Role of cooperation between the private and public sector in market reforms introduction and economy development : Czech case

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Abstract Michal Mejstrik : **Role of cooperation between the private and public sector in market reforms introduction and economy development : Czech case**

Economic Transition could be divided into two stages followed by the stage of response to global competition. In the course of all stages the cooperation of the private and public sector is vital.

The First Stage Transformation Features had represented the creative destruction through abandoning the rigid and stagnating system of central planning and institutions and contracts associated with it and moving gradually towards institutions of market economy. The abandoning of microdistortions such as liberalization of prices, retail trade (incl. Small Privatization), foreign trade (the refocus of SME and large exporters from Russian and Comecon countries to European and other financially liquid countries) and investment model enabled corrections of missing or biased signals for private activities and the creation of new private firms.

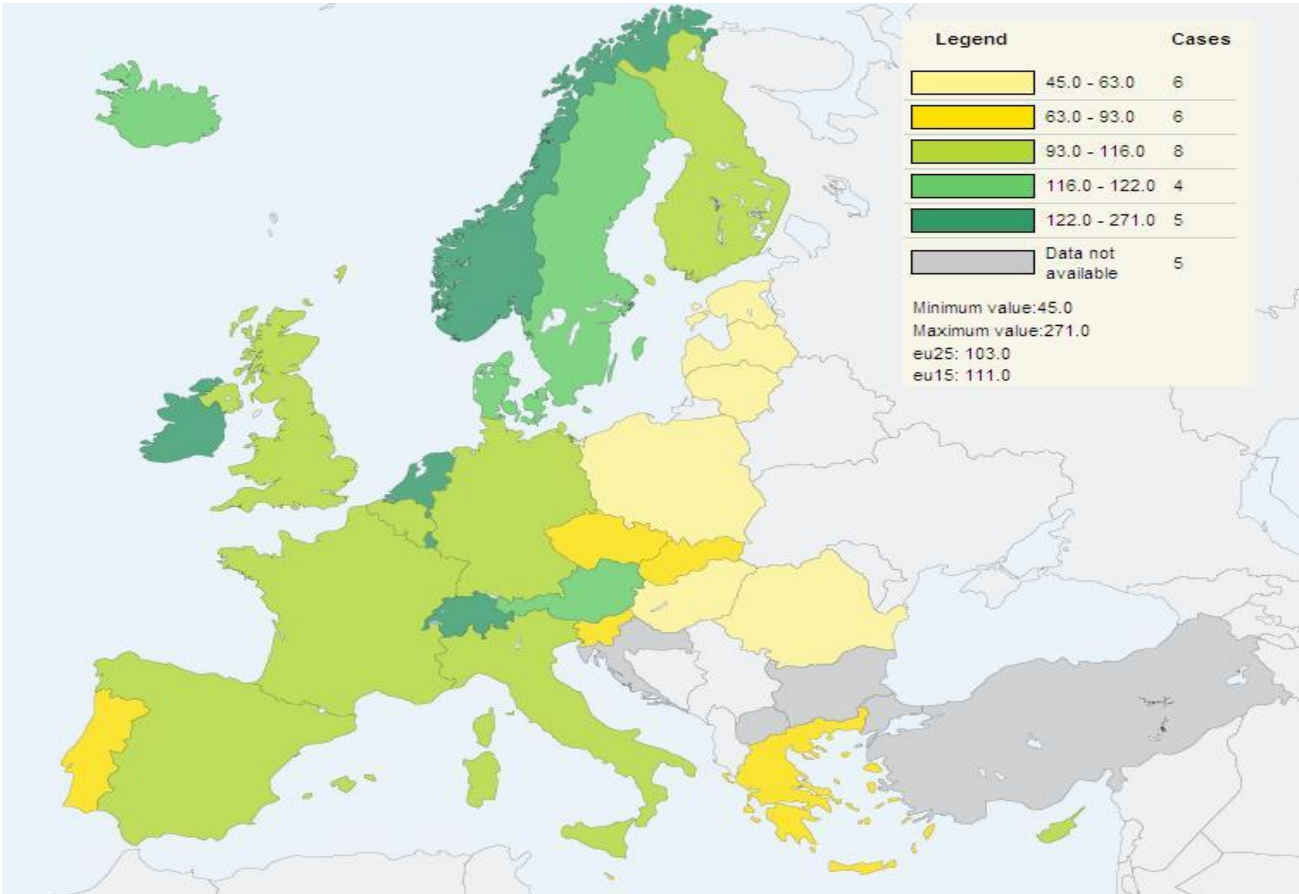
The Second Stage Transformation Features included not only large scale corporate Privatization (Both Up-down and Bottom-up) but also development and cultivation of private Financial Sector. And also creation of limited number of regional and selective economic policies such as FDI incentive system, zone policies for SME clusters etc. High level of financial intermediation in the CR and CEE especially via banks (Bank dependent economy) required perfection of originally liberal licensing policy, weak legal and corporate governance system and passive bank regulation and supervision (transferred to the central bank). Special task was harmonizing enforceable legal system with EU legislation to allow businesses for joining EU single market in goods and capital (the question of the capacity to assume the obligations of membership, that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union). A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.The private sector is firmly established and accounts for the overwhelming part of the Czech economy and property rights are established and transferable.

The current stage of response to global competition provides another cooperation of between the private and public sector in market reforms. It should combine the efforts towards **fiscal responsibility with joint effort to increase competitiveness of public institutions (inc. education) and private firms** to fight with global challenges.

Czech Republic case

- **The Czech Republic (CZ) is situated in the geographical center of Europe**. It is a landlocked country with an area of 78,866 sq km sharing its borders with Germany (810 km), Poland (762 km), Austria (466 km) and Slovakia (265 km).
- **The Czech Republic currently has ~10.3 mil inhabitants**. Population levels are decreasing, due to low birth rates, and should be ~10 mil in 2015. Immigration partially compensates the decrease. The Czech Republic has a high proportion of its population in the productive age ranges of 40 – 54 and 20 – 25 years.
- Since 1990, the Czech economy has undergone a far-reaching and successful adaptation to new market conditions. Before the fall of the "Iron Curtain" the Czech economy was centrally planned, with all economic activity subject to far-reaching controls. The transformation process commenced with a fundamental liberalization of the economic system: virtually all prices were freed of previously existing controls, foreign trade was liberalized and the Czech koruna (CZK) became a convertible currency. All enterprises, previously state owned, were transformed into corporations and ownership was transferred in two waves of voucher privatization (in 1992 and 1994) as well as by direct privatizations and new start-ups. Currently the Czech Government, through the Ministry of Finance of the Czech Republic, retains ownership stakes only in a very limited group of companies, mostly those of strategic importance. The massive restructuring had significantly changed most of corporations and entrepreneur's structure and behavior.

GDP per capita in PPS 2009 map



Source: Eurostat

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3. Czech and CEE Economies features comparative overview 2002 vs.2012
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1. Basics of Czech Economic Reforms

Different background and structure of financial intermediation - CEE Features in 1H 1990´s

- Economic Transition
- High level of financial intermediation in the CR and CEE especially via banks (Bank dependent economy)
- Liberal licensing policy, weak legal system and passive bank regulation and supervision
- Emergence of Capital Markets (IPOs, coupon privatizations)

The First Stage Transformation Features
...Creative Destruction

- Transition economy abandoning the rigid and stagnating (0.8% in 1980´s) system of central planning and institutions and contracts associated with it and moving gradually towards institutions of democracy and market economy

- Mejstrik (1999), Svejnar (2002)

...creative destruction (Cont.) – Microdistortions abandoned

- Liberalization of Prices, Trade (incl. Small Privatization), Foreign Trade and Investment Model,
- Gradual Reduction of Subsidies
- Removal of barriers to the creation of New firms
- Corporatization
- Break-up of Administrative Trusts and the Monobank System, McDermott, Mejstrik (1993)

...creative destruction (Cont.) – Microadjustments

- Gradual Reorientation of Production and Trade to new and/or more liquid customers, which, even after inclusion of new price information, comply with the conditions of efficiency
- Totally different structure of Foreign Trade
- Different structure of GDP Formation (see below for the Czech republic)

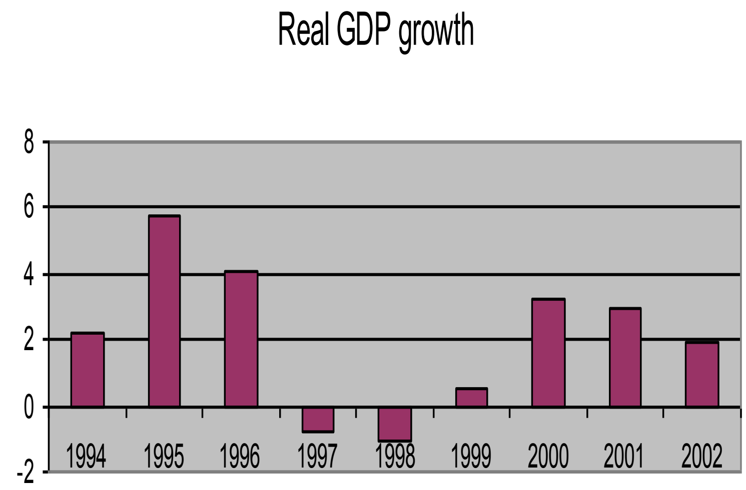
Sectors (CSU CR)	1990	1992	1994	1999
Industry	48.7	43.1	34.8	34.4
Construction	5.2	5.3	5.9	7.5
Agriculture,For.	8.6	6.1	5.8	3.7
Services	37.5	45.5	53.5	54.4

...creative destruction (cont.) – Development of New Private Sector as the Bottom-up Privatization, Liberalization of Labor Market and Introduction of Social Safety Net

- Flow of Start-ups and Green-field Investments (FDI) as „the Bottom-up Privatization“
- Structural Changes in GDP Formation supported by the newly developed private sector (see above) absorbed part of growing unemployment and changed the employment pattern

•McDermott, Mejstrik (1993), Benacek (2001)

...creative destruction (cont.) – Macroeconomic (fiscal and monetary) Stabilization, Liberalization of Labor Market and Introduction of Social Safety Net

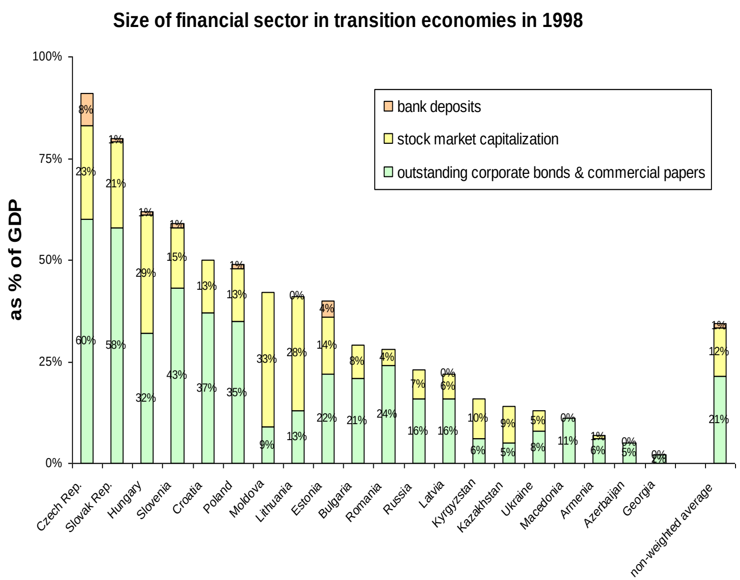


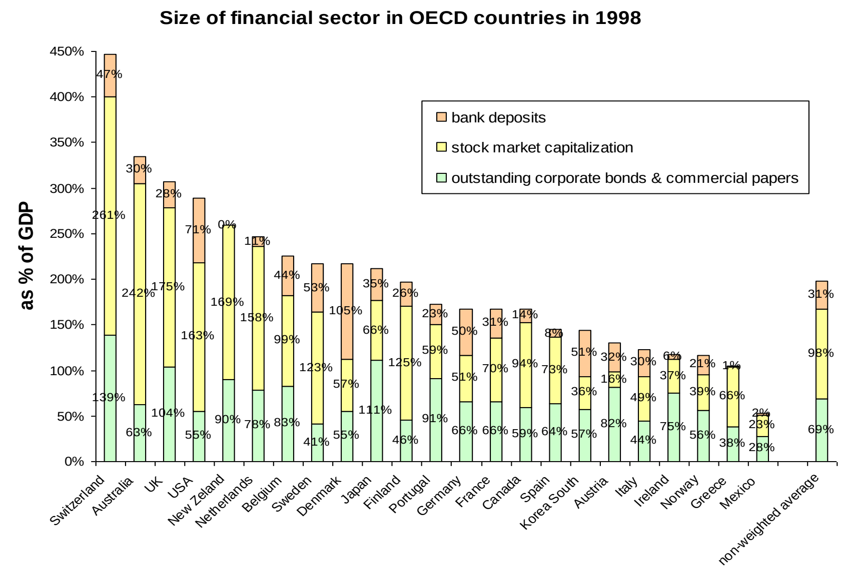
The Second Stage Transformation Features

- Large Scale Corporate Privatization (Both Up-down and Bottom-up)
- Development and Cultivation of Private Financial Sector, Capital and Money Market
- Perfectioning the institutions of democracy and market economy, law enforcement
- Reconstruction of the Tax System
- Creation of limited number of Regional and Selective Economic Policies such as FDI incentive system, zone policies for SME clusters etc.

Financial Sector Structure – Bank dependent CEE - Czech economies

Comparison of CEE, Czech and OECD financial institutions size in 1998 –
bank deposits in green, stock market cap in yellow,outstanding corporate bonds+compaper in red





…with huge grow potential of bank disintermediation

Source: Kawalec,2000

The Privatization as one-off Game

Privatization and Corporate Governance
- „not only ownership matters, but institutions as well“

Privatization is an one-off process and has conflicting economic, financial and political objectives of particular interest groups (foreign vs. domestic buyers – either insiders or outsiders).

