CNB-EIB Conference:
Investment in the Czech Republic

Czech National Bank, Tuesday 6 June 2017

Conference Proceedings

On 6th of June, 2017, the Czech National Bank and the European Investment Bank co-organized a conference on investment in the Czech Republic at the premises of the Czech National Bank (CNB) in Prague. The EIB Vice-President Vazil Hudak and the CNB Board Member Marek Mora opened the conference with their welcoming remarks. V. Hudak kicked off the discussion by contemplating how to position CEE countries to be competitive and to avoid the middle income trap. Understanding the investment gaps in the CEE– with the help of the newly launched EIB Investment Survey –helps to identify what type of activities need to be financed. Debora Revoltella, Director of EIB's Economics Department presented the EIB Investment Survey for the Czech Republic, and Flavia Palanza, Director of EIB's CEE Operations, presented EIB activities in the Czech Republic. Two subsequent panel discussions comprised leading economists, policymakers and practitioners, who provided their views on both the economic and practical aspects of the Czech investment environment.

(Photos: CNB)

P. KRAL (CNB) described the investment activity in the Czech Republic. Investment to GDP ratio has been decreasing over time, reflecting the shift of the economy's structure to less capital-intensive production. Capital stock increases have been generating a relatively stable contribution to potential growth. While business cycle in the last decade has been tightly synchronized with investment cycle, in 2015 and 2016, the investment cycle diverged significantly from the business cycle due to the end/start of the respective EU funds program periods. Both, investment activity of the government as well as of the corporate sector were strongly influenced by the EU funds cycle in 2015-2016. According to the CNB analysis, private investment records the biggest positive response to an increase in external demand, and government investment partially crowds out private investment, especially in manufacturing and agriculture, but supports investment in construction and to a lesser extent in trade and services. In 2017-2018, the growth of government investment is expected to rebound with improved drawdown of EU funds from the new program period.

D. REVOLTELLA (EIB) outlined that the EIB Investment Survey for the Czech Republic confirms that investment activity of the Czech firms remains strong, with positive outlook and relatively small investment gap. Like some of the other cohesion countries, investment development in the Czech Republic has been recently strongly influenced by the EU funds cycle. In comparison to EU, there are gaps in health and communication infrastructure, and in PPP-funded projects. Access to finance is favourable. Quality of the capital stock, rather than its quantity seems to be a concern for Czech firms. Companies in the Czech Republic invest in new products, but they mostly adopt existing technologies. R&D activity of the Czech firms is broadly in line with EU average, but they have relatively lower overall intangible investment share than the EU average. Better governance of R&D spending could help improving the link between research and business. There seems to be a gap between domestic and foreign firms. Foreign owned firms in the Czech Republic have in general more positive investment outlook, face almost no external finance constraints, have better quality of their capital stock and innovate more for the global market. The country might therefore focus more on enhancing the spillovers from the foreign owned companies to the domestic owned ones. As for the barriers to investment, lack of skilled staff and labour market regulation constrain investment of the Czech companies, more than the EU average. Manufacturing and construction firms complain the most about high labour market regulation. In order to move up the value chain, the Czech economy would benefit from further investment in skills and education, updating the quality of the capital stock, financing support of innovative SMEs, as well as boosting health care and communication infrastructure.

M. MORA (CNB) chaired the first panel discussion on economic aspects of the Czech investment environment. As a first panellist, **V. DLOUHY** (Czech Chamber of Commerce) remarked that many Czech companies are still relatively low in the global value chain. There is a need for efficient public investment in R&D that can be practically utilized by the industry. Instead of specific government programs supporting the corporate investment, he preferred creating economic conditions conducive to entrepreneurship. He saw the critical role of the government in upgrading basic infrastructure and in supporting telecommunications infrastructure. **C. MARTINEZ-MONGAY** (European Commission) presented the recent European Commission recommendations to the Czech Republic. He also wondered why a catching-up economy is not outperforming the growth rate of more advanced economies. He saw potential in wider use of the "Juncker plan" in the Czech Republic to help crowding-in new private investment. More needs to be done to streamline the building permits processes and public administration (including through digitalization), address the pressing skills mismatches in the economy, and better align public spending on R&D to business needs. **J. SVEJNAR** (Columbia University) started with the good news from the EIB Investment Survey: Czech firms are not financially constrained and their indebtedness is not high. On the other hand, there is a need to invest in high quality infrastructure and quality human capital across the country, as it does not pay to be "second grade". In addition, public investment in the Czech Republic remains largely pro-cyclical. He also mentioned that the over-reliance on own resources in funding investment generally leads to smaller economies and slower growth. Generally speaking, he pointed out that Europe missed the boat on digital economy in comparison to the United States.

