Overview of Central/Eastern Europe and Czech Republic

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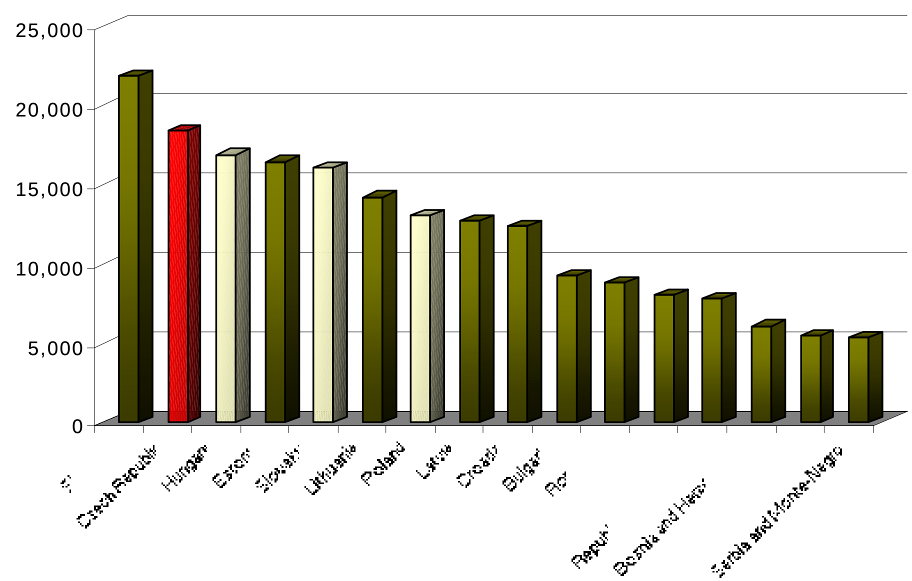
CEE – General facts (1)

GDP per capita (PPP, 2005 in USD)



CEE – General facts (2)

	Area (km2)	Population (mil.)	GDP (2005 in EUR bn)	Exports in % of GDP (2005)
Slovenia	20,273	2	27.4	64.6
Czech Republic	78,866	10.2	98.4	71.7
Hungary	93,033	10.1	87.8	64.9
Estonia	45,227	1.3	10.7	78.4
Slovakia	49,034	5.4	37.3	76.8
Lithuania	65,301	3.4	20.6	52.4
Poland	312,685	38.2	242.8	33.7
Latvia	64,589	2.3	12.7	47.4
Croatia	56,538	4.4	30.9	49.4
Bulgaria	110,994	7.8	21.4	60.1
Romania	238,391	21.6	79.3	33
Turkey	n/a	n/a	n/a	n/a
Republic of Macedonia	25,713	2.1	4.5	41.8
Bosnia and Herzegovina	51,129	3.8	7.5	38.7
Albania	n/a	n/a	n/a	n/a
Serbia and Monte-Negro	102,713	8.2	20.9	27.1

Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

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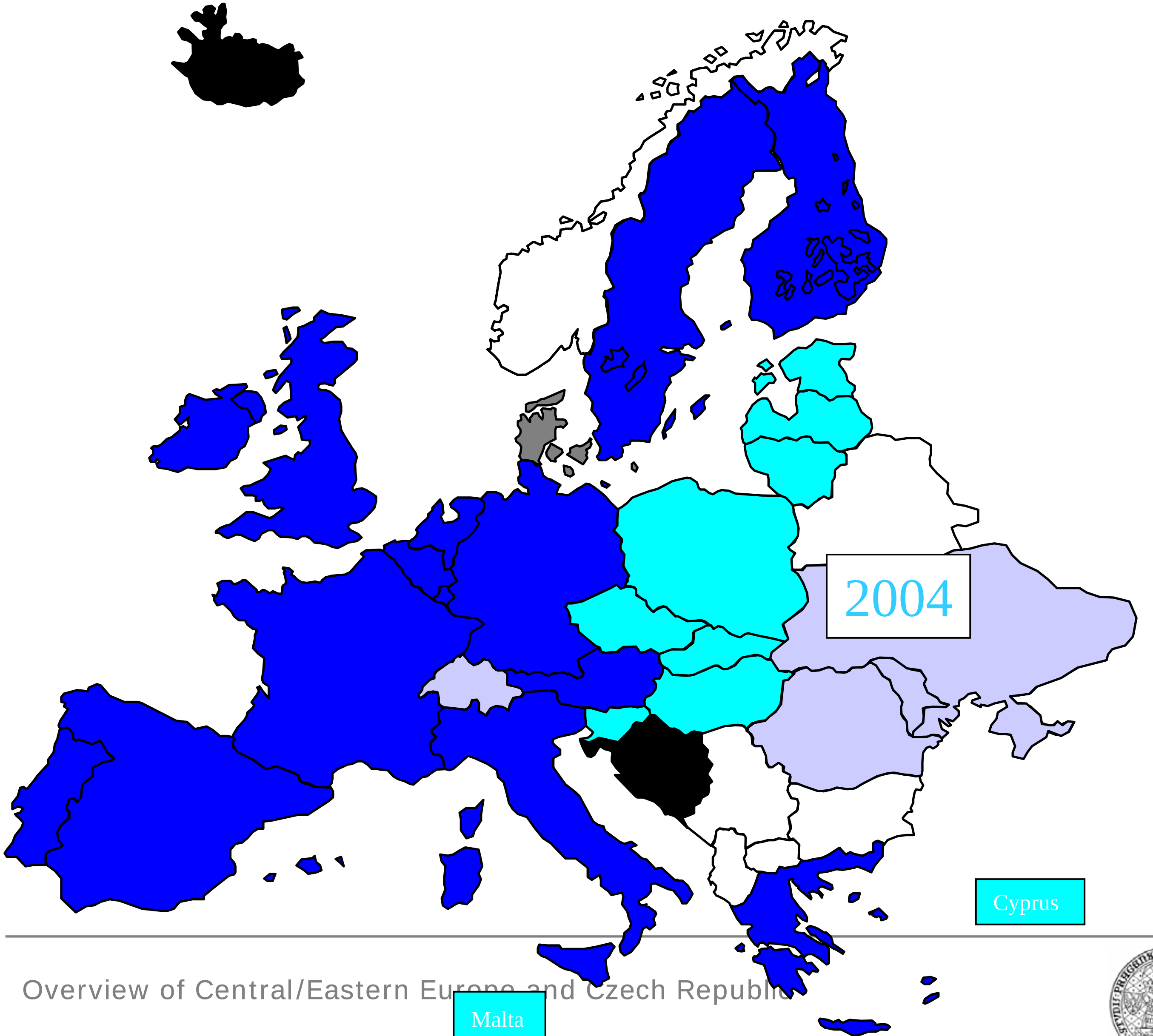
Ten New EU Member Countries as of 1 May 2004



History – Central European countries

Czech Republic

- October 28, 1918 - Creation of independent Czechoslovakia
- March 15, 1939 - Occupation of Bohemia and Moravia by Nazi Germany
- May 1945 - Liberation from Nazi occupation by the Soviet Army and the US Army, Warsaw Pact
- February 25, 1948 - Communist take-over (Coup d´Etat) of power
- Spring 1968 -"Prague Spring" reformist movement (August 20, 1968 occupation by Warsaw Pact Armies)
- November 17, 1989 - "Velvet Revolution", end of communism
- January 1, 1993 - Independent CR and SR
- May 27, 1999 - CR became member of NATO
- May 1, 2004 - Accession of CR to EU

Slovakia

- 1918 - Slovakia + Bohemia + Moravia ⇒ Czechoslovakia
- 1938 - Munich Agreement - Slovakia - separate republic controlled by Nazi Germany.
- After WW II, Czechoslovakia reassembled, under the influence of SU
- 1989 - End of communist rule
- January 1, 1993 - Federation dissolved
- June 1992 – President V. Meciar
- 1998 – M. Dzurinda - launching a policy of economic and social reforms and acceleration of economic and political integration into Western Europe.
- 2004 - Slovakia joined both NATO and EU

Poland

- WWII. - Warsaw surrendered on September 28, 1939 ⇒ at its conclusion Soviet Union (SU) - right to occupy former Polish territory - Molotov-Ribbentrop Pact partially confirmed, SU instituted a new communist government in Poland ⇒ 1948 - beginning of the totalitarian rule
- 1952 - The People's Republic of Poland officially proclaimed
- 1980 - Formation of the independent trade union, "Solidarity" = erosion of the dominance of the communist party
- 1989 - Elections – Solidarity won ⇒ 1990 - Lech Wałęsa (Solidarity)-president
- Shock therapy program during the early 1990s enabled the country to transform
- 1999 - Poland became member of NATO
- May 1, 2004 – Accession of Poland to EU

Hungary

- WWII - On the losing side
- 1947 - Elections brought the communists to power
- 1956 - Anti-Soviet revolution that left thousands dead
- After reprisals and the consolidation of the regime, János Kádár began a programme of 'goulash' (consumer-oriented) communism ⇒ his reforms worked, and by the mid-1970s, Hungary was the most developed, most liberal and the richest nation in the region.
- 1988 - Kádár was ousted - the continuing spectre of unemployment, a high inflation rate and increasing debt
- 1989 - The Republic of Hungary
- April 1999 - Hungary became member of NATO
- May 1, 2004 – Accession of Hungary to EU

History – Baltic states

Estonia

- 1920 - Peace treaty – SU recognising Estonia independence
- 1939 - The Nazi-Soviet non-aggression pact - Estonia under the Soviet sphere of influence
- 1941- Adolf Hitler's troops occupation
- 1944 - The Soviet reoccupation
- 1988 - Singing Revolution
- November 1988 - Declaration of sovereignty
- August 1989 - Human chain - wish of the Baltic States for independence
- August 1991 - Estonia declared full independence
- March 29, 2004 - Estonia became member of NATO
- May 1, 2004 – Accession of Estonia to EU

Lithuania

- February 16, 1918 - Resolution on the restoration of the independent state of Lithuania, with the capital in Vilnius
- 1920 - 1938 - Vilnius occupied by Poland. Kaunas became provisional capital
- 1940 - Molotov-Ribentropp pact - Lithuania occupied SU
- 1941 - 1944 - Lithuania occupied by the Nazi Germany
- 1944 - 1953 - Resistance movement to stop the Soviet occupation, forced collectivisation, mass persecutions and deportations
- 1988 - SĄJŪDIS independence movement established
- March 11, 1990 - Restoration of the independence of the Republic of Lithuania
- 1993 - Soviet troops left Lithuania
- 2004 - Lithuania became member of NATO
- 2004 – Accession of Lithuania to EU

Latvia

- November 18, 1918 - Latvia’s independence (recognised by SU)
- August 23, 1939 – M.-R. Pact ⇒ June 17, 1940 - the Soviet army occupation, a few months later Latvia forcibly incorporated into SU
- Summer 1941- Latvia invaded by German occupation forces
- 1944 - USSR reinvaded Latvia ⇒ 1945 - Latvia again under SU
- mid 1980s - Liberalisation within the communist regime in the USSR, known as ‘glasnost’
- August 23, 1989 - Human chain 600 km from Tallin to Rīga, Vilnius - wish of the Baltic States for independence
- May 4, 1990 - Latvian SSR parliament adopted a declaration for the restoring independence following a transition period ⇒ August 21, 1991- independence
- 2004 - Latvia joined both NATO and the European Union

History – Bulgaria and Romania

Bulgaria	Romania
➢ WW II. - Bulgaria led a policy in the interest of Germany and the Axis powers ➢ After the end of World War II - Bulgaria under the political and economic influence of the SU ➢ 1946 - Bulgaria proclaimed a republic, the communist party came to power = the Queen-Mother, King Simeon and Princess Maria-Louisa left Bulgaria for Egypt via Turkey, the economy and banks were nationalised, the arable land was organised in cooperatives ➢ November 10, 1989 - the beginning of the democratic changes in Bulgaria ➢ 1991 - New Constitution was adopted ➢ 1991 – Bulgaria became a member of the Council of Europe ➢ March 29, 2004 - Bulgaria became a member of NATO ➢ April 25, 2005 - Signing the Treaty of Accession, set to join EU on January 1, 2007 at the earliest	➢ WW II. - Romania entered the war joining Nazi Germany, Italy, Hungary and Bulgaria - under the leadership of Marshal Ion Antonescu ➢ August 1944 - Antonescu regime toppled, Romania joined the Red Army against Nazi Germany ➢ 1946 - With the Red Army forces still stationed in the country, communists and their allied parties claimed 80% of the vote Romanian elections, establishing themselves as the dominant force ➢ 1947 - King Michael I forced to abdicate and leave the country, Romania proclaimed a communist state, under direct military and economic control of the USSR until 1958 ➢ 1958 - Retreat of Soviet troops from Romania ➢ Late 1960s and the beginning of the 1970s - Short-lived period of relative economic well-being and openness - this period gradually ended ⇒ Ceauşescu - Romania police state ➢ December 22, 1989 - Communist dictatorship ended - power was taken by an ad hoc group called the National Salvation Front (FSN) ➢ 2004 – Romania became a member of NATO ➢ April 25, 2005 - Treaty of Accession of Romania has been signed

History – Albania, Turkey, Macedonia

Albania

- November 29, 1944 - Communists control of the country - Enver Hoxha
- 1946 - The People's Republic of Albania and, in 1976, the People's Socialist Republic of Albania, Albania turned to the communist world: Yugoslavia (1944-48), the SU (1948-61), and China (1961-78) – economic benefits - aid and credits, the assistance of a large number of technicians and specialists
- 1985 - Ramiz Alia, sought to preserve the communist system while introducing gradual reforms in order to revive the economy - legalized some investment in Albania by foreign firms and expanded diplomatic relations with the West.
- December 1990 - Alia endorsed the creation of independent political parties
- March 1992 - a decisive electoral victory was won by the anticommunist opposition led by the Democratic Party. Alia resigned as president and was succeeded by Sali Berisha
- Since 1990 - Albania has been oriented towards the West, it was accepted to the Council of Europe and has requested membership of NATO

Turkey

- 1923 - Foundation of the modern Republic of Turkey by Mustafa Kemal Ataturk
- 1939-45 - Turkey manages to remain neutral during the second world war
- 1946 - Charter membership of the UN
- 1952 - Turkey joins NATO
- 1960 - Military coup, successive governments ineffective
- 1964 - Associate member status of EU
- 1974 - Cyprus crisis
- 1980 - Kanan Evren leads military coup, 3 years of military government
- 1983 - Turgut Ozal elected prime Minister
- 1985-90 - Full EU membership for Turkey impeded by Cypriot issue and questions over human rights
- 1991-93 - Suleyman Demirel elected Prime Minister, inflation at 70%
- 1993-96 - Demirel President, Tansu Ciller Prime Minister, Turkey joins EU Customs Union
- 1997-98 - 5 attempts at forming coalition governments, Islamic Welfare party disbanded, reforms as Virtue and is the largest single party in parliament. Military intervenes to prevent Islamicists forming governments.

Republic of Macedonia

- 1941 - Yugoslavia occupied by the Axis Powers and the Vardar Banovina (Southern Serbia, including all of what is now the Republic of Macedonia) divided between its neighbours, Bulgaria and Albania
- After WW II. - Tito (communist partisan) Yugoslavia's president, the People's Federal Republic of Yugoslavia established
- Macedonia as one of the six republics of the Yugoslav federation
- 1963 - Renamed as the Socialist Republic of Macedonia
- September 8, 1991 - Independence day - the referendum endorsing independence from Yugoslavia
- Republic of Macedonia remained at peace through the Yugoslav wars of the early 1990s
- 1999 - Destabilized by the Kosovo War
- Albanian radicals on both sides of the border took up arms in pursuit of autonomy or independence for the Albanian-populated areas of the Republic ⇒ March-June 2001 short war between government and ethnic Albanian rebels, ended with the intervention of a NATO
- 2005 - Macedonia officially recognized as a European Union candidate nation

History – Ex-Yugoslav countries

Slovenia

- November 29, 1945 - Slovenia became a part of the Socialist Federal Republic of Yugoslavia
- Spring 1990 - Slovenia became the first Yugoslav republic to hold free elections
- June 25, 1991- Declaration of independence
- January 15, 1992 - EC formally recognised the country. Slovenia was admitted to UN in May 1992
- 2004 - The country was one of a host of countries to be admitted to the EU and NATO. In a referendum in that same year, voters embarrassed the government by rejecting moves to restore civil and property rights removed from nationals of other Yugoslav republics following independence.

Serbia and Montenegro

- 1992 - Upon the break-up of the Socialist Federal Republic of Yugoslavia, the remaining confederation of Serbia and Montenegro reconstituted as the Federal Republic of Yugoslavia (FRY).
- UN and many individual states refused to recognise it, although they accepted it as constituting a state due to the ongoing Yugoslav wars. The FRY was also suspended from a number of international institutions because of its perceived role in the wars. It was re-admitted to the UN in 2000.
- 2002 - Serbia and Montenegro came to a new agreement regarding continued cooperation, which promised the end of the name Yugoslavia.
- February 4, 2003 - Federal parliament of Yugoslavia created a loose commonwealth of Serbia and Montenegro. A new Constitutional Charter was agreed to provide a framework for the governance of the country.
- Based on the results of a referendum held on May 21, 2006, Montenegro declared independence on June 3, 2006.