Given the unrepeatable character of privatization and incompleteness of most of contracts and of institutional framework itself, many actors in the corporate sector, not just the managers but also investment funds and asset management companies, played a one-shot game at the expense of managed companies and their own minority shareholders as well.

The rational behavior in such a game is well described by „the prisoners dilemna“ . Then to no surprise there was a temptation for a dominant short term strategy of “cheating”- i.e. exploiting any contractual incompleteness in largely unregulated environment of privatization to one´s own advantage. Such a model describes wider Eastern Europe environment (both Czech and Russian) of recent past.

CEE Corporate Governance Models

Anglo-Saxonian approach

Problems:

right to vote limited

high transastion costs

very low liquidity

Single owner

Problems:

limited information

low transparency to business partners

Stakeholder model

Limited in the CR: ex. Sale of blocking minority of local distribut. companies to municipalities

Problems:

Unefficient governance

Loss of interest

“CEEE“ transition model

0 or 1 approach: large shareholder behaving as single owner

Problems:

Disadvantageous contracts

“tunnelling“

Bank Lending Failure with Asset Bubles followed by the Poor Performance of Large Industrial Customers

Within given corporate governance model number of (mostly state-owned) banks provided Privatization and Acquisition Lending to highly leveraged related conglomerates in order to create TBTF groups with soft budget constraint backed by the state. Czech Asset Bubles broke in the first 1997 recession and resulted into huge NPLs and fall of many businessmen. 71% of **related lending** in Russia was not repaid according to Laeven (2001)- result?

Possible solutions: support by the government – inefficient but keeps

-mergers with other domestic companies – a lack of domestic capital -----reprivatisation to foreign owners – often positive results, but not always (inadequate investor, lack of knowledge of the local environment, etc.)

-bankruptcy procedure with going concern sale (to Siemens) or liquidation

In the CR, Czech Konsolidacni agency owns the majority of non-performing loans. It is preparing sales of those assets in selected packages on the market. Other instruments: debt-to-equity swap

CG failure and Restructuring in mid´90s

We noted above that economic relationships typically have a co-operative game or prisoner´s dilemma characteristic: full co-operation maximizes the participants´ joint pay-off in the long-term (“repeated game”) but “cheating”- i.e. exploiting any contractual incompleteness to one´s own advantage, remaining the dominant strategy in one-shot game. :

- the analysis of the ownership structures and its influence on banking corporate governance failure that resulted in different restructuring profiles of particular types of companies – two speed economy:
- Given the unrepeatable character of privatization and mostly vague contracts and of institutional framework itself, many actors in the corporate sector, not just the managers but also investment funds and asset management companies, played a one-shot game at the expense of managed companies **and their own minority shareholders** as well. The dominant strategy was “**cheating”- i.e. exploiting any contractual incompleteness in largely unregulated environment to one´s own advantage connected with neglectance or adaptive restructuring.**
- Some industrial companies, mostly **foreign controlled**, have properly responded to demand and market signals (GDP growth at OECD countries generating stronger demand) properly by **deeper restructuring** – by cost adjustments (including a temporary decrease of real wages succeeded by quick wage growth after rapid productivity growth was achieved), by new products and technologies, more active marketing, etc., frameworked by a new **“contract architecture”**. They significantly increased their non-price competitiveness (e.g. VW – Škoda cars) and became the engine of **outward-looking, export led growth** stimulated by foreign demand growth. Sectors exporting market segments with higher value added (machines, equipment) sold mostly at the highly competitive OECD markets. These companies also had a lower cost of capital of those firms as they could borrow more cheaply at the international markets via their parent companies
- On the example of foreign controlled companies we illustrated the hypothesis that firms which build a reputation for ethical collaboration over a long period are able to substitute co-operative outcomes for unsatisfactory cheating ones. These relationships - the internal and external “contractual architecture” of the firm undoubtedly happened to be the source of considerable competitive advantage. Furthermore, firms which have established such a reputation have established themselves as “islands of microeconomic institutional stability” and enjoyed an advantage in attracting new trading partners - whether as customers, suppliers, or employees - precisely because the latter knew that the former can be expected to maintain their reputations.
- The foreign controlled companies seem to represent long-term standard of behaviour, with new internal and external contractual architecture, although these may in future be partially eroded in an environment with prevailing incomplete contracts used by number of participants for their individual benefit.

2. CEE and EU enlargement

EU Enlargement

- **The fifth EU enlargement since its beginning 50 years ago was finalized again in Copenhagen in December 2002.** The **Accession Treaty** was signed at a ceremony at the Stoa of Attalos in Athens on 16 April 2003. The Treaty was then submitted for ratification by the current Member States and acceding states, in accordance with each state's national ratification procedures.
- Referenda on accession required in nine candidate countries (except Cyprus) had been successful. (Accession of the Czech Republic has been approved by a referendum held on June 13-14, 2003). The major task of the governments were to finalize wide ranging legislative and administrative reforms and implement them prior or close to the EU accession, which happened for **Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia as new members on 1 May 2004.**
- **Romania, Bulgaria (joined in 2011) and Turkey** are still in the process. Several new countries such as Croatia started to prepare themselves (Croatia submitted).
- **The new member countries are expected to adopt the EUR before the end of this decade,** which requires a continued reform of the fiscal and pension system in order to allow for a reduction in government spending and indebtedness.

2. The global context of eurozone problem
Sovereign risk of EMU countries now reflected in interest rates!

Investors distinguish risk

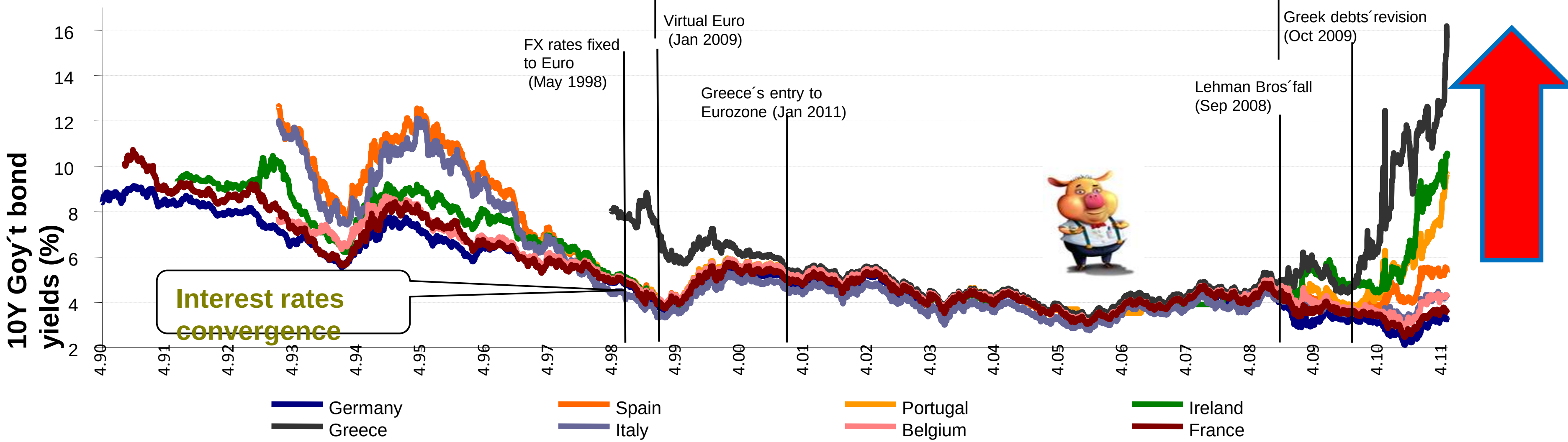
Sovereign risk =
FX risk + credit risk

Investors do not distinguish

No FX risk -> PIGS as "safe heaven"

Underpricing risk!

Investors distinguish risk again!
In credit risk



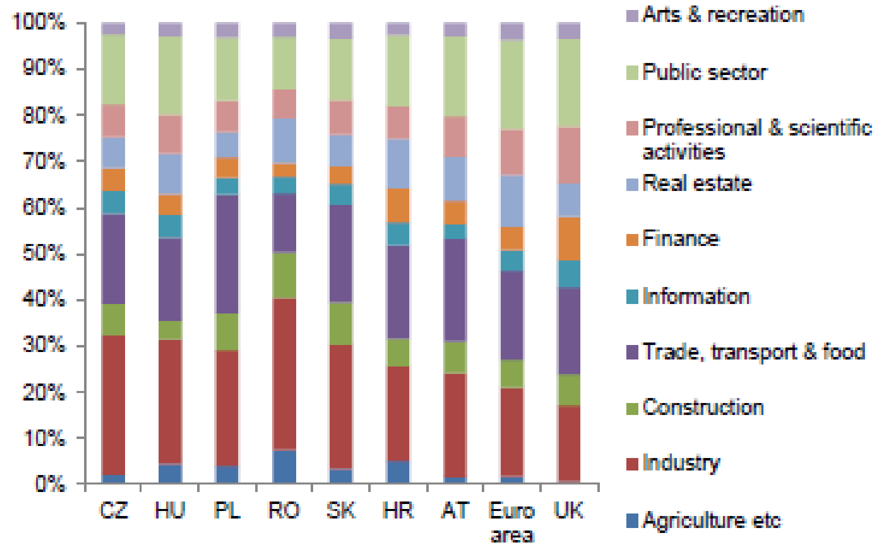
Source: EEIP based on Kohutikova (2011)

2. Importance of manufacturing to CEE and Czech republic within EU

As discussed by Erste (2013) the history behind economic convergence is the re-integration of Europe after the fall of the Iron Curtain. The early prospect of entry into the EU propelled CEE countries to undertake structural reforms which led also to the restructuring of enterprise sector often supported by FDI, new technologies and productivity gains (Mejstrik(1999, 2010) resulting in exports refocus to EU. After a brake in 2009 the further growth partially reoriented outside EU**. In contrast the peripheral countries were facing de-industrialization** .

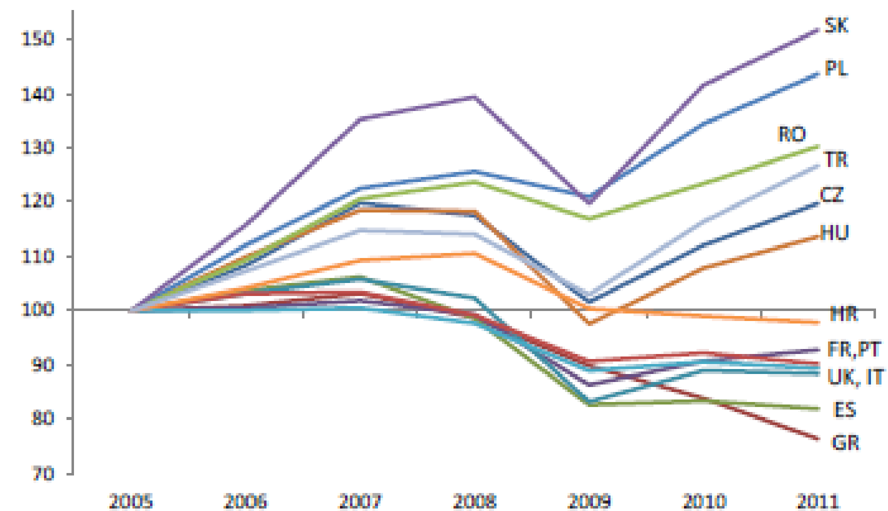
Note CR has started with more developed manufacturing base (now 30% to GDP and mostly private) and so its development was slower.

Contribution of main economic branches to GDP (2011)



Source: Eurostat, Erste Group Research

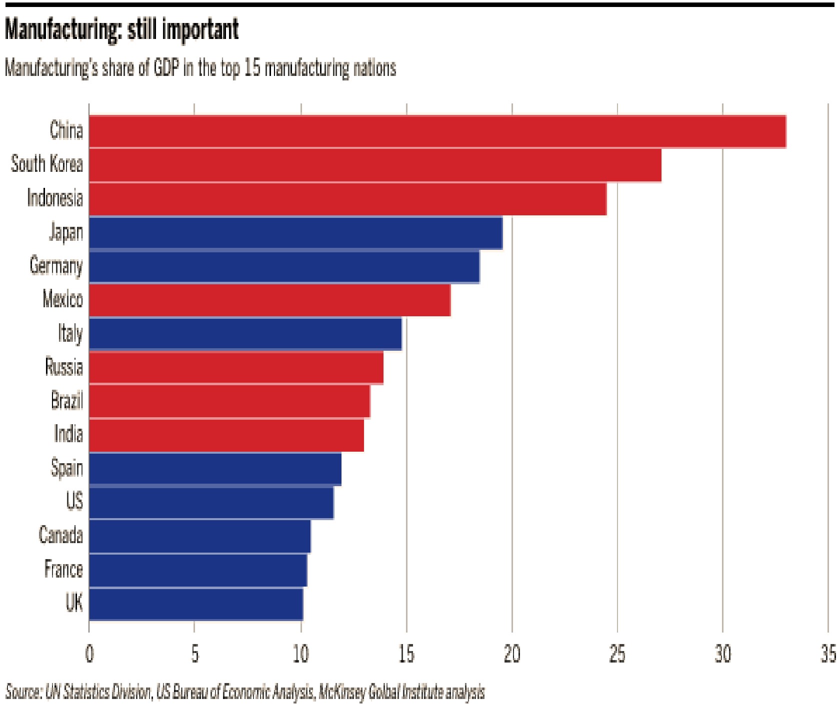
Industrial production (Construction excluded, 2005=100)



