A STRATEGIC FRAMEWORK FOR THE VISEGRAD GROUP’S ECONOMIC COOPERATION
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1. EXECUTIVE SUMMARY

Commissioned by the Foreign Trade Director responsible for the management of the Hungarian V4 Presidency, the Economic Research Institute of Századvég School of Politics Foundation analysed the potential action areas of the strategic framework of the Visegrad Group’s economic cooperation between 1 October and 30 November 2017. The conclusions of the study will be summarised below.

The V4 countries continue to constitute stability and growth in the European Union, and have the legitimate intention to contribute substantially and as equal partners to the dialogue on the future of the EU.1

Out of the four priorities of the programme of Hungary, who holds the Presidency of the Visegrad Group for the fifth time between 1 July 2017 and 30 June 2018, Digital Visegrad, which aims at increasing the Central European region’s competitiveness with a special emphasis on the requirements of the digital era, is of prior importance.2

The aim of this package of strategic recommendations is to lay the foundations of the Visegrad countries’ strategic cooperation, which shall respond to global economic challenges, be in line with the objectives of European integration and the EU’s framework, and shall provide a mid- and long-term basis for the region’s and in a broader sense, the EU’s sustainable growth, ensuring dignified living conditions and noticeable growth for all citizens of the EU.

The measures outlined below offer an answer and a solution to the crisis of European integration that has become increasingly visible after the financial and economic crisis of 2007-2008, as well as to the current failure of efforts aimed at deepening the integration.

With the help of the below recommendations, countries of the Visegrad Group may become potential leaders in deepening the European integration, which is acknowledged and serves as an example around the world. By applying innovative tools, they may become equalisers of the economic imbalances arising globally.

The implementation of the recommendation would also increase the visibility of the V4, it would underpin their commitment to Europe and would also serve their interests.

The recommended measures are as follows:

1. Financial transaction tax for an effective distribution of funds;
2. Approximation of wage ratios and achieving an equilibrium across the EU Member States;
3. Supporting the establishment of global value chains in the region;
4. Further opportunities for cooperation;

3. See page 22 of the Hungarian presidential programme.

DEAR READER,

The aim which this study is meant to achieve is one that is essential for the reinforcement and development of the Visegrad cooperation and for opening new dimensions within it: it is to map the opportunities for cooperation and to provide a strategic foundation for it.

Such a comprehensive study has thus far not been prepared. Individual policy areas have attempted to shape the economic aspects of the cooperation alongside with arising current issues, but they did so without a complex and coherent strategy for economic cooperation. The 2017/18 Hungarian V4 Presidency is an excellent opportunity to open the outstandingly successful and broad primarily political cooperation towards a jointly approved and strategically founded economic cooperation.

Putting the issue of economic cooperation on the agenda through the findings of the study may help deepening the cooperation and exceeding the results reached so far. At the same time, it may open new horizons both to individual policy areas and to leaders of states and governments.

The study prepared by Századvég Research Institute at the request of the Ministry of Foreign Affairs and Trade formulates concrete recommendations for a strategic economic cooperation. It builds on the economic analysis of the Visegrad countries and keeping the so far achieved results and gained experiences, as well as the economic diplomacy directions of the countries involved in mind, it also presents their expected results and consequences.

Our aim was to prepare a discussion paper that reflects the Hungarian position and at the same time – wishing to establish a joint strategy – attempts to formulate and harmonise the fundamental economic interests of the V4 cooperation and of the region.

I hope that the well-founded and detailed nature of the study will provide new information and generate many new ideas that may shed light on the V4 concept from a new angle.

Dr Ákos Erdődi
Ambassador Extraordinary and Plenipotentiary
Foreign Economic Director of the V4 Hungarian Presidency

PREFACE

"The V4 countries are interested in an economically stable European Union."1 The measures outlined below offer an answer and a solution to the crisis of European integration that has become increasingly visible after the financial and economic crisis of 2007-2008, as well as to the current failure of efforts aimed at deepening the integration.

With the help of the below recommendations, countries of the Visegrad Group may become potential leaders in deepening the European integration, which is acknowledged and serves as an example around the world. By applying innovative tools, they may become equalisers of the economic imbalances arising globally.

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Initially, European integration took place among countries with similar levels of development, who - in order to ensure integration - were committed to the elimination of the differences in the development levels of acceding countries. In order to achieve this, intensive redistribution measures were implemented in the beginning among the founding members of the EEC and the first acceding Members States. Currently however, the EU is becoming increasingly segregated; it is divided into capital and labour intensive, low and high added value producing, central and semi-peripheral countries.

The sustainable development of the EU and the convergence of regions with lower levels of development can be ensured in two ways: through fiscal and through monetary policy.

- In the current framework, fiscal policy is constituted of targeted support from more developed countries to less developed regions. In the 2014-2020 multi-annual programming period this is being implemented through the Structural Funds and the Cohesion Fund. In this respect, the main conclusion is that the most effective means of eliminating differences and deepening integration is greater income redistribution as outlined by the MacDougall report. According to the 1977 report, in successful cases of integration the amounts redistributed by the developed regions of the analysed countries to support the convergence of the less developed ones accounted for some 3-10 per cent of the latter’s GDP. In contrast to this, the level of redistribution from the Structural and Cohesion funds in the case of V4 countries between 2007 and 2013 amounted to an average of 2.5 per cent.

- Monetary policy only provides room for manoeuvre for these countries up until their accession to the eurozone. Therefore, these Member States - especially the three Visegrad countries still using their national currencies - can only give up monetary policy if appropriate guarantees and commitments were ensured, which could be achieved through joint negotiations on the accession to the monetary union.

Responsible fiscal and monetary policy is therefore needed to allow for a potential eurozone accession, the elimination of the centre - semi-periphery division and for the creation of a developed and competitive Europe that suits all Member States. The policies should also be supplemented with active measures stimulating national economies to be discussed below.

RECOMMENDATIONS:

1. Financial transaction tax for a more effective distribution of funds and a potential eurozone accession

In light of the EU’s future, it is advisable to establish a joint V4 plan to complement the existing ones, in order to avoid splitting political decisions, which would lead to forced actions on behalf of the countries of the region in case of the eurozone accession of a V4 Member State currently still using national currency, and which would endanger the sustainability of EU funds and the eurozone.

According to a possible V4 scenario, the prerequisite for any further economic integration, including the enlargement of the eurozone is to increase the level of development and automatic convergence funds directed to the less developed Member States from the current regional level of 1.5-3.3 per cent of the GDP to at least 6.5-7 per cent. This could be achieved through the introduction of a financial transaction tax, as this mechanism would not constitute a sacrifice in terms of growth for the central countries either.

The Hungarian Presidency of the V4 countries is committed to all initiatives that could result in the fair distribution of the benefits of growth and would impact a shift towards the equal distribution of capital and labour income. We support OECD and EU initiatives aimed at tax optimisation and the prevention of tax evasion, and in line with this, the fight against tax havens as well as the proportional taxation of transnational companies, which would contribute to the further expansion of development funds.

Furthermore, we believe that with the help of the successful banking transaction tax introduced in Hungary, and with the introduction of various forms of the Financial Transaction Tax (FTT) (STT - Securities Transaction Tax, BTT - Banking Transaction Tax, CTT - Currency Transaction Tax) already recommended by James Tobin in the 1970s and currently advocated by the OECD and the European Commission, a greater, some 3-4 percentage points higher level of redistribution could be possible without any sacrifice of economic growth after 2020. Financial transaction taxes are also fair, as they redistribute income from financial actors often suspected of optimising or evading taxes.

According to an earlier EU-28 estimation by the European Commission, the revenues from these taxes would amount to EUR 81 billion annually. Based on the conservative estimation of the Commission, annual revenues amounting to some EUR 65 billion could be expected from 2020 on, which would account for an estimated 0.48 per cent of the EU-27’s annual GDP.