Bosnia and Herzegovina

- 1946 - Bosnia and Herzegovina became one of the six constituent republics of Yugoslavia under the communist regime
- October 1991 - Fearing Serbian domination, vote for a declaration of independence from Yugoslavia
- 1992 - Sovereignty recognized by EC, and it entered UN
- Many Bosnian Serbs opposed the new republic, in which they were a minority, and Serb troops, both from Serbia and Bosnia, began to carve out the Serb-populated areas and declared the Serbian Republic of Bosnia and Herzegovina. Croats in Bosnia, also fearing Bosniak domination, declared their own Croatian Community of Herceg-Bosna (Bosnian Serb leader Radovan Karadzic later indicted in absentia by UN tribunal for war crimes)
- December 1995 - Dayton - peace accord - central government and two semiautonomous regions
- Peacekeeping forces remain in the region

Croatia

- After the WWII. - Croatia was granted republic status within the Yugoslav Federation, governed by the communist Marshal Tito
- 1990 - Franjo Tudjman's - Croatian Democratic Union won elections
- June 1991 - Croatia declared its independence from the Federation, the Serbian enclave of Krajina declared its independence from Croatia. Heavy fighting broke out throughout the country, and the Yugoslav People's Army, dominated by Serb communists intervened. Croatia agreed to freeze its independence declaration for 3 months. Fighting continued.
- December 1995 - Dayton agreement - stability to the country
- January 2000 - Croatian Democratic Union, Stipe Mesic president - opened up the economy, democratised and pursued membership of the EU and cooperated with the tribunal in the Hague, re-elected in 2005
- Croatia is currently in the process of joining EU, accession negotiations started in December 2005

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Demographic situation - Summary

	Total population (million)		Net migration (per 1,000 citizens)		Infant mortality (per 1,000 births)		Above 65 (%)	
	1995	2005	1992	2005	1993	2005	1993	2005
Albania	n.a.	3.56	n.a.	-4.80	n.a.	21.52	n.a.	8.60
Bosnia and Herzegovina	n.a.	4.03	n.a.	0.30	n.a.	21.05	n.a.	10.90
Bulgaria	8.43	7.45	-10.70	-4.30	15.50	20.55	14.20	17.20
Croatia	4.78	4.50	2.00	1.58	9.90	6.84	n.a.	16.60
Czech Republic	10.33	10.24	1.10	0.97	8.50	3.93	12.90	14.20
Estonia	1.45	1.33	-27.10	-3.18	15.60	7.87	12.50	16.80
Hungary	10.34	10.00	1.80	0.86	12.50	8.57	13.80	15.10
Latvia	2.50	2.29	-20.50	-2.24	16.20	9.55	12.80	16.10
Lithuania	3.64	3.60	-6.60	-0.71	15.70	6.89	11.60	15.20
Poland	38.58	38.64	-0.30	-0.49	15.40	8.51	10.50	13.00
Republic of Macedonia	n.a.	2.05	n.a.	-0.70	n.a.	10.09	n.a.	10.80
Romania	22.71	22.33	-1.30	-0.13	23.30	26.43	11.30	14.60
Serbia and Monte-Negro	n.a.	10.83	n.a.	-1.30	n.a.	12.89	n.a.	15.00
Slovakia	5.36	5.43	-0.50	0.30	10.60	7.41	10.50	11.90
Slovenia	1.99	2.01	-2.80	1.00	6.80	4.45	11.40	15.40
Turkey	n.a.	69.66	n.a.	0.00	n.a.	41.04	n.a.	6.70

Source: Eurostat, World Bank, World Factbook
Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

- Besides fertility, net migration is an important factor influencing total population. This is important when considering the effects of an ageing population on, for example, the future sustainability of health and social security systems. Many of CEE countries reported negative level of net migration.

- As in majority of European countries, the population of CEE countries is decreasing.
- The share of the age group above 65 years increases significantly in all the countries.
- Infant mortality rate is relatively high in comparison to EU, where this indicator declined to 5 in 2003. Only in the Czech Republic and Slovenia infant mortality is below this level.

Demographic situation – Age structure

	up to 14	15-24	25-49	50-64	65-79	more
Albania	25.6	65.8			8.6	
Bosnia and Herzegovina	18.3	70.7			10.9	
Bulgaria	14.2	13.8	35.3	19.7	14.2	2.9
Croatia	16.4	67			16.6	
Czech Republic	15.2	13.8	36.7	20.4	11.1	2.9
Estonia	16.6	15.1	34.7	17.8	13	2.8
Hungary	15.9	13.4	36.1	19.1	12.3	3.2
Latvia	15.4	15.4	35.4	17.7	13.3	2.9
Lithuania	17.7	15.3	35.9	16.1	12.2	2.8
Poland	17.2	16.7	36.1	17	10.6	2.4
Slovakia	17.6	16.5	37.7	16.8	9.3	2.3
Slovenia	14.6	13.8	38.2	18.4	12.2	2.9
Republic of Macedonia	20.5	68.7			10.8	
Romania	16.4	15.6	36.8	16.8	12.2	2.2
Serbia and Monte-Negro	18.1	66.9			15	
Turkey	26	67.3			6.7	

Source: Index mundi
Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

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Economic situation - Summary

	GDP real (yoy, %)		Gross fixed capital formation (real, yoy, in %)		CPI (yearly average)		Unemployment (yearly average)		Budget balance (in % of GDP)		CA (% of GDP)		FDI (inflow, net in EUR mil.)		Gross foreign debt (in % of GDP)		Average exchange rate - / EUR
	2002	2005	2002	2005	2002	2005	2002	2005	2002	2005	2002	2005	2002	2005	2002	2005	2004
Bosnia and Herzegovina	5.5	5.5	-	-	1	2.5	-	-	-3.7	0	-22.1	-24.6	280	400	444.3	33.6	1.96
Bulgaria	4.9	5.3	8.5	13	5.8	4.5	17.4	11.7	-0.6	1.5	-5.6	-9.8	951	1800	65.1	65.5	1.96
Croatia	5.2	3.5	10.1	2.5	2.3	3.3	22.5	18.3	-5.2	-5	-8.4	-5.7	1195	1100	67.6	85.6	7.5
Czech Republic	1.5	4.8	3.4	2	1.8	1.9	9.2	9.7	-6.8	-3.5	-5.6	-2.7	8791	6800	36.4	37.4	31.9
Estonia	7.2	7.7	17.2	11	3.6	3.7	10.3	9.3	1.5	0.6	-10.2	-10.6	167	1920	60.1	82.3	15.65
Hungary	3.5	3.7	9.3	7.3	5.3	3.7	5.8	7.1	-8.5	-6.1	-7.2	-7.7	2670	3000	56.6	71.4	251.7
Latvia	6.4	9	13	13.5	1.9	6.6	12	9.8	-2.3	-0.8	-6.7	-10.6	265	390	73.6	99.8	0.67
Lithuania	6.8	6.5	12.4	11	0.3	2.8	13.8	10.5	-1.4	-2	-5.1	-7.8	754	580	39.5	43.9	3.45
Poland	1.4	3.2	-6.8	4	1.9	2.1	20	18.2	-3.3	-3.9	-2.7	-1	4371	3410	40.7	43.1	4.53
Republic of Macedonia	0.9	3.5	10		1.8	1.2	31.9	33	-5.6	-1.5	-9.5	-6.2	83	90	43.4	41.5	61.9
Romania	5.1	4.7	8.2	9	22.5	9	10.2	6	-2.5	-1	-3.4	-8.9	1194	4000	31.2	39.6	40.532
Serbia and Monte-Negro	3.8	4.5			21.2	15	29	32.5	-3.4	0.2	-8.9	-6.6	595	1510	76.5	57.6	72.6
Slovakia	4.4	5	-0.9	6.6	3.8	3	17.8	11.5	-7.8	-3	-8.2	-4	4069	1780	55.7	59.4	40.1
Slovenia	3.5	3.8	0.9	3	7.5	2.5	6.3	6.2	-2.7	-1.9	1.5	-0.7	1582	200	48.5	58.5	238.9

Source: Bank Austria, Czech Statistical Office
Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

Current conditions

- Growth of close to 4.6% in 2005
- Increasing domestic and foreign investment
- Rising intra-regional trade
- Expanding world market shares
- Deepening structural reforms

Necessary to

- Continued improvements in labor productivity
- Accelerated infrastructural development
- Greater macroeconomic discipline

External risks

- Growth in the CEE-8's key EU-15 markets
- Dollar decline
- Heightened competition for foreign direct investment

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Economic situation – Welfare and consumption

	GNI per capita (USD)	Household final consumption expenditure (% of GDP)		Household final consumption expenditure (million USD)		Per capita average annual growth of consumption (%)
	2005	1990	2004	1990	2003	2000-2004
Albania	2,580	61	89	1.27	3.89	2.1
Bosnia and Herzegovina	2,440	n.a.	84	n.a.	6.40	n.a.
Bulgaria	3,450	60	68	12.40	13.72	5.9
Croatia	8,060	75	58	13.53	16.91	4.8
Czech Republic	10,710	49	50	17.20	45.60	3.3
Estonia	9,100	51	58	3.02	5.14	8.1
Hungary	10,030	61	69	20.29	56.30	6.7
Latvia	6,760	53	63	3.92	6.98	8.7
Lithuania	7,050	57	67	5.97	11.79	7.1
Poland	7,110	48	64	28.28	136.49	3.3
Republic of Macedonia	2,830	72	79	3.02	3.46	3.1
Romania	3,830	66	70	25.23	40.32	8.4
Serbia and Monte-Negro	3,280	n.a.	93	n.a.	18.27	9.4
Slovakia	7,950	54	56	8.35	18.15	3.1
Slovenia	17,350	53	54	9.25	15.10	2.0
Turkey	4,710	69	67	103.32	160.08	1.0

Source: World Bank
Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

Economic situation – Current issues

- EU-15 slowdown
- Euro appreciation - low inflation rates and strong productivity growth have preserved the export competitiveness despite real currency appreciation. However, a dramatic rise in the euro in 2005 could potentially have damaging repercussions for the small accession countries anchored to the common currency.
- FDI competition
  - China and to a lesser degree India - labor-cost advantages
  - Necessity to leverage the strong human capital, high-quality infrastructures and geographical centrality in the Pan-European market to sustain the FDI inflows
- Wage growth ⇔ the ability to compete with China and others for FDI - productivity gains have served to neutralize the wage increases and maintain regional competitiveness.
- Fiscal deficits - the high fiscal deficits of the Visegrad countries are declining - deficit spending remains problematic in Hungary.
- Current account deficits – Baltic states large CA deficits ⇔ high import demand for advanced capital equipment, raw materials and other products unavailable locally (21.0% of GDP in Estonia, 17.0% in Latvia, 10% in Lithuania)
- Inflation - price increases in fuel and raw materials - the resource-poor CEE countries heavily dependent.
- Interest rates - rise in interest rates = rise in the debt servicing costs.
- The political and economic challenges of systemic reforms of their public sectors.

Economic situation – Implications of EU membership for national policies

- Adoption of the full body of EU law (the acquis communautaire) = it improves the business environment and the attractiveness of the accession countries x its application may increase the cost of doing business.
- In 2003, a number of CEE countries introduced policy measures aimed at liberalizing, promoting and protecting FDI.
    - Czech Republic – liberalization of the energy market and telecom industry,
    - Hungary – adoption of the laws on the privatization of healthcare and on the gradual liberalization of the natural gas market in accordance with EU regulations
    - Serbia and Montenegro – adoption of the various reform enabling the free transfer of financial and other resources related to foreign investment, lifting of the previous limitations on the establishment of wholly owned foreign affiliates in the telecom and public information industries and approval requirements for establishing foreign affiliates or for the acquisition of domestic companies
- Even adjusted for labour productivity - new EU member countries offer major labour cost advantages.
- The taxes - reductions at the beginning of 2004 by the majority of new EU member countries - not one of the eight CEE accession countries is in the top 11 in terms of corporate tax rates, while six are in the bottom eleven.
- The EU Structural Funds - the eight new CEE members can expect (in the framework of the objectives defined by the EU regional policy) total transfers amounting to €21.5 billion over a three-year period (2004-2006) from the common budget of the EU - a basic infrastructure (including transportation), human resource development, competitiveness and enterprise development, rural development and improving environment.

⇒ enhancement of the FDI attractiveness and improvement in the investment climate of CEE countries

Comparative advantage (1)

- **Taxes**: a wave of tax reductions at the beginning of 2004 was made by the majority of new EU member countries. Not one of the eight CEE accession countries is in the top 11 in terms of corporate tax rates, while six are in the bottom eleven.
- **Transfers**: The eight new CEE members can expect total transfers amounting to EUR 21.5 billion over a three-year period (2004-2006) from the common budget of the EU. These funds are intended mainly for such purposes as building basic infrastructure (including transportation), human resource development, competitiveness and enterprise development, rural development and improving environment. If used for the above purposes, they can enhance FDI attractiveness and improve the investment climate of CEE countries.

Corporate tax rates in selected economies (%)

Economy	1/1/2005	1/1/2006
Albania	23	20
Bosnia and Herzegovina	n/a	n/a
Bulgaria	15	15
Croatia	20.32	20.32
Czech Republic	26	24
Estonia	0/24	0/23
Hungary	16	16
Latvia	15	15
Lithuania	15/13	15/13
Poland	19	19
Republic of Macedonia	n/a	n/a
Romania	16	16
Serbia and Monte-Negro	n/a	n/a
Slovakia	19	19
Slovenia	25	25
Turkey	30	30
Japan	40.69	40.69
US	40	40
Cyprus	10	10
Ireland	12.5	12.5

Source: KPMG's Corporate Tax Rates Survey – 2006
Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

Comparative advantage (2)

Wages + productivity + tax system + favourable business climate + highly skilled workforce = CEE countries attractive locations for FDI, both from other EU countries and from non-EU members

Gross monthly average salary, adjusted to productivity (EUR and %)

Country	Gross monthly average salary					Productivity[a]	Productivity/salary (EU-15=100%)
	1998	1999	2000	2001	2002	2000	2000
Average for the EU-15[b]	1 845	1 923	2 127	2 191	..	42.5	100
Of which:							
Greece	1 101	1 160	1 227	1 286	1 357	19.4	79
Portugal	..	..	1 052	1 112	..	10	48
Spain	..	1 297	1 326	1 372	1 425	26.1	98
New EU members from CEE	..	381	410	460	..	11.7	117
Of which:							
Czech Republic	..	343	379	430	510	10.9	144
Estonia	..	282	303	328	..	8.3	137
Hungary	307	314	348	408	489	11.1	160
Latvia	..	257	277	280	..	..	..
Lithuania	233	251	270	300	..	..	..
Poland	346	442	471	626	598	9.3	99
Slovakia	274	260	299	320	382	9.2	154
Slovenia	..	895	935	988	1 041	21.3	114
EU candidates	..	115	132	146	153	..	..
Of which:							
Bulgaria	101	111	120	127	132	..	..
Romania	..	120	144	165	174	..	..

Source: UNCTAD, based on http://europa.eu.int/comm/eurostat/; www.dree.org/elargissement (data in *italics*); and Stephan 2003, p. 10 (for productivity data).

[a] Value added per € 1,000 labour costs, national average.
[b] EUROSTAT estimate. Data for Austria, Ireland and Italy are not available.
[c] Average productivity is based on data for the Czech Republic, Estonia, Hungary, Poland, Slovakia and Slovenia only.

- **Wages and productivity**: there have been longstanding differences between the more developed, higher wage, and the less developed, lower wage EU members. With the accession of ten new countries, discrepancies have further widened. In 2001, the average for the EU-15 was more than three times higher than that for the ten new member countries. Even adjusted for labour productivity, new EU member countries offer major labour cost advantages.

Economic situation – Central European countries

Czech Republic

- The Czech Republic has been recovering from recession since mid-1999. Growth in 2000-2001 was led by exports to the EU, especially Germany, and foreign investment, while domestic demand is reviving.
- Uncomfortably high fiscal and current account deficits could be future problems.
- Moves to complete banking, telecommunications, and energy privatisation will add to foreign investment, while intensified restructuring among large enterprises and banks and improvements in the financial sector should strengthen output growth.
- The Czech government has expressed a desire to adopt the euro currency in 2010, but the introduction of the currency is currently only in the early planning stages.

Slovakia

- Major privatisations are nearly complete, the banking sector is almost completely in foreign hands, and foreign investment has picked up.
- Solid domestic demand boosted economic growth to 4.4 % in 2002. Strong export growth, in turn, pushed economic growth to a still-strong 4.2 % in 2003, despite a downturn in household consumption. The estimated GDP growth was around 5.7 % in 2005 and it is expected to reach around 6 % in 2006.
- Unemployment (19.2 % at the end of 2001) during the radical reforms decreased again to 12.7 % (March 2005).
- Inflation dropped from an average annual rate of 12 % in 2000 to 3.3 % in 2002, but it rose again in 2003-2004 due to necessary increases in taxes and regulated prices. Nonetheless, CPI fell below 3 % in 2005.
- Slovakia plans to adopt the Euro on January 1, 2009.

Poland

- Restructuring and privatisation of "sensitive sectors" (e.g., coal, steel, railways, and energy) has begun. The biggest privatisations so far were a sale of Telekomunikacja Polska to France Telecom (2000) and issue of 30% shares of the biggest Polish bank, PKO BP, on the Polish stock market (2004).
- Poland has a large agricultural sector of private farms. Challenges remain, especially under-investment. Structural reforms in health care, education, the pension system, and state administration have resulted in larger-than-expected fiscal pressures.
- GDP growth had been strong and steady from 1993 to 2000 with only a short slowdown from 2001 to 2002 - in 2004 GDP growth equalled 5.4%, and in 2005 3.3%. Forecasted GDP for 2006 is 4.3%.
- Since joining the EU, many young Polish people have left their country to work in other EU countries because of high unemployment rate (about 17%).