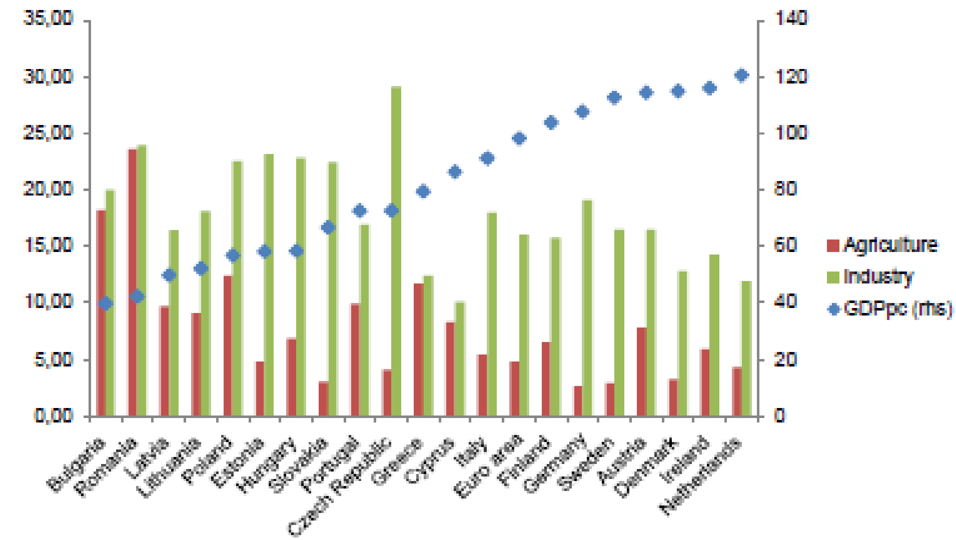
Source: AMECO, Erste Group Research

2. Importance of manufacturing to emerging markets and Czech republic

Within the top 15, the proportion of the economy that is manufacturing varies to a large degree, with China being over 33 per cent, to the UK where it is just 10 per cent. And it is this chart (below) that shows the greater EM dependency on manufacturing, with emerging markets (in red) towards the top of the chart: China, South Korea and Indonesia have a quarter to a third of GDP based in manufacturing. The world's biggest manufacturer, the US, has a more modest 12 per cent. Czech republic (not mentioned due to its size) has got around 30 % of mostly private firms.



Employment in Industry and Agriculture (in % of total hours worked, 2010)



Source: Eurostat, Erste Group Research

2. The importance of manufacturing to emerging markets as a road to convergence

Manufacturing raises incomes and provides the machinery, tools, and materials to build modern infrastructure and housing. For some emerging economies, large energy deposits can provide a fast boost to growth. But to move up towards middle income status or beyond so-called middle-income trap , manufacturing has almost always been a necessary step for EMs to build a modern economy supported by rule of law, open competition and individual freedom to create and innovate. Below we can see the McKinsey picture of the world's top manufacturers in size and dynamics. Due to its size Czech republic is not mentioned but the manufacturing share is among Top 15

Top manufacturing countries by decade

Emerging markets move up the ranking

Rank	1980	1990	2000	2010
1	US	US	US	US
2	Germany	Japan	Japan	China
3	Japan	Germany	Germany	Japan
4	UK	Italy	China	Germany
5	France	UK	UK	Italy
6	Italy	France	Italy	Brazil
7	China	China	France	South Korea
8	Brazil	Brazil	South Korea	France
9	Spain	Spain	Canada	UK
10	Canada	Canada	Mexico	India
11	Mexico	South Korea	Spain	Russia
12	Australia	Mexico	Brazil	Mexico
13	Netherlands	Turkey	Taiwan	Indonesia
14	Argentina	India	India	Spain
15	India	Taiwan	Turkey	Canada

Source: IHS Global Insight, McKinsey Global Institute analysis

2. The importance of services to emerging markets and Czech republic

As often discussed the spill-over effect of more sophisticated manufacturing is already taking place in emerging markets integrated in global value chains (see ICC (2013)).

The manufacturing / services divide is blurring as manufacturing involves more service-like activity (including everything from maintenance to software management), and vice versa. Manufacturing requires greater service inputs than in the past, in terms of IT, logistics and finance.
“Intermediate demand” for services from manufacturing is far greater driver of output in China than it is in the US.

2. Emerging economies will produce the majority of the world's goods and services for the first time in 2013 according to IMF

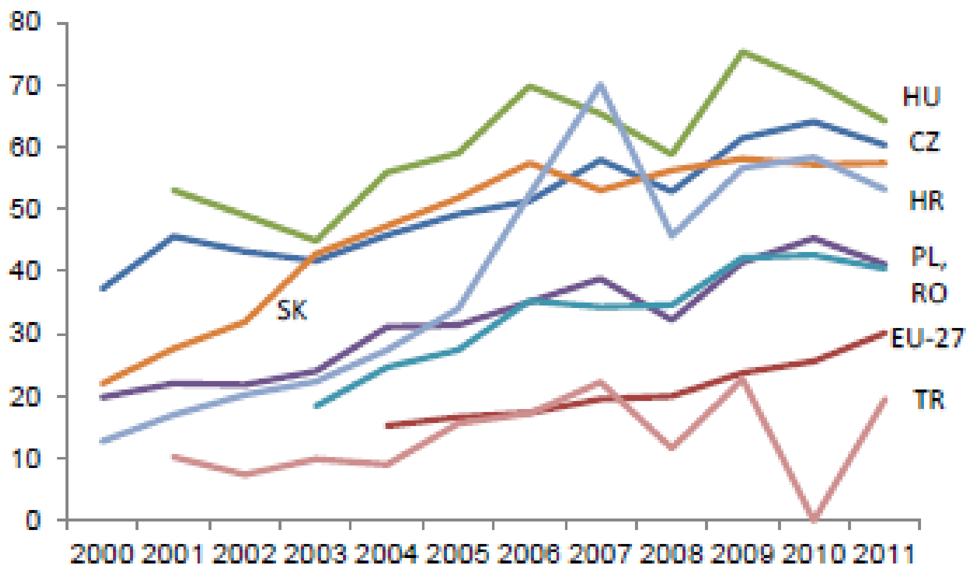
This year is pivotal for the global economy. In 2013, **for the first time** since mechanisation led Britain down the path of industrialisation in the 19th century, **emerging economies will produce the majority of the world's goods and services according to the IMF**. The inhabitants of rich, advanced economies have long represented only a small but powerful proportion of the world's population. Now, they are less economically important than the mass of people living in the world's poor and middle-income countries.

The shift in the balance of global economic power is profound. It is also one that economists expect to continue. By 2018, the International Monetary Fund reckons emerging markets' share of world output will have risen to 55 per cent, making the term "emerging" increasingly irrelevant.

2. Importance of FDI to CEE and Czech republic within EU and high-tech

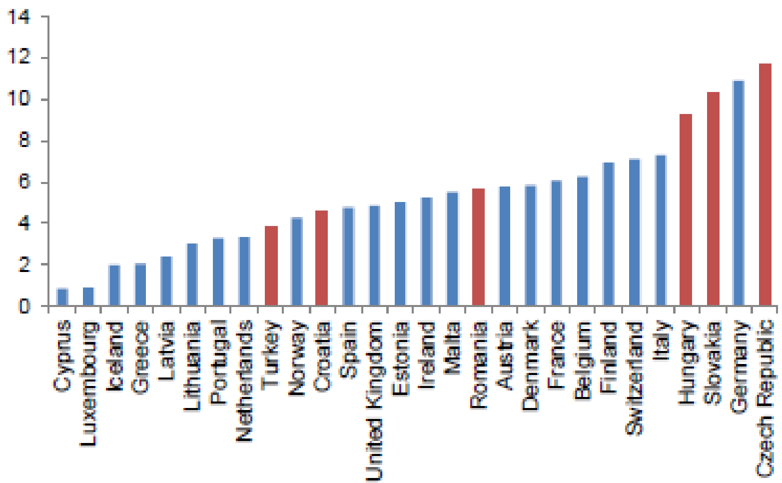
As discussed by Erste (2013) the history behind economic convergence is the re-integration of Europe through restructuring of enterprise sector often supported by foreign direct investments - FDI (see also Mejstrik(1999, 2010). The last years saw certain slowing down in several countries such as Hungary but the composition of FDI stock has been different and changed due to fresh inflow, outflow (profit repatriation) and profit reinvestments . During stepwise restructuring the employment has grown in high-and medium-high technology manufacturing sectors.

Inward direct investment stocks (% of GDP)



Source: Eurostat, Erste Group Research

Employment in high- and medium-high technology manufacturing sectors (in % of total employment, 2008)



3. Czech and CEE Economies features: comparative overview 2002 vs. 2012

3.Comparison of accession countries in 2002 (1)

Country	Area 1000 km2	Population Million inhabitants	GDP in purchasing power standards Billion EUR P.P.S.	EUR/inhab. P.P.S.	EUR/inhab. percent EU average	GDP percent growth Percent	Inflation rate Year on year	Unemployment rate Percent active population	Current account Balance percent G.D.P.
Bulgaria	111.0	7.9	47.4	5,900.0	25	4.8	5.8	18.1	-4.7
Cyprus	9.0	0.8	14.0	17,400.0	72	2.2	2.8	3.8	-5.3
Czech Republic	**79.0**	**10.2**	**146.9**	**14,400.0**	**60**	**2.0**	**1.4**	**7.3**	**-6.3**
Estonia	45.0	1.4	13.5	10,000.0	42	6.0	3.6	9.1	-12.3
Hungary	93.0	10.2	138.2	13,600.0	57	3.3	5.2	5.6	-4.0
Latvia	65.0	2.4	19.9	8,500.0	35	6.1	2.0	12.8	-7.7
Lithuania	65.0	3.5	34.3	9,400.0	39	6.7	0.4	13.1	-5.3
Malta	0.3	0.4	4.6	11,700.0	55	1.2	2.2	7.4	-3.9
Poland	313.0	38.2	363.0	9,500.0	39	1.6	1.9	19.9	-3.6
Romania	238.0	21.8	128.9	5,900.0	25	4.9	22.5	7.0	-3.4
Slovakia	49.0	5.4	61.3	11,400.0	47	4.4	3.3	18.6	-8.2
Slovenia	20.0	2.0	35.3	17,700.0	74	3.2	7.5	6.0	1.7
Turkey	775.0	69.6	382.9	5,500.0	23	7.8	45.0	10.4	-0.8
EU 15	3,234.0	378.4	9,166.5	24,010.0					
Acceeding 10	739.0	74.3	831.0	11,150.0					
EU 25	3,973.0	452.7	9,997.5	21,910.0					

Note: Malta GDP figures are for 1999, EU 25 per capita PPS is an approximation based on EU 15

Source: EUROSTAT, "Continuing enlargement: Strategy Paper and Report of the European Commission on the progress towards EU accession" (October 2003), p.42; EEIP analyses

3. EBRD outlook May 2013: slower GDP growth

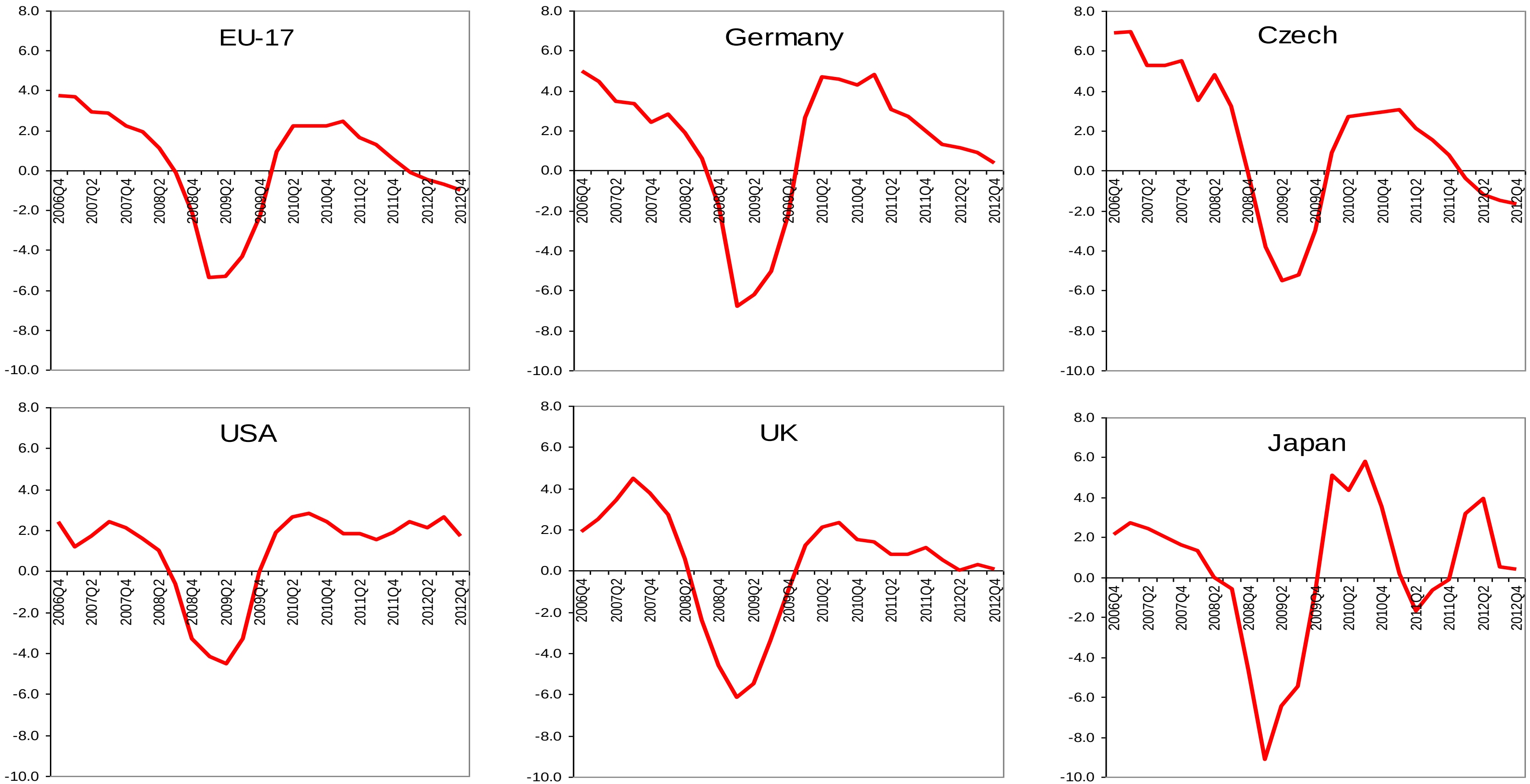
Growth in real GDP

(In per cent; EBRD forecasts as of 26 April 2013)