Based on the experiences in Hungary, revenues from the financial transaction tax could however be significantly higher. In Hungary, in 2013 and 2014 for example, the revenues from the BTT type of financial transaction tax accounted for 0.864 per cent of the GDP. Taking the 2020 GDP prognosis as a basis, FTT revenues (EU-27) could reach EUR 116.5 billion by 2020.

The financial transaction tax to be introduced on an EU level would serve a more optimal redistribution and could well be the most important project of the Visegrad Group, which would allow the promotion of an innovative and fair position. As a result of the introduction of the financial transaction tax, the EU’s budget could be maintained at the same level (even after Brexit), without a substantial decline of the cohesion and agricultural funds, and a new, automatic financial transfer could also be financed for the less developed regions, while the net contributing Member States’ GNI-based contribution could significantly be decreased.

Taking the above aspects into consideration, we have outlined an indicative distribution for 2020 based on the optimistic scenario. The FTT revenues of EUR 116.5 billion would be utilised as follows:

- Similar to the duties collected for the EU, Member States could withhold 20 per cent of the revenues to cover their costs, in other words, EUR 23.3 billion would remain with the Member States directly;
- The tax collected could also be used to substitute lost EU funds resulting from the 50 per cent decrease of Member States’ GNI-based contribution (-EUR 46.5 billion) on the one hand and the revenues lost because of Brexit (-EUR 9 billion) on the other;
- As a result, balancing resources would be accumulated, which - as an automatic financial transfer - would provide additional support to less developed regions through a new fund. From the total of EUR 37.7 billion, 77 regions that have not reached 75 per cent of the EU’s GDP per capita would be benefited proportionately.
2. Approximation of wage ratio across the Member States of the European Union

In case of inseparable, joint Visegrad action, by means of approximating wage ratio to the Western level, wages in the Member States of the region could be doubled in real terms within ten years. In terms of wage ratio, the Visegrad countries’ situation is less favourable than that of Western Member States, both with a view to the entire economy and the corporate sector separately. In 2015, the wage ratio in the economies of the V4 countries was around 45–47 per cent, which is lower than the EU-15’s average of 56 per cent, and significantly lower than the optimal level of 65–65 per cent of the three decades preceding the 1980s.

The centre-periphery division and the division of labour can also be detected in the differences between the wage ratio of the different Member States. Several economists have pointed out that countries of Eastern Central Europe have become foreign-owned economies after the change of regimes.

At the same time, foreign ownership also meant a higher dependency of Western capital. This is most obvious in the low levels of wage ratio in the region, and in the gap between productivity and wages. However, it is important to note that the differences in productivity are partially caused by different price levels.

Germany’s productivity is 2.2 times higher than that of the Czech Republic, 2.4 times higher than that of Slovakia, 2.9 times higher than that of Poland and some 3 times higher than that of Hungary. In contrast to this, the multiplier in the case of wages is 3.2, 3.2, 3.8 and 4, respectively. Thus, the gap between wages in Germany and wages in the region is currently larger than that between the productivities of the two regions.

By decreasing the difference between productivity and wage ratio, wages in real terms could increase by some 30-40 per cent. As a result, an annual economic growth of 2-3 per cent and – with increasing EU development funds – a net wages increase of some 78-102 per cent could be recorded within a decade in the countries of the Visegrad Group.

The increase of tax revenues that would result from the increase of wages would provide an ideal basis for the Visegrad countries to compensate economic actors of the Western Member States, both with a view to the entire economy and the corporate sector separately. In 2015, the wage ratio in the economies of the V4 countries was around 45-47 per cent, which is lower than the EU-15’s average of 56 per cent, and significantly lower than the optimal level of 63-65 per cent of the three decades preceding the 1980s.

3. Supporting the establishment of global value chains in the region

It is important that a strong national bourgeoisie is established in the Visegrad countries as well, and that as part of this, sectors, and more concretely national companies that have the potential of being linked into global value chains are identified. The joint task of Visegrad governments is to support first the regional and later the international expansion of promising companies of the region.

Switching to higher added value production in the Visegrad economies is essential for both the V4 and the entire EU to be able to reinforce their position taken in the current world economic situation. In 2015, the world trade to GDP ratio was 58.2 per cent and 80 per cent of the world trade was generated by some 600 global value chains. In other words, these 600 global value chains produced more than 45 per cent of the world’s GDP.

For producers from developing and emerging countries, the spectacular initial catching-up facilitated by international economic integration and the opening of markets is limited. The reason for this is that as a result of the wage increase that goes hand in hand with the catching-up process, the competitiveness of these countries decreases due to the disappearance of their advantage of lower wages. Additionally, according to the U-shaped smiling curve theory by Stan Shih, the Visegrad subsidiaries of multinational corporations are typically in the middle of the curve, producing relatively little added value with their production activities. The goal is to establish high added value capacities (research and development, sales) that are presented in the top left and right corners of the smiling curve locally.

Following the step of identification, a mutual market demand can be created for each other’s potential global value chains in the regional markets of the Visegrad Group, which in terms of its population is similar to that of Germany, France or the Pearl River Delta. The goal is to reinforce the position in these markets by gaining experience and building capacities, thus allowing nationally owned companies of the V4 countries to successfully compete in the global market.

Throughout history, similar growth-enhancing, free market measures had been taken: the miracle of Germany’s productivity is 2.2 times higher than that of the Czech Republic, 2.4 times higher than that of Slovakia, 2.9 times higher than that of Poland and some 3 times higher than that of Hungary. In contrast to this, the multiplier in the case of wages is 3.2, 3.2, 3.8 and 4, respectively. Thus, the gap between wages in Germany and wages in the region is currently larger than that between the productivities of the two regions.

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4. Further opportunities for cooperation

The above-mentioned aspects are the most important areas for cooperation, which could provide the strongest possible tie in terms of the V4’s joint economic interests. Further recommendations not detailed in the Hungarian presidential strategy, which however support the realisation of the above recommendations are as follows:

a. Educating the elite of the region: One of the first steps of reinforcing the region’s EU and world economic position could be the creation of a young, intellectual layer of society, who have a profound knowledge of the Visegrad countries’ historical traditions and shared cultural roots, have a large informal network, and are well embedded internationally. It is desirable that a network of the Visegrad countries’ most important universities (Visegrad Network University) is established to serve the regions political, economic and diplomatic interests. We believe it is important to educate a V4 political-diplomatic elite to strengthen the cooperation, to improve R&D and the quality of higher education, as well as to promote the internationalisation of the region’s higher education (the Visegrad Fund may provide an ideal basis for further measures).

b. Closer cooperation between the Exim banks, for example in the form of joint tendering: primarily to support the participation in international tenders in order to make the financing of projects to be implemented through V4 cooperation acceptable to the institutions announcing the tenders.
Currently, the Exim banks can only finance projects up to the amount of the national contribution, which does not allow for the provision of sufficient funds for the implementation of larger developments (the elaboration of the cooperation is already under way).

c. Cooperation in the field of national bank reserves and a V4 system of criteria: building foreign-exchange reserves in each other’s government bonds in a 40:20:20:20 scheme following the principle of the Maastricht criteria: rules governing foreign-exchange reserves are not published, however, it can be assumed that most national banks build the overwhelming part of their foreign-exchange reserves in low-risk German and French government bonds. This constitutes additional economy-enhancing revenues for the German and French economies, but rather low interest revenues for the reserve building countries. Therefore, purchasing each other’s government bonds from the foreign-exchange reserves could serve as a basis for further negotiations for the V4. This way, increased demand could be recorded in their respective government bond markets, which would contribute to the reduction of the interest rate burdens of government debt, and would also provide relative security for the V4 countries in times of turbulences in the international financial market.

d. The issuance of special purpose V4 “government bonds” also deserves further examination, for example to support joint network (digital, energy and transport) infrastructure developments: in addition to V4 countries increasing the share of each other’s government bonds within their foreign-exchange reserves, they could also jointly issue government bonds to support V4 infrastructure developments. This measure could also promote the development of a national bourgeoisie and the establishment of nationally owned global value chains. Furthermore, these revenues could be used to symbolically purchase China bonds, thus supporting the infrastructure developments of the Chinese initiative called One road, one belt.

