VIII. THE CZECH REPUBLIC IN THE EUROPEAN UNION

VIII.1 Entering the EU

EU Accession Referenda

Country	Date	Yes	No	Votes Cast
Cyprus	No referendum	n.a.	n.a.	n.a.
Czech Republic	June 13–14, 2003	77.33%	22.67%	55.18%
Estonia*	September 14, 2003	66.92%	33.08%	64.02%
Hungary	April 12, 2003	83.76%	16.24%	45.59%
Latvia	September 20, 2003	67.00%	32.30%	72.53%
Lithuania	May 10–11, 2003	91.04%	8.96%	63.30%
Malta*	March 3, 2003	53.65%	46.35%	90.86%
Poland	June 8, 2003	77.45%	22.55%	58.85%
Slovakia	May 16–17, 2003	93.71%	6.29%	52.15%
Slovenia	March 23, 2003	89.61%	10.39%	60.23%

Source: PriceWaterhouseCoopers
* The referendum is not binding

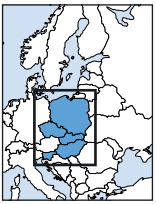
In May 2004, the Czech Republic, along with nine other countries, will become a member of the European Union. While the entry marks the culmination of a long accession process, it will not lead to any dramatic instant changes in the Czech economy. The effects of the integration process vis-à-vis the EU countries are already evident and will continue to be so for the foreseeable future. On the other hand, the EU accession will instantly liberalize trade and investment relations with other accession countries, which will likely lead to a faster integration process on this front. Ultimately, EU accession will lead to a dramatic economic change when the Czech Republic joins the EMU and accepts the euro as its currency.

The negotiations with the EU were completed at the end of 2002 and, at the December summit in Copenhagen, the date of accession was set at May 1st 2004 in order to enable the new member states to participate

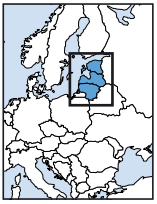
The Situation of the Candidate Countries I. (Data for 2002)

	CR	Hungary	Poland	Slovakia	Slovenia
Surface (1,000 km^2)	79	93	313	49	20
Population (millions)	10.2	10.2	38.2	5.4	2.0
Number of Votes in EP	24	24	54	14	7
GDP per Capita (in EUR)	14,400	13,600	9,500	11,400	17,700
GDP Growth (%)	2.0	3.3	1.6	4.4	3.2
Unemployment (%)	7.3	5.6	19.9	18.6	6.0
Inflation Rate (%)	1.4	5.2	1.9	3.3	7.5
Share of Agriculture in GDP (%)[1]	3.7	4.3*	3.1	4.5	3.3*
Life Expectancy (Men/Women)	72.1/78.4	68.3/76.6	69.5/78.1	69.9/77.6	72.1/79.6

Source: Czech Statistical Office, Canstat
* 2001 [1] as % of gross added value



in the 2004 European Parliament elections. On 16th April 2003 the Heads of States and Ministers met in Athens and signed the Accession Treaties, which were subsequently ratified in national referenda. Key issues that caused controversy and received much public attention included agricultural subsidies, Beneš decrees (which were used after World War II to expel the large German minority), and the case of the nuclear power plant near Austria (see part VII). In the end, none of these issues proved to be an obstacle to accession.



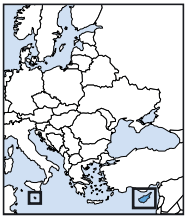
The Situation of the Candidate Countries II. (Data for 2002)

	Estonia	Lithuania	Latvia
Surface (1,000 km^2)	45	65	65
Population (millions)	1.4	3.5	2.4
Number of Votes in EP	6	13	9
GDP per Capita (in EUR)	10,000	9,400	8,500
GDP Growth (%)	6.0	6.7	6.1
Unemployment (%)	9.1	13.1	12.8
Inflation Rate (%)	3.6	0.4	2.0
Share of Agriculture in GDP (%)[1]	5.4	7.1	4.7
Life Expectancy (Men/Women)	65.2/77.0	66.2/77.6	65.4/76.8

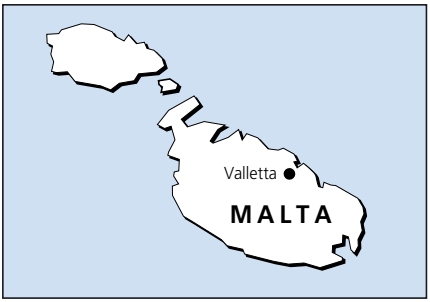
Source: Czech Statistical Office, Canstat

[1] as % of gross added value

The Czech Republic confirmed its will to join the EU in a referendum held on 13 and 14 June 2003. The results were quite unambiguous with 77% of participants saying "Yes" and 23% saying "No". The turnout rate was also relatively high at 55%, regardless of the fact that no minimum threshold was required for the referendum to be valid. As for political support for accession, it was highest among the parties of the ruling coalition (Social Democrats, Christian Democrats and the Freedom Union). The opposition Civic Democrats also expressed themselves in favor of entry but with many reservations and the former chair of the party and the current president, Václav Klaus, refused to give a clear yes in media coverage before the referendum. Finally, the Communists were against the accession.