	Current forecast			EBRD Forecast in January 2013			
	2012	2013	2014	2012	Change January-April	2013	Change January-April
Central Europe and the Baltic states							
Croatia	-2.0	-0.3	1.9	-1.9	-0.1	0.8	-1.1
Estonia	3.2	3.0	3.1	3.3	-0.1	3.1	-0.1
Hungary	-1.7	-0.8	0.9	-1.5	-0.2	-0.1	-0.7
Latvia	5.6	3.5	3.2	5.4	0.2	3.0	0.5
Lithuania	3.6	2.8	3.0	3.2	0.4	2.9	-0.1
Poland	1.9	1.2	2.0	2.0	-0.1	1.5	-0.3
Slovak Republic	2.0	1.0	2.0	2.2	-0.2	1.7	-0.7
Slovenia	-2.3	-2.5	-0.9	-2.1	-0.2	-2.0	-0.5
Average[1,2]	*1.1*	*0.8*	*1.8*	*1.3*	*-0.2*	*1.2*	*-0.4*
South-eastern Europe							
Albania	1.6	1.5	1.9	1.8	-0.2	2.0	-0.5
Bosnia and Herzegovina	-0.5	0.1	1.8	-0.5	0.0	0.6	-0.5
Bulgaria	0.8	1.0	2.5	1.1	-0.3	1.9	-0.9
FYR Macedonia	-0.3	1.5	2.6	-0.5	0.2	1.8	-0.3
Kosovo	2.5	3.0	3.5	2.5	0.0	3.0	0.0
Montenegro	-0.5	1.0	2.0	0.3	-0.8	0.8	0.2
Romania	0.7	1.4	2.2	0.3	0.4	1.4	0.0
Serbia	-1.7	2.2	1.9	-1.9	0.2	2.1	0.1
Average[1]	*0.3*	*1.4*	*2.2*	*0.1*	*0.2*	*1.5*	*-0.1*
Eastern Europe and the Caucasus							
Armenia	7.2	5.0	4.0	6.0	1.2	5.0	0.0
Azerbaijan	2.2	3.5	4.0	2.2	0.0	4.0	-0.5
Belarus	1.1	2.0	2.5	1.5	-0.4	1.5	0.5
Georgia	6.2	3.0	5.0	6.5	-0.3	5.0	-2.0
Moldova	-0.5	2.5	4.0	0.0	-0.5	3.0	-0.5
Ukraine	0.2	-0.5	2.5	0.0	0.2	1.0	-1.5
Average[1]	*1.2*	*1.2*	*3.0*	*1.2*	*0.0*	*2.1*	*-0.9*
Turkey	2.2	3.7	4.0	2.6	-0.4	3.7	0.0
Russia	3.4	1.8	3.0	3.5	-0.1	3.5	-1.7
Central Asia							
Kazakhstan	5.0	4.9	5.5	5.0	0.0	6.0	-1.1
Kyrgyz Republic	-0.9	6.5	5.0	-0.9	0.0	7.0	-0.5
Mongolia	12.3	16.0	17.0	11.0	1.3	16.0	0.0
Tajikistan	7.5	5.0	5.0	7.5	0.0	5.0	0.0
Turkmenistan	11.1	10.0	10.0	11.1	0.0	10.0	0.0
Uzbekistan	8.2	7.5	7.0	8.2	0.0	7.0	0.5
Average[1]	*6.3*	*6.2*	*6.6*	*6.2*	*0.1*	*6.9*	*-0.7*
Average EBRD region (excluding SEMED)[1]	*2.5*	*2.1*	*3.1*	*2.6*	*-0.1*	*3.0*	*-0.9*
Southern and Eastern Mediterranean							
Egypt	3.1	2.0	3.6	3.1	0.0	3.8	-1.8
Jordan	2.7	3.0	3.4	2.6	0.1	3.0	0.0
Morocco	2.4	5.0	5.2	2.6	-0.2	5.2	-0.2
Tunisia	3.7	3.8	4.3	2.4	1.3	3.0	0.8
Average[1]	*3.0*	*3.0*	*4.1*	*2.9*	*0.1*	*4.0*	*-1.0*
Average EBRD region (including SEMED)[1]	*2.6*	*2.2*	*3.2*	*2.6*	*0.0*	*3.1*	*-0.9*

EBRD lowered its development 2013 outlook for emerging countries of CEE anf North Africa from 3.1% (January) to 2.2%.

3. Business cycle shape : “L”, “V”, “U”, or “W” ?



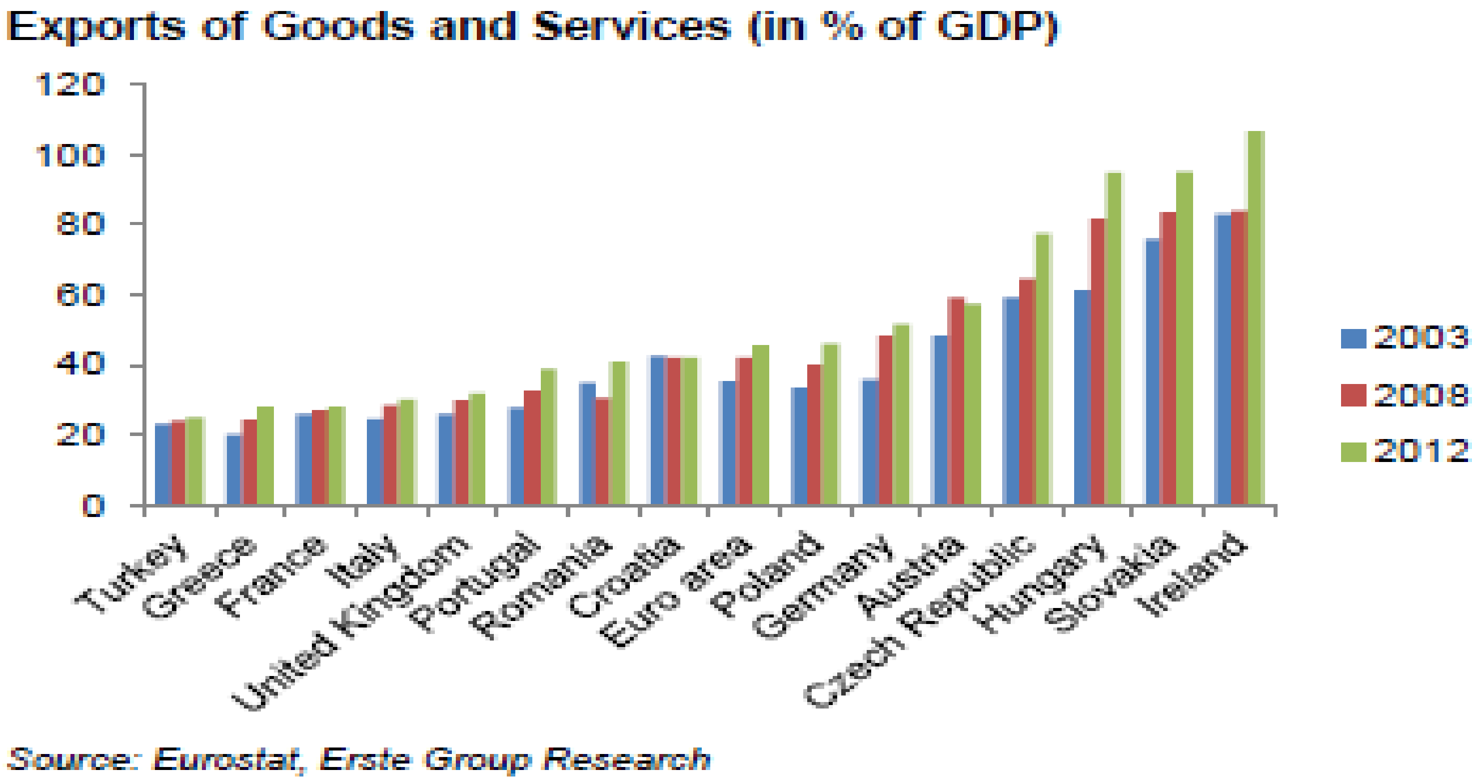
Source: P.Sobíšek Unicredit, CFO Forum (May 2013)

3. Comparison of accession countries in 2002 (2)

Country	Foreign direct investment	Foreign direct investment	General government budget	Share of agriculture	External trade	External trade	External trade	External trade
	Net inflow in % of GDP	EUR per capita	Balance in % of GDP	%t of gross added value	Exports % of imports	Exports to EU, % of total exports	Imports from EU, % of total imports	Balance with EU, in EUR mil
Bulgaria	3.9	273	-0.6	12.5	78.2	55.6	50.2	606
Cyprus	4.3	N/A	-3.5	4.3	12.5	48.0	55.8	2,173
Czech Republic	13.4	2,289	-3.9	3.7	94.4	68.4	60.2	1,673
Estonia	4.4	2,092	1.3	5.4	71.6	68.0	57.9	847
Hungary	1.8	N/A	-9.2	4.3	91.4	75.1	56.3	-68
Latvia	4.6	978	-3.0	4.7	56.4	60.4	53.0	620
Lithuania	5.3	723	-2.0	7.1	71.0	48.4	44.5	1,290
Malta	8.8	6,418	-6.2	2.8	74.1	46.6	67.0	1,575
Poland	2.2	963	-4.1	3.1	74.4	68.7	61.7	9,165
Romania	2.9	252	-2.2	13.0	77.6	67.1	58.4	1,003
Slovakia	17.0	903	-7.2	4.5	87.1	60.5	50.3	-982
Slovenia	8.3	1,543	-2.6	3.3	94.7	59.4	68.0	1,806
Turkey	0.6	296	-10.0	11.5	69.1	51.5	45.5	2,178

Source: EUROSTAT, "Continuing enlargement: Strategy Paper and Report of the European Commission on the progress towards EU accession" (October 2003), p.42; EEIP analyses

3. Rising role of export for CEE countries but much more in the medium-size countries



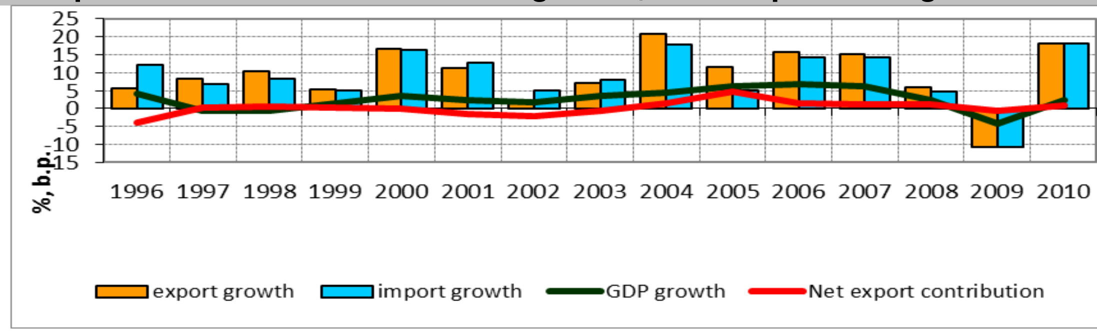
Sourcej: Erste (2013)

3. Both CR and key partner Germany in situation : “data on trade „in contrast" to stagnation of economy, and economy "flirted with technical recession“.” (Carsten Brzeski)

CR openness – export quota - ratio of export/GDP – nearly 70%.
Over 80% share of intra EU27 exports from CR,.
31.9% share of CR exports to or via Germany – No.1 partner **with 33 bn. EUR,** then Slovakia 20, Poland, France, UK, Italy etc.