2. THE ECONOMIC SITUATION OF THE VISEGRAD COUNTRIES IN THE YEARS FOLLOWING THE FINANCIAL CRISIS

The financial crisis of 2007-2008 lead to a significant economic downturn in the Member States of the European Union. Before the recession, the economic development of the Visegrad countries was significantly higher than the EU’s growth rate. Initially, the intensive expansion could be explained with the difference in the relative levels of development and with increasing integration resulting from the accession to the EU, while after the crisis it was due to the different methods applied to manage the crisis.

![Figure: GDP increase in the European Union and in the Visegrad countries (in per cent)](image_url)

The success of crisis management in the EU Member States was primarily determined by the budgetary situation and the room available for budgetary manoeuvre. In countries where thanks to the low level of government debt governments had a larger room for manoeuvre to provide fiscal stimulus, the recovery after the crisis was swifter. In contrast to this, higher levels of government debt resulted in higher interest expenditures, thus posing a limit to government measures. In 2008, the debt-to-GDP ratio in the V4 countries amounted to 43.5 per cent, while in the EU, it was as high as 60.7 per cent. The V4 debt-to-GDP ratio peaked in 2013 at 57.8 per cent, and it has been decreasing ever since. In contrast, that of the EU peaked in 2014 at 86.5 per cent. In other words, the correction after the crisis has led to a much lower increase of government debt in the Visegrad countries, and has thus placed a smaller burden on future generations.
The level of government debt in the individual Visegrad countries significantly differs. Before the crisis (and ever since), Hungary has had the highest debt-to-GDP ratio (71 per cent in 2008). At the same time, in the Czech Republic and in Slovakia, the level of government debt was lower than 30 per cent of the gross national income and the same figure in Poland amounted to 46.3 per cent. Similar differences could also be detected in the interest expenditure of the national budgets. While Hungary spent 4 per cent of its GDP on interest payments in 2008, the Czech Republic spent 1.3 and Poland 2.1 per cent of their respective GDPs. The EU-28 average amounted to 2.7 per cent.

Since then however, interest expenditure has significantly decreased in the countries of the region thanks to disciplined budgetary policies (Hungary has not surpassed the 3 per cent Maastricht criterion since 2012, the Czech Republic and Slovakia since 2013, and Poland since 2015). The interest burden in Hungary decreased to 3.2 per cent, in Poland to 1.7 per cent and in the Czech Republic to 0.9 per cent. It only grew in the case of Slovakia, where it reached 1.6 per cent.

Due to the increase in employment, unemployment rates in all four Member States fell to a new low, not measured since the change of the regime. The unemployment rate of the active population in 2016 in the Czech Republic was 4 per cent, in Hungary 5.1, in Poland 6.2 and Slovakia 9.7 per cent. In contrast to this, the same figure in the EU-24 amounted to 9.1 per cent, and in the eurozone to 10.1 per cent. Thanks to the expanding labour market, the region is now facing a so far unprecedented problem, that of labour shortage, which has become one of the most important challenges of the V4 Member States.

In addition to differences in the governments’ room for manoeuvre, there are also significant differences in the labour markets of the Visegrad countries and those of other EU Member States (EU24)

Due to the increase in employment, unemployment rates in all four Member States fell to a new low, not measured since the change of the regime. The unemployment rate of the active population in 2016 in the Czech Republic was 4 per cent, in Hungary 5.1, in Poland 6.2 and Slovakia 9.7 per cent. In contrast to this, the same figure in the EU-24 amounted to 9.1 per cent, and in the eurozone to 10.1 per cent. Thanks to the expanding labour market, the region is now facing a so far unprecedented problem, that of labour shortage, which has become one of the most important challenges of the V4 Member States.

In addition to differences in the governments’ room for manoeuvre, there are also significant differences in the labour markets of the Visegrad countries and those of other EU Member States (EU24)4. Before the crisis, the employment rate in the V4 countries was 6 percentage points lower than the average of other EU Member States. This difference has been decreased to 5.4 percentage points, mainly thanks to the reforms implemented in Slovakia and Poland - the employment rate rose in both countries by 6-7 per cent. In Hungary and the Czech Republic, the figures increased by less than one percentage point. The turning point in the catching-up process was brought about by the crisis: while the EU-24 only reached the pre-crisis employment peak of 2008 in 2016, the Visegrad region’s labour market recovered by 2013. Thanks to the outstanding employment growth process that has been in motion since 2013, the V4’s employment rate surpassed that of the EU-24 by 2016.

4. EU-24 covers the Member States of the EU-28 without the four Visegrad countries (Czech Republic, Poland, Hungary and Slovakia).
The dependency is most obvious in the gap between productivity and wages. While wages in Germany are in average four times higher than in Hungary, the difference in productivity is only threefold. Similarly, Germany’s productivity is 2.2 times higher than that of the Czech Republic, but the wages are 3.2 times higher. The productivity multiplier compared to Germany in Slovakia is 2.4, and in Poland it is 2.9. However, the wage multiplier is 3.2 and 3.8, respectively. In other words, the gap between the wages is larger than that between the productivities.

In addition to the above factors, there is a significant difference in terms of foreign trade between the European Union, Germany and the V4. The sum of exports and imports in all four Visegrad countries amounts to at least 100 per cent of the GDP, in other words, all four are open economies and are therefore highly exposed to world trade developments. In contrast to the V4, the sum of exports and imports in the EU and Germany accounts for only 84 per cent of the GDP.

Another difference is that 41.4 per cent of Germany’s exports and 34 per cent of its imports is conducted with non-EU countries, primarily with the United States and China. In contrast to that, only 17.5 per cent of the Visegrad countries’ exports is directed to countries that are not members of the EU, and only 23 per cent of their imports comes from non-EU countries.

If we look at the region’s trade within the EU, we can observe Germany’s dominance. The German market’s influence is the lowest in Slovakia. One quarter of their EU trade goes to Germany (Table 1.). The figures are similar in the case of imports as well: in the case of Poland and the Czech Republic, German imports constitute 39 per cent of the total EU imports, while in Hungary and Slovakia they account for 35 and 25 per cent, respectively.

There is no specialisation among the Visegrad countries, as relatively little trade is conducted within the Group. Slovakia has the highest rate with 30 per cent of its total exports being directed to the other three Member States of the V4. This at the same time means that there is a significant growth potential.


6. However, it is important to note that the differences in productivity are partially caused by different price levels. Germany’s productivity measured as purchasing power parity per person employed is 64 per cent higher than that of Hungary.

7. Countries of origin in the top row, partner countries in the column.
in strengthening the trade relations within the V4. By supporting mutual trade within the Group, the region’s opportunities for growth could be further expanded.

An unfavourable development with respect to the V4 is the constant decrease of trade in value added (TIVA) that started in 1995; this means that even though the export-to-GDP ratio is high, a significant share of it is generated through exports. The TIVA figure shows that countries of the region primarily function as assembly plants for the world economy; a significant share of the value added is produced in other countries.

Even in spite of the favourable trends in the V4 countries, there is still potential for further development. Between 2002 and 2016, the GDP at purchasing power parity per capita increased from 58 per cent of the EU’s average to 76 per cent. The successes so far were mainly achieved by the Visegrad countries on their own, but there are a number of areas, where harmonised action and joint measures could lead to further economic achievements that would serve the catching-up process of the region.
3. STRATEGIC RECOMMENDATIONS TO EXPAND THE ECONOMIC COOPERATION OF THE VISEGRAD COUNTRIES

3.1. The EU's future: financial transaction tax and a potential eurozone accession

The prerequisite for any further economic integration is to increase the level of development and automatic balancing resources directed to the less developed Member States from the current regional level of 1.5-3.3 per cent of the GDP to at least 6.5-7 per cent. This surplus could be derived from the introduction of the financial transaction tax. Thanks to the introduction of the FTT, the increase in the funds provided to the peripheral countries would not constitute a sacrifice in terms of growth for the central countries either. The tax revenues would amount to approximately double the amount of the support allocated from the Cohesion Fund and the Structural funds. Additionally, rethinking fund allocation could also provide the basis for the Visegrad countries’ accession to the eurozone.