Similar referendum results were obtained in other accession countries (except Cyprus, which held no referendum). The highest support rate was achieved in Slovakia (94%) and Malta featured the lowest level of support (54%).



The attitudes and expectations of the Czech population regarding EU entry are not always as optimistic as the high support achieved in the referendum would suggest.

The Situation of the Candidate Countries III. (Data for 2002)

	Cyprus	Malta
Surface (1,000 km^2)	9.0	0.3
Population (millions)	0.8	0.4
Number of Votes in EP	6	5
GDP per Capita (in EUR)	17,400	11,700*
GDP Growth (%)	2.2	1.2
Unemployment (%)	3.8	7.4
Inflation Rate (%)	2.8	2.2
Share of Agriculture in GDP (%)[1]	4.3	2.8
Life Expectancy (Men/Women)	74.8/79.5	75.8/81.0

Source: Czech Statistical Office, Canstat

* 1999 [1] as % of gross added value

In general, following from the Pew Global Attitudes Project "What the World Thinks in 2002", people in the Czech Republic, as well as in most other Central European countries, are more supportive of the EU than they are of their national governments, which explains the high support for entry. However, when asked whether they expected personal benefits from the Czech Republic's membership of the EU, only 36% answered yes while 40% answered no. In most of the other accessing countries (all except Estonia, Latvia and Slovenia), the people were more optimistic (Eurobarometer 2002.2, December 2002). In questions regarding the impact on their living standard, people were quite optimistic about the growth of their wages. On the other hand, the negative expectations typically concern the accessions' impact on prices.

Transitory Periods

Because of the large differences in economic performance and in prices and wages between the current and future member states, there were fears on both sides of the potentially negative impact of enlargement on certain markets and social groups. To calm these fears, certain transitory periods were required and negotiated. During these periods the full application of acquis will be postponed. Below is a list of the most important transitory periods and their brief characterization:

- *Free movement of workers from the Czech Republic into EU. For the period of two years there will not be automatic access to the labor markets of the current member states. Under certain conditions, this period can be prolonged by another three years and, under yet further conditions, by additional two years. After a maximum of seven years no further restrictions are possible. It is completely up to the individual current member states whether they will insist on this transitory period or open their labor markets earlier. Five countries, Denmark, Ireland, Netherlands, Sweden and United Kingdom, have promised free access to their labor market from the moment of entry.*
- *Seven-year transitory period for the acquisition of agricultural land and forests in the Czech Republic by current EU citizens. However, no restrictions shall apply to EU-born farmers with permanent residence in the Czech Republic.*
- *Five-year transitory period for the acquisition of secondary residential structures. As of today there are already no restrictions for the acquisition of immovable property by companies registered in the Czech Republic and by the subsidiaries of foreign companies.*
- *Agriculture. Gradual build-up of direct payments to the Czech farmers will occur in two stages. In the first stage (2004–2007), the direct payments will start at 25% of the EU level in 2004 and will increase by 5 percentage points every year. In the second stage (2008–2013), the direct payments will increase by 10 percentage points every year until 2013 when they get to the EU level. The Czech Republic will be allowed to make additional payments, also limited by certain ceilings, above the direct payments from the EU from its own resources.*

Payments to Czech Farmers

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Direct payments from EU (in % of EU level)	25	30	35	40	50	60	70	80	90	100
Maximum additional payment to % of EU level	55	60	65	75	85	95	100	n.a.	n.a.	n.a.

Source: Ministry of Foreign Affairs

- *Maximum five-year transitory period in road transport, disabling Czech road transport entrepreneurs from offering their services in the current member states. Negotiations are still being held regarding this transitory period, as the Czech Republic opposes its implementation. The major focus is on agreement with Germany, which represents a crucial market for the Czech truckers.*
- *Taxes. Permanent exemption enabling the Czech Republic not to require persons subject to VAT to register for this tax if their annual turnover is less than EUR 35,000. Transitory period until the end of 2007 for the application of lowered VAT rate on certain products and services (mainly heating and construction works). Transitory period until the end of 2006 for gradual increase of the excise taxes on cigarettes to a minimum level valid in the EU.*
- *Transitory period until the end of 2004 for the liberalization of the gas market. As of this time, the CR should achieve a market openness of at least 28%.*
- *Certain transitory periods in the area of environment. Until the end of 2010, for the clearing of municipal wastewater. Until the end of 2007, for the reduction of pollution by some pollutants from large combustion facilities. Until the end of 2005, for the treatment of packages and packaging waste.*
- *Transitory period of five years for a gradual build-up of contributions to the capital and reserves of the European Investment Bank; the first installment will not occur before mid 2005.*

Farewell to Regular Reports

Although negotiations with the EU were closed in December 2002, there remained some areas in which further progress with economic reforms and with the adoption, implementation and enforcement of acquis needs to be made. The areas in need of improvement are stated in the last European Commission report, issued in October 2003. This report concludes the process of regular annual assessments of the candidate countries.