German openness export quota – 41.3% .
Still 60% share of intra EU27 exports from Germany, and 71% within Europe.
Since 2009 German extra Europe exports have grown significantly both in absolute and relative terms but reached only 16% for Asia, and 10% for America, while Africa with 2% and Australian/Oceania 1%. Imports are similar – 69% Europe, 19% Asia and 9% America. Top 3 Dutch, China, France

Net Exports contribution to CR GDP growth, in 2011 positive again



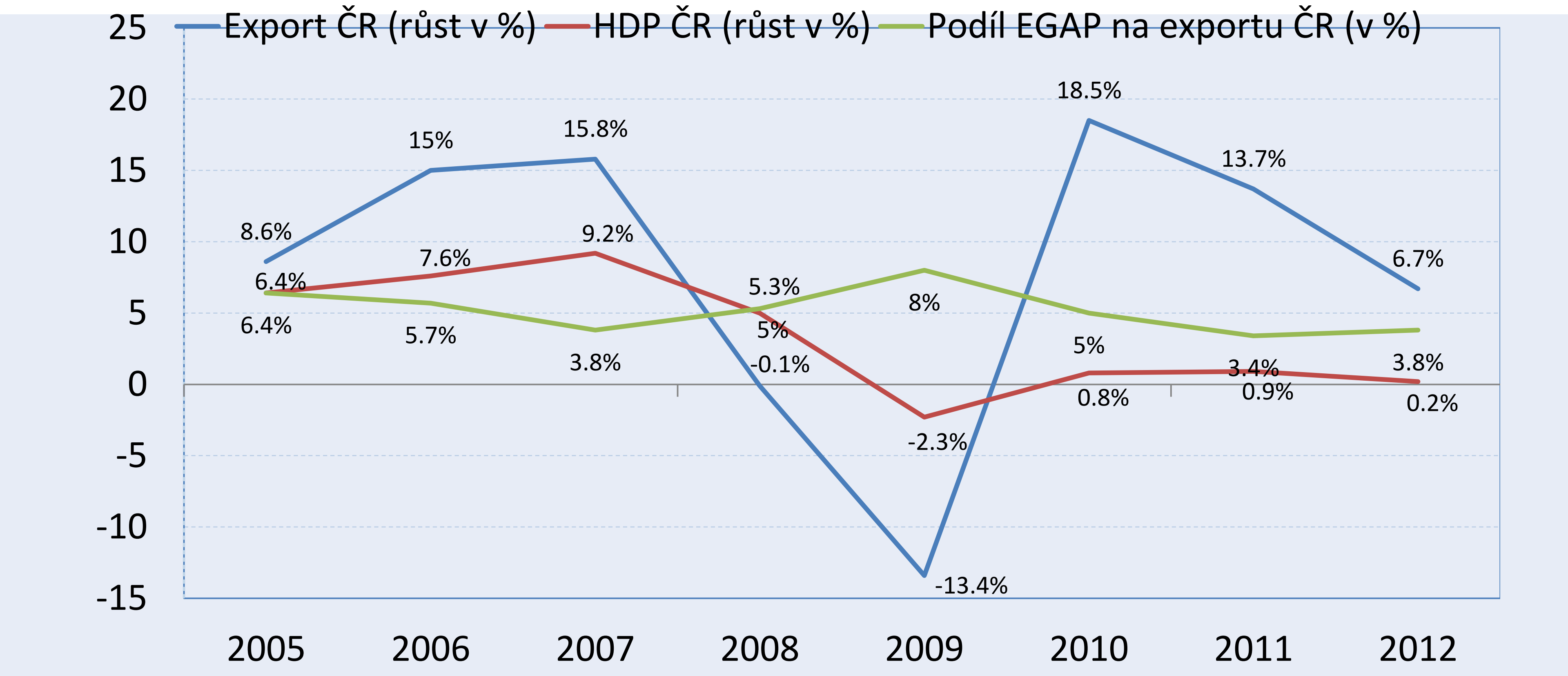
Germany was unseated as the world's biggest exporter by China in 2009 and was overtaken by the US in 2010, according to ifo.

China remained export champions in 2011 - accounting for 11 percent of worldwide exports – to be followed by the US with 8.4 percent and Germany with 8.3 percent.

However, Germany was in for a "strong comeback in 2012“. Countries outside the European Union drove the rising German figures, with the volume of non-EU exports rising by 13.4 percent in recent few months. EU exports have grown as well.
In 2011 another export surplus of 158 bil. EUR and the highest total volume of exports (1060 bn.EUR) with No. 1 France (9.6%), No.2 US (7%), No.3 Netherlands (6.5%), No.4 UK (6.2%), No.5 China (6.1%), No.6 Italy (5.9%), No.7 Austria (5.5%), No.8 Switzerland (4.5%), No.9 Belgium (4.4%), No.10 Poland (4.1%), No.11 Spain (3.3%), No.12 Russia (3.3%), No.13 Czech Republic (2.9% with 30.6 bn exports), No.14 Sweden (2.1%),..No.19 Slovakia (1%)

Sourcej: NERV, EUROSTAT (2012)

3. Czech exports, Czech GDP and Role of Export and guarantee Agency (EGAP)



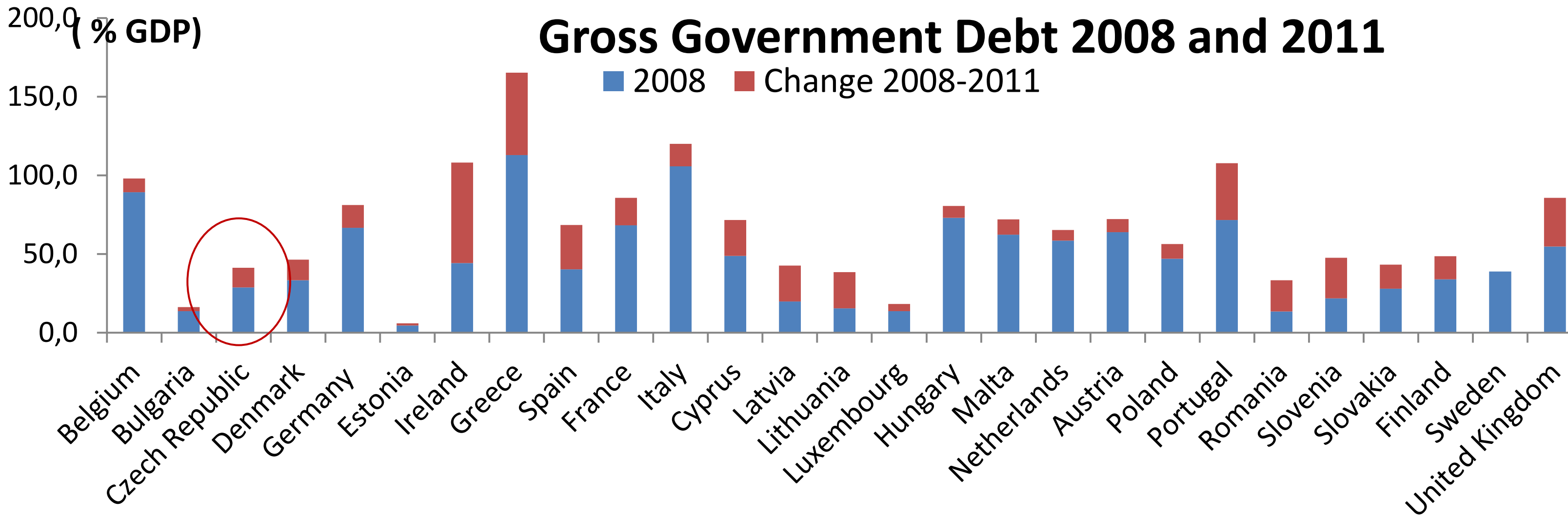
Source: J.Procházka , EGAP CFO Forum (2013)

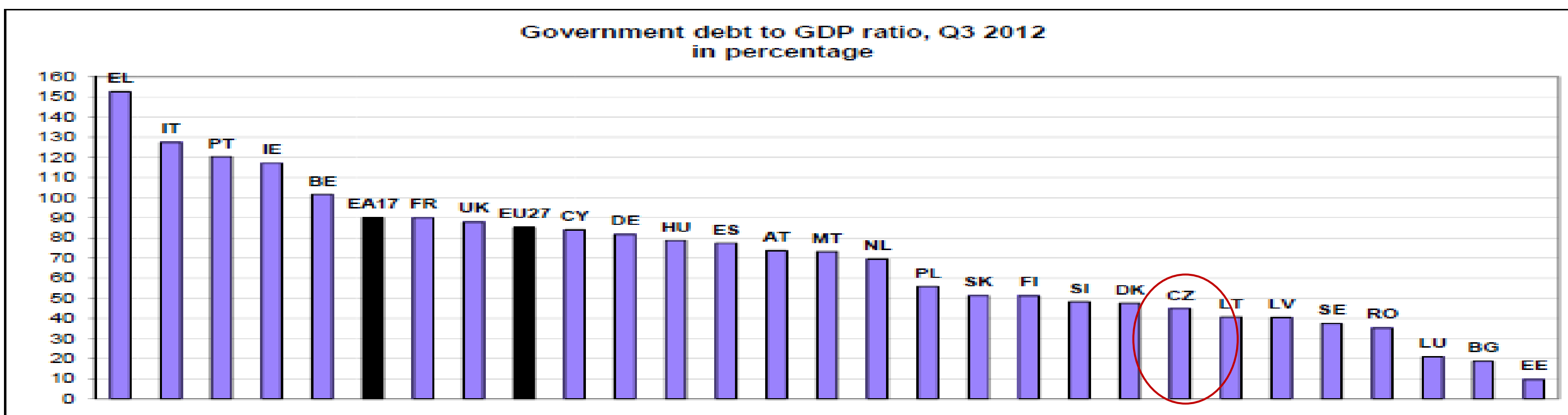
3.Contagion of EU Private and Public Sector

- The efforts of national governments to mitigate the negative impacts of the global financial sector led to a rapid growth of public debts ►currently, the contagion of the private financial sector spilled over to the public sector
- This situation unveils the long-lasting problems of both old and new EU Member States with appropriate and prudent management of budget deficits as well as “EU divide” in competitiveness (as suggest the case of PIIGS countries, but also of Belgium, etc.)
- Still no light at the end of the tunnel - huge governmental debt instruments to be issued in 2012-15 again to cover structural budget deficits and lack of banking capital to cover regulatory risks ►fierce competition among countries (e.g.states in Eurozone vs non-eurozone countries – making risky public debts much more expensive) and private and public bonds.

3. Macroeconomic consequences of crisis interventions for EU periphery versus CR

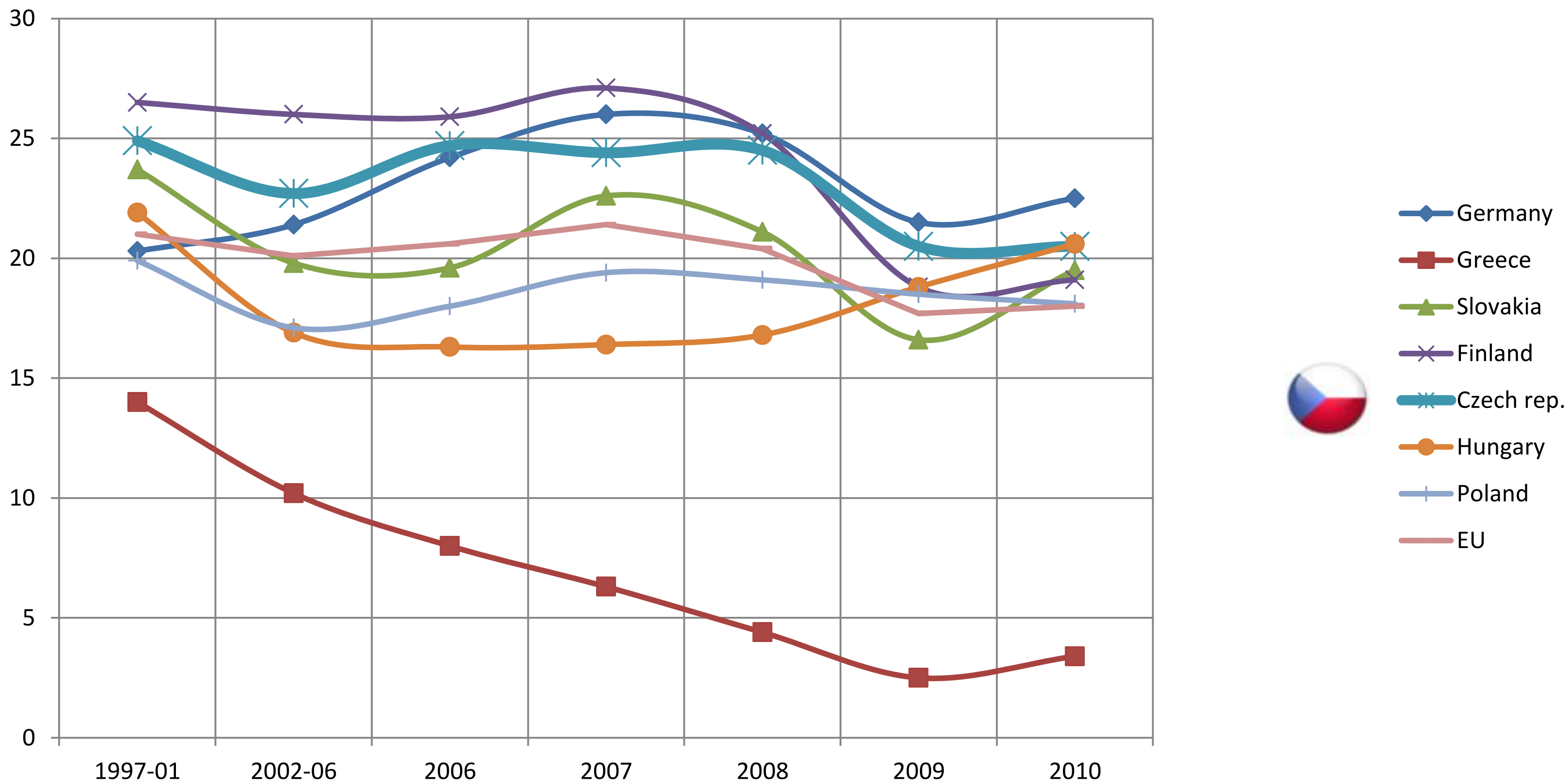
High debt/HDP ratio of periphery (PIIGS] while debt of CR relatively low (the 7th lowest)





Source: *Eurostat* *http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/database*