The EU’s single currency was created as a result of a joint political decision in 1999. Therefore its future fate is also primarily a matter of political decision, an issue that by today has become one with that of the EU integration’s future. The European Economic and Monetary Union and the single currency symbolising unity can undoubtedly be regarded as one of the most important tangible results of the European integration process.

Results of the 2017 elections show that the citizens of Europe remain committed to the single currency, however, they also expect significant changes. While France and the less developed Member States of the eurozone wish to decrease the imbalances within the area, even by providing extra funds, Germany and the richer Northern Member States expect further progress from common budgetary rules and greater budgetary discipline. A common characteristic of both groups however is that they seem to be willing to have a “two-speed” European Union, that is to further deepen the cooperation within the single currency area, thus gradually pushing countries outside the eurozone to the periphery. It was under these circumstances that the President of the European Commission, who envisages a joint deepening of the integration, presented his reform proposals. To gain support for avoiding a two-speed Europe, he will have to win over not only the central countries, but Member States outside the eurozone as well. The latter could be achieved by offering a package of economic incentives. The fourth pole could be joint action by the Visegrad countries.

The reform of the eurozone and the EU is a serious dilemma, however, it also represents an opportunity for finding progressive answers to the fundamental issues of the sustainability of the monetary union and that of economic integration on the grounds of national interests. Just like the establishment of the single currency area was a decision of sovereign states, so will the decision on the next question be: do we want to maintain a centre-periphery type of capital and labour division or a Union of equally highly developed nation states? We believe that striving for the latter can ensure Hungary’s, the region’s and the entire continent’s unity and a dynamic development for decades to come. This is why we recommend returning to pragmatic economic fundamentals, building on a new economic stabilisation and redistribution mechanism, which can ensure the real convergence of Member States, can make the introduction of the Euro beneficial to the countries in our region and can make the realisation of a two-speed Europe avoidable. Below we will elaborate on:

1. The pressing imbalances that have been in place since the establishment of the eurozone;
2. Plans to strengthen the EU and the eurozone;
3. Potential joint V4 plans: the establishment of a new, automatic distribution mechanism endowed with increased resources, based on an EU-level financial transaction tax, as well as the joint eurozone accession of Poland, the Czech Republic and Hungary.

3.1.1. Imbalances of the single currency area

The eurozone currently does not meet the criteria of an optimal currency area, the system established has not only failed to cope with the consequences of the global economic crisis, its own functioning has also contributed to deepening it.

- The single currency has amplified the differences in competitiveness, as in peripheral countries, the labour cost per unit increased by a greater extent than in the central countries. The cost advantage of peripheral countries against central ones is continuously decreasing.
- Before 2009, the current accounts of central countries ran significant surpluses, while the current accounts of peripheral countries ran increasing deficits. Based on these imbalances it is obvious that consumption in peripheral countries was significantly higher than the available revenues, which was financed from capital inflow from the central countries.
- The thus established structural imbalances resulted in the 2008-2009 crisis, which impacted the individual Member States differently (asymmetric shock): they have led to a prolonged crisis situation in the periphery, which individual governments were only able to do little against due to the lack of sovereign monetary policy.
- Structural imbalances have not ceased to exist; rather, they have reappeared in a new form: the Target2 system. The point of this is that central banks of the eurozone can have unlimited debts towards one another through the European Central Bank, as the liabilities to each other do not appear as loans, but as items in the ECB’s balance sheets. Loans coming from the central countries are needed in the peripheral countries because financial actors strive to invest their savings in “German euros” so that their assets maintain their value even after the break-up of the area. The purpose of Target2 is to prevent the drying-up of markets in the peripheral countries, of which capital outflows are characteristic. In case of leaving, the balances become actual external debts (receivables).
- In addition to the above, impact assessments also prove that while before the 2008-2009 crisis, almost all Member States (except Germany) profited from their membership in the monetary union in terms of real GDP per capita, after the crisis, peripheral countries suffered significant economic losses because of the single currency. Central countries however - with the exception of the Netherlands - still typically benefit from their eurozone membership. It is noteworthy that Germany has become the biggest winner, while the greatest losses were suffered by Greece.
### 3.1.2. Plans to strengthen the EU and the eurozone

#### THE MACRON PLAN

A central element of the French President’s election programme was the eurozone reform. His plans would not only include the modification of technical rules, but would also constitute the first steps towards a common fiscal policy, even if only covering certain limited areas.

- In his speech given on 26 September 2017, the French President primarily emphasised one of his campaign promises: the idea of a common eurozone budget. Among his proposals the introduction of an EU-level financial transaction tax (FTT) was mentioned, the revenues of which could serve developments ensuring future competitiveness and the financing of a new European innovation agency.
- Macron declared that within the eurozone extra financial transfers similar to EU development funds are necessary to increase the economic competitiveness of less developed Member States in order to ensure the sustainability of the currency area.
- As a possible coverage of part of the common budget after the harmonisation of corporate tax rates he mentioned revenues from this tax type (among several other new, common revenue sources, including the already mentioned FTT). At the same time, he also referred to the expected prolongation of the implementation: the harmonisation of corporate tax bases and tax rates will require time even in the case of eurozone Member States. This could ensure sufficient time to convince the Government of Germany and to elaborate the details. In order to ease Germany’s doubts, Macron and his Government will first have to show results with respect to France’s budget and its economic situation.
- Altogether, the deepening of integration within the eurozone would definitely point towards a “two-speed” EU, which could also mean that Member States of the eurozone would increasingly carry the signs of a common state, thus pushing non-eurozone countries to the periphery.

#### THE MERKEL PLAN

By now, Germany is almost the only eurozone Member State, which is interested in maintaining the status quo, as the area ensures a huge market and an advantageous price development for its highly export-oriented economy.

- Germany has little interest in a quick and deep reform. This position may change depending on the outcome of the coalition talks.
- The Government of Germany is concerned that through a potential common budget, peripheral Member States – and even France – may excessively rely on German resources, which would lead to the loosening of the common budgetary discipline at the German taxpayers’ expense.
- The need of reform was already admitted by Angela Merkel and by the previous minister of finance of Germany, Wolfgang Schäuble to a certain extent, and cautious signs have been given to France on a potential support for their reform plans.
- Altogether, the deepening of integration within the eurozone would definitely point towards a “two-speed” EU, which could also mean that Member States of the eurozone would increasingly carry the signs of a common state, thus pushing non-eurozone countries to the periphery.

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8. At the time of closing this document, on 15 November 2017, the coalition partner is not yet known.
THE JUNCKER PLAN

With its recommendation for the joint deepening of integration, the European Commission strives to maintain the unity of the EU.

- In his speech given on 13 September 2017, Jean-Claude Juncker said it was unnecessary to establish parallel structures, such as a eurozone budget or a eurozone parliament. At the same time, Juncker would like to see all Member States joining the eurozone from 2019 on. The reform plans in this case therefore point towards deepening the integration, which according to the President of the Commission shall happen in join action.
- In addition to the directions outlined by the Juncker speech, the European Commission’s discussion paper on the future of the Economic and Monetary Union is also relevant, as it identifies three main areas where progress is needed:
  1. establishing a real monetary union;
  2. putting in place a more integrated economic and budgetary union;
  3. increasing the accountability and transparency of the institutions.
- More and more signs point toward the fact that using the ‘reform momentum’ and the opportunities provided by Brexit, the Commission in cooperation with the central Member States, wishes to create a possibility for the joint deepening of the integration, the methods of which are yet undefined. Presumably, this is what the President of the Commission hinted at when he mentioned a sixth, mysterious scenario in addition to the five previously presented ones, to be recommended to the Member States by the Commission.