In the area of economic issues, the Commission points out the need for deeper reform of the social benefits system, pension system and healthcare. Another economic problem is seen in the Czech Consolidation Agency (ČKA). The process of the sale of ČKA assets to private investors needs to accelerate in order to free the economy of the misallocation of resources. Also the transparency of the process remains a question and needs to be dealt with.

Regarding the adoption, implementation and enforcement of acquis, the emphasis is on the requirement that the Czech Republic meets all the commitments arising from the negotiation process. The Czech Republic has almost fully harmonized its legislation with the acquis. However, there are still certain areas, which are not yet fully in accordance or in which the alignment needs to be finalized. The most serious concerns are in the following areas:

- *Rules regulating the mutual recognition of professional qualifications;*
- *Several issues in the Agriculture area (e.g. veterinary and phytosanitary regulations);*
- *Road transport regulation;*
- *The long postponed closure of duty free shops;*
- *Inappropriate public procurement legislation allowing for preferential treatment of Czech firms and including clauses enabling the avoidance of public tenders;*
- *Legislation in the area of foodstuffs.*

The Commission examined not only the formal adoption of the rules but also the quality of their enforcement. In the area of implementation and enforcement, the Commission concluded that the Czech Republic was generally able to implement and enforce the acquis. The areas in need of improvement are the length of court proceedings and the fight against fraud, corruption and money-laundering.

VIII.2 Institutional arrangements

Number of votes in the European Parliament

	1999–2004	2004–2007	2007–2009
Belgium	25	24	24
Bulgaria	–	–	18
Cyprus	–	6	6
Czech Republic	**–**	**24**	**24**
Denmark	16	14	14
Germany	99	99	99
Greece	25	24	24
Spain	64	54	54
Estonia	–	6	6
France	87	78	78
Hungary	–	24	24
Ireland	15	13	13
Italy	87	78	78
Latvia	–	9	9
Lithuania	–	13	13
Luxembourg	6	6	6
Malta	–	5	5
Netherlands	31	27	27
Austria	21	18	18
Poland	–	54	54
Portugal	25	24	24
Romania	–	–	36
Slovakia	–	14	14
Slovenia	–	7	7
Finland	16	14	14
Sweden	22	19	19
United Kingdom	87	78	78
(Max) Total	**626**	**732**	**786**

Source: European Parliament

The coming enlargement of the EU has brought about a need for a change in its institutional system. The foundations of the current system were laid down in the 1950s, when there were only 6 member states. Since then, the number of states has increased substantially but, apart from the introduction of direct elections to the European Parliament, no major changes have occurred in the EU's institutional setup. In 2004 the number of members will increase to 25, introducing dramatic dispersion in the level of economic development. Thus, it was generally accepted that institutional reform must be agreed upon before the enlargement takes place. The process leading to such an agreement was completed at the Nice conference, where the so called Treaty of Nice was signed.

The treaty enhanced the role of the European Parliament and the Commission and distributed power (votes) across member states. However, the distribution of power across states is now again being hotly debated (with Poland and Spain being the countries which gained most from the Nice treaty). Each member country will have its EU commissioner and the selection of the Czech candidate is now in progress.

The European Constitution

The accession process having been completed, the Czech Republic is already focusing on its position within the enlarged EU. This position will depend, to a substantial extent, on the outcome of the current negotiations regarding the European Constitution. This document, prepared by the European Convent, a body established exclusively for this purpose, will bring together the founding treaties of the European Communities. Apart from that, it will bring changes to the decision making process within the EU, reflecting the substantially higher number of members. The negotiations represent an extremely complicated procedure as all the national governments, including the Czech one, are under strong pressure to achieve maximum satisfaction of national interests. However, to ensure that national interests are not overruled within the EU, one would have to stick to consensual decision making and this would prevent the Union from achieving progress on many fundamental issues. In such a case, the EU could loose momentum and become a useless, bureaucratic and costly superstructure of the national governments.

The most controversial issue is the system of voting in the Council of Ministers, the most important legislating body of the EU. The big states, especially Germany, France, Italy and the UK, pursue a mechanism that would account for the differences in the population among member states. Their favored proposal assumes that decisions would be taken by the so-called double majority, consisting of at least 50% of member states representing at least 60% of the EU population. This would, for example, mean that no decision could be passed if Germany and any of the two remaining states named above were against because this triple would always represent more than 40% of the population and could block the decision in question.

Some countries, including the Czech Republic, would be willing to accept a variant of this system but only with the thresholds being adjusted in favor of the smaller states. For example,

some of the suggestions assume that the two thresholds could be set at the same level, either at 60 or at 50 percent for both. Poland and Spain have a different attitude. They require that the system agreed upon in Nice in 2000 is embodied into the Constitution. This system ascribes a specific number of votes to each country and specifies what majority has to be obtained for which decisions. The allocation of votes according to the Nice Treaty is especially favorable for Spain and Poland.