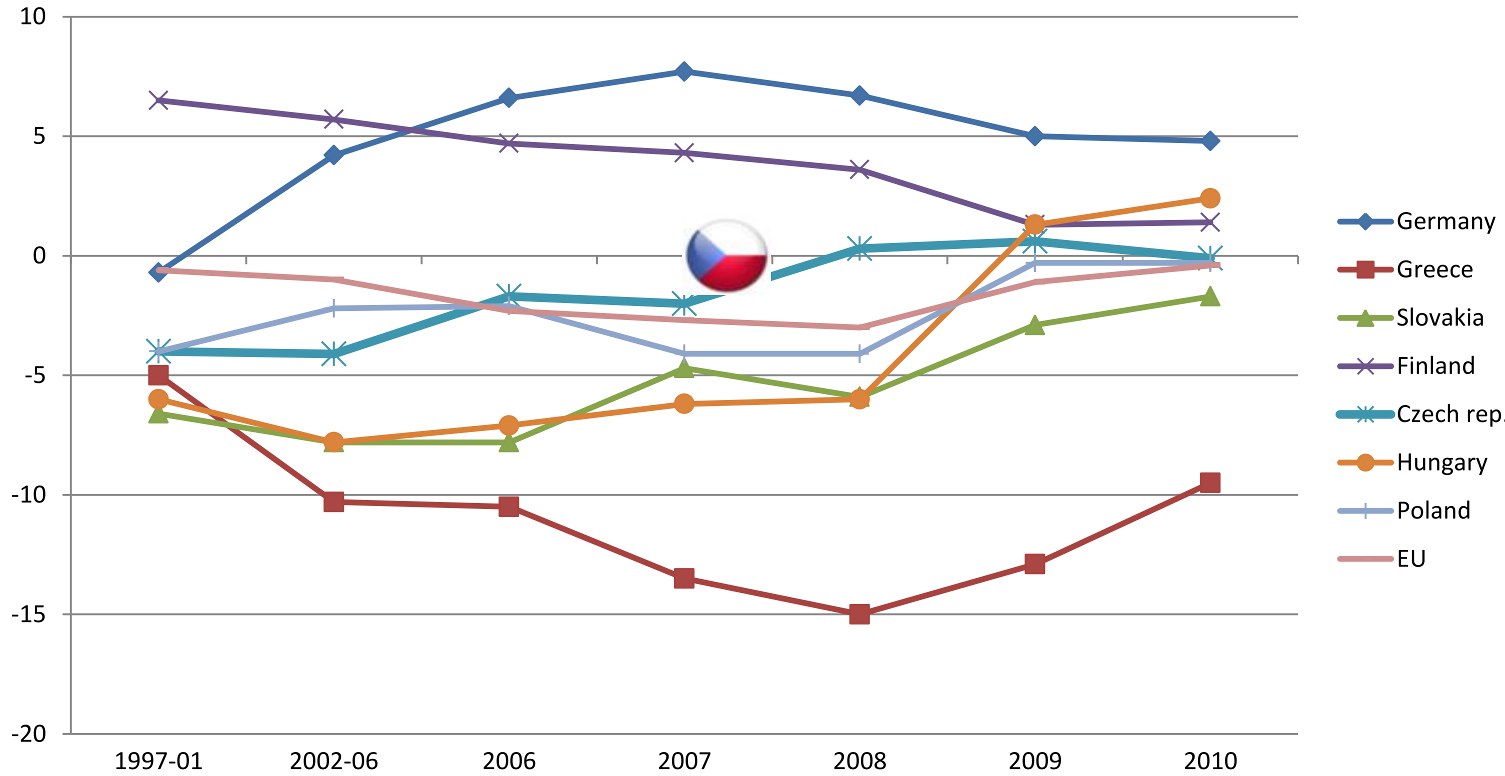
3. Gross national saving (as a percentage of GDP) supports the health of financial sector



Source: Statistical Annex of European Economy – Autumn 2010, Tables 43, 44 a 45, http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-7_en.pdft

3. Net Lending (+) or net borrowing(-) nation(as a percentage of GDP)

What was the quality of GDP growth ?



Source: Statistical Annex of European Economy – Autumn 2010, Tables 43, 44 a 45,
http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-7_en.pdft

3. Credit ratings EU members T-bonds EU by the end of 2012

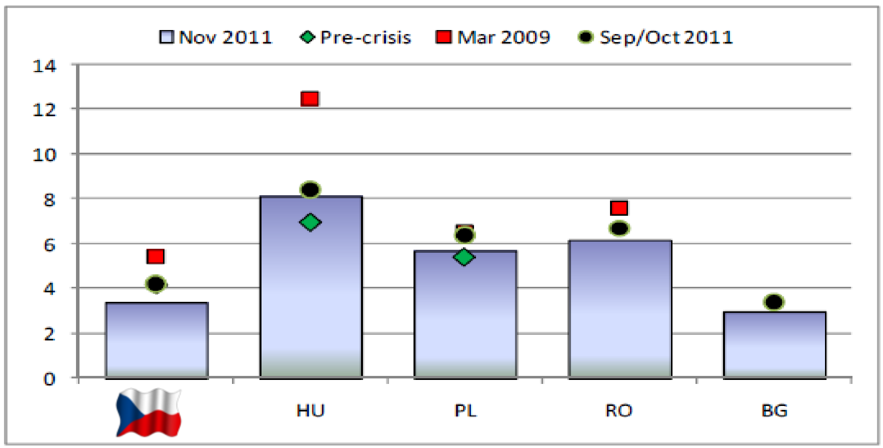
Rating	Fitch Ratings	Moody`s	Standard & Poor`s
AAA/Aaa	Denmark, Finland, France Luxembourg, Germany, Netherlands, Austria, Sweden United Kingdom	Denmark, Finland, Luxembourg, Germany, Netherlands, Austria, Sweden, United Kingdom	Denmark, Finland, Luxembourg, Germany, Netherlands, Sweden, United Kingdom
AA+/Aa1		France	France, Austria
AA/Aa2	Belgium		Belgium, Czech Republic
AA-/Aa3	Czech Republic	Belgium	Estonia
A+/A1	Slovakia, Estonia, Malta	Czech Republic, Estonia	
A/A2	Poland	Poland, Slovakia	Poland, Slovenia, Slovakia
A-/A3	Slovenia, Italy	Malta	Malta
BBB+/Baa1	Ireland, Lithuania, Latvia	Lithuania,	Ireland, Italy
BBB/Baa2	Bulgaria, Romania, Spain	Bulgaria, Slovenia, Italy	Bulgaria, Lithuania, Latvia
BBB-/Baa3	Hungary	Latvia, Romania, Spain	Spain
BB+/Ba1	Portugal	Hungary, Ireland	Romania
BB/Ba2			Hungary, Portugal
BB-/Ba3	Cyprus	Portugal	
B+/B1			
B/B2			Cyprus
B-/B3		Cyprus	
CCC+/Caa1			
CCC/Caa2	Greece		Greece
CCC-/Caa3			
CC/Ca			
C		Greece	
D			

Note: Domestic long-term rating, countries with a negative outlook are in red, countries with a stable or positive outlook are in green.
Source: Fitch Ratings, Moody`s, Standard & Poor`s

3. In 4Q 2012 Czech T-bond yields within the lowest Top 10 worldwide (around 2%). **CEE < PIIGS**

- 10Y bond yields quite low in history…

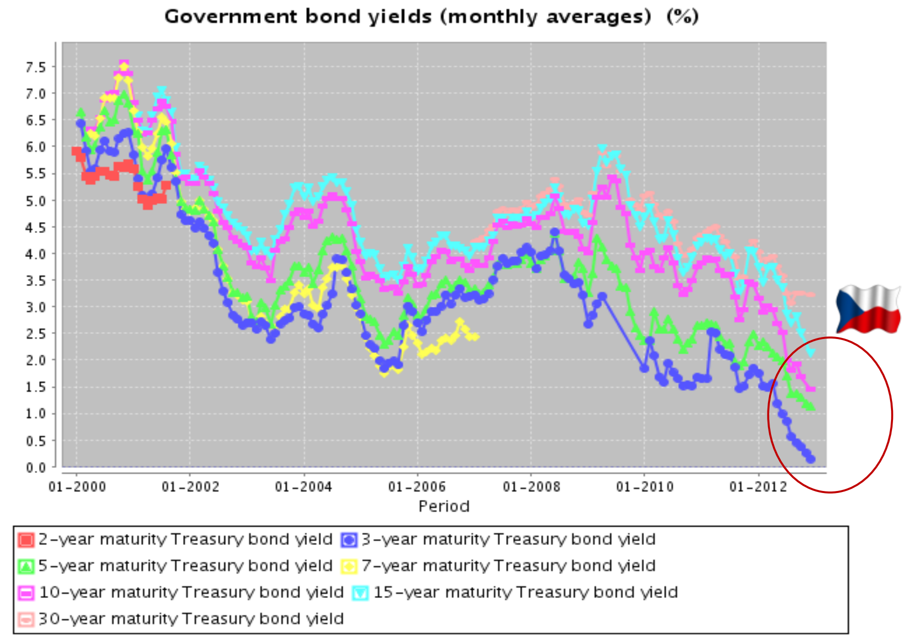
Figure 24. 10Y bond yields in the Czech Republic, Hungary, Poland, Romania and Bulgaria, percent



Source: Reuters, World Bank staff calculations

Notes: RO- pre-crisis not available, BG - data prior to 2011 not available

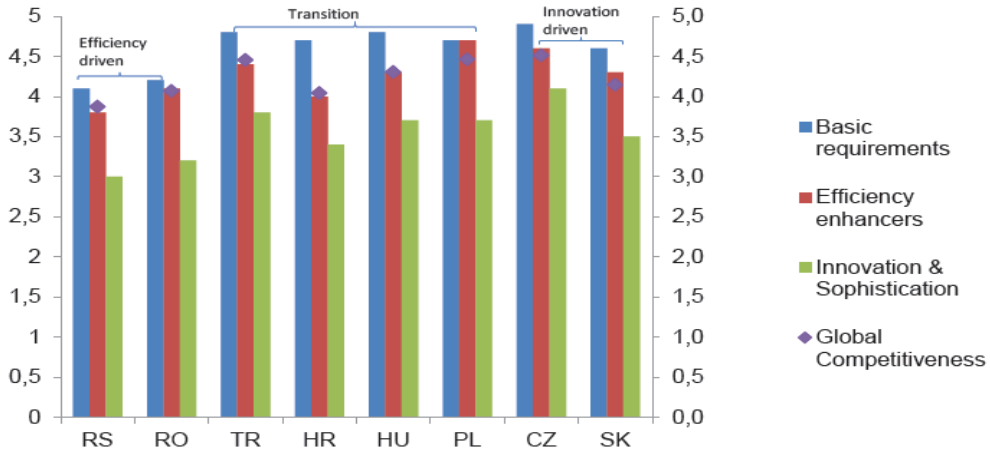
- …and continuing quite low now, cheap household and enterprise loans



Source: http://www.cnb.cz/cnb/STAT.ARADY_PKG.PARAMETRY_SESTAVY?p_sestuid=450&p_strid=EBA&p_lang=EN, *World Bank (2012)*

3. Regional competitiveness in CEE

The Global Competitiveness Index (range 1-7 with 7 highest rank)

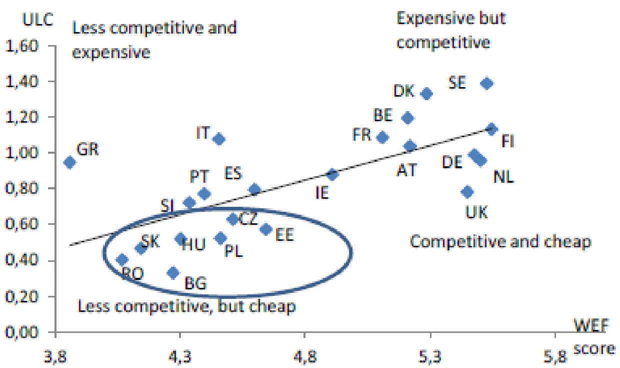


Who is competitive and rich?

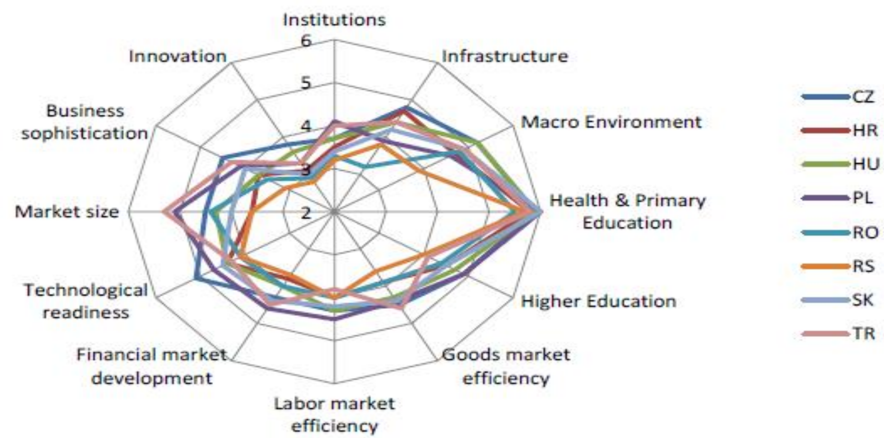
The graph shows country ranks by competitiveness (WEF rank) and by knowledge economy (KEI rank). The lower the rank, the better.