Hungary

- Hungary continues to demonstrate strong economic growth (since 2004). The private sector accounts for over 80% of GDP. Hungary gets nearly 1/3 of all FDI flowing in to CE. Foreign ownership of and investment in Hungarian firms are widespread, with cumulative FDI totalling more than US$23 billion since 1989.
- Hungarian sovereign debt was upgraded in 2000 to the second-highest rating among all the CE transition economies.
- Inflation and unemployment – both priority concerns in 2001 – have declined substantially.
- Economic reform measures such as health care reform, tax reform, and local government financing have not yet been addressed by the present government.
- The Hungarian government has expressed a desire to adopt the euro currency in 2010.

Economic situation – Baltic states

Estonia

- In 1999, Estonia experienced its worst year economically since it regained independence in 1991, largely because of August 1998 Russian financial crisis.
- Privatization of energy, telecommunications, railways, and other state-owned companies is a continuing process.
- The Estonian economy is growing fast, partly due to a number of Scandinavian companies relocating their routine operations and Russian oil transit using Estonian ports. Estonia has a strong information technology (IT) sector. GDP PPP per capita is at $17,672, the highest among the Baltic states.
- In 1994, Estonia became among the first in the world to adopt a flat tax, with a uniform rate of 26% regardless of the income a person makes. In January 2005 the personal income tax rate was reduced to 24%. A subsequent reduction to 23% followed in January 2006. In the following years the income tax rate will be decreased by 1% annually to reach 20% by January 2009.
- Since January 1, 2000, companies have not had to pay income tax on re-invested income. However, tax is due on profit distributions (incl. hidden distributions) at a rate of 24%. The current legislation is said to be in violation of one of the fundamental freedoms of the European Union - free movement of capital. Estonia is to remove this hindrance by January 2009 when the temporary derogation expires.
- In June 1992, Estonia replaced the Ruble with its own freely convertible currency, the Kroon (EEK). A currency board was created and the new currency was pegged to the German Mark. The Estonian government is intending to adopt the Euro as the country's currency on 1 January 2007, and finalised the design of Estonia's Euro coins in late 2004.

Latvia

- Since year 2000 Latvia has had one of the highest GDP growth rates in Europe. In 2004, annual GDP growth was 8.5% and inflation was 6.2%. Unemployment was 8.5% - almost unchanged compared to the previous two years.
- Privatization is mostly completed, except for some of the large state-owned utilities.
- The Latvian government aspires to adopt the euro as the country's currency on January 1, 2008

Lithuania

- In 2003, prior to joining the European Union, Lithuania had the highest economic growth rate amongst all candidate and member countries, reaching 8.8% in the third quarter. In 2004 growth of GDP was 6.6%.
- 1998 Russian financial crisis forced the country to orient toward the West.
- Accession to the EU reduced previously high unemployment to 10.6% in 2004, although some argue that this has been prompted by the high rate of emigration from Lithuania.
- Lithuania has nearly completed the privatization of its large, state-owned utilities.
- Litas, the national currency, has been pegged to the Euro since February 2, 2002 and Lithuania is expected to switch to the Euro on January 1, 2007.
- Lithuanian income levels still lag behind the rest of the older EU members, with per capita GDP in 2004 at 46 percent of the EU average. Like other countries in the region (Estonia, Latvia and Russia) Lithuania has also adopted a flat rate of tax rather than a progressive scheme. However, at 33% of income, the tax rate is considerably higher than that of its neighbours.

Economic situation – Bulgaria and Romania

Bulgaria	Romania
➢ Bulgaria's economy contracted dramatically after 1989 with the loss of the market of the Council for Mutual Economic Assistance (COMECON) member states. The standard of living fell by about 40%, but it regained pre-1990 levels in June 2004. In addition, UN sanctions against Yugoslavia and Iraq took a heavy toll on the Bulgarian economy. ➢ The first signs of recovery emerged in 1994 when the GDP grew and inflation fell. During 1996, however, the economy collapsed due to lack of international economic support and an unstable banking system. ➢ Since 1997 the country has been on the path to recovery, with GDP growing at a 4-5% rate, increasing FDI, macroeconomic stability and EU membership set for 2007. ➢ The former government, elected in 2001, pledged to maintain the fundamental economic policy objectives adopted by its predecessor in 1997, i.e., retaining the Currency Board, practicing sound financial policies, accelerating privatisation, and pursuing structural reforms. ➢ Economic forecasts for 2005 and 2006 predict continued growth in the Bulgarian economy. The annual year-on-year GDP growth for 2005 and 2006 is expected to total 5.3% and 6.0%, respectively. Industrial output for 2005 is forecast to rise by 11.9% year-on-year, and for 2006 - by 15.2% year-on-year. Unemployment for 2005 is projected at 11.5% and for 2006 - at under 10%.	➢ Economic growth since 2000 has averaged 4-5%, rising to 8.3% in 2004. ➢ Romania's per-capita GDP, calculated by purchasing power parity is estimated to be $8,800 at end of 2005. The national budget is €28.9 billion euro, which represents 31.2% of GDP. ➢ Romania has intensively developed its agricultural and industrial sectors over the past 20 years. Romania is largely self-sufficient in food production. High-technology, car-manufacturing, military equipment, software, pharmaceuticals, fine chemicals, and agricultural products (fruits, vegetables, and flowers) are leading exports. ➢ Inflation in 2004 was registered at 9.2%, and is expected to fall to 7.5% in 2005 and 5.0% in 2006. ➢ Unemployment in Romania is at 5.5% (July 2005), which is very low compared to other large European countries such as Poland, France, or Germany. ➢ Since the late 1990s, there have been several economic reforms - the liquidation of large energy-intensive industries and major reforms in the agricultural and financial sectors. As of 2005, a significant amount of Romania's major companies have been privatised, including the majority of banks, the largest oil companies Petrom and Rompetrol, energy distributors and telecommunications companies. The country continues to privatise remaining state enterprises, including Romanian Post and the Romanian Commercial Bank. ➢ Total FDI in Romania for 2005 was € 6 Billion.

Economic situation – Albania, Turkey, Makedonia

Albania

- Half of the economically-active population is engaged in agriculture and a fifth is said to be working abroad. The country has to deal with a high unemployment rate, corruption up to high government levels and organized crime.
- The country has almost no exports, and imports most if its goods from Greece and Italy. Money for imports comes from financial aid and from the money that emigrants working abroad - mostly in neighbouring Greece - bring to Albania.
- Albania's coastline on the Ionian Sea, near the Greek tourist island of Corfu, is becoming increasingly popular with foreign visitors. However, the tourist industry is still in its infancy.

Turkey

- Turkey is a big economic player in the Black Sea and East Mediterranean region.
- While Turkey has no energy resources of its own, it holds the key to much of the region's oil and gas transports, both via pipelines and tankers which pass the Bosporus.
- GDP per capita is only 28% of the EU average.
- Turkey's economy is characterized by sharper contrasts. For instance, there is a number of highly developed industrial plants in the country, most of them owned by private holdings. In parallel, there is a large number of small and medium-sized enterprises, some of them still using rather archaic production methods. State-owned enterprises play an important role too. Privatizing them, as was planned a long time ago, is likely to rank high on the government's agenda in the next few years, but it is not that clear how much foreign capital will be involved.
- Since 2001 real GDP has always grown at high rates, reaching nearly 12% in the first half of 2004.
- The consolidation of the banking sector has been successful, and at least the big banks are now in relatively good shape.
- Inflation declined to around 10% per year, after decades when it was sometimes difficult to prevent hyperinflation.
- The most problematic aspect of Turkey's economy is probably the labour market. The creation of new job opportunities diverges strongly among individual regions, and internal migration is correspondingly high.

Republic of Macedonia

- The Republic of Macedonia has an open economy, highly integrated into international trade, with a total trade-to-GDP ratio of 79.5%. The most important sectors are agriculture and industry. The service sector also grew in the past few years. The economic policy is to attract FDI and to increase employment rate. One of the biggest features of the country economy is the fiscal discipline. The country also makes effort to develop SME sector.
- The outbreak of the Yugoslav wars and the imposition of sanctions on Serbia and Montenegro, Greece trade embargo caused great damage to the Republic's economy. The Kosovo War of 1999 and the 2001 Albanian crisis caused further destabilization.
- The Macedonian economy has since made a sluggish recovery, though the extent of unemployment, the grey market, corruption and a relatively feeble legal system continue to cause significant problems and a low growth rate. The Republic still has one of the lowest per capita GDPs in Europe.
- Since the end of the Greek embargo, Greece has become the most important business partner.
- Growth barely recovered in 2002 to 0.9%, then rose by 3.4% in 2003, 2.9% in 2004, and about 4% in 2005.

Economic situation – Ex-Yugoslav countries

Slovenia

- Slovenia is the wealthiest of the former Yugoslavia's six republics. GDP declined in the early 1990s but has picked up in recent years. In 2000 the economy grew at 4.1% and has maintained around 3% growth.
- Inflation, standing at 200% in 1992, declined dramatically to 6.1% in 1999 and has been around 7% since then.
- Unemployment has been quite high, standing at 10.9% in 2003.
- Manufacturing (including metalworking, chemicals, pharmaceuticals and the electronics industry) - is the most important economic sector in Slovenia, accounting for 27% of GDP. Tourism is another important sector (services make up 61% of GDP).
- Nearly two-thirds of Slovenia's exports go to the EU, with Germany and Italy being particularly important trade links. Another 8.7% goes to Croatia. Similarly, the EU supplies over two-thirds of Slovenia's imports.

Serbia and Montenegro

- Period of economic sanctions, the damage to Yugoslavia's infrastructure and industry caused by the Kosovo War have left the economy only half the size it was in 1990.
- Since October 2000, the Democratic Opposition of Serbia (DOS) coalition government has implemented stabilization measures and embarked on an aggressive market reform program.
- Both republics have separate central banks, different currencies - Montenegro uses the euro, while Serbia uses the Serbian dinar as official currency. The two states also have different customs tariffs, separate state budgets, police forces, governments.
- Severe unemployment remains a key political economic problem.
- Corruption also presents a major problem, with a large black market and a high degree of criminal involvement in the formal economy.

Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

Bosnia and Herzegovina

- Three years of war destroyed a large part of the economy and infrastructure in Bosnia and Herzegovina, causing unemployment to increase and production to fall.
- The economy has started to slowly recover, but the GDP remains below the 1990 level. Today Bosnia and Herzegovina has one of the best banking sectors in former Yugoslavia.
- The currency Konvertibilna marka KM or Bosnian Mark BAM, fixed to the euro (1:0.51) is also very stable.
- The inflation rate was 1.9% in 2004, and international debt was approx. $2 billion; making it the smallest amount of debt owed from the former Yugoslav countries.
- Real GDP growth rate is 5.0% for 2004.

Croatia

- Croatia has an economy based mostly on various services and light industry. Tourism is a notable source of income.
- The estimated GDP per capita in PPP terms for 2004 was 41.6% of the EU average for the same year.
- Main problems include massive structural unemployment followed by an insufficient amount of economic reforms.
- In February 2005, Croatia implemented the Stabilization and Association Agreement with the EU and is advancing further towards full EU membership.
- Some big trading companies have already taken advantage of the liberalization of the Croatian market. Croatia is expecting a boom in investments, especially greenfield investments.

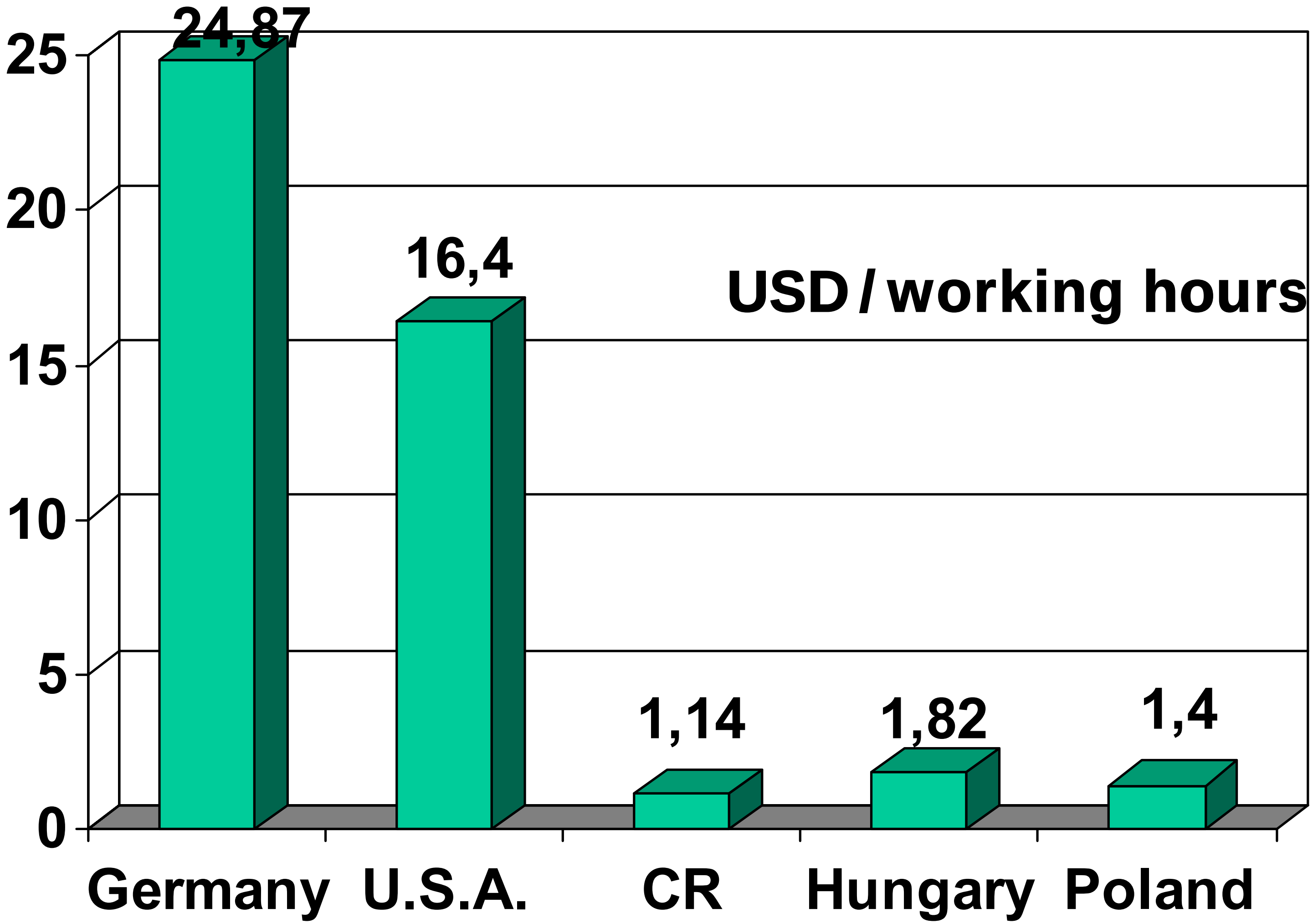
Contents:

1. Brief overview
2. History
3. Demographics
4. Economic situation and trends
5. FDI
6. Czech Republic

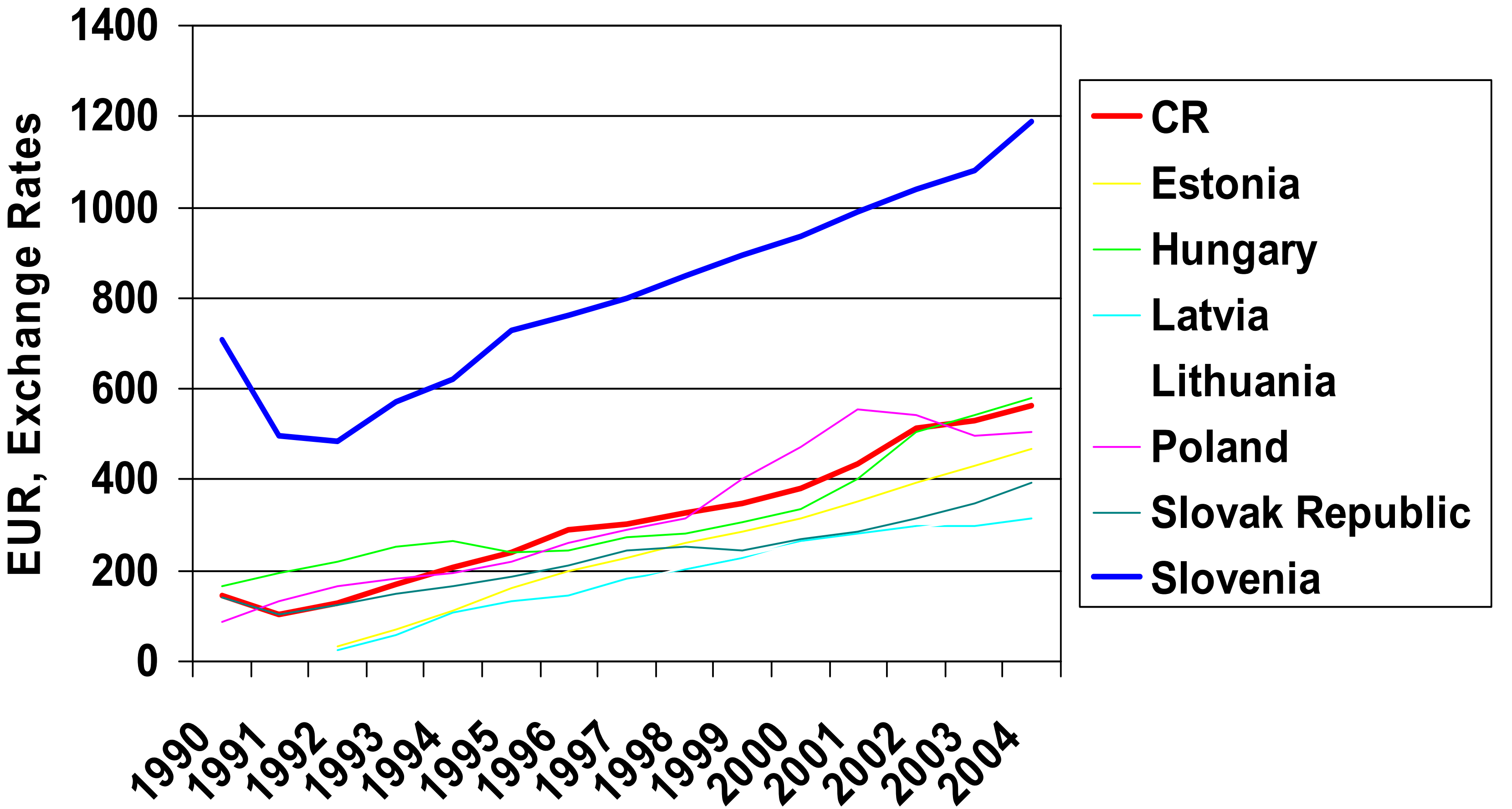
Motivation to Invest in New Member Countries