There are two more important points of disagreement in the draft of the European Constitution, although in these cases agreement is more likely to be achieved than in the above problem. The first concerns the number of European Commission members. The draft Constitution assumes that the Commission would have 15 members with voting right and 10 members without voting right. Therefore, in some periods some states would not have a commissioner with a voting right. The smaller countries, including the Czech Republic, disagree with this system and wish to maintain the current principle of one commissioner with full voting rights per country, i.e. 25 commissioners with equal rights.

The last thing on which the member states disagree is the question of some reference to religion in the Constitution. The traditionally catholic states like Poland, Spain, Italy and Ireland, require that the Constitution preamble includes an explicit reference to Christianity. This is opposed, for example, by France, which has a large Muslim population. Also, it could represent a problem after the assumed accession of the Islamic Turkey.

The key negotiations regarding the Constitution were held in Brussels on December 13, 2003. As expected before their commencement, the crucial point turned out to be the allocation of votes in the Council of Ministers and, in particular, the contradictory attitudes of Poland and Spain on the one hand and Germany and France on the other. These starting conditions offered only a low chance of some acceptable compromise. Finally, the skeptical predictions came true and the negotiations broke down only shortly after their beginning as Poland and Spain made clear that they were not going to step back from their requirements on the implementation of the Nice Treaty into the Constitution. This, however, does not mean a final end to the efforts, of which the Constitution is a significant part, to reform the EU decision-making process. New talks are supposed to start at the beginning of 2004.

VIII.3 How Will the EU Benefit from the Enlargement?

The enlargement of the EU brings benefits both to the countries invited to join the EU in 2004 and to the current 15 EU members. While the new entrants will be net financial receivers of EU transfer funds for the first several years, the most important stream of benefits received by both entrants and incumbents occurs in terms of improved safety, regional stability and will be manifested throughout the whole EU economy.

1. Economic benefits

The new enlarged EU will become the largest free trade zone in the world in terms

of the number of consumers and will be comparable to the United States in terms of the total volume of GDP. Current EU firms will get direct access to an additional 70 million new consumers without any quota or tariff limitations. Independent studies estimate the neighboring countries will gain an additional 0.5% of GDP growth after the enlargement. Due to the lower labor costs in the new countries EU firms from high labor costs areas could gain from investing in the new member countries and hence be able to compete with low-cost American and Asian firms. In addition, as the new entrants grow richer, they will become a natural additional outlet for sophisticated design and high-value-added products that are hard to find a new market for.

2. Safety

As the new members of the EU club will be part of the developed Europe, they will have incentives to protect common values against both external and internal threats. The common immigration and safety policies enable both new and old members to fight organized crime, money laundering and terrorism more effectively. The closely watched borders will move eastward from the current members as the current border countries will become surrounded by EU members.

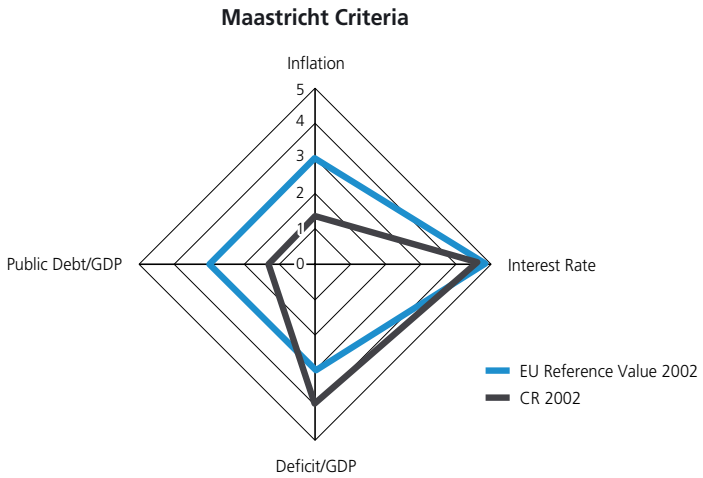
3. Stability

Although the risk of war in the accession countries is quite low, it will become almost nil after the accession and hence further increase regional and global stability. During the period of negotiation the new members had to adopt legal and business standards of the current EU members. This ultimately led to the improvement of their business environment, political culture and decrease of corruption; and such process will continue after the entry of the new members. Therefore, these countries become less risky and more stable. In addition, as a by-product, conducting business in the new countries will become cheaper.

The Common Agricultural Policy (CAP)

The EU can benefit form embracing 10 new members (Poland in particular) because their entry may exert pressure on the (long overdue) reform of the current system of agricultural subsidies. Such reform was politically not feasible within the current EU-15. The CAP consists of enormous subsidies for farmers. Among economists, it is widely considered to be a disaster. According to some estimates, the CAP may cost EU member countries as much as 3% of their total GDP per year when the indirect costs that farm protection imposes on other sectors (manufacturing, trade, and services) are taken into account (see Gylfason (1995) "The Macroeconomics of European Agriculture", Princeton Studies in International Finance, No. 78). Georganta (1997) "The Effect of a Free Market Price Mechanism on Total Factor Productivity," International Journal of Production Economics, suggests that had the CAP not applied to Greece in the years after it joined the EU, the growth rate of total factor productivity in agriculture would have been approximately four times what actually occurred under the CAP. The impact of CAP in the Czech Republic is likely to be similar, locking un-competitive farmers into an unproductive sector while preventing the efficient or environmentally friendly ones from growing.