Below, we will briefly present our recommendations – a “package” to be potentially offered to the Visegrad Group and other, currently non-eurozone Member States – in exchange of deepening integration and expanding the eurozone.

MACDOUGALL REPORT (1977)

One means of reforms could be supplementing the current system of financial resources. Financial resources are constituted of support provided by the more developed regions and Member States to the less developed ones, just like in the case of a federal state (e.g.: Germany). Ideally, the transfers are automatic, and therefore they do not require further political decisions and negotiations after their introduction, but can fulfil their function continuously.

Currently, the most important financial transfers in the European Union are agricultural and rural development funds and cohesion funds. The task of the EU’s regional policy has for the last several decades been to strengthen regional, economic and social cohesion. Through the European Structural and Investment Fund (ESIF) significant financial resources are attached to this effort. ESIF funds only have a limited effect on decreasing internal imbalances. In the case of these funds, two important limiting factors can be identified: they are not automatic, and they still only allow for a rather low redistribution-to-GDP ratio.

During the previous programming period, Hungary had the highest annual EU cohesion fund allocation measured as a percentage of GDP in the region amounting to some 3.3 per cent, while the same figure only amounted to 1.5 per cent in Slovenia. Of course, if agricultural and rural development funds were also included, the figures in the below graph would be somewhat higher.

In defining the ideal ratio, a report prepared for the Commission in the early phase of European integration around the second half of the 1970s might serve as a yardstick (MacDougall report). According to the report, one of the most important reasons against establishing a monetary union was that the EU’s budget would not be able to appropriately handle differences between the regions, mostly because of the extremely low level of redistribution. Based on the example of eight federal states analysed, the report has shown that, within the individual states, more developed regions typically redistribute some 3-10 per cent of the regional GDP to the less developed regions, but often the public funds provided to decrease regional differences are even higher, sometimes accounting for as much as 30 per cent of the regional GDP. These funds not only supplement revenues in less developed regions, they also play an important role in treating short-term and cyclical fluctuations, thus providing a protective net to poorer regions.


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8. FIGURE: Cohesion funds as a percentage of GDP in the CEE countries between 2007-2013 (%)

Source: KPMG (2016), edited by Századvég
EU funds (ERDF, ESF, CF) of the 2007-2013 period divided over 7 years, as a percentage of the GDP of the individual countries, based on data from 2015.
It is clearly visible that the level of annual financial transfers to the Visegrad countries as a percentage of their GDP was much lower than that, some 2-3 per cent, which is the lowest limit of necessary financial transfers. Even with the agricultural and rural development funds added, the transfers did not surpass 5 per cent. In case of those countries of the region that have adopted the euro, the level of funds as a percentage of the GDP was even lower.

The MacDougall report points out direct allowances between governments and the system of tax sharing as an effective means of transfers. The rate of redistribution, including the defence budget in the case of federal states smaller than the United States or Germany would be around 7.5-10 per cent annually, which - considering current trends - is not realistic. Authors of the 1977 report regarded a “federal type” of scheme redistributing some 2-2.5 per cent of the annual GDP to be realisable. This would still be twice the amount of the current rate of redistribution and would allow for the financing of joint external action and cyclical policies, including regional developments, job protection and the management of crises.

The expansion of the room for budgetary manoeuvre would furthermore make providing financial support to the less developed regions possible, amounting to some 3-10 per cent of their GDP.

- In order to cut costs, a harmonisation of regulation and diminishing bureaucratic obstacles may be justified.
- The system of social benefits would still remain in the competence of the Member States. The areas of adult education and unemployment may receive significant funds.
- The recommendations also include the provision of extra funds for Member States that are not able to ensure at least 65 per cent of the EU average of public and social services and benefits to their citizens.
- Furthermore, they also include the idea of establishing a crisis management fund.13

Considering above aspects, ESIF funds are important means of decreasing regional, economic and social differences. At the same time, other, automatic transfers may also be justified within the eurozone, for example as an element of a common eurozone budget.

### 3.1.3. V4 plan for a more effective distribution of funds and for a stronger eurozone

The most likely scenario is that of the fact that Germany is currently concentrating on its internal affairs, we are to expect a slow and prolonged eurozone reform. Throughout it, it is necessary to avoid all splitting political decisions, which would lead to forced actions on behalf of the countries of the region in the case of the eurozone accession of a V4 Member State currently still using national currency on the one hand, and would endanger the sustainability of EU funds and of the eurozone on the other.

Supposing that over the coming few years we will find ourselves in a situation where we will have to decide on the concrete date of the adoption of the euro, our bargaining power could be significantly improved if the three Visegrad countries that have not yet adopted the Euro - Hungary, the Czech Republic and Poland - acted in a united manner and were supported by Slovakia.

The decision - which would be closely related to the future of European integration - could provide an opportunity to return to pragmatic economic fundamentals and to decide whether we want to maintain a centre-periphery type of capital and labour division or a have a Union of equally highly developed nation states. To support the latter, we can come forward with a mutually beneficial offer reaching back to the MacDougall report, in order to continue integration with a modern approach and to avoid the establishment of a two-speed Europe. We recommend the following points for consideration:

- maintaining its optional nature;
- coordinated V4 accession to the eurozone;
- preventing the plan of a two-speed EU;
- ensuring financial transfers necessary for the effective and sustainable operations of the monetary union through an EU-level financial transaction tax.

**RECOMMENDATION:** the prerequisite for any further economic integration is to increase the level of development and automatic balancing resources directed to the less developed Member States from the current regional level of 1.5-3.3 per cent of the GDP to at least 6.5-7 per cent.

- An ideal source for this could be the introduction of a financial transaction tax, with a broader scope than the bank transaction tax (BTT) already tested in Hungary, including the bank, the securities and the currency transaction tax as well (FTT = BTT + STT + CTT).
- According to an earlier EU-28 estimation by the European Commission, the revenues from these taxes would amount to EUR 81 billion. Based on the conservative estimation of the Commission, annual revenues from the introduction of the FTT in the EU-27 post-Brexit are expected to amount to some EUR 65 billion from 2020 on, which would account for an estimated 0.48 per cent of the EU-27’s annual GDP.
- Based on the experiences in Hungary, revenues from a comprehensive financial transaction tax could however be significantly higher. In Hungary, in 2013 and 2014, the revenues from the bank transaction tax amounted to 0.864 per cent of the GDP. Taking the revenue-to-GDP ratio as a basis, FTT revenues in the EU-27 could amount to EUR 116.5 billion by 2020.
- There are a number of possible methods for distributing FTT revenues: the Commission would see a part of it as the EU budget’s own revenues of, thus replacing some of the own funds; a part of it would stay with the Member States, while the rest could function as an automatic balancing resource as part of a new fund for less developed regions.
- Taking the above aspects into consideration, we have outlined an indicative distribution for the year 2020 based on the optimistic scenario (of EUR 116.5 billion).

![Potential distribution mechanisms for revenues from the financial transaction tax](image)

**Source:** Edited by Századvég (2017)

13. ibid
1. Maintaining the level of the EU’s own resources while halving GNI-based contributions and compensating for lost revenues resulting from Brexit.

By introducing the FTT, EU revenues could be kept at the same level even if GNI-based budgetary contributions were reduced by 50 per cent. Member States would profit directly from the savings generated by decreasing these contributions, which especially benefit net contributor countries. Based on the European Commission’s estimation, Member States could save some EUR 46.5 billion annually. Furthermore, it would also allow to replace revenues amounting to some EUR 9 billion lost because of the United Kingdom leaving the EU. In other words, using the revenues of FTT, this item could amount to some EUR 55.5 billion annually.

2. Remaining in direct Member State competency: similar to the duties collected for the EU, 20 per cent of the revenues would be directly left with the Member States to cover administrative costs.

