SKK/EUR on 19. May, 1999). So far, NBS has directly intervened in order to revalue and devalue the exchange rate. According to the opinion of the governor of NBS Mr. M. Jusko, in case of favourable macroeconomic development, NBS will try to stabilize the currency exchange rate on the level of 42.5 SKK/EUR which is considered by NBS to be still appropriate. Exchange rate of Slovak crown has been recently moving around 43.775 SKK/EUR and 50.003 SKK/USD (12. October, 2000). This development reflects the devaluation of EUR on international financial markets and revaluation of USD.

Present currency exchange rate of Slovak crown contributes to the solution of external disequilibrium and to the decrease of deficit of current account of balance of payment. Together with other economic measures the currency exchange rate of Slovak crown helps to decrease domestic demand and the consumption of households. It has also stopped the decrease in foreign exchange reserves of official subjects and enables further advancement in liberalization of foreign exchange policy of Slovak Republic.

Its stability can be supported mainly by increase of foreign investment, especially direct, decrease of external disequilibrium, especially the deficit of current account of balance of payment, decrease in interest rates on monetary market, suitable economic and legal environment for domestic and foreign subjects, political stability, improving the rating of Slovak Republic, *etc*.

The change of system of currency exchange rate has raised perceptiveness of economic subjects to the rise of exchange rate risk in imports, exports, financial credits and in other economic activities of domestic subjects in abroad. Slovak crown is considerably sensitive to many realities. Most of all, Slovak crown is sensitive to impacts resulting from considerable openness of Slovak republic and relatively small economic environment.

Therefore, its movement will probably be larger than it was in the fixed system of currency exchange rate which Slovak economic subjects were used to. From Slovak economic subjects, it will require a better management of existing possibilities of preventing from exchange rate risk, for example through terminal foreign exchange trading and other possibilities such as insurance of risk, the use of proper forms of international payment contact, monetary clauses and other present possibilities of reducing risk.

3. RESUME

The article deals with the creation of the convertibility and the exchange rate of the Slovak crown since the formation of the new economy regime and the independent Slovak currency. It brings the present state of the Slovak crown showing the restrictions our convertibility still has, we will have to get rid off, especially in connection with the admission of the Slovak Republic into the European Union. The present state and the further development of the exchange rate regime of the Slovak crown, as well as its position relating to the change of the monetary policy of the National Bank of Slovakia, are the next questions to be solved. The article shows the inevitability of the change of the Slovak economy, subjects, and activities in relation to the increasing risk in the Slovak currency exchange rate regime.

4. THE LIST OF USED LITERATURE

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POLITYKA DEWIZOWA W REPUBLICE SŁOWACKIEJ

Artykuł omawia kreowanie wymienialności i kursu wymiany korony słowackiej od utworzenia nowego reżimu ekonomicznego i ustanowienia niezależności słowackiej waluty. Przedstawia obecną sytuację słowackiej korony, pokazując utrzymujące się ograniczenia jej wymienialności, które trzeba będzie usunąć, szczególnie w kontekście przyjęcia Republiki Słowackiej do Unii Europejskiej. Obecny stan i dalszy rozwój reżimu kursu wymiany słowackiej korony, jak również jej położenie związane ze zmianą polityki monetarnej Narodowego Banku Słowacji, są kolejnymi kwestiami, które należy rozwiązać. Artykuł ukazuje nieuchronność przekształcenia ekonomii słowackiej, jej podmiotów i działań, biorąc pod uwagę rosnące ryzyko wymiany dewizowej słowackiej waluty.