VIII.4 Convergence?



One of the easiest ways of comparing economic performance of countries seeking membership in the EU is to measure their distance from the four convergence criteria set out in the Maastricht Treaty. Two are related to monetary issues, one is fiscal, and one is currency oriented. **(1) Convergence in inflation** is satisfied when inflation is not higher than 1.5% above the average of the three best-performing countries. **(2) Interest rate convergence** defines the maximum interest rate as 2% above the average of the three lowest interest rates among EU states. **(3) EMR convergence** requires two years without currency revaluation or devaluation. **(4) Convergence in deficit** stipulates a maximum budget deficit at 3% of GDP a year and governmental debt at 60% of GDP.

The Czech level of inflation has recently become acceptable but the distance from the reference numbers is widening in the public deficit criterion. Further, unless fiscal reform takes place soon, the public debt threshold will be broken as well. While the Czech Republic has a functioning market economy with the capacity to cope with the competitive pressure and market forces of the Union, the country has made little progress in catching

Maastricht Criteria

	Inflation	Interest Rate	Deficit of Public Budgets (% of GDP)	Public Debt (% of GDP)
EU Reference Value 2002	2.9	4.8	-3.0	60.0
CR 2000	3.9	7.4	-4.0	16.6
CR 2001	4.5	5.7	-5.5	23.3
CR 2002	1.4	4.6	-3.9	27.1

Source: National Bank of Belgium, The Bank of England, CNB (Česká Národní Banka)

Budget Deficits of EU - Accessing Countries (% of GDP)

EU Methodology (Maastricht)	2002	2003 est.	2004 est.	2005 est.
Bulgaria	-0.6	-0.7	-0.5	0.0
Cyprus	-3.5	-1.9	-0.6	-0.3
Czech Republic	**-3.9**	**-6.0**	**-5.7**	**-5.5**
Estonia	1.3	0.0	0.0	0.0
Hungary	-9.2	-4.5	-3.0	-2.5
Latvia	-3.0	-2.5	-2.2	-2.0
Lithuania	-2.0	-1.7	-1.6	-1.5
Malta	-6.2	-4.6	-3.9	-3.1
Poland	-4.1	-3.6	-3.3	-2.2
Romania	-2.2	-2.4	-2.4	-2.4
Slovak Republic	-7.2	-4.1	-3.1	-2.6
Slovenia	-2.6	-1.3	-1.0	0.8
Turkey	-10.0	-5.9	-3.0	-0.5

Source: Preparation of the Candidate Countries for Participation in Economic Policy Co-ordination

up with the EU GDP per capita levels, primarily because of policy failures resulting in the 1997 currency crisis and recession. If the Czech Republic fails to overhaul its fiscal expenditures, it is unlikely that it will be able to move closer to the EU's level of economic performance. Yet, the potential for convergence (in absence of further policy failures) is strong, thanks to a well-skilled labor force and a relatively high level of gross fixed capital formation with strong FDI.

Can Countries with Such Low Growth Rates Ever Catch Up with the EU?

The growth data from transition countries suggest that these countries have not trimmed much from the income gap between themselves and the EU during the last decade. There is however a substantial argument that incomes have been converging at a much faster rate because statisticians tend to (or at least tended to do in the early transition years) overestimate inflation rates. These high rates were caused by neglecting the improvements in quality and variety of goods, which were provided at higher prices. Thus the growth of nominal GDP was ascribed to inflation instead of technological improvements.

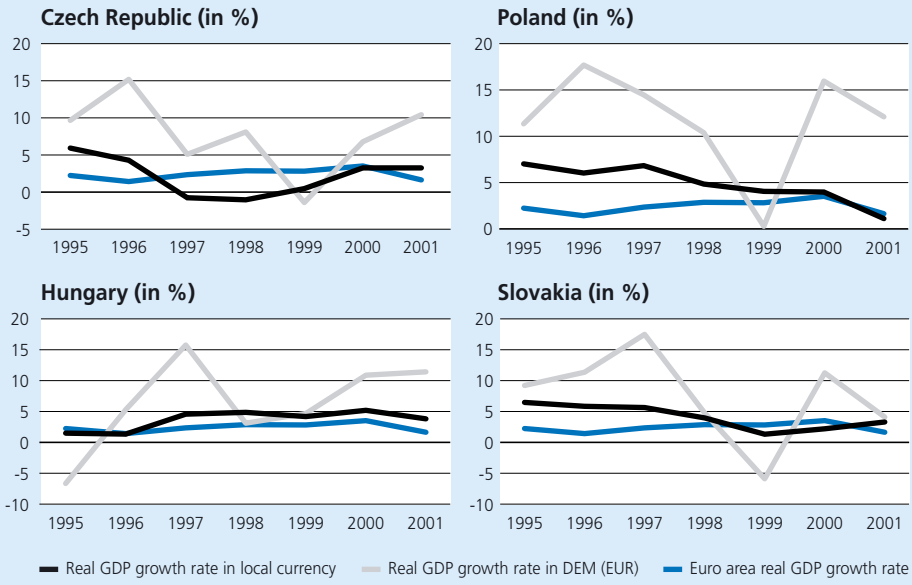
One possible approach to demonstrating this overestimation of inflation is to look at the growth of GDP converted to a foreign currency of a developed economy. This method is based on the theory of purchasing power parity (i.e. the long-run comparability of the consumer basket prices in both countries). Purchasing power parity requires the full flexibility of the domestic currency that devaluates according to "true" inflation. Since the currencies of the