- Main factors
  - Easy access to the EU/EEA market
  - Lower labor costs
  - Qualified labor
  - Similar norms and standards as in “old” member countries
  - Fast growth of domestic demand
- Additional factors
  - Privatization means opportunity to buy interesting assets and special resources
  - Investment incentives – governments are actively trying to attract foreign investors

Wage Costs in Industry - 1993



Gross Monthly Wage Rates



Source: WIIW Handbook of Statistics 2005

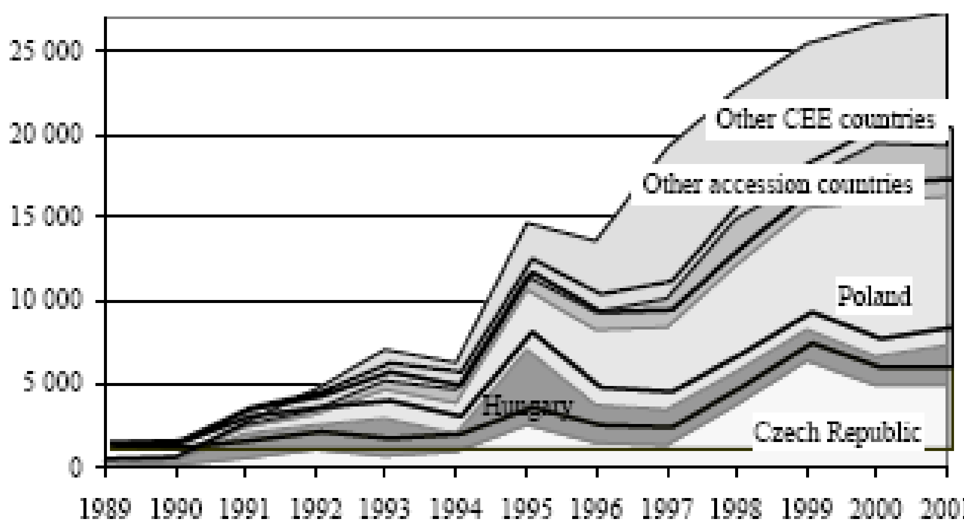
Why do CEE countries want FDI?

- Chance to find new and very good owners for their troubled state-owned companies
- FDI absorbs available human capital from many restructured or closed companies that lost markets and/or competitiveness
- FDI means inflow of capital, know-how, and substitute the missing domestic R&D
- FDI helps to finance deficits of trade

CEE countries – FDI inflows in long-term (1)

- From the mid-1990s onwards, inward foreign direct investment (FDI) has gained importance in an increasing number of CEE countries. Data show a major boom in inward FDI: until 1990, the FDI inflows of the region remained under USD 1 billion; by 1995, they exceeded USD 14 billion in 1995 and USD 27 billion by 2001. As a result, from 1995 to 2001, the region's inward FDI stock quadrupled, from USD 40 billion to USD 160 billion.
- The region's share in global FDI inflows remained under 1% until 1990. In the early 1990s, that share increased almost every year, and exceeded 4% by 1995. By 2000, it declined to 1.8%, just to climb again to 3.7% in 2001.y

CEE FDI inflows, 1989-2001 (USD million)



Source: UNCTAD, FDI/TNC database.

CEE countries – FDI inflows in long-term (2)

- In 1995, the ratio of the inward FDI stock to gross domestic product, 5 per cent, was only half of the world average, 10%. Within five years, by 2000, CEE had almost completely caught up with the rest of the world: 19%, as compared with 20% for the world. Moreover, some CEE countries exhibited higher ratios: 50% for Estonia and 40% for Czech Republic and Hungary.

Inward FDI stock in CEE (% of GDP)

Country/region	1995	2000
World average	10.0	20.0
CEE average	5.4	18.9
Estonia	14.1	53.2
Hungary	26.7	43.4
Czech Republic	14.1	42.6
Moldova, Republic of	6.5	35.7
Latvia	12.5	29.1
Croatia	2.5	27.1
Bulgaria	3.4	26.4
Slovakia	4.4	24.2
Poland	6.2	21.3
Lithuania	5.8	20.6
Romania	3.2	17.7
Serbia and Montenegro	2.7	15.6
Slovenia	9.4	15.5
Albania	8.7	15.4
Ukraine	2.5	12.1
Belarus	0.5	11.9
TFYR Macedonia	0.7	10.9
Bosnia and Herzegovina	1.1	8.1
Russian Federation	1.6	7.7

Source: UNCTAD, FDI/TNC database.

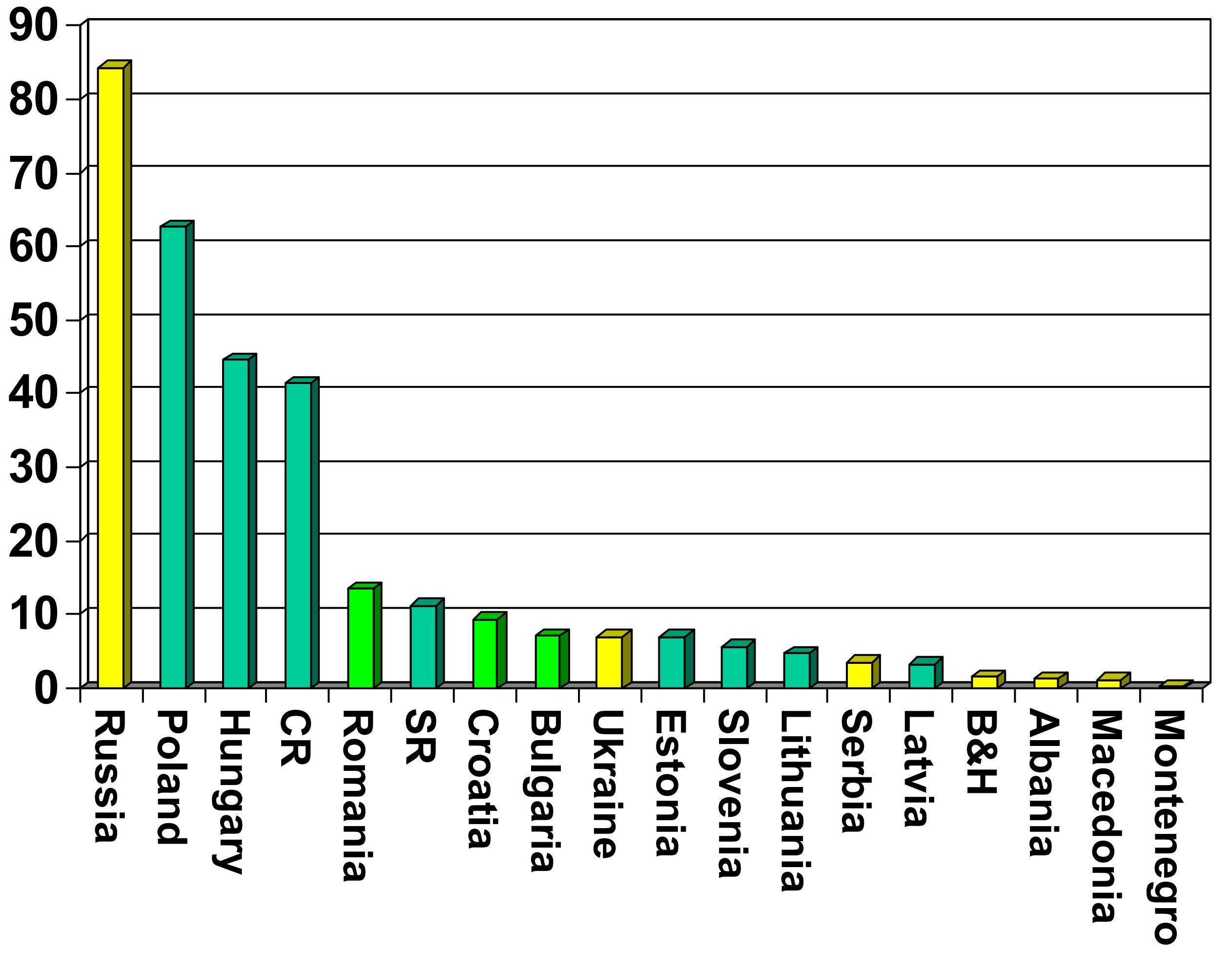
CEE countries – FDI inflows in long-term (3): comparison with EU15

Over most of the late 1990s and early 2000s, the combined inflows of the eight new member states (joining EU in May 2004) remained considerably below the inflows for older EU members such as France and Germany and, more recently, Ireland and Spain. Since mid-1995, FDI flows into the eight new member states accounted for a fraction of the inflows of the EU – a mere 4% in 2003, declining from a high of 11% in 1995.

FDI inflows into CEE countries acceding to the EU in 2004, compared with the EU-15, 1995-2003 (USD billion)

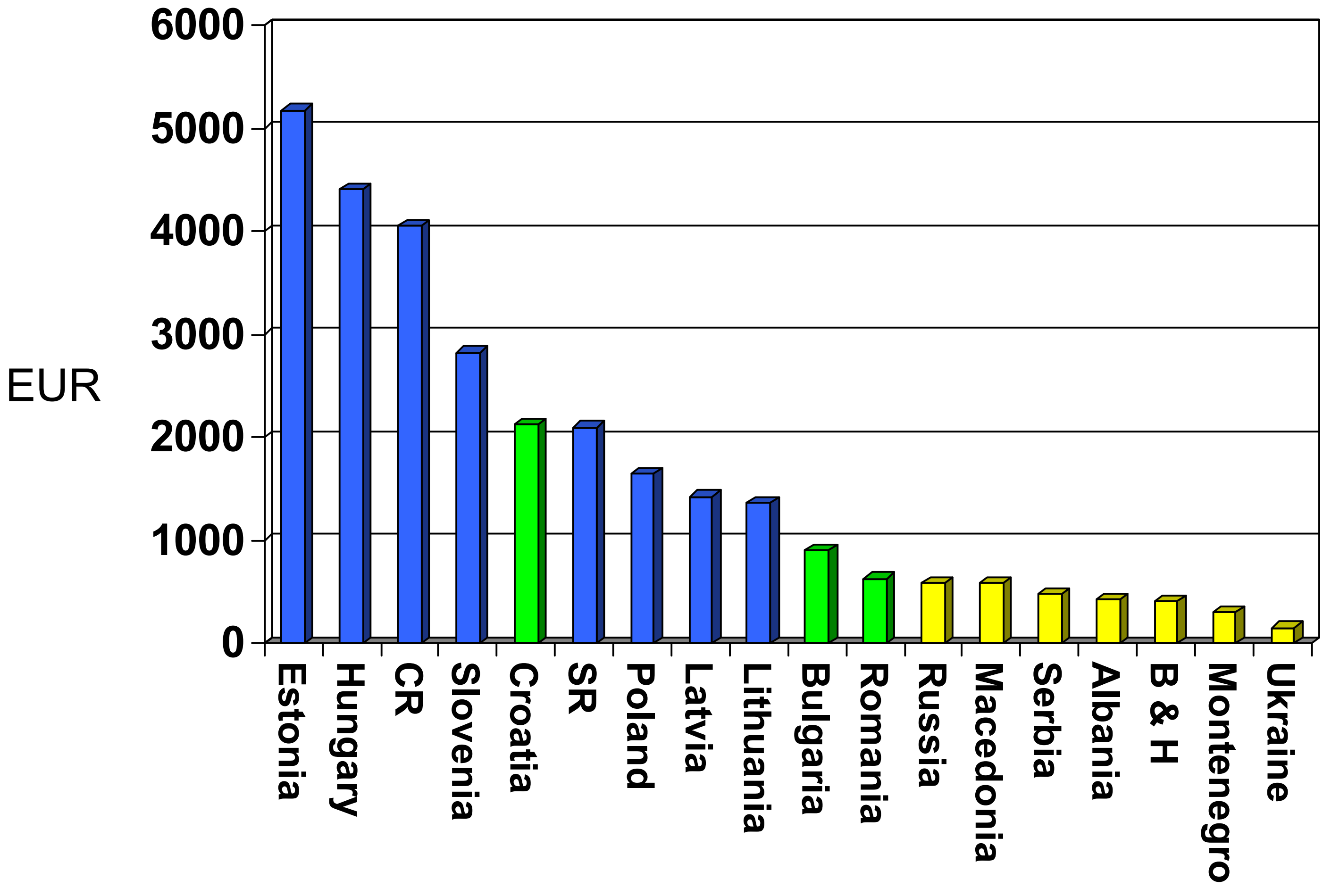
Country/region	1995	1998	1999	2000	2001	2002	2003
CEE countries acceding to the EU	12.2	16.7	18.6	20.3	18.4	22.6	11.5
Of which:							
Czech Republic	2.6	3.7	6.3	5.0	5.6	8.5	2.6
Hungary	5.1	3.8	3.3	2.8	3.9	2.8	2.5
Poland	3.7	6.4	7.3	9.3	5.7	4.1	4.2
Slovakia	0.3	0.7	0.4	1.9	1.6	4.1	0.6
Memorandum:							
World	335.7	690.9	1 086.8	1 388.0	817.6	678.8	559.6
EU-15	114.6	249.9	479.4	671.4	357.4	374.0	295.2
Of which:							
France	23.7	31.0	46.5	43.3	50.5	48.9	47.0
Germany	12.0	24.6	56.1	198.3	21.1	36.0	12.9
Ireland	1.4	8.6	18.2	25.8	9.7	24.5	25.5
Spain	6.3	11.8	15.8	37.5	28.0	35.9	25.6
Share of FDI into CEE countries acceding to the EU in total inward FDI of EU-15 (%)	10.6	6.7	3.9	3.0	5.1	6.0	3.9

FDI Inward Stock (Bil. EUR), 2004



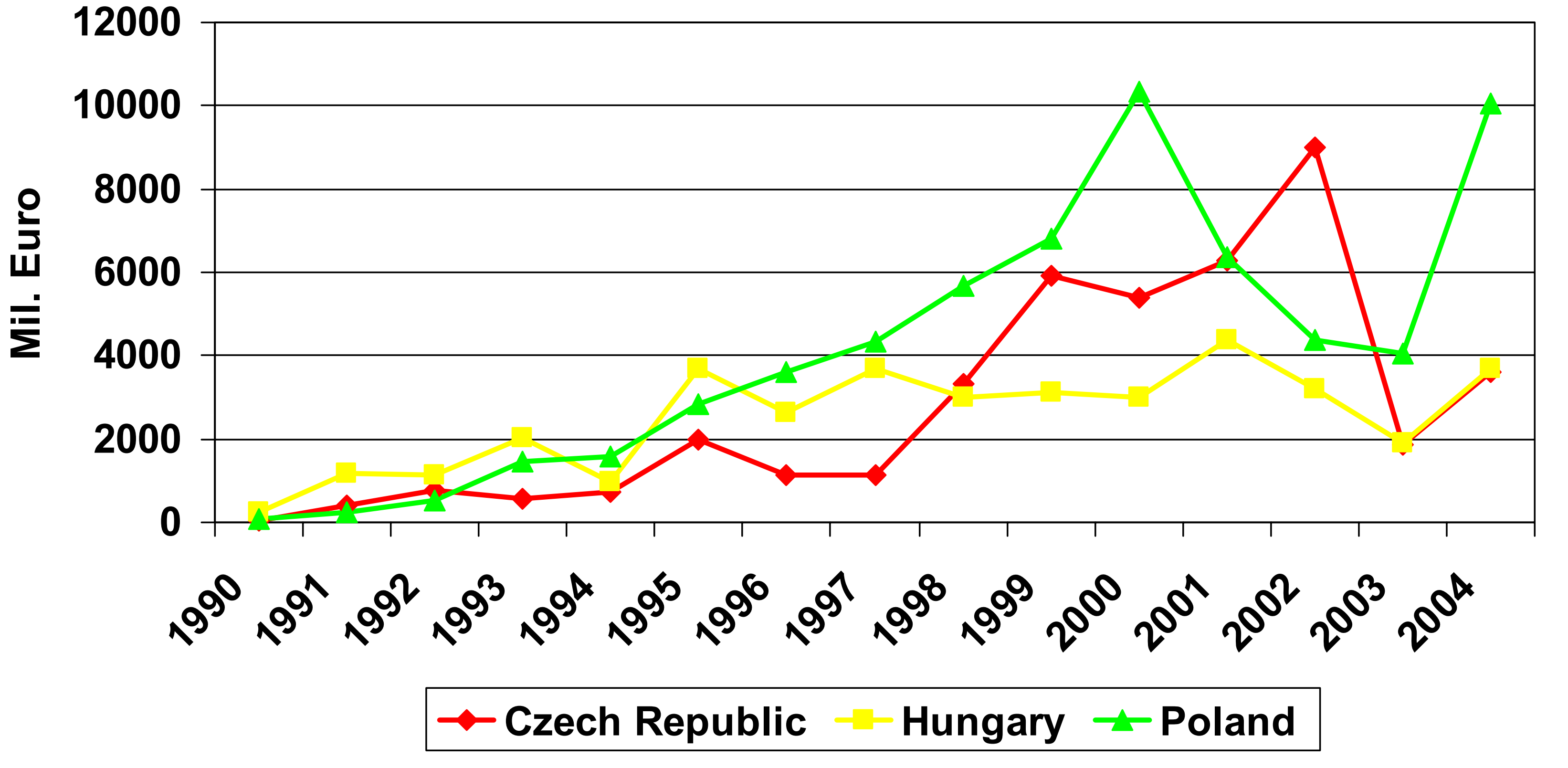
Source: WIIW Handbook of Statistics 2005