Source: WEF, World Bank , Erste Group Research (Size of bubble by GNI p.c., Atlas Method; innovative economies according to WEF in red color)

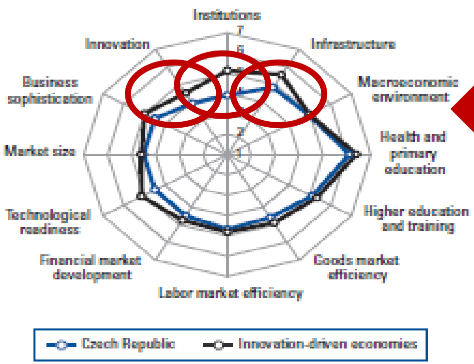
... but relatively cheap in terms of total unit labour costs (2011)



Strong on basic needs, weak on innovation



3. Competitiveness – price and non-price

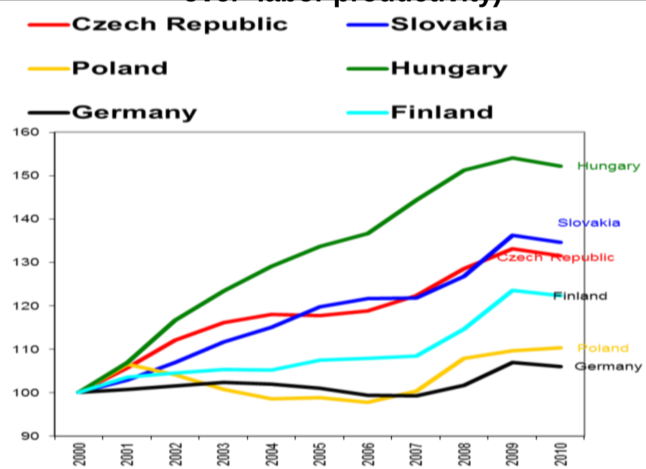


Main problems

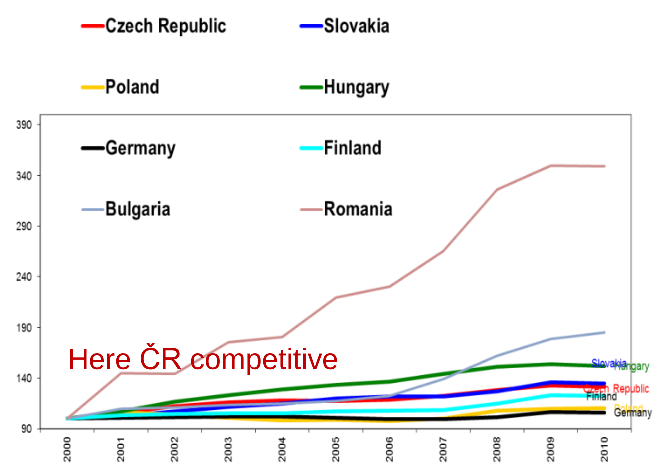
- Problem 3 i: inadequte institutions, infrastructure and underutilization of inovation potential threatens competitiveness ČR
- Another foreign trade threat koruna appreciation and excess growth of unit labor costs in comparison to the slower productivity growth
- Slovac example shows that eura is not a key

ČR:
→ STRATEGY MIX ?

Unit labor costs (full employee compensation over labor productivity)



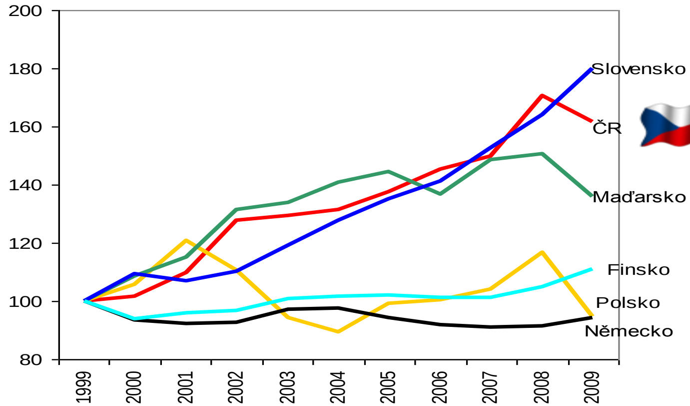
Unit labor costs – processing industry only



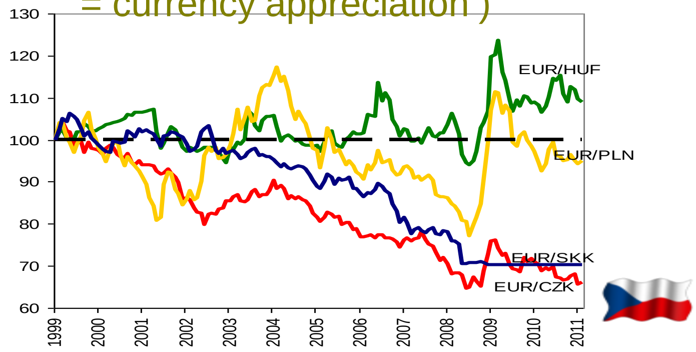
Source: Mejstrik (2011)

3. Competitiveness in costs and price…

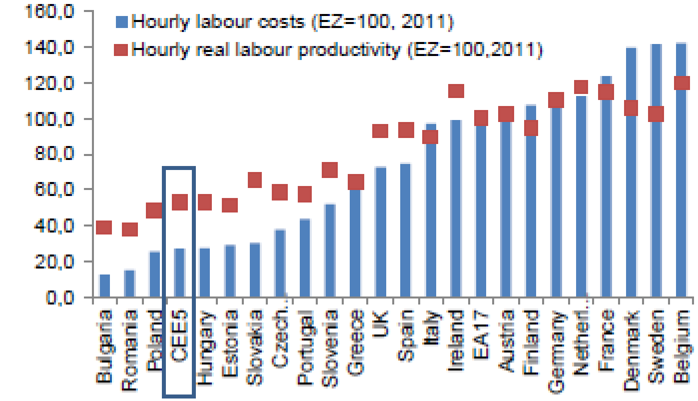
Real effective exchange rate (rok 1999=100)



Exchange rate (january 1999=100, downwards = currency appreciation)

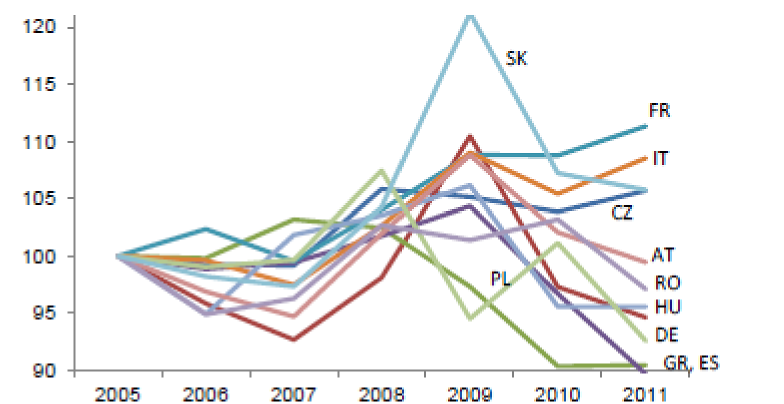


Labor productivity exceeds labor costs in CEE



Source: Eurostat, Erste Group Research

Real unit labour costs in manufacturing industry (2005=100, local curr.)

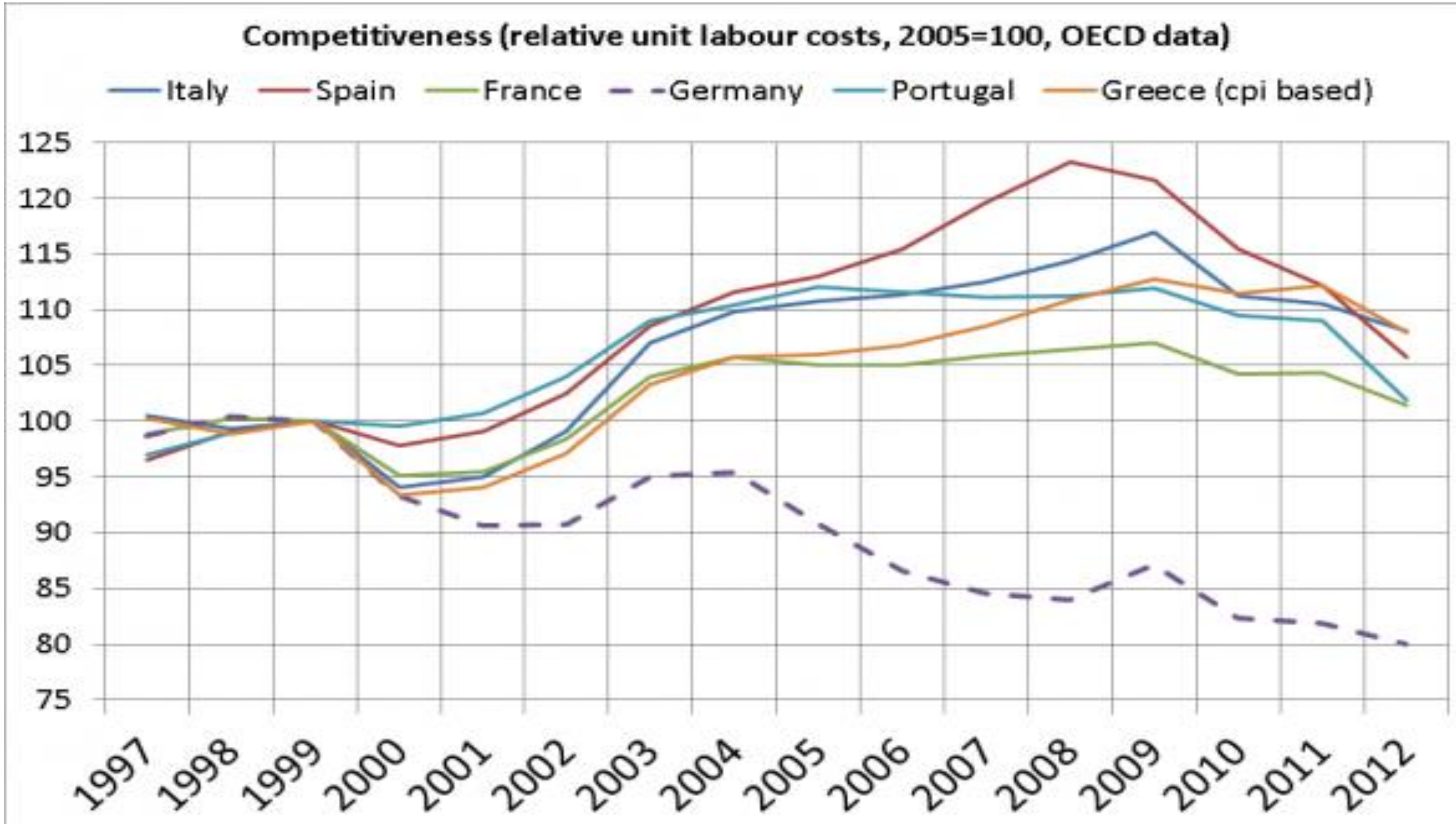


Source: Ameco, Erste Group Research, (RO shows real ULC for total economy)

source: Mejstřík et al (2011) , Erste (2013)

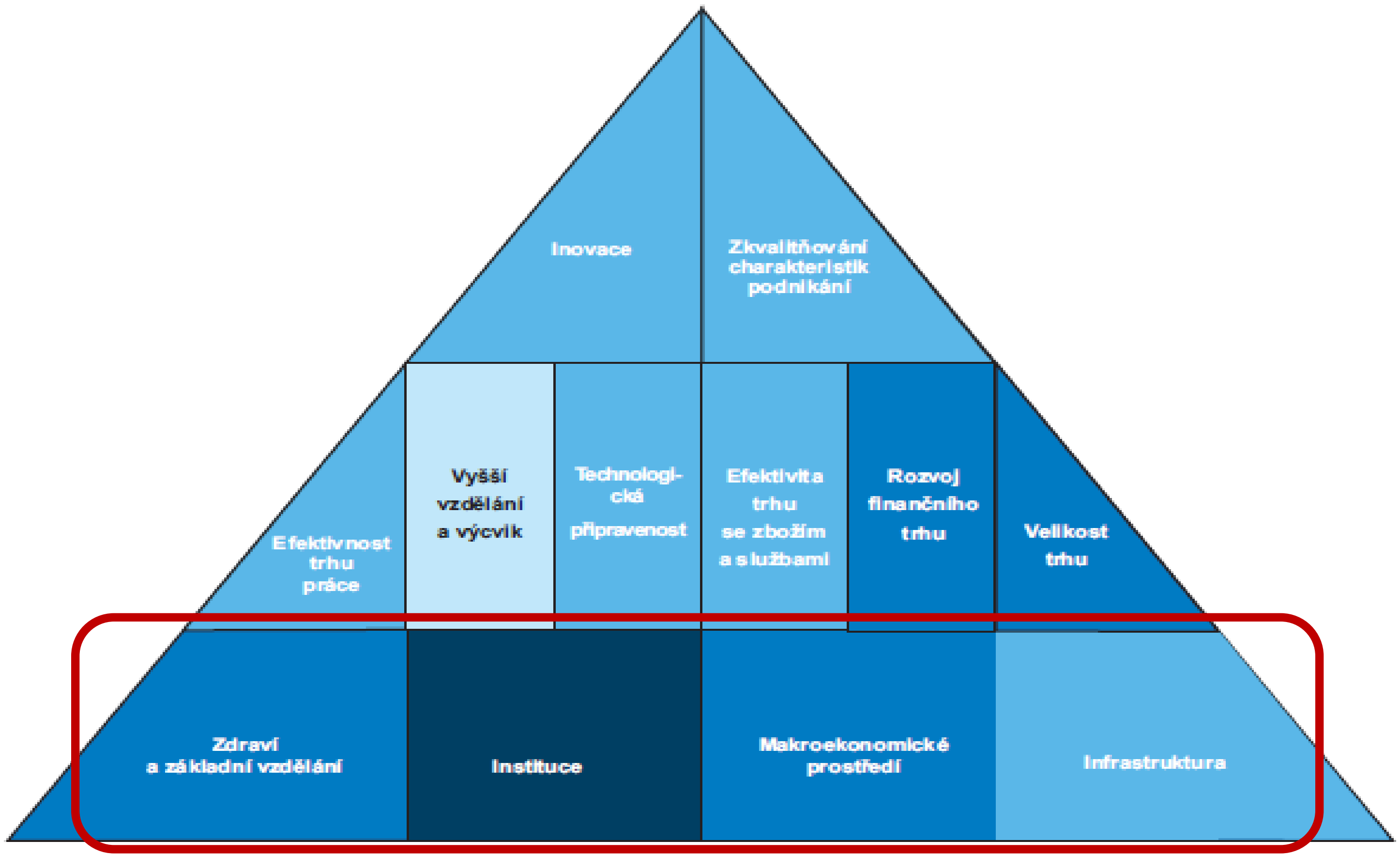
http://www.vlada.cz/cz/media-centrum/aktualne/nerv-ramec-strategie-konkurenceschopnosti-82538/