Czech Republic, Hungary, Poland, and Slovakia are internationally traded in large amounts, we can assume that their exchange rates cannot be influenced domestically over a long period of time. We have chosen DEM as the foreign currency since Germany is the biggest trading partner of the transition countries in question. (From 1999 onwards, the DEM exchange rate is computed using the euro exchange rate.)

GDP expressed in Deutsch Marks is then deflated by the German GDP deflator to obtain the real GDP series. The figures compare the growth rate of real GDP expressed in the domestic currency, growth rate of real GDP expressed in DEM, and the growth rate of the Euro zone GDP for comparison.

As expected, the growth rates expressed in DEM are most of the time significantly higher than the growth rates in local currencies for all countries. In the case of the Czech Republic, the Euro area outperformed the Czech GDP growth (measured in local currency) in four out of seven periods displayed. However if we consider the GDP converted to DEM, the Czech growth rates are strictly higher than those of the Euro zone for all the years except 1999, and are as high as 15 percent. We get a similar picture looking at the figures of Hungary, Poland and Slovakia.

When we subtract the DEM-measured GDP growth in a transition country from the GDP growth in the Euro area, we obtain a much better measure of the true speed of convergence. On average, the transition country's growth exceeds the Euro area growth by 4.5% (Slovakia), 4.8% (Czech Republic), 6% (Hungary) and 9.2% (Poland). The transition countries seem to be converging to the Euro zone's income levels at a much faster pace than is usually perceived. This belief of slow convergence speed may be a statistical illusion rather than a real phenomenon.



Source: OECD Statistical Database

VIII.5 EU Accession and Labor Migration

Labor mobility was a contentious issue during the accession negotiations. Germany and Austria in particular insisted on a transitory period before lifting all restrictions on employment of Czech workers inside the current EU.

The average monthly wage in the EU is about four times higher than the average wage in the Czech Republic while living in the EU is only about two-and-a-half times more expensive. This wage gap has triggered fears that labor markets in the West will be flooded by cheap labor from the East, crowding out indigenous workers, reducing wages and social standards. The final agreements allow the current EU-15 countries to restrict the employment of Czechs for up to 7 years.

Yet, the expectations of large inflows of Eastern European workers are probably exaggerated. Europeans in general and Czechs in particular are very immobile (see chapter VI.2). If large within-country differences in wages and unemployment are not sufficient to induce people from North Bohemia to move a mere 100km to Prague, why should they move even farther abroad where they would lack the language skills? A sneak preview of how much migration can be expected is provided by a German policy of attracting foreign IT professionals by giving away 20,000 work permits. Three years after the program was introduced, only 319 Czechs took advantage of it. Cross-border commuting from the Czech Republic to Austria and Germany, while prevalent in the early 1990's, has actually been declining since then. The reported number of commuters at the German border reached a high of 12,400 in 1992, while today it is around 5,000. For yet more evidence we can look at the accession of Portugal, Spain and Greece in the 1980s, when similar restrictions on labor movement were imposed. Once lifted, no significant labor migration occurred.

Economists' estimates of the inflow of Czech workers into Germany produced an upper bound of 35,000 workers over a four-year period, but the actual number is expected to be much lower.

Do Czechs Want to Work Abroad?

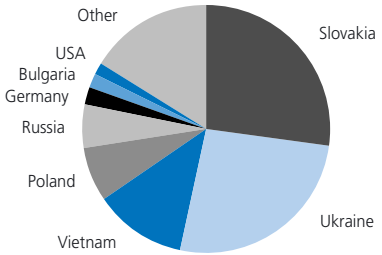
The Germans may fear an inflow of workers from the East, but are the Czechs interested? The Czech Research Institute of Labor and Social Affairs conducted surveys about the intentions to work abroad or the actual migration experience. (Complete results are available at http://www.vupsv.cz/ in Czech, English and German).

- *In one piece of research concerning pendlers (over-the-border commuters), a sample of 1,197 citizens from border regions were questioned with the help of labor offices, and customs officers. 5.1% of citizens had at some point experienced commuting to Austria, 2.7% to Germany. Only 2.2% went abroad at some point for a longer stay. The prevailing age of pendlers is 40–49 years, and only one fifth of them are women.*
- *A nation-wide survey of more than 4,500 citizens verified that the vast majority of respondents (86%) are not interested in working and living abroad. Among those respondents*

who would consider emigration, only 12% have taken concrete steps to get information about it. Among them are mainly young people who want to study, travel and get short term experience abroad. The most popular countries for possible emigration are Germany, USA and Canada, and Austria. The increasing popularity of the English language among the young should further mitigate the concerns about the Czechs' migration to Germany and Austria in the longer term.