FDI Inward Stock per Capita, 2004



Source: WIIW Handbook of Statistics 2005

FDI Inflows – CR, Hungary, Poland



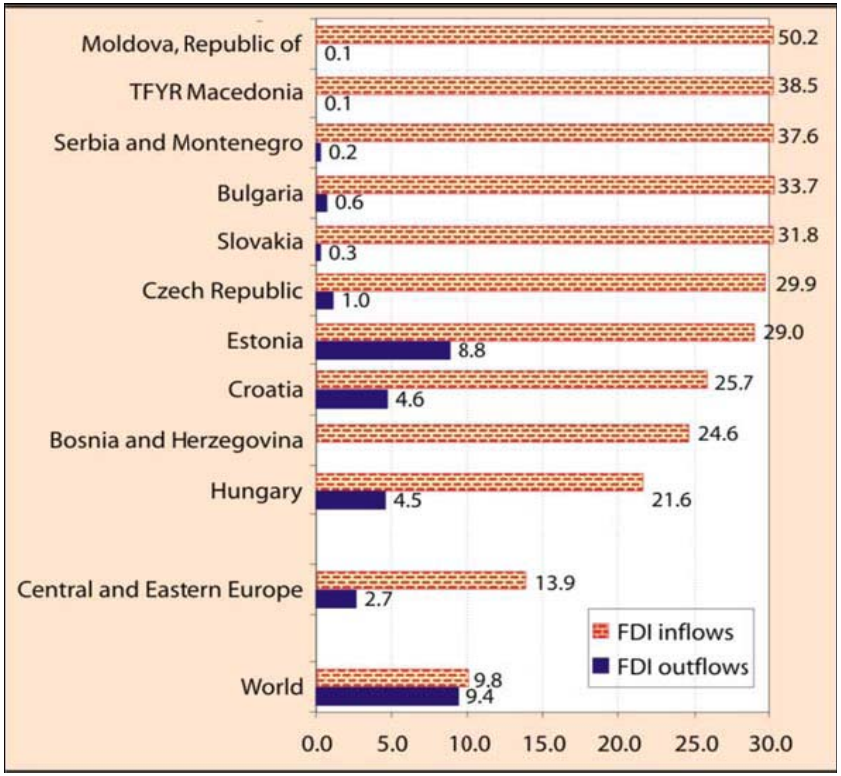
Source: WIIW Handbook of Statistics 2005

EU Integration of Transition Economies

- For old member countries
  - Chance to move production from old to new member states and produce with lower costs
- For third countries (Japan, Korea, USA)
  - Chance to use new member countries as advantageous low-cost entry point to the European markets

FDI - Summary

CEE: FDI flows as a percentage of gross fixed capital formation, top 10 countries, 2001-2003 (a) (Per cent)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

(a) Ranked on the basis of the magnitude of 2001-2003 FDI inflows as a percentage of gross fixed capital formation.

Note: Based on the results of a referendum on May 21, 2006, Montenegro declared independence on June 3, 2006.

Investment risk ratings

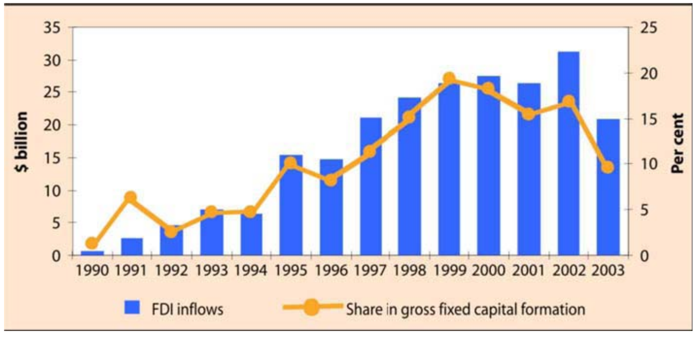
COUNTRY	STANDARD AND POOR´S	MOODY´S	FITCH-IBCA
Slovenia	AA	Aa3	AA
Czech Republic	**A-**	**A1**	**A**
Hungary	BBB+	A1	BBB+
Poland	BBB+	A2	BBB+
Estonia	A	A1	A
Slovakia	A	A2	A
Romania	BBB-	Ba1	BBB-
Russia	BBB	Baa2	BBB+

Source: Czech National Bank, August 2006

FDI - Inflows (1)

- FDI inflows into CEE declined from a record $31 billion in 2002 to a low of $21 billion in 2003, the result of the end of privatization in the Czech Republic and Slovakia.
- FDI inflows in 2002 rose in 10 of the region´s countries and fell in 9, with most countries receiving less than $1 billion.
- Inward FDI flows as a percentage of gross fixed capital formation in CEE declined from 17% in 2002 to 10% in 2003.

CEE: FDI inflows and their share in gross fixed capital formation, 1990-2003



Source: UNCTAD, World Investment Report 2004

CEE: country distribution of FDI inflows, by range, 2003

Range	Economy
More than $ 1 bil.	Bulgaria, Croatia, CR, Hungary, Poland, Romania, Serbia and Montenegro, Ukraine
Less than $ 1 bil.	Albania, Belarus, Bosnia and Herzegovina, Estonia, Latvia, Lithuania, Slovakia, Slovenia, Macedonia

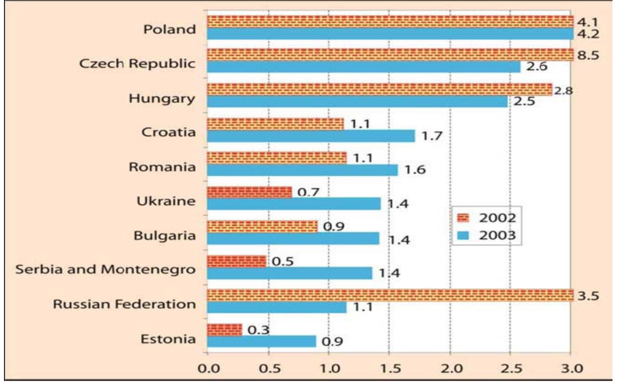
Source: UNCTAD, World Investment Report 2004

- Greenfield projects, spread over a longer period and generally smaller in size, could not immediately compensate for the fall in privatization-related FDI in the Czech Republic and Slovakia, despite the fact that both countries had been selected as locations for new automobile plants by transnational corporations (TNCs) (Toyota-PSA in the Czech Republic and PSA and Hyundai in Slovakia).

FDI - Inflows (2)

- Aside from the Czech Republic and Slovakia, the decline in FDI inflows was small, from $19 billion in 2002 to $18 billion in 2003 – re-establishment of Poland, the Czech Republic and Hungary as the three top locations for inward FDI in the region.
- Far from diverting FDI flows from the old members of the EU, the group of eight CEE countries that joined the EU in May 2004 - the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia - saw their combined FDI inflows shrink from $23 billion in 2002 to $11 billion in 2003.
- In the other 11 countries of the region, inflows climbed from $8.6 billion in 2002 to $9.5 billion in 2003, representing an increase in their share of total FDI inflows to CEE from 28% in 2002 to 45% in 2003.
- In the South-East European members of this group (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro and The Former Yugoslav Republic of Macedonia), a part of the high FDI inflows can be explained by privatization deals, although these do not yet match the size of previous privatization deals in such countries as the Czech Republic, Hungary and Poland.
- During the period 2001-2003, the Republic of Moldova, the Former Yugoslav Republic of Macedonia and Serbia and Montenegro were the region's leaders in terms of the ratio of FDI to gross fixed capital formation. Most of these high ratios reflect small national economies.

The top 20 recipients of FDI inflows in Central and Eastern Europe, 2002 and 2003



Source: UNCTAD, World Investment Report 2004 Ranked on the basis of the magnitude of 2003 FDI inflows.

Incentives available in CEE

Czech Republic

- The manufacturing sector – investment projects CZK 100-200 mil.
  - tax incentives (corporate tax relief for up to 10 years);
  - job creation grants (CZK 100-200 th. per employee);
  - training and retraining grants (up to 35% of the expenses);
  - site support (transferring of public land at a favorable price).
- Technology centers (CZK 15 mil.) and business support services (CZK 30 mil.)
  - a subsidy for business activity which covers certain operational costs related to the project and/or a subsidy for training and retraining expenses
  - subsidies for business activity granted for 5 year investment in assets or for 2 years salary for employees employed within the first three years
- Job creation support program (CZK 10 mil.)
  - financial support for the creation of new jobs or for the training or retraining of employees (CZK 200 th. per employee, 35% of the expenses)

Hungary

- The Investment Incentives Decree
  - non-repayable contributions or grants;
  - non-repayable interest coverage;
  - subsidised guarantee fees;
  - real property or the right to use real property (or direct subsidies for the acquisition of real property or the right to use real property);
  - subsidised factoring fees; and
  - subsidised leasing fees
    - tender process - projects: the promotion of the investment of working capital, the development of logistics centres and their services, technological development and modernisation, subsidising training, subsidising investments and subsidising research and development
    - priorities as research and development and innovation ⇒ support of the information society and the development of e-economy and e-commerce, the improvement of the information (digital content) sector, and the expansion of the broadband telecommunications infrastructure
- The Investment Tax Incentives Decree – tax allowances for the initial year of the project and the following five years (HUF 3 bn (approx. EUR 12 mil.))
- Industrial parks - the widest selection of ind. parks in the CEE region:

Slovak Republic

- The Slovak Act on Investment Incentives
  - tax allowances (the receipt of which may be delayed for up to three years from the start of operations) and cash contributions for the creation of new jobs and the training of new employees
  - an investment of at least SKK 400 million
- October 2005 - New guidelines - tax allowances, subsidies for creating new jobs and training, support for investment costs and offering state assets at preferential prices granted to an investor depending on the region of the investment and the economic sector

Poland

- Incentives under the Act on Financial Investment Support
  - subsidies for a wide range of expenses; including for the price of land (up to 10% of the total project expenditure), fixed manufacturing assets, used fixed assets, intangible assets (up to 25% of the total project expenditure), materials and construction works, legal consultancy fees, notaries' fees and the cost of technical and financial expertise and for bank account fees
  - grants to assist with creating new jobs up to the equivalent of EUR 4,000 per job
- Special economic zones

Process for receiving incentives in CEE

Czech Republic

- CzechInvest, the Investment and Business Development Agency - central role in the application process
- Application for investment incentives to CzechInvest
- CzechInvest - an assessment of the application to evaluate whether the investment will be able to meet all the requirements set by the legislation, presentation to the MIT
- MIT requests approval for the individual incentives from the relevant ministries
- MIT with the Office for the Protection of Economic Competition then decides on the total amount of investment incentives available for the project
- An offer with all incentives available for the project and conditions under which the incentives are granted
- The actual recipient of the incentives must be a Czech subsidiary
- Based on the offer - submission of an application for a grant of incentives to the MIT through CzechInvest ⇒ MIT final decision
- The government monitoring of fulfilling the criteria - the authorities can demand that the incentives be repaid

Hungary

- The Hungarian Investment and Trade Development Agency
- Tenders - the relevant guidebook sets out exactly what information the investor must provide in the application
- Application ⇒ verification of the Participating Organisation (i.e. the Hungarian Development Bank) responsible for the application program that the application complies with the relevant criteria defined ⇒ evaluation according to a predefined set of evaluation criteria and the assigned scoring system, recommendation to the Selection Committee on granting aid
- The head of the managing authority will decide whether and to whom to grant the incentives based on the recommendation of the Selection Committee
- If successful, the investor must then sign an aid agreement with the grantor of the incentives
- The rules on monitoring of incentives

Slovak Republic

- The Slovak Investment and Trade Development Agency (SARIO).
- The new guidelines - the investor will submit an indicative application for incentives to SARIO which will rule within a 10 days whether the application for aid is complete and correct.
- The relevant ministries – comments
- The investment agreement - the exact contents negotiated with SARIO
- The government will then approve the agreement and execute it

Poland

- PAIIZ
- The Minister responsible for economic affairs reviews the application for incentives
- Once a positive decision is made, the investor is invited to sign a contract with the Minister
- The President of the Office of Competition and Consumer Protection (the OCCP) responsible for monitoring the grant of incentives in Poland

Real estate issues

Czech Republic	Hungary
➢ The real estate issues which an investor must consider - same as those for other purchasers of land ➢ The potential to acquire land at a discount - advantage of local benefits which may be provided by municipalities seeking, for example, to increase employment in their region = the sale of land at an undervalue to an investor ➢ Requirement of a number of criteria to ensure that the investor does not acquire the land for speculative purposes ➢ In order to sell large areas of land to investors, municipalities may need to purchase the land from private individuals - the municipalities do not do this under any special statutory powers, the government does have the power to order the compulsory purchase of land from individuals, however this power does not come from any legislation related to incentives but is a power of general public interest	➢ The main issues facing an FDI investor when seeking to acquire real estate in Hungary - the same as those for any other purchaser of land ➢ Some general restrictions on foreign entities purchasing land ➢ As a general rule, foreign individuals or legal entities may not acquire the proprietary rights to any agricultural land or protected natural areas. ➢ The property rights of properties that do not qualify as agricultural land may be acquired by foreign individuals or legal entities, if such acquisitions are authorised by the head of the Budapest or county administrative office with jurisdiction over the locality of the properties ➢The acquisition of property by foreign natural persons establishing themselves as independent entrepreneurs in Hungary must also be authorised, if such properties are directly required for the performance of the economic activities they are establishing ➢ It may be possible for an investor to negotiate a preferential price for land owned by the Hungarian Government or by a local municipality
Slovak Republic	**Poland**
➢ SPV - a special purpose vehicle, funded by the state, which will acquire the ownership of all the land ➢ The SPV - sale to the investor for the price of the land ➢ The status of a "large investment" - further benefits - simplified acquisition procedure of state-owned land, expropriation, restriction of other rights	➢ The state-owned land - special regimes regarding transfer of the title to the land set out in the Polish Real Estate Law – tender procedure ➢Apart from the ownership title the real estate may be subject of a perpetual usufruct, which is a legal concept similar to a leasehold agreement and is specific to Polish law

Source: Foreign Direct Investment in Central and Eastern Europe, Allen & Overy

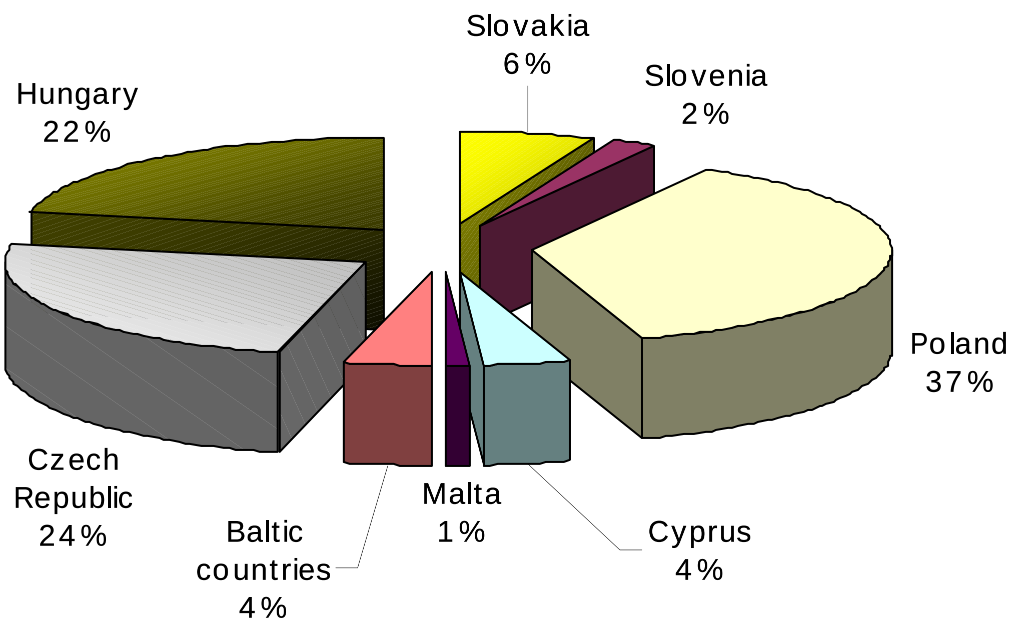
Origin of FDI to Transition Economies

- Most of FDI come from EU15 countries

- Problem:
  - Statistics actually record only the origin of the last investor, which may be actually a subsidiary of mother company from different country
    - Example: Japanese FDI realized via Dutch subsidiary will be recorded as FDI from the Netherlands