In her overview of EIB activities in the Czech Republic, **F. PALANZA**, (EIB) pointed out that in 2017 the EIB objectives in the Czech Republic aim at supporting the development and upgrade of regional transport and health-care infrastructure, continuing the support for SMEs and other EIB priority areas. Over the last five years, the EIB lending to the Czech Republic totalled EUR 3.6 bn, making the total EIB exposure to the Czech Republic stand at 4.2% of the Czech Republic's GDP. Most of the EIB's activity has been focused on support of the SMEs and mid-caps, predominantly through intermediated lending. Support to industry, services, agriculture and energy have also been important sectors of EIB lending in the Czech Republic.

L. TASSAN ZANIN (EIB) moderated the second panel with the practical focus on supporting investment in the Czech Republic. **J. KOTRBA** (Deloitte) started out the discussion by pointing out that Czech firms are too conservative and reluctant to raise capital from the equity market and they rely predominantly on bank financing and own resources. They use debt in sub-optimal manner and they are risk averse to grow and expand. He also pointed out to the too complex state as an impediment to entrepreneurship, and he saw a role for the EIB as an EU institution to advise the government to make the state simpler. **R. SPICAR** (Czech Confederation of Industry and Transport) outlined the top threats of the Czech firms seen from their own firm survey run jointly with the CNB, and lack of finance was not among the impediments mentioned by Czech firms. In line with the EIB Investment Survey, lack of skilled staff is regarded as a major obstacle seen by the Czech firms. This is followed by regulation, changing legislative environment, limited e-government, high indirect cost of labour and infrastructure gaps, including inferior telecommunications infrastructure. He highlighted the cumbersome process to obtain construction permit as one of the main obstacles to low investment of foreign firms in R&D and innovation centres in the Czech Republic. Looking at the structure of Czech companies, Mr. Spicar saw limitations to innovation stemming also from the fact that most Czech firms are not final producers, but they are integrated in Western European supply chains, and they are predominantly subsidiaries with low margins (in comparison to parent companies), not allowing them to invest as much in innovation. In addition, the value added of the Czech exports is among the lowest in the OECD, with limited use of automatization, digitalization and robotization, affecting the overall productivity. He also confirmed Mr. Kotrba's observation that Czech firms do not want to take on debt, and they prefer to invest out of their own resources and they are too averse to risk and do not want to grow in size beyond certain threshold. He saw the role for the EIB on the Czech market predominantly in SME support through local banks, and, due to the conservativeness of the Czech banks, in supporting new creative industries. **M. SINGER** (GENERLI) mentioned that EU funds influence on investment is not a unique phenomenon of the Czech economy. He outlined the main strengths of the Czech Republic from the corporate perspective: location in the centre of Europe, tradition in logistics and production processes and the associated skilled labour force, and orderly state. On the other hand, Czechs are not good sales persons, and they are not patient enough to test and develop new innovation. Where the EIB's role could be of help, he mentioned the need to tackle the quality gap in road infrastructure, worsening quality of education, and the risk-aversion and unwillingness of companies to get bigger.

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EIB Investment Survey for the Czech Republic: http://www.eib.org/infocentre/publications/all/econ-eibis-2016-czech-republic.htm

EIB Investment Survey for the CESEE: http://www.eib.org/infocentre/publications/all/econ-eibis-2016-cesee-overview.htm