Similar to the case of revenues from duties, Member States would directly keep 20 per cent of the revenues collected for the EU to cover their administrative expenditure. This would mean an annual tax revenue of EUR 23.3 billion for the Member States.

3. Balancing resources: establishing an automatic financial transfer through a new fund to ensure the convergence of less developed regions.

By means of the introduction of the FTT, the direct support of less developed Member States could be realised through an automatic stabilisation mechanism. According to present estimation, revenues that could be spent on support would amount to some EUR 37.7 billion annually. The scope of regions receiving the support would always change due to the automatic distribution, thus ensuring that the most deprived regions are benefitted. Eligible for the balancing resources would be those regions whose level of development measured in purchasing power parity does not reach 75 per cent of the EU’s GDP per capita. According to the NUTS2 breakdown, there are currently 77 such regions. The resources amounting to EUR 37.7 billion would be divided between them, based on their deviation from the 75 per cent threshold.

### Table: Estimated amount of transfers to be provided for the less developed regions of the V4 countries

<table>
<thead>
<tr>
<th>Region</th>
<th>GDP per capita in the EU average (%)</th>
<th>Deviation from the average (%)</th>
<th>Support to the region (EUR million)</th>
<th>As percentage of the region’s GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Great Plain (HU)</td>
<td>43</td>
<td>32</td>
<td>906</td>
<td>8.7%</td>
</tr>
<tr>
<td>Southern Transdanubia (HU)</td>
<td>45</td>
<td>30</td>
<td>849</td>
<td>12.9%</td>
</tr>
<tr>
<td>Northern Hungary (HU)</td>
<td>45</td>
<td>30</td>
<td>849</td>
<td>10.0%</td>
</tr>
<tr>
<td>Lubelskie (PL)</td>
<td>47</td>
<td>28</td>
<td>792</td>
<td>4.8%</td>
</tr>
<tr>
<td>Southern Great Plain (HU)</td>
<td>48</td>
<td>27</td>
<td>764</td>
<td>7.7%</td>
</tr>
<tr>
<td>Podkarpackie (PL)</td>
<td>48</td>
<td>27</td>
<td>764</td>
<td>4.5%</td>
</tr>
<tr>
<td>Podlaskie (PL)</td>
<td>49</td>
<td>26</td>
<td>736</td>
<td>7.8%</td>
</tr>
<tr>
<td>Warmińsko-Mazurskie (PL)</td>
<td>49</td>
<td>26</td>
<td>736</td>
<td>6.4%</td>
</tr>
<tr>
<td>Swietokrzyskie (PL)</td>
<td>50</td>
<td>25</td>
<td>708</td>
<td>6.9%</td>
</tr>
<tr>
<td>Východné Slovensko (SK)</td>
<td>54</td>
<td>21</td>
<td>594</td>
<td>3.6%</td>
</tr>
<tr>
<td>Opolskie (PL)</td>
<td>55</td>
<td>20</td>
<td>566</td>
<td>6.3%</td>
</tr>
<tr>
<td>Kujawsko-Pomorskie (PL)</td>
<td>56</td>
<td>19</td>
<td>538</td>
<td>2.8%</td>
</tr>
<tr>
<td>Lubuskie (PL)</td>
<td>57</td>
<td>18</td>
<td>509</td>
<td>5.4%</td>
</tr>
<tr>
<td>Zachodniopomorskie (PL)</td>
<td>58</td>
<td>17</td>
<td>481</td>
<td>3.0%</td>
</tr>
<tr>
<td>Malopolskie (PL)</td>
<td>62</td>
<td>13</td>
<td>368</td>
<td>1.1%</td>
</tr>
<tr>
<td>Stredné Slovensko (SK)</td>
<td>62</td>
<td>13</td>
<td>368</td>
<td>2.4%</td>
</tr>
<tr>
<td>Central Transdanubia (HU)</td>
<td>64</td>
<td>11</td>
<td>311</td>
<td>2.8%</td>
</tr>
<tr>
<td>Lodzie (PL)</td>
<td>64</td>
<td>11</td>
<td>311</td>
<td>1.2%</td>
</tr>
<tr>
<td>Northwest (CZ)</td>
<td>65</td>
<td>10</td>
<td>283</td>
<td>2.1%</td>
</tr>
<tr>
<td>Pomorskie (PL)</td>
<td>66</td>
<td>9</td>
<td>255</td>
<td>1.0%</td>
</tr>
<tr>
<td>Slaskie (PL)</td>
<td>71</td>
<td>4</td>
<td>113</td>
<td>0.2%</td>
</tr>
<tr>
<td>Western Slovakia (SK)</td>
<td>71</td>
<td>4</td>
<td>113</td>
<td>0.5%</td>
</tr>
<tr>
<td>Northeast (CZ)</td>
<td>72</td>
<td>3</td>
<td>85</td>
<td>0.4%</td>
</tr>
<tr>
<td>Moravskoslezsko (CZ)</td>
<td>72</td>
<td>3</td>
<td>85</td>
<td>0.5%</td>
</tr>
<tr>
<td>Central Moravia (CZ)</td>
<td>73</td>
<td>2</td>
<td>57</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

Source: Eurostat (2017); calculated by Századvég
### 3.2. Approximation of wage ratios in the region

In case of inseparable, joint Visegrad action, by approximating wage ratios to the Western level, wages in the Member States of the region could increase significantly, and could even be doubled in real terms within ten years. The goal is to increase wage ratios (the ratio of wages to the income generated) to the optimal level in the Visegrad countries.

#### 3.2.1. Development of wage ratios around the world

Over the past more than three decades, those offering jobs and capital holders did not benefit from national income in a permanent ratio. Since the 1980s, labour has received an ever-shrinking slice from the pie produced, in spite the fact that labour productivity has continuously been on the rise.

The decrease of wage ratios since the 80s is a well-documented fact, even if different analyses and sources of data calculate the wage ratio differently.

According to the OECD’s analysis, employees’ consideration pay in the developed countries has been constantly decreasing between 1990 and 2009. In 26 out of the 30 countries with data available to analyse, the wage ratio dropped from 66.1 per cent to 61.7 per cent. The period, where the wage ratio showed a trend of significant growth seems to have ended with the 80s.¹⁴

Wage ratios in G20 countries went down by about 0.3 percentage points per year between 1980 and the late 2000s. Analyses by the IMF (2007), the European Commission (2016), the BIS (2006) and the ILO (2012) also scrutinised this negative trend, which is also applicable to developing countries. According to the ILO (2011), the wage ratio decline was more drastic in North Africa and Asia. The downward trend of wage ratios stopped during the economic and financial crisis of 2008 which is typical for crises in general, where in the first years, wage ratios slightly increase, and then during recovery, they return to their long-term negative trend (OECD, 2015). At the time of the dotcom bubble of the turn of the millennium and the 2008 financial crisis, the decline of wage ratios stopped for a while (Figure 10.) and then continued again.

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In addition to the above, long-term data series of France, Germany, Italy and the United Kingdom (Figure 13) show that in the corporate sector excluding agriculture, a sort of convergence of the wage ratios could be observed over the four decades in the four countries concerned. Italy, having had the highest share, has been gradually getting close to the other three countries, in which no decline in merit could be observed, on the contrary, an upward trend was recorded. In these countries, the economic structure and economic policy were jointly able to ensure maintaining a high level of wages: in 2010, a sectoral wage ratio of more than 70 per cent could be observed in all four countries.

3.2.2. Development of wage ratios in the Visegrad countries

Looking at the ten relatively less developed countries that joined the EU in 2004, one can observe that wage ratios increased in four countries and declined in six. In contrast to the 2.8 percentage point wage ratio decline measured in the EU-15, it declined to a lesser extent, by one percentage point.

In terms of wage ratio, the Visegrad countries’ situation is less favourable than that of Western Member States, both with a view to the entire economy and the corporate sector separately. In 2015, the wage ratio in the economies of the V4 countries was around 45–47 per cent, which was lower than the EU-15’s average of 56 per cent.