New Member States: FDI inflows from EU15 (1)

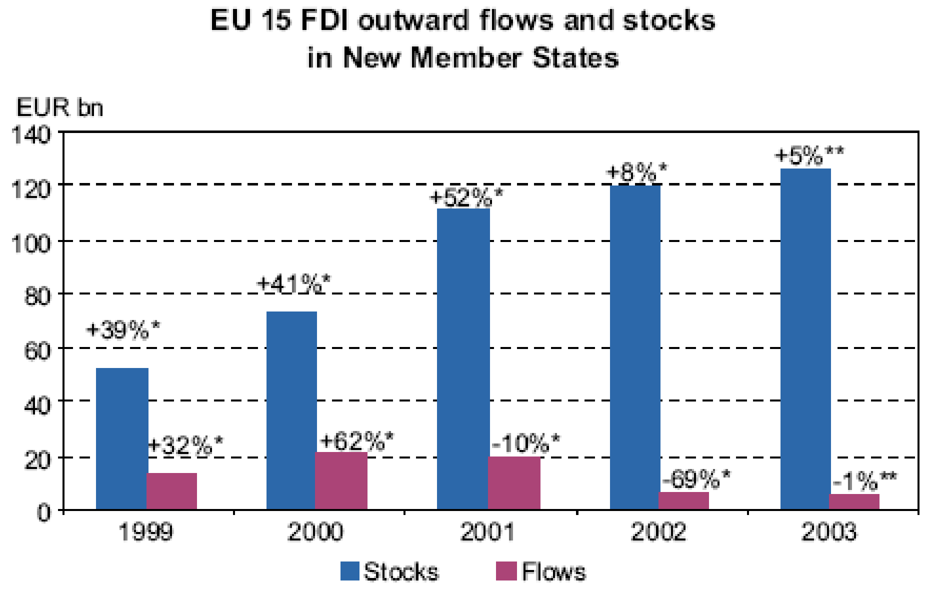
Shares of EU15 FDI outward stocks in new Member States (end-2002)



Source: EU FDI yearbook 2005

New Member States: FDI inflows from EU15 (2)

- EU-15 FDI outflows to new member states slowed down since 2001
  - 2003 - slight reduction in EU outflows to the 10 new Member States (EUR 5.9 bn, -1% compared to 2002) ⇔ continuation of two years of stronger decrease, particularly in 2002
  - 2003 - EU15 FDI outflows were
    - lower than in 2002 for six new Member States
    - grew only in the case of Hungary, Malta (in both cases after a disinvestment in 2002), Lithuania, and Slovenia



*annual growth rate

**estimated stock value

Source: EU FDI yearbook 2005

New Member States: FDI inflows from EU15 (3)

- 2003 - Hungary was the main destination of EU-15 FDI among the 10 new Member States
  - EUR 4 billion - Hungary
  - EUR 2 billion – Poland
  - EUR 1 billion - Slovenia

EU-15 FDI outflows to New Member States, 1999 – 2003 (EUR mil.)

	1999	2000	2001	2002	2003
Extra-EU-15	320.307	435.676	304.466	133.453	130.767
New Member States	**13.034**	**20.754**	**18.969**	**5.94**	**5.854**
Share of Extra-EU-15	4%	5%	6%	4%	4%
Poland	7.662	10.568	6.753	2.485	1.988
Cyprus	:	:	170	504	-462
Malta	:	:	-38	-2.218	432
Baltic Coutnries	685	925	833	733	438
Estonia	331	276	339	404	203
Lithuania	241	211	221	280	335
Latvia	115	435	274	47	-102
Czech Rep.	3.485	2.897	4.732	-199	-2.541
Slovakia	347	1.366	1.489	4.311	876
Hungary	608	4.875	4.451	-751	4.018
Slovenia	481	126	578	1.074	1.104

Source: EU FDI yearbook 2005

New Member States: FDI inflows from EU15 (4)

- Germany = the main investor in the New Member States
  - End of 2002 - Germany by far the main holder of FDI stocks in the New Member States (23%)
  - France - 11%
  - Austria - 10%
  - Netherlands - 9%
- France = the main EU investor in Poland - EUR 8 billion of stocks (more than 60% of French stocks in the new Member States)

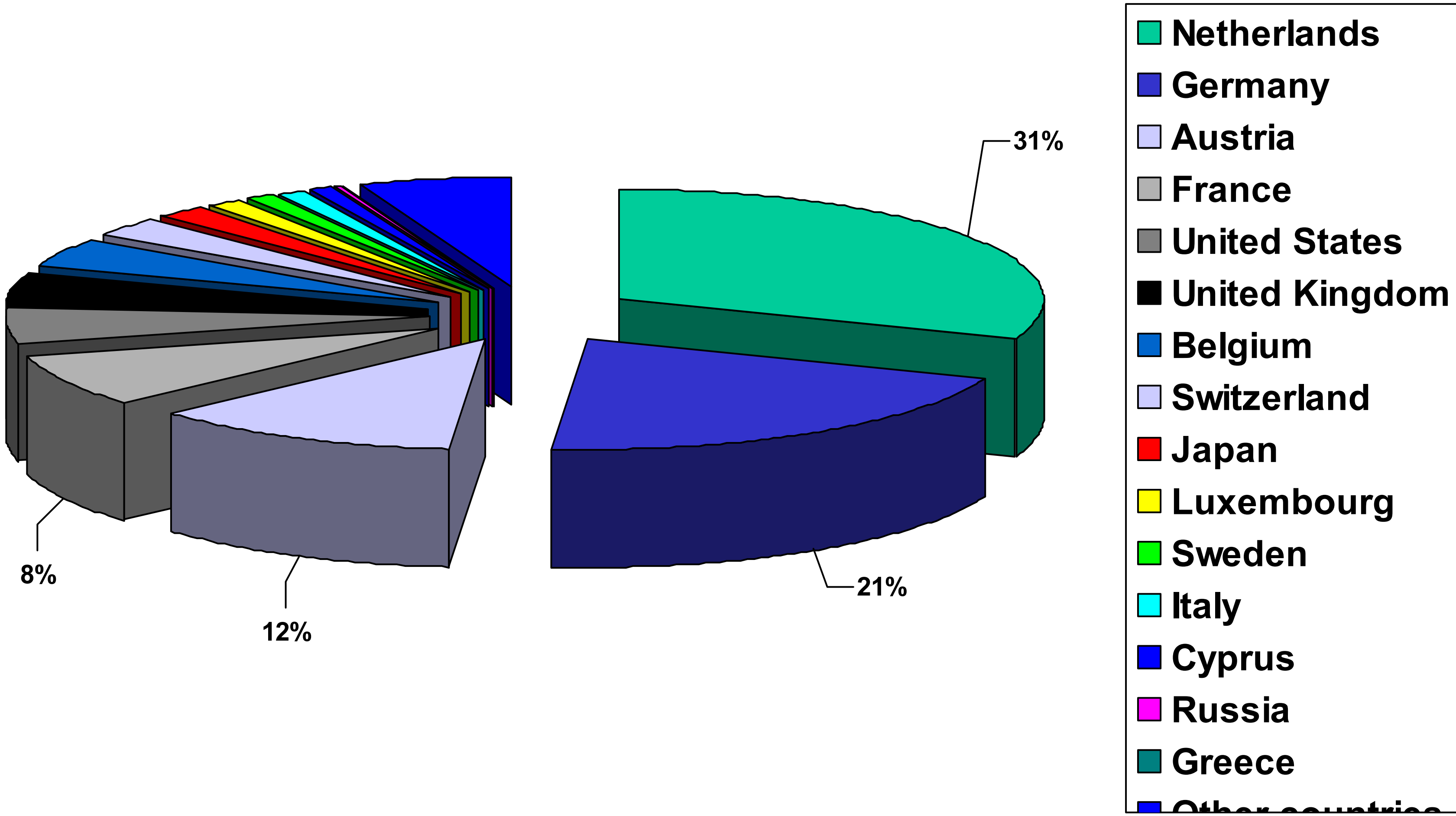
EU 15 FDI assets in New Member States at the end of 2002 (EUR mil.)

	EU 15	DE	FR	IT	NL	AT	UK	Other MS*
New Member States	119.875	27.705	13.389	2.925	10.562	11.952	8.224	45.118
Poland	44.532	7.743	8.206	1.92	4.627	1.394	3.786	16.856
Cyprus	4.509	235	68	19	c	48	c	3.887
Malta	874	197	10	127	c	515	c	44
Baltic Countries	5.349	499	72	28	66	17	45	4.622
Czech Republic	28.244	7.211	1.581	137	3.205	4.19	1.651	10.269
Hungary	26.581	9.017	1.62	465	1.898	3.429	2.16	7.992
Slovakia	7.523	2.442	1.492	142	c	1.382	c	1.116
Slovenia	2.26	360	339	87	c	977	c	330

Source: EU FDI yearbook 2005

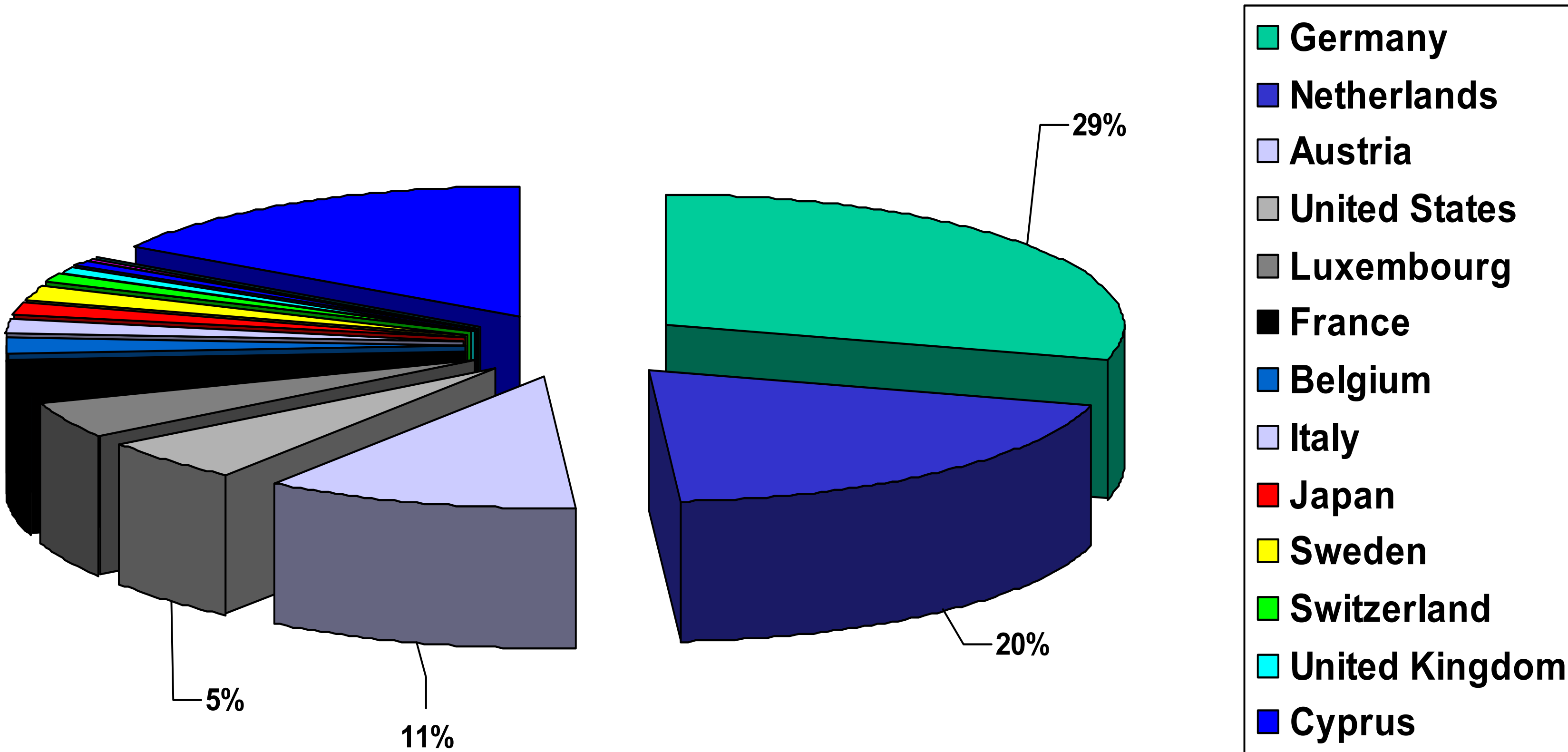
* 'Other MS' are computed as the difference between the estimated EU aggregate and the sum of the selected declaring countries.

CR – FDI Stock by Country of Origin



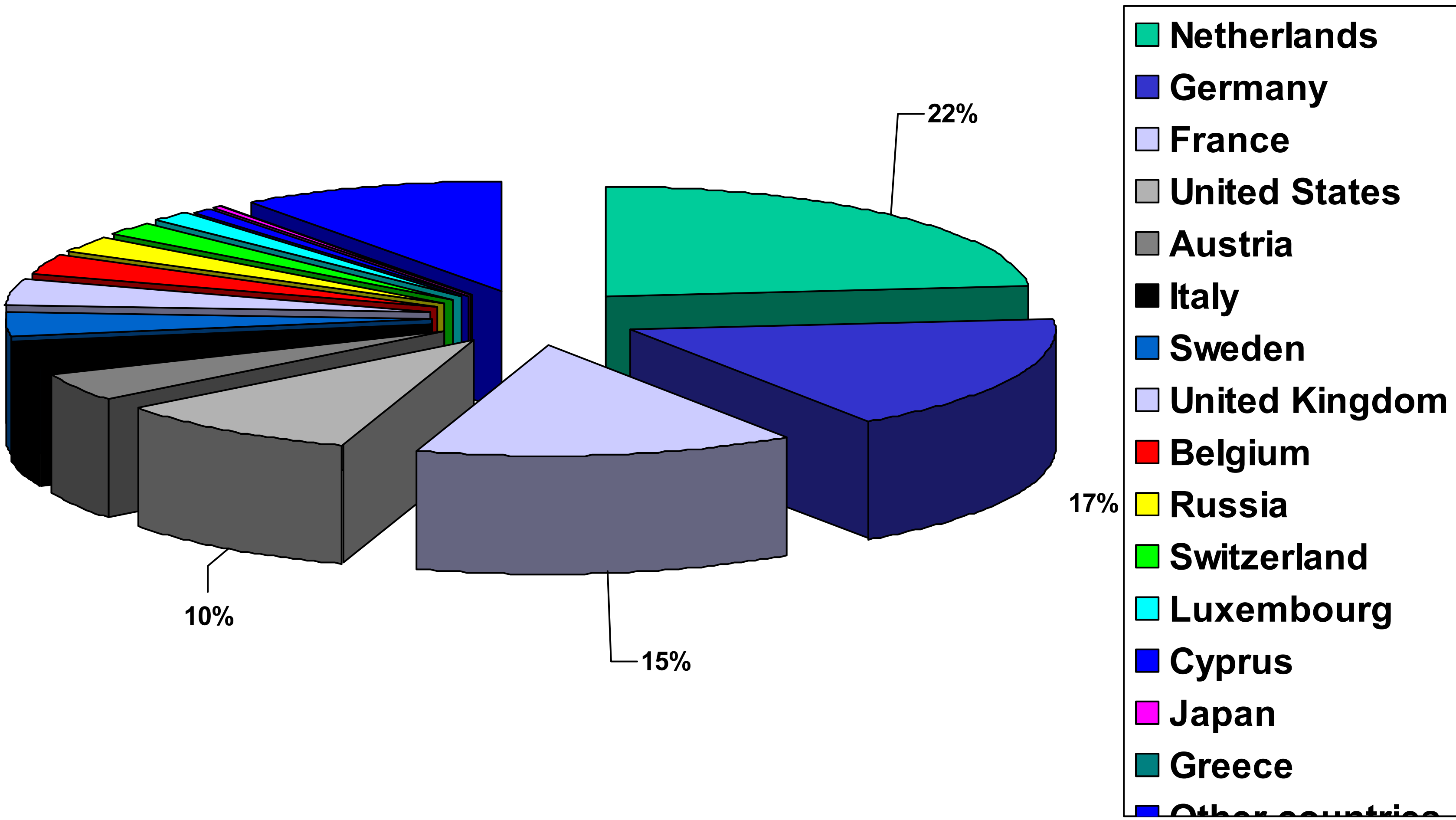
Source: WIIW Handbook of Statistics 2005

Hungary – FDI by Country of Origin



Source: WIIW Handbook of Statistics 2005

Poland – FDI by Country of Origin



Source: WIIW Handbook of Statistics 2005

FDI - Outflows

- FDI outflows from CEE expanded by 42% in 2003, from $5 billion to $7 billion. The Russian Federation remained the leading source, accounting for the lion´s share (59%).
- The ratio of FDI outflows to FDI inflows more than doubled, from 16% in 2002 to 33% in 2003 - Slovenia became a net capital exporter in 2003, while the ratio reached 62% for Hungary in the same year.
  - Slovenian and Hungarian TNCs - seek to improve their intra-regional competitiveness by focusing their investment mostly on the lower income CEE or some developing countries.
    - Hungary - oil and gas (MOL) accounted for 63% of outward FDI in 2003, followed by financial intermediation (22%) – OTP (MOL integration of Slovnaft (Slovakia) into the group, expansion Romania and acquisition of INA (Croatia). OTP - consolidation with its Slovakian affiliate and purchased DSK Bank in Bulgaria.
    - Slovenia – Lek - a production of generic drugs in Poland and Romania, automotive supplier Prevent – Morocco, plans in Shanghai.