3. Price Competitiveness response in EU in the longer term



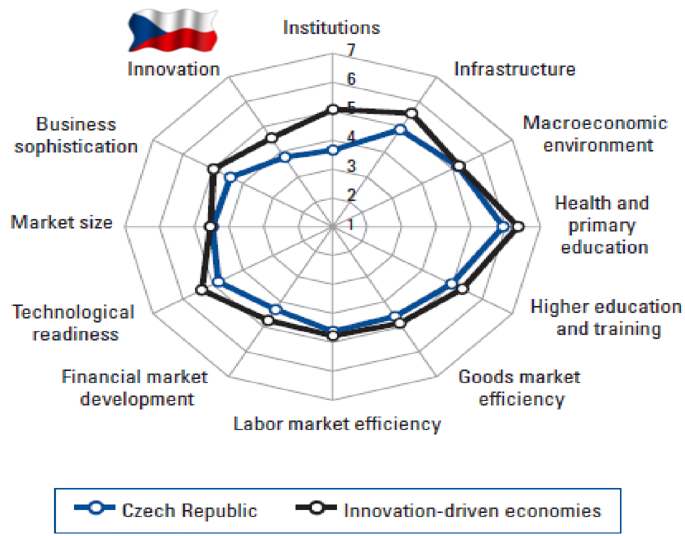
Zdroj: OECD (2013)

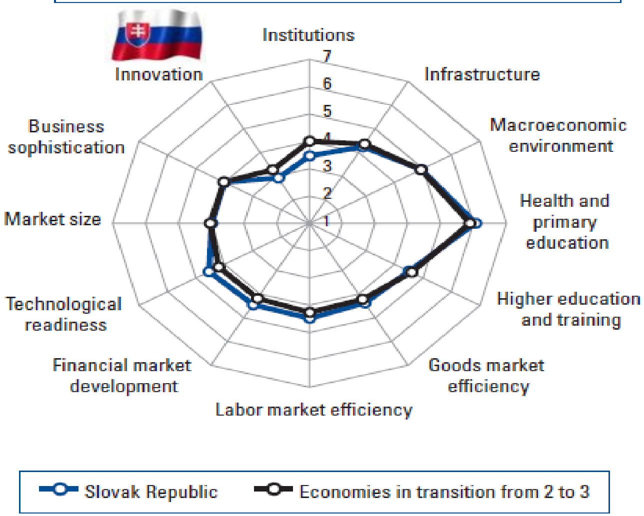
3. competitiveness
…nonprice – factor pyramide



source: Mejstřík et al (2011)
http://www.vlada.cz/cz/media-centrum/aktualne/nerv-ramec-strategie-konkurenceschopnosti-82538/

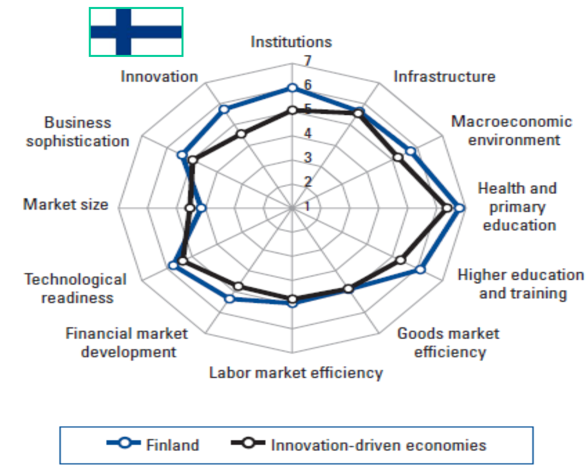
3. Global Competitiveness Index: problem 3i

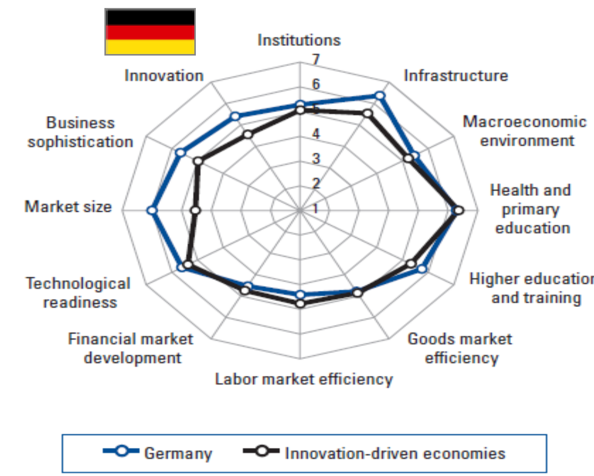




ČR is close to the average levels, but there is visible difference in **inovation, infrastructure,** and mainly in **institutions** (problem 3I).

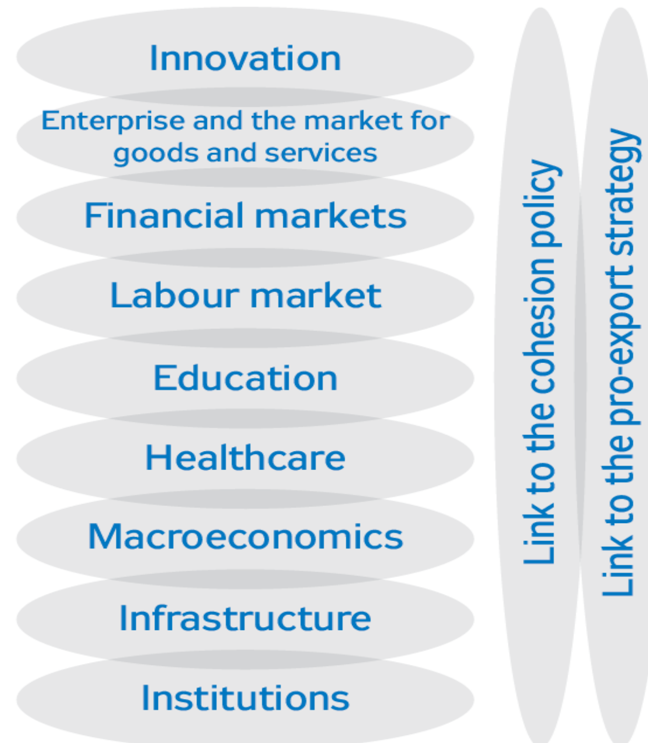
Source: WEF (2011-3)





3.Czech Competitiveness Strategy 2011 and its tools

- **nine pillars**
- **43 specific projects**
- **250 measures in 4 implementation programs**
  - **Public sector**
  - **Education and employment**
  - **Business environment**
  - **Economy of global innovation**
- **two links** to other strategic documents (cohesion policy, export strategy)
- **Interaction** with other conceptual documents and policies (Energy Policy, National Reform Program, National Innovation Strategy)



OECD Report on the CR (2011) highly appreciated Czech Competitiveness Strategy (2012–2020)

3. Implementation : Public Sector examples

- **Key measures**
  - **Running projects**
    - Pilot projects of overview of public budgets via the internet (few ministries, Prague municipality; “www. wheredoesmymoneygo.org” - UK)
    - New law on public tenders
    - Creation of single points of payment - Central management of social benefits , Labor office…
    - Introduction of RIA and CIA for concepts, Parliament initiatives and law amendmends, new RIA working committee of Legislative council of government
    - …
    - The implementation mechanism…

4. Preliminary conlusions

Conclusions

Consolidation of Corporate Governance within Financial and Industrial Sector

- ***M&A with other domestic companies*** – usually ST=one-off game based on contract.incompleteness,lack of domestic capital,unacceptable risks(IPFs)

- Better ***legislation and enforcement*** *Additional costs of bank regulation and supervision* vs. ***State subsidy***: usually moral hazard and inefficient, but large bank's pre-privatization clean-up ? *State konsolidacni agency owns the majority of non-performing loans. Sales of those assets in selected packages on the market or debt-to-equity swap*

- ***Acquisition by foreign owners*** : repeated LT game - if present value of future business attractive (such as pension funds, insurance, Škoda Auto, cleaned banks) New contractual architecture from inside international corporate standards. But not always positive (inadequate investor, market change) and gradual erosion if not supported by the improvement of weak local contracts.

Conclusions

New CEE tendencies responding to the emerging EU standards

- Industry Corporations mostly privatized
- Utilities privatization and liberalization speeds up
- Costs of Financial stabilization (and delayed banks´ privatization) plus Financial Restructuring of Companies for Taxpayers: E.g. Czech Fiscal innocence (since 1918 – Rasin prudential approach) will be lost – in spite of privatization proceeds consolidated public budgets debt might grow from neglectable 10% to 30% GDP just in few years partially due to transformation costs.
- CG Codes of conduct stepwise implemented – Warsaw (CG surveys – IEWS) + corporate social responsibility (pension funds)
- Transparency and Disclosure – corporate reporting improvements
- Twinning activities Corporate governance legislation – fine tuning compliance with international EU standards
- RIA (Regulatory Impact Analysis) for new draft acts to mitigate regulatory risk

Structural reforms needed to boost growth and employment. The crisis has continued to act as a catalyst for reforms also for CEE

The OECD (2013)acknowledged that implementing structural reforms could dig into government budgets, entailing cuts or tax rises at a time of fiscal austerity. But the eventual gains would outweigh the short-term costs . “In the longer term, the effect of structural reforms on the budget will differ mainly according to whether they boost growth through employment or productivity. In both cases, reforms generate higher tax revenues, but only in the case of employment are they likely to significantly improve the budget balance,” the OECD report said

One should press ahead with reform of the structure of their economies, especially jobs markets, in spite of the lack of growth. “Better structural policies will help achieve fiscal sustainability and provide greater leeway for monetary policy. Importantly, structural reforms can bolster confidence,” the OECD said in a report. It added that addressing problems in the jobs market was chief among the challenges facing many of the largest economies. “The absence of a vigorous and sustained recovery in economic activity has pushed a rising share of workers to the margin of the labour market in many OECD countries, hurting youth and the low-skilled most,” the report said. Unemployment figures striking.

In many emerging economies, pervasive informality represents a drag on potential growth, with large economic and social costs. The informal employment concerns between one-third and one-half of total employment in Brazil and Mexico, and well above that in India and Indonesia. Improving incentives to create and take-up jobs in the formal sector is clearly a common priority. Doing so requires extending the coverage of social protection, easing hiring and firing regulation, and providing adequate resources for primary and secondary education.

All of these measures are easier to implement in a context of strong growth. Emerging economies do have strong growth potential. But in most cases, fulfilling this potential requires the economy to be modernized

Conclusions

General problems Financial Supervision and Regulation

- **Governments should avoid interventions leading to making bad loans**. No more „homeownership targets“
- **Creative destruction of banking** (univerzal vs. Investment banks)
- **Minimal moral hazard.** Shareholders and governments should bear the consequences of their own past decisions as a principle of regulation. This is especially important in the today’s very diverse situation of both individual banks (banking groups) and national economies. More prudent players should not be levied the same costs as bigger risk takers. Economically and financially more stable countries should not carry the same costs as countries with riskier and more unbalanced economic policies in the recent past that were allowed by their financial regulators. The approval generates implicit liability.

Conclusions

Some banking De-globalization open issues : crisis response ?

The quarter-century leading up to the financial crisis saw a remarkable leap in globalisation. In particular, cross-border financial flows grew rapidly. Western investors piled into China and the other Brics. The new phenomenon of south-north flows emerged, as sovereign wealth funds from Asia and the Middle East acquired developed economy assets on a massive scale. But the fastest growth was in cross-border bank lending,

Since the crisis that last trend has gone into reverse*: cross-border lending has fallen sharply and the ambitions of major American and European banks have been scaled back. HSBC has withdrawn from a number of countries; Citibank and Barclay's have other preoccupations. The continental European banks are struggling to strengthen their capital bases, and emerging market assets have been realised to bolster the parents' balance sheets*.

So are we entering a new age of financial deglobalisation? If so, should we care?

Some of the retrenchment was inevitable, so we may as well welcome it. Banks had become overextended. Their appetites exceeded the capacity of their digestive systems. We need not regret the retreat of Icelandic and Irish banks to their geysers and Loughs. But there are signs that some of the withdrawal may be traced to regulatory actions, and to a form of financial protectionism, which could be as dangerous as protectionism in the trade of physical goods.

Source : Davies (2012)

Conclusions

General problems : Stimulus and Monetary Risk

- **Huge interventions generate historically unique double digit deficits in MT both in US and in UK** – how to handle them ?
- **Different potential scenarios of crises (deflation with depression, long stagnation, slow take-off with certain inflation, hyperinflation of stagflation). Who is engine of growth?**
- Hyperinflation – a threat for Chinese treasuries' investors – call for new global reserve currency (SDR ?) replacing USD with huge risk
- **Sociological problems of failed mortgage holders due to government misallocation into subprimes due to „homeownership“ goals**.
- **Global cycle** finance/industry **synchronization** due to economics of scale (e.g. global fashion waves…) limiting the impact of regional diversification

Conclusions

General problems : Wealth and power redistribution

- **Rising role of BRIC (except of Russia) demonstrated at G20 importance, in the World bank voting rights resulting in the massive defense of their interests.**
- **„Open Source" Policy is getting more wide spread. Protection of intellectual, intangible property rights (brands, innovations,…) less and less efficient and temporary monopoly of value added goods and services eroded. Smaller profitability and more rapid catch-up process.**
- **Global energy markets more synchronized inspiring China and India to go global : efforts to get an access to fragile energy sources in Africa, Latin America** and Australia due to economics of scale (e.g. global fashion waves…) limit the impact of regional diversification

Conclusions

General problems : R&D and global education

- **Minimize cyclicality of R&D expenses**
- **stabilize importance of apropriate strategies : education with international mobility segment.**
- **Rising role of dynamic human resources and their world-wide presence, their retraining**
- **Adequate solution of LT structural problems that were enlightened by current crisis ? New structure of less leveraged firms and households in the US ? What impact…**

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