Once the Czech Republic joins the enlarged EU, it will increasingly have to deal with a new challenge: immigration to the Czech Republic by non-EU citizens. Currently, foreign inhabitants in the Czech Republic represent 2.3% of the population, which is low relative to that of the EU (9% in Austria and Germany), but higher than in other CEE countries. The pie chart shows the distribution of foreigners holding residence permits as of end of 2002 by their country of origin.

Legal foreign residents by country of origin



Legal Migration from and to the Czech Republic (Number of Persons)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
From the Czech Republic to Austria (Emigrants), from Austria to the Czech Republic (Immigrants)														
Emigrants	127	226	182	29	26	16	41	57	59	137	92	93	235	377
Immigrants	19	138	255	444	281	314	307	201	178	144	122	102	131	339
From the Czech Republic to Germany (Emigrants), from Germany to the Czech Republic (Immigrants)														
Emigrants	832	1,226	1,393	205	79	108	195	207	237	245	361	379	701	1,087
Immigrants	38	4,30	1,286	1,671	1,391	1,374	1,198	942	859	688	560	537	470	987

Source: Statistical Yearbooks of the Czech Republic

Illegal Migration from and to the Czech Republic

Citizenship	1993	1994	1995	1996	1997	1998	1999	2000
Czech	1,537	1,648	2,040	2,526	2,014	1,715	1,948	
Foreigners	41,765	18,832	17,132	21,179	27,325	42,957	30,377	
From the Czech Republic	41,327	17,030	15,374	18,680	22,011	37,142	26,951	27,585
To the Czech Republic	1,975	3,450	3,798	5,025	7,328	7,350	5,374	6,134
Crossing the Border with								
Austria	1,663	1,320	1,114	1,762	2,251	3,480	4,535	3,660
Germany	40,133	16,047	14,407	16,654	20,860	32,859	19,820	20,021

Source: Ministry of Interior

The 1999 Immigration Act made the entry and residence conditions for most foreigners actually stricter. However, traditionally, Slovak citizens have enjoyed virtually unrestricted access to the Czech labor market – with the only requirement being registration at an employment office.

VIII.6 Capital Markets in the Accession Countries

The main stock exchanges in CEE (Bratislava, Budapest, Ljubljana, Prague and Warsaw) were established at approximately the same time in the early 1990's. Their startup was different; Bratislava and Prague started with large amounts of equities from the voucher privatization while the other three markets gradually increased the number of listed securities.

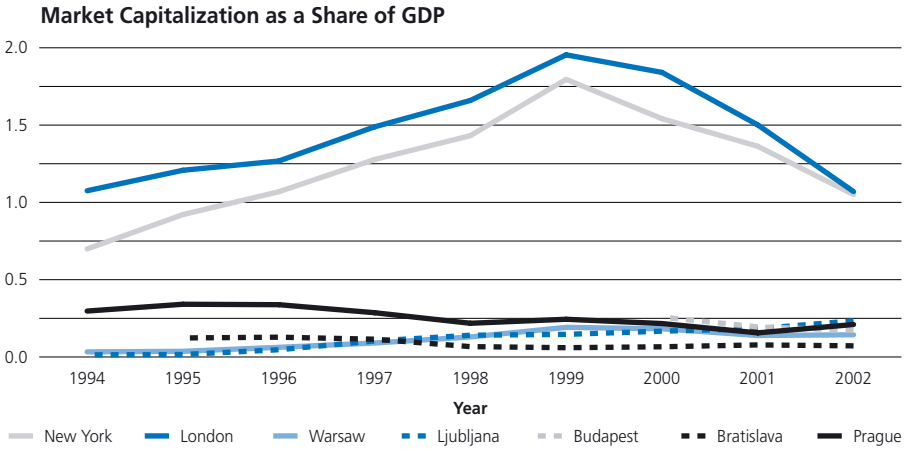
Later, the stock exchanges developed in different ways. The Budapest Stock Exchange introduced derivatives and index trades, in Warsaw short positions were made possible, in Prague the dealer's market was set up besides the traditional auctions. All these developments contributed to an increase of liquidity and attraction of foreign investors. However, the exchanges still do not function as standard developed stock exchanges and they lack full transparency. Making the markets system more transparent is the key to attracting new investors and new firms seeking cash.

All the problems notwithstanding, investment in these markets sometimes produced enormous returns (sometimes highly volatile, too). The table shows that the last year was particularly good and the gains in indices exceeded 13% in all markets. Measured in dollars, the gains in the indices were enhanced by appreciation of the local currencies, so the return on a dollar investment in the Prague index would surpass 50%.