The top 10 non-financial TNCs from Central and Eastern Europe, ranked by foreign assets, 2002 (Millions of dollars and number of employees)

Rank	Corporation	Home country	Industry	Foreign Assets	Foreign Sales	Foreign Employment	TNI ᵃ (Per cent)
1	Lukoil JSC	Russian Federation	Petroleum and natural gas	5 354.0	10 705.0	13 000	33.8
2	Novoship Co.	Russian Federation	Transportation	962.9	270.7	85	55.5
3	Pliva d.d.	Croatia	Pharmaceuticals	689.1	668.1	3 213	58.5
4	Norilsk Nickel, OJSC MMC	Russian Federation	Mining	502.0	2 360.0	34	27.2
5	Primorsk Shipping Corporation	Russian Federation	Transportation	331.8	96.0	1 305	71.3
6	Gorenje Gospodinjski Aparati	Slovenia	Domestic appliances	312.8	531.6	731	42.7
7	Hrvatska Elektroprivreda d.d.	Croatia	Energy	272.0	8.0	-	6.3
8	Mercator d.d., Poslovni sistem	Slovenia	Retail trade	224.6	139.1	1 893	15.1
9	Krka Group	Slovenia	Pharmaceuticals	180.7	282.6	817	42.3
#	Far Eastern Shipping Co.	Russian Federation	Transportation	123.0	101.0	233	22.8

Source: UNCTAD, World Investment Report 2004

Note: a "TNI" is the abbreviation for "Transnationality Index". The Transnationality Index is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

New Member States: FDI outlows (comparison with EU25)

- Comparison of the shares of EU15 and New Member States in relation to total FDI in extra-EU25.
  - The share of New Member States on EU25 stocks in extra-EU25 as a whole very low - 0.2%
  - however, more than 14% of EU25 stocks held in Ukraine, Belarus and Croatia were owned by the 10 New Member States
  - For neighboring countries, the New Member States had higher than average shares

New Member States FDI outward stocks as % of EU25 FDI stocks in extra-EU25 countries (end-2002)

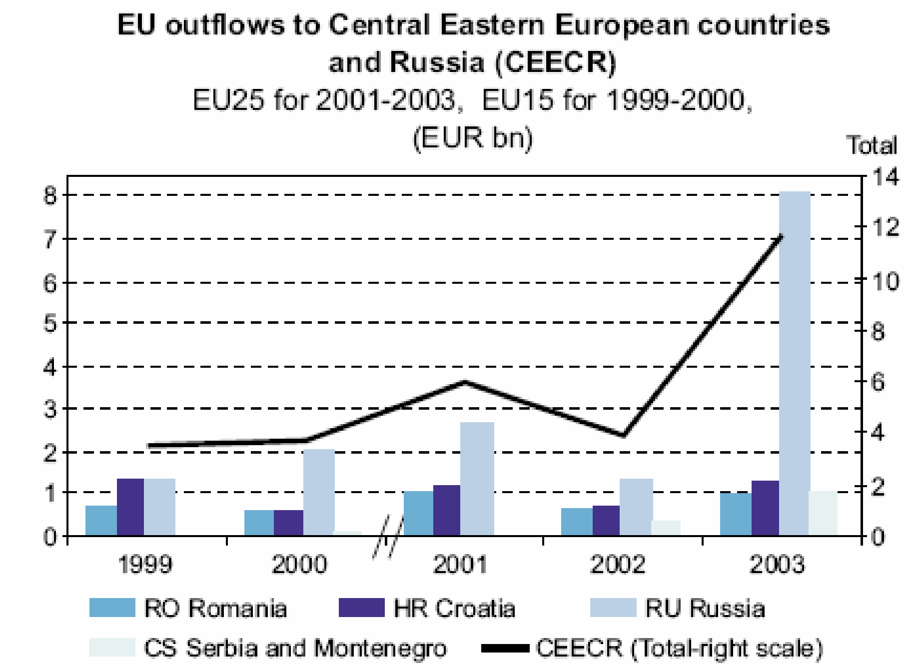
Extra-EU	0.2
Ukraine	18.2
Belarus	15.0
Croatia	14.8
Romania	5.3
Serbia & Montenegro	2.8
Bulgaria	1.7
Russia	1.6
Israel	1.5
Turkey	1.3

Source: EU FDI yearbook 2005

CEECR countries: FDI inflows from EU (1)

EU FDI outward flows, stocks and their annual growth rates in Central, Eastern European countries and Russia

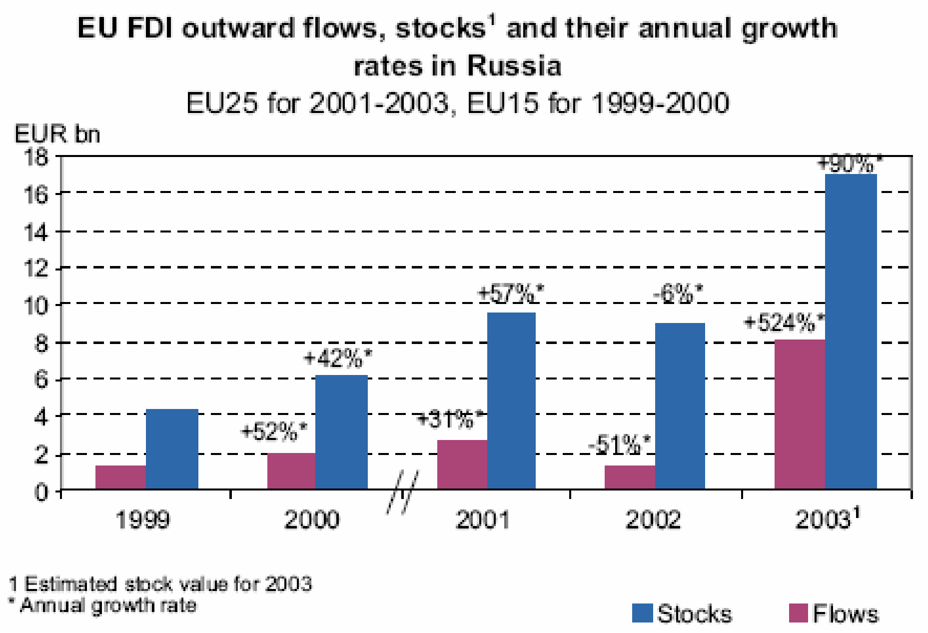
- Central, Eastern European countries and Russia: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia: the former Yugoslav Republic of, Romania, Serbia and Montenegro, Russia, Belarus, Ukraine.



Source: EU FDI yearbook 2005

CEECR countries: FDI inflows from EU (2)

- Unprecedented increase in EU investments to Russia in 2003 but certain disappointment recently



Source: EU FDI yearbook 2005

- Since 1999 - EU investment activity in the CEECR relatively stable starting from EUR 3.5 billion in 1999 and growing slightly to EUR 3.9 billion in 2002
- 2003 - the EU investors changed significantly their engagement in this region by placing there a hefty amount of FDI (EUR 11.6 billion) = 201% increase from 2002 levels
- Russia - the main host country of the EU investment capital attracting EUR 8 billion in 2003 - the UK first in terms of investment activity in Russia with EUR 3.7 billion, the Netherlands with EUR 1.3 billion, troubles with energy investments
- Croatia - the second most important destination in 2003 with EUR 1.3 billion

Contents:

1. Brief overview
2. History
3. Demographics
4. Economic situation and trends
5. FDI
6. Czech Republic

Czech Republic – General information (1)

- 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 ca. 10.3 million inhabitants. Population levels are decreasing, due to low birth rates, and should fall to ca. 10 million 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. Currently the Czech Government, through the National Property Fund (NPF) of the Czech Republic, retains ownership stakes only in a limited group of companies, mostly those of strategic importance.

Czech Republic – General information (2)

		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 forecast
GDP	increase in %, const. pr.	.	.	.	4.2	-0.7	-1.1	1.2	3.9	2.6	1.5	3.2	4.7	6	4.6
Household consumption	increase in %, const. pr.	.	.	.	8.8	1.4	-1.5	2.2	2.9	2.8	2.7	4.6	3.3	2.7	3.5
Gross fixed capital formation expenditure	increase in %, const. pr.	.	.	.	7.6	-3.4	-1.1	-3.5	4.9	5.4	3.4	4.7	5.3	3	3.4
GDP deflator	increase in %	.	.	.	8.7	8.3	11.2	2.8	1.4	4.9	2.8	2.6	3.4	0.5	2.2
CPI	%	20.8	10	9.1	8.8	8.5	10.7	2.1	3.9	4.7	1.8	0.1	2.8	1.9	2.6
ILO general unemployment rate	average in %	4.3	4.3	4	3.9	4.8	6.5	8.7	8.8	8.1	7.3	7.8	8.3	7.9	7.6
CA/GDP	%	.	.	-2.5	-6.7	-6.3	-2.1	-2.5	-4.9	-5.4	-5.6	-6.3	-5.2	-2.7	-2.3
CZK/EUR		.	.	.	.	.	.	36.9	35.6	34.1	30.8	31.8	31.9	29.8	28.9

Source: Czech Statistical Office, MF CR

Czech Republic – GDP and inflation (1)

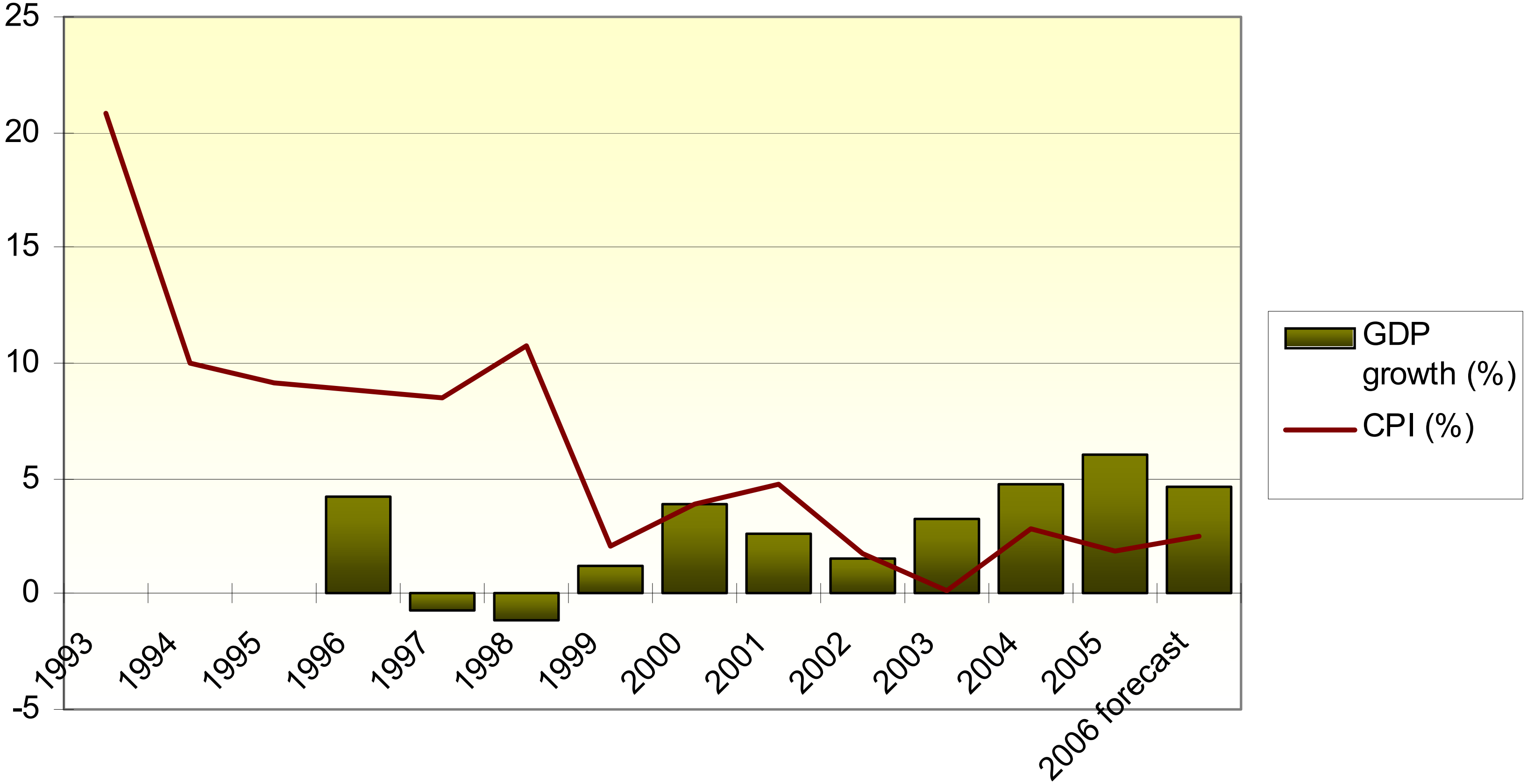
Output

- **According to the newest data of the Czech Statistical Office (March 9, 2006), an all-time high growth of constant price GDP in Q4 2005 (+6.9%) and in the year 2005 (+6.0%) was reached primarily due to the favourable development of external trade balance.**
- Contribution of the balance of external trade in goods and services can be estimated at 5.3 percentage points.
- On the other hand: Falling prices of Czech exports not being accompanied by a proportional decline in import prices -> The trade balance at current prices less favourable than net exports at constant prices. Owing to the above trend, real gross domestic income grew much less (4.2%).
- Household consumption – real increase by 2.6% in 2005
- Government consumption – real increase by 0.8 % in 2005
- Process of economic-level convergence with the advanced EU countries expected to go on
  - boosted by new export capacities and cuts in tax burden of legal entities
  - EU entry, high oil prices, low growth in countries of our most important export markets

Inflation

- Since the beginning of 2005 growth of consumer price level has slowed down compared to 2004. Average rate of inflation in 2005 reached 1.9 %.
  - Strengthening of the exchange rate (on average by 7.1% against EUR and 7.3 % against USD)
  - Slowdown in price movement on world and domestic commodity markets of raw materials and products except for oil
- In 2005 import prices increased on average by 0.3%, while export prices decreased by 1.6%.

Czech Republic – GDP and inflation (2)



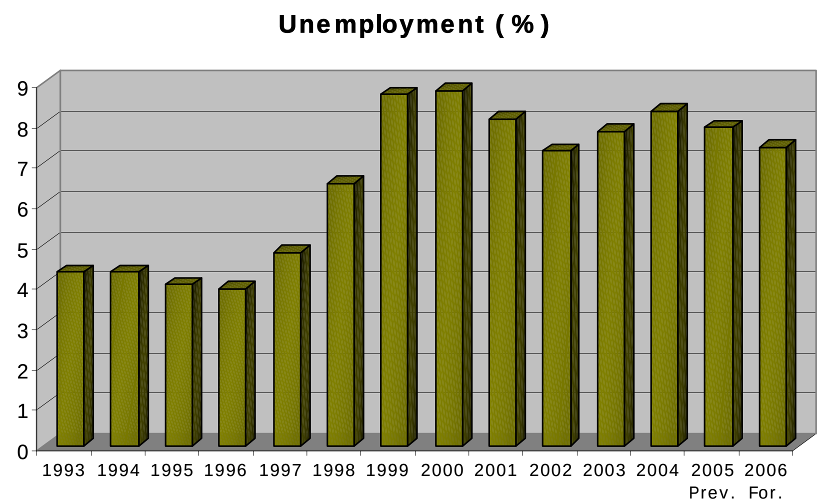
Czech Republic – Unemployment and interest rates

Unemployment

- Ongoing decrease in unemployment in 2005 (seasonally adjusted) is mostly of cyclical character and structural problems do not improve significantly.
- From the regional point of view differences were rather being removed over the year, especially due to major support of districts with rate of unemployment above 14 %.
- Unemployment is expected to continue in its decline with seasonal swings.
    - Economic growth, active employment policy x structural deficiencies, lower adaptability, qualification discrepancy in supply of and demand for workforce.