Looking at the Visegrad countries specifically, the Czech Republic and Slovakia were able to record an increase in their wage ratios between 1995 and 2015 (2.2 and 2.3 percentage points, respectively). Poland’s and Hungary’s wage ratios however decreased significantly (by 9.7 and 8.9 percentage points, respectively). Despite the upward trend, wage ratios in Slovakia and the Czech Republic remained below that of Hungary and Hungary’s wage ratios however decreased significantly (by 9.7 and 8.9 percentage points, respectively). Despite the upward trend, wage ratios in Slovakia and the Czech Republic remained below that of Hungary and Poland for a long time, which then later on also dropped to the Czech and Slovak level.

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12. FIGURE: Share of wages in the north Western European corporate sector (agriculture excluded)

13. FIGURE: Share of wages in the European corporate sector (agriculture excluded)


Source: OECD (2017), edited by Századvég
3.2.3. Possible reasons for the decline of wage ratios and possible solutions

In the literature, following factors influencing the decline of wage ratios are mentioned.

1. The institutional set-up plays an important role in the decline of wage ratios. This includes labour market institutions, product market regulations, the share of domestic or state ownership, the bargaining power of employees and the size of the welfare state. Among these, special attention is paid to the density of the network of trade unions, minimum wage regulations, unemployment benefits and the pool of those eligible for them, the amount of redundancy payments and government consumption. Bargaining power is a decisive factor on three levels: on the economic, the political and the global level.

2. Additionally, the movement of labour between sectors could also be an important reason. Contrary to expectations, a study by the OECD analysing 20 sectors of 26 countries from 1990 on has come to the conclusion that the average wage ratio does not result from the movement of labour between sectors, but from the decline of wage ratios within the sectors.

3. A number of authors point out changes in the field of technology. Over the past years, the productivity of capital has increased by a greater extent than labour productivity. The relative price of capital goods decreased thanks to information technology, which urged companies to turn towards capital, rather than labour, when organising their production processes. However, neither technology, nor productivity can by themselves explain why wage ratios are different in countries which have had a similar development of productivity.

4. Instead of technological changes, Stockhammer (2013) points out globalisation, a greater extent of economic openness, the phenomenon of financialization, the declining importance of welfare states and the weakening of trade unions as reasons for the changes in wage ratios. This theory reinforces the importance of market-based wage improvement efforts realised through participation in income.

5. According to various analyses, one element of globalisation, the liberalisation of capital flows has also contributed to the decline of wage ratios. Liberalised capital flows benefit transnational capital, rather than mobile employees. The openness of capital movements has a negative effect on wage ratios, while greater government presence measured as a percentage of the GDP and government spending measured in budget positions have a positive influence. Greater benefits to the unemployed and welfare state functions strengthen the bargaining power of labour force. Another observation is that financial openness pushes wages lower in both developing and developed countries. The openness of capital movements has a negative effect on wage ratios, while greater government presence measured as a percentage of the GDP and government spending measured in budget positions have a positive influence. Greater benefits to the unemployed and welfare state functions strengthen the bargaining power of labour force. Another observation is that financial openness pushes wages lower in both developing and developed countries. Liberalisation does not result in a convergence of labour’s share in national income between different countries. Therefore, according to Onaran (2007), the wish to attract FDI at any price does not pay off in terms of wage ratios.

The role of capital flows and the presence of centre-periphery division and the division of labour can also be detected in the differences between the wage ratios in different Member States. As pointed out in Chapter 2, the difference between the productivities of Germany and the Visegrad countries is smaller than the difference between the wages.

This means that in the Visegrad countries, there is room for approximating wages through increasing the wage ratios. The optimum level of the wage ratio is around 60–65 per cent, in the developed Western economies it is around 54–57 per cent, while in the Visegrad countries it moves around 45–47 per cent.
Wage increase can be ensured through wage negotiations with social partners and through the increase of minimum wages. The increase of tax revenues that would result from the increase of wages would provide an ideal basis for the Visegrad countries to compensate economic actors of the Western Member States, as well as for converting the economies of the region into countries producing higher value added. A part of the revenues accrued could be allocated for education on the one hand and for the purchase of technological developments and digital equipment (know-how) from Western partners on the other, thus contributing to the implementation of the Digital Visegrad initiative aimed at the improvement of the region’s and the EU’s global competitiveness.

3.3. Supporting the establishment of global value chains in the region

It is important that a strong national bourgeoisie is established in the Visegrad countries as well, and that as part of this, sectors, and more concretely, national companies that have the potential of being linked into global value chains (GVCs) are identified. The joint task of Visegrad governments is to support first the regional and later the international expansion of promising companies of the region.

In 2015, the world trade to GDP ratio was 58.2 per cent and 80 per cent of the world trade was generated by some 600 global value chains. In other words, these 600 global value chains produced more than 45 per cent of the world’s GDP.15 For producers from developing and emerging countries, the spectacular initial catching-up facilitated by international economic integration and the opening of markets is limited. The reason for this is that as a result of the wage increase that goes hand in hand with the catching-up process, the competitiveness of these countries decreases due to the disappearance of their advantage of lower wages.

Without the accumulation of capital on micro-level to be facilitated by state intervention for development purposes, government investments aimed at the development of human capital and innovation potential and without appropriate policies, national companies cannot create new global value chains. Furthermore, joining the supplier network of already existing foreign value chains does not ensure catching-up, nor a breakout from the trap of mediocre wages. The evidence of regional experience shows that:

- multinational companies that have global value chains bring their own suppliers with them and wedge themselves into the respective economy, instead of integrating into it under local market circumstances;
- global value chains limit the effect of mechanisms that can create a spontaneous equilibrium - especially that of price mechanism. The internal price of multinational companies weighs down the economy and spreads out like a net, conserves price and wage relations, the development level of the economy and freezes in the imported technological level.
- traditional monetary and budgetary policy has a limited scope over economies governed by GVCs, therefore the elaboration of special set of tools is necessary.

Based on the above, two conclusions can be made.

- Global value chains are an integral part of the world economy and therefore the goal for the Visegrad Group is to become a target area for them. Studies show that growth rates are higher in countries that are successful in joining global value chains (by means of higher value added activities for example in the case of machine industry on a higher supplier level, or in the case of technological companies).
- The other pillar could consist of the establishment of own, regional value chains. Although global value chains spread their activities across the world, they produce and also retain the highest value added in their countries of origin.16

According to our hypothesis, only the state can supplement the part of value added produced, which is not recognized by the internal pricing of multinational companies on a national level. Support may be necessary not only in the form of loans, but also by means of selective capital injections, and by having mid- and long-term expectations, rather than those related to venture capital.

In the Visegrad countries, progress for the region’s nationally owned companies could be ensured through mutual market creation efforts in line with the EU’s competition laws and by supporting joint, harmonised international market entry. This could constitute the topic of further analyses.

3.3.1. The Visegrad countries’ current situation17

Over the decades following the change of regime, the requirements for the settlement of foreign companies has been established in the Visegrad countries. There are differences between the individual countries in terms of the aspects and pace of privatisation and market opening, but in general, the region counted as an attractive target for investments, as due to its proximity to developed Western countries, it was relatively inexpensive to import materials from the region and to export finished products. It was cheap and easy to find labour and manufacturing capacities, and the integrity of private property was protected by international organisations, which additionally also ensured the possibility to move profits on a global level. According to today’s governing theories, the swift opening of the markets was also necessary, because the competition in the international arena took place between global value chains, rather than companies related to nation states, and these value chains established their manufacturing capacities at different locations around the world.