The exchanges should cooperate more closely in order to increase liquidity. After all, each of them is a very local market with an unavoidably limited base of investors and tradable securities. So far, they have only been publishing a common index (CESI) since 1996. One of the most serious obstacles to closer integration is the large costs of a new trading system that no exchange is willing to undertake. Only Ljubljana Stock Exchange bought a new system in 2003, which made future cooperation even more problematic.

Year-to-year returns on stock market indices in local currencies (%)

	Jan 2000-Jan 2001	Jan 2001-Jan 2002	Jan 2002-Jan 2003	Nov 2002-Nov 2003	compound return Jan 2000-Nov 2003
Czech Republic	-9.47	-15.28	9.46	34.42	12.84
Hungary	-14.69	-0.46	-7.68	14.64	-10.13
Slovakia	19.28	34.38	28.02	19.67	145.56
Poland	-9.25	-8.75	-13.81	31.16	-6.39
Slovenia	-1.38	17.47	50.06	13.94	98.08
Average	-3.10	5.47	13.21	22.77	42.04



Source: International Federation of Stock Exchanges, website of the respective exhanges, authors' calculations

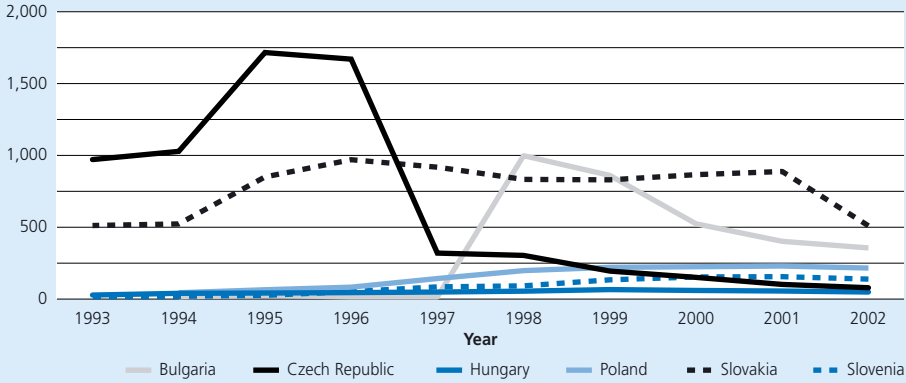
Whatever the stock exchanges intend to do they should do it fast. After EU accession competition from the established European markets, namely Deutsche Bourse and Vienna, will increase and with it the risk that many investors and most liquid securities will leave. It is also possible that the local stock exchanges will integrate with some of the bigger European ones and thus will cease to function as separate markets.

Does the method of privatization affect capital market development?

The problems faced by CEE's stock markets today can to some extent be attributed to early transition privatization policies. The most questionable in this respect is the voucher privatization method that was with certain modifications implemented in the majority of transition economies. It was popular because of its high speed. Moreover, it seemed well suited for the nonstandard environment where there were few buyers with sufficient funds, a weak banking sector, valuating firms was a tricky business and foreigners were reluctant investors.

Yet, voucher privatization also had some unanticipated costs. In countries that used it, the shares of privatized companies were usually subject to mandatory listing on the stock exchange (see table). This is a strange way to create a capital market because privatization authorities, not firms themselves, were the ones to decide who would be listed. Some firms that would otherwise prefer to be privately owned ended up being public. Some firms that would not meet listing requirements of a typical western stock exchange were listed, too. Such strict administrative arrangements bypassed the traditional market development by gradual selection of the best firms. This method was very common in the stock markets in these countries, but it was non-transparent and most of the securities were illiquid. Massive delisting followed (see graph).

Number of companies listed on stock markets



Source: Homepages of national stock exchanges

Note: The numbers above include companies listed at both official and free markets. However, the frequency of trading and conditions necessary to enter these markets differ around countries

While delisting is not bad per se, delisting hundreds of companies within a short period of time certainly sent a negative signal to investors, whose confidence was already fragile because of imperfect legislative framework and weak enforcement.

On the other hand, capital markets that started with a small number of issues and voluntary initial public offerings (namely Poland and Hungary) were not plagued by these problems. Warsaw Stock Exchange in particular has been relatively successful in attracting both issuers and investors. 27 new companies were introduced to the Warsaw Stock Exchange in the last two years.

All in all, it is possible to speculate that mass privatization has negatively influenced the creation and functioning of capital markets in the transition economies. Such long-term consequences of mass privatization were not anticipated at the time when privatization decisions were made.

Origins of stock markets in transition countries

Mandatory listing after voucher privatization	Voluntary initial public offerings	Mandatory listing of minority packages during privatization
Bulgaria	Croatia	Armenia
Czech Republic	Estonia	Azerbaijan
FYR Macedonia	Hungary	Kazakhstan
Lithuania	Latvia	Kyrgyzstan
Moldova	Poland	Poland
Romania	Slovenia	Russia
Slovakia		Ukraine
		Uzbekistan

Source: Claessens S., Djankov s., Klingebiel D. (2000): "Stock Markets in Transition Economies," Financial Sector Discussion Paper No.5, The World Bank.