Interest rates

- In October 2005 – increase in reference interest rates
    - 2W repo rate at 2.00 per cent
    - Discount rate at 1.00 per cent
    - Lombard rate at 3.00 per cent
    - ECB policy rate 2.25% - interest spread 0.25 p.p
- Average value of PRIBOR 3M was 2.11 % in Q4 2005.



http://ies.fsv.cuni.cz
www.eeip.cz

Czech Republic – Taxation

Taxpayers in the Czech Republic are subject to the following taxes:

- Corporate income tax: 26 % for tax periods ending in 2005 and 24 % for tax periods ending in 2006 and thereafter
- Personal income tax: Progressive taxation with the tax rates from 15 % to 32 %
- Value added tax (VAT): 5 % (food, health-care services) or 19 % (most goods and services)
- Excise tax: Levied on petrol and petrol derivates, alcohol (beer, wine and spirits) and tobacco
- Road tax: CZK 1,200 - 4,200 cars (EUR 40 – 140), CZK 1,800 - 50,400 trucks (EUR 60 – 1,680)
- Real estate tax: According to type, location and purpose of use of the real estate
- Real estate transfer tax: 3 %
- Inheritance tax & gift tax: From 1% (0.5 % for inheritance tax) to 40 % (20 % for inheritance tax)

Czech Republic – FDI (1): Inflows - outflows

		1998	1999	2000	2001	2002	2003	2004	2005	2006 Forecast	2007 Outlook
Exports of goods	*bill.USD*	25.8	26.3	29.1	33.4	38.3	48.6	66.7	78.3	86.6	96.2
	prev.year=100	117.6	101.6	110.6	114.9	114.8	126.7	137.3	117.4	110.6	111.1
Imports of goods	*bill.USD*	28.5	28.2	32.2	36.4	40.5	51.0	67.5	76.6	83.4	91.2
	prev.year=100	106.2	99.0	114.3	113.2	111.1	126.0	132.3	113.4	108.9	109.4
Balance of trade	*bill.USD*	-2.6	-1.9	-3.1	-3.1	-2.2	-2.5	-0.9	1.7	3.2	5.0
Exports of services	*bill.USD*	7.6	7.0	6.9	7.1	7.1	7.8	9.7	10.8	11.4	11.9
Imports of services	*bill.USD*	5.7	5.8	5.4	5.6	6.4	7.3	9.2	10.0	10.7	11.2
Balance of services	*bill.USD*	1.9	1.2	1.4	1.5	0.7	0.5	0.5	0.8	0.6	0.7
Balance of income	*bill.USD*	-1.1	-1.3	-1.4	-2.2	-3.5	-4.2	-5.4	-6.0	-7.3	-8.1
of which:											
- compensation of employees	*bill.USD*	-0.4	-0.3	-0.3	-0.5	-0.6	-0.6	-0.9	-1.0	-1.5	-1.6
- investment income	*bill.USD*	-0.7	-1.0	-1.1	-1.7	-3.0	-3.6	-4.5	-5.0	-5.8	-6.5
Balance of transfers	*bill.USD*	0.5	0.6	0.4	0.5	0.9	0.6	0.2	0.9	0.5	0.8
Current account	*bill.USD*	-1.3	-1.5	-2.7	-3.3	-4.2	-5.7	-5.6	-2.6	-3.0	-1.6
Capital account	*bill.USD*	0.0	0.0	0.0	0.0	0.0	0.0	-0.5	0.2	.	.
Financial account	*bill.USD*	2.9	3.1	3.8	4.5	10.6	5.6	7.0	5.8	3.2	1.8
- foreign direct investments	*bill.USD*	3.6	6.2	4.9	5.5	8.3	1.9	3.9	10.1	.	.
- portfolio investments	*bill.USD*	1.1	-1.4	-1.8	0.9	-1.4	-1.3	2.4	-3.0	.	.
- derivatives	*bill.USD*	.	.	0.0	-0.1	-0.1	0.1	-0.1	-0.1	.	.
- other investments	*bill.USD*	-1.7	-1.8	0.7	-1.8	3.9	4.8	0.8	-1.3	.	.
Change in reserves	*bill.USD*	1.9	1.7	0.8	1.8	6.6	0.5	0.3	3.8	.	.
Gross official reserves	*bill.USD end-year*	12.6	12.8	13.1	14.5	23.7	27	28.4	30	30	30
Gross external debt	*bill.USD end-year*	24.3	22.9	21.6	22.4	27	34.9	45.3	45.5	47	47
Balance of trade / GDP	*per cent*	-4.3	-3.2	-5.6	-5	-3	-2.7	-0.8	1.4	2.5	3.6
Current account / GDP	*per cent*	-2.1	-2.5	-4.9	-5.4	-5.6	-6.3	-5.2	-2.1	-2.3	-1.1
Financial account / GDP	*per cent*	4.8	5.2	6.9	7.5	14.4	6.1	6.5	4.7	2.4	1.3
Gross external debt / GDP	*per cent*	37	40.3	38	35	33.7	35	36.6	37	36	33

Source: Ministry of Finance, Czech National Bank

http://ies.fsv.cuni.cz
www.eeip.cz

Czech Republic – FDI (2): Inflows

in USD year	FDI inflow per capita				FDI stock per capita				Cumulative FDI inflow per capita			
	Czech R.	Hungary	Poland	Slovakia	Czech R.	Hungary	Poland	Slovakia	Czech R.	Hungary	Poland	Slovakia
1990	**NA**	NA	NA	NA	**NA**	53.3	NA	NA	**NA**	NA	2.3	NA
1991	**NA**	141.2	7.6	NA	**NA**	205.7	NA	NA	**NA**	141.2	9.9	NA
1992	**NA**	142.9	17.7	NA	**280.1**	351.8	NA	NA	**NA**	284.3	27.6	NA
1993	**63.2**	227.4	44.7	NA	**331.5**	591.4	NA	NA	**63.2**	512.2	72.3	37.4
1994	**85.0**	111.0	48.8	50.5	**440.1**	723.6	98.6	167.8	**148.2**	624.1	121.0	87.7
1995	**248.7**	438.8	95.2	44.0	**711.9**	1,284.4	204.1	241.9	**397.0**	1,063.9	216.1	131.5
1996	**139.1**	221.3	117.1	65.3	**831.2**	1,574.1	298.5	380.7	**536.6**	1,287.6	333.4	196.5
1997	**124.9**	211.5	127.7	32.3	**896.4**	1,708.8	379.7	386.9	**662.1**	1,502.7	461.0	228.5
1998	**359.4**	199.5	165.7	104.2	**1,396.9**	1,852.4	585.3	535.9	**1,022.3**	1,707.2	627.0	332.3
1999	**614.0**	194.3	189.4	65.5	**1,707.2**	2,019.1	679.5	590.3	**1,637.3**	1,907.6	816.9	397.4
2000	**485.4**	162.4	243.6	379.4	**2,107.0**	1,968.6	892.4	877.6	**2,124.1**	2,076.8	1,060.9	776.3
2001	**481.7**	241.3	149.1	272.5	**2,618.7**	2,202.0	1,076.3	1,027.6	**2,616.5**	2,324.1	1,210.8	1,047.7
2002	**822.3**	85.3	141.0	737.5	**3,306.2**	2,636.2	1,250.4	1,150.8	**3,429.1**	2,418.1	1,352.3	1,783.4

Eastern Europe

- No. of projects (Jan-Sep 2004) : 252
- Market-share of projects in the region: 12.6%
- Value of projects relative to GDP : 29.6%
- Top 3 destination sectors: Auto components, machinery & industrial goods, consumer electronics
- Top 3 business functions: Manufacturing, retail, sales, marketing & support
- Top 3 source countries: Germany, Japan, US
- Top 3 investors: Volkswagen, Matsushita, Deutsche Post

Source: www.fdimagazine.com

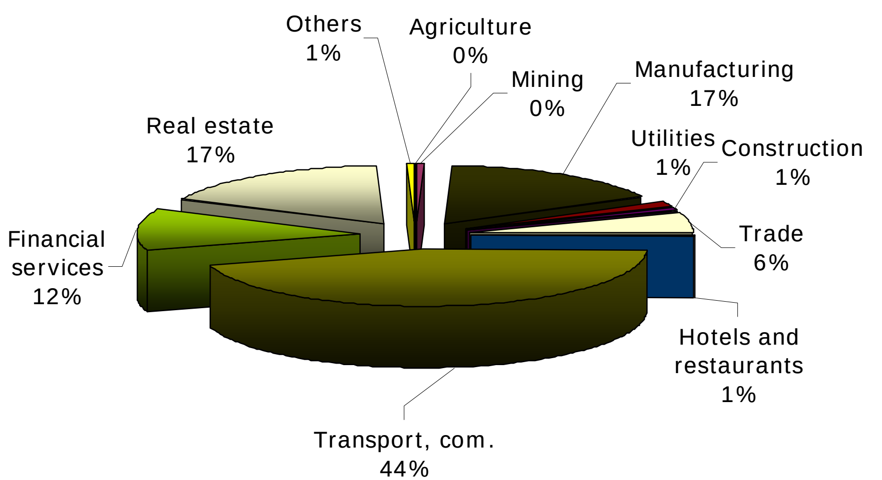
Czech Republic – FDI (3) in 2005

Between 2004 and 2005 FDI inflows doubled and increased to USD 11 billion.

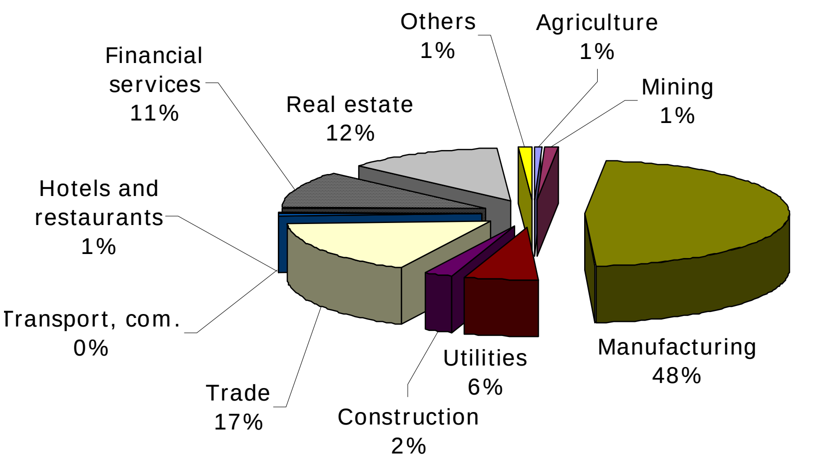
FDI inflows in 2005 were influenced by privatization. Spanish Telefonica bought state share in Český Telecom for more than USD 3 billion, Polish PKN Orlen paid more than USD 0.5 billion for Unipetrol. Also in other sectors of the economy there was visible trend of increasing FDI inflows.

FDI outflows in 2005: USD 0.9 billion.

Foreign direct investment inward flows broken down by economic activity in 2005



Foreign direct investment inward flows broken down by country in 2005



Source: CNB

Czech Republic – Main investors

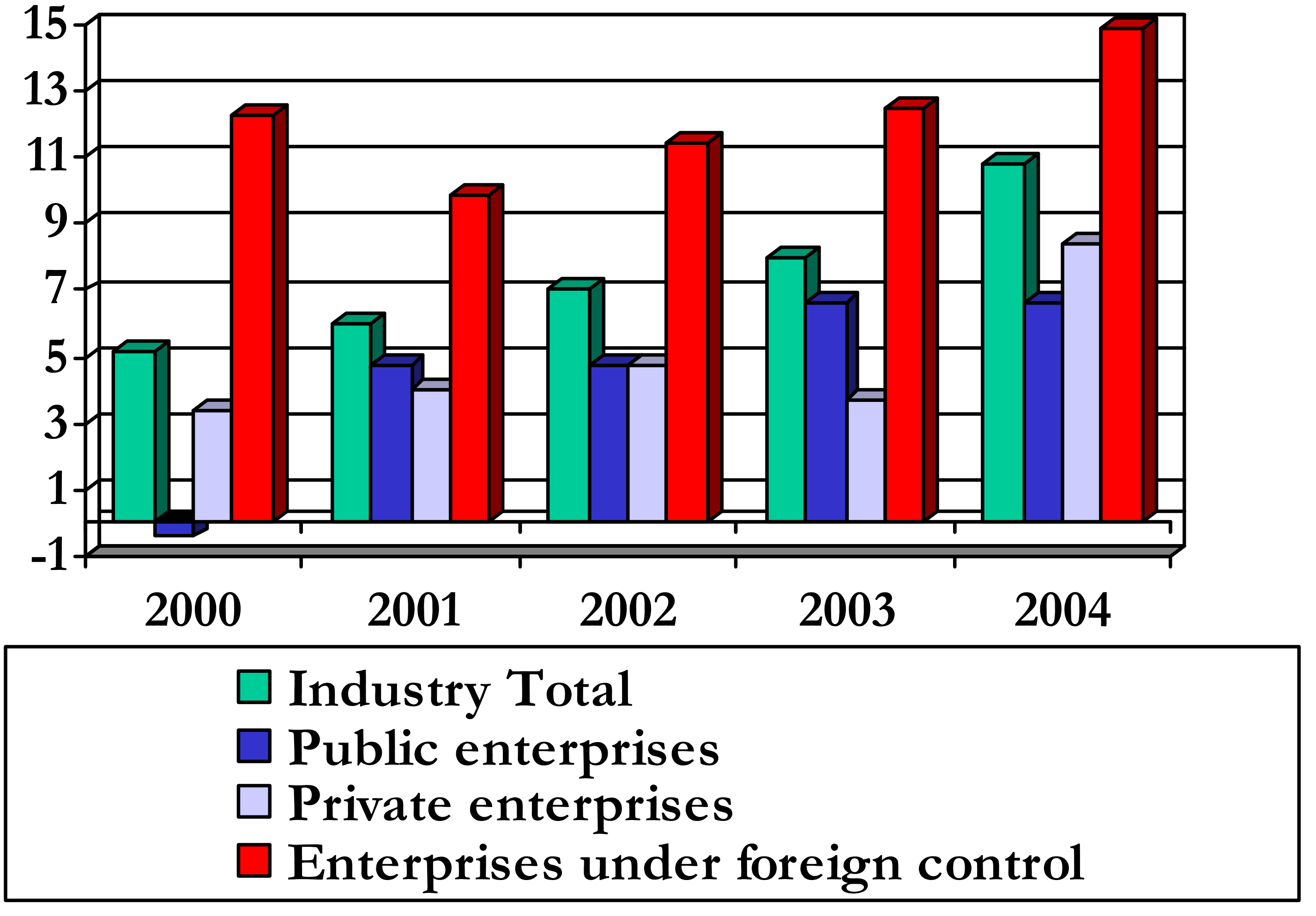
Sector	Investor	Country of origin
Automotive	Volkswagen Toyota/PSA Robert Bosch Denso TRW Automotive DaimlerChrysler	Germany Japan/France Germany Japan USA Germany/Japan
Electronics	Panasonic ON Semiconductor L.G. Philips Siemens Foxconn	Japan USA Netherlands/South Korea Germany Taiwan
Engineering	ABB Parker Hannifin Ingersoll Rand Boeing Daiho Siemens	Sweden and Switzerland USA USA USA Japan Germany
Life Sciences & Healthcare	Baxter Lonza Arrow Mölnlycke	USA Switzerland USA Sweden
Business Support Services	IBM Accenture Philips Logica	USA USA Netherlands UK
Technology centers	Rieter Panasonic Honeywell Kostal	Switzerland Japan USA/Germany Germany

FDI Impacts on Economic Activity

- Microeconomic effects – firm level effect
  - Entry of foreign owner with know-how and sufficient capital may increase profitability and efficiency of the companies
  - Problem – selection bias (forejgn investors develop growing industries)

- Macroeconomic effects – impacts on the overall growth and balance of payments
  - FDI may help the economy to grow faster
  - FDI may lead to initial worsening of the balance of trade (the investor imports some technologies and equipment), but in the long-run there can be positive impact on balance of trade (the new company starts producing and exporting)
  - The foreign owner will want some profit. FDIs therefore can lead to worsening current account because of profit repatriation (transfers of profits abroad)

CR – Return on Equity (ROE) by Ownership Structure



Source of data: MPO

Czech Republic – Investment incentives (1)

Manufacturing sector

- April 1998 - The Czech government in originally approved investment incentives for manufacturing
- May 1, 2000 - A new Act on Investment Incentives (Act No. 72/2000 Coll.), amendments in May 2004 -the Act was discussed with the European Commission and follows European rules on state aid.

- Tax incentive - Corporate tax relief for up to 10 years for new companies; Partial tax relief for up to 10 years for existing companies
- Job creation grants - Financial support to create new jobs
- Training and retraining grants - Financial support to train and retrain new employees
- Site support - Transfer of public land at a favourable price

- The investment must be made into a manufacturing sector and at least 50% of the production line must consist of machinery listed on a government-approved list of high-tech machinery
- The investment must be made into the launch of new production or into the expansion of existing production or modernisation
- The investor must invest at least CZK 200 million (approx $8 mil.) within three years. This limit is reduced in regions with high unemployment to CZK 150 million or CZK 100 million, depending on the unemployment rate
- Half of the investment minimum (above) must be covered by the investor’s own equity
- At least 40% of total investment must be made into machinery
- The proposed production must meet all Czech environmental standards

Czech Republic – Investment incentives (2)

Business support services and technology centres

- December 10, 2003 - the Framework Programme for Support of Technology Centres and Centres of Business Support Services
- As of the end of December 2005, 64 companies have received the Project support decision

- Subsidy for business activity - Paid yearly up to 50% of eligible business expenses (either wage or capital expenditures on tangible and intangible assets)
- Subsidy for training and re-training - paid yearly at a level of 35% (30% in Prague) of special training costs and 60% (55% in Prague) of general training costs

Job creation support programme for regions worst affected by unemployment

- June 2, 2004 - Government Decree No. 566
- As of December 31, 2005 - 24 companies have received the Project support decision

- Financial support for new job creation - Granted at the rate of CZK 200,000 per each newly created job up to 50% of total eligible costs actually incurred (total gross wages and salaries paid out over two years to employees in new jobs created by the project)
- Financial support for employee training or retraining - Granted at the rate of 35% of eligible costs actually incurred for employee training or retraining, but to a maximum of CZK 30,000 per each newly created job. y

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