The Visegrad Group primarily expected that the GVCs entering their countries would bring benefits, such as the inflow of modern technologies, management skills, the strengthening of direct relations to other markets and the faster development of domestic companies linked to them. In contrast to these expectations however, it can be observed that global value chains still typically keep their higher value added activities that ensure higher wages (R&D, product design, marketing)

The phenomenon is more generally depicted by the so-called smiling curve, which illustrates the added value created by various corporate activities. Based on this, it is visible that truly valuable activities in the phase of product development include research and development, branding, and during the introduction stage they include design and distribution, marketing and sales. Manufacturing activities at the middle of the curve are the least profitable ones and typically also those that are most frequently outsourced by GVCs.

This finding is also underpinned by an analysis of the export market share of domestically owned companies, which shows whether a given economy is able to generate capital income in addition to lending their labour force. Available data show that as a result of economic transformation, small and medium-sized enterprises in the Czech Republic and Poland account for 73 per cent of the exports and less than 50 per cent of the domestically owned companies. In Hungary, the situation is less favourable: four-fifths of the country’s exports are provided by large, internationally-owned companies accounting for 1 per cent of all companies, and only one-fifth of it comes from the mostly Hungarian-owned small and medium-sized sector. The export share of the majority Hungarian-owned companies amounts to 20 per cent, while that of majority internationally owned ones to 60 per cent.

The structural problem of the semi-peripheral Visegrad area is best represented by their comparison to Germany. In Germany, 85 per cent of the export is generated by SMEs and the share of export of internationally owned companies is only 15 per cent. In comparison to the 80:20 ratio of domestic to international companies in developed central countries, the Visegrad countries’ lagging behind is significant.


We come to similar results when analysing the value added by domestically owned companies within the value added of exports in the Visegrad countries. In 2010, domestic value added in the total exports was around 30 per cent in Slovakia and Hungary, 38 in the Czech Republic and 47 in the case of Poland.

3.3.2. International experience

KEEPING CRITICAL INFRASTRUCTURES IN NATIONAL OWNERSHIP

A common criticism of (mostly Polish and Hungarian) regional economic policies introduced after 2010 is that - in order to correct the share of foreign ownership - they attempted to influence the economy too much. Analysing the relationship of successful economies to so-called critical infrastructures and to internationally competing value chains, regional efforts to strengthen domestic ownership become understandable.

The economy can be divided into two parts according to the activities that constitute the foundation of economic value creation and activities which can be separated from that. The former are called critical infrastructures, including physical or virtual assets, systems, and networks, the hindering of which would paralyse national security, the functioning of national economy, public health and public security. Applying a different approach, all infrastructure elements where a breakdown would threaten the smooth functioning of society and economy can be regarded as critical.

The concept of critical infrastructures and the necessity of protecting them comes from the United States. In its National Infrastructure Protection Plan, the US identified 16 critical sectors.21 The primary reason for the so-called Exon-Florio amendment concerns over the emerging Chinese market industry, in answer to which and with a view to increasing foreign ownership of American companies, in 1988, Congress passed the President the right to investigate foreign investments. The Americans were concerned that the Japanese would try to circumvent trade benefits resulting from the dollar’s decline against yen by direct investments in the American market.22 The above-mentioned legislation was amended in 2007 due to increasing national security risks by the enactment of the Foreign Investments and National Security Act. According to thus established rules currently in force, a permanent committee called the Committee on Foreign Investment in the United States (CFIUS) was set up, which is dedicated to analysing the effects of foreign investments on the national interests and national security of America. The implementation of certain foreign investments can be vetoed based on the analysis conducted by CFIUS. This has so far occurred twice: the last time in 2012, when President Obama prevented a Chinese-owned company buying a wind farm close to an air base23 and once in 2007, when Congress prevented an attempt by the Chinese to buy the American oil company Unocal.

In China, the National Development and Reform Commission (NDRC) has a similar function as the CFIUS. It has the competency to authorise foreign investments in sectors of strategic importance (including the steel industry, automotive industry and the energy sector). If the NDRC concludes that a particular investment threatens China’s national interests, it can refuse the issuance of permits.24 Additionally, the NDRC also supports the strengthening of Chinese companies with a help on a multi-year strategy, and it also maintains a record of state-owned and private Chinese companies being established.

Germany has similar practices in place: critical infrastructures and several companies of the traditional manufacturing sector partially constitute property of the state. Furthermore, since 2009, the Government of Germany has the general competency - as opposed to a sectoral one - to limit the acquisition of ownership of citizens and companies that are not members of the European Union or the European Free Trade Association.25 The basis for limitations is the protection of public order and security.

As concerns critical infrastructures, there are only a few developed Western European countries, where foreign ownership limitations following the German example are in place, which can primarily be explained by the high level of domestic ownership. In market capitalist countries (England, the Netherlands), the share of domestic private ownership is higher, while in state capitalist countries (Germany, France) – due to historical characteristics - the share of community ownership is higher.

Similar policies are and were being pursued by South Asia’s little tigers, Japan, Taiwan, South Korea and Singapore, that joined the global front-line in a unique manner over the past forty-fifty years.

EXAMPLES OF POLICIES AIM AT SUPPORTING THE STRENGTHENING AND MARKET ACCESS OF NATIONALLY OWNED COMPANIES

As described above, the right of decision of economic policy over critical infrastructures and its utilisation to gain market shares is a common practice in the international arena. The majority of today’s global value chains - going from the East towards the West - were also promoted by economic policy to some extent: the Korean POSCO or the Japanese Fuyo Group, the state-owned SingTel and Temasek Holding companies in Singapore, the 30 per cent German state-owned Deutsche Telekom that is currently expanding in Central Eastern Europe, the technological renewal of France lead by state-owned companies or Britain’s Rolls-Royce nationalised in 1971.

The United States is heavily investing in military developments, the civil use of which then contributes to the establishment of global value chains. In the case of iPhone for example, the most important innovations (touch screen, GPS, battery, mobile network, Siri) were in fact developed with state support for the defence industry. Apple - having analysed consumer needs - “simply” put together the iPhone from parts developed with state support.26

With its significant foreign exchange reserves, scale-related opportunities and practices often cited by Western journals, China is a flagship in building global value chains.

- From 2017 on, China has been increasing the intensity of its mercantile economic development programmes. As part of the ‘Made in China 2025’ programme, the aim is to achieve China’s dominance in both domestic and developing markets in technologically developed industries as well.
- As of 2017, the acquisition of foreign companies with the aim of allowing the Chinese buyers to gain new technologies is supported by even higher benefits than before.
- From the beginnings on, automotive companies entering the Chinese market had to enter into joint ventures with Chinese companies, in which their ownership could not exceed 50 per cent. In the future, companies entering China will also have to commit to technology transfer.27

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21. Chemical sector, commercial facilities sector, communications sector, critical manufacturing sector (including the manufacturing of primary metals, machinery, electrical equipment and transportation equipment), defence sector, dams sector, energy sector, emergency services sector, financial sector, food and agriculture sector, government facilities, healthcare, information technology, nuclear, transportation systems sector, water and waste-water systems sector.
• The Chinese have made it clear to the two largest aircraft manufacturers, the American Boeing and Europe’s Airbus for example that in order to receive larger aircraft orders, they will have to help build China’s own aircraft manufacturing capacities.

The shorter the time that was available for the catching-up process, the lower the starting point and the more recent the development was, the more spectacular was the role played by economic policy in the convergence. 28

Based on the above and emphasising the points made earlier, our conclusions are as follows:

• Joining global value chains is in the interests of the companies of any country. It is therefore of utmost importance that the region becomes an attractive target for them. Studies show that growth rates are higher in countries that are successful in joining global value chains. 29
• The other pillar could consist of the establishment of own, regional value chains. Although global value chains spread their activities across the world, they produce and also retain the highest value added in their countries of origin. 30

28. Developed Western states also applied intensive and effective methods to promote their advancement, starting from the industrial revolution on. Initially, they treated rules of patent protection flexibly. First, they opened their markets, then closed them; copying foreign products they built their own capacities and reopened their markets. This strategy was followed in early times by England, the German territories, Switzerland, the Netherlands and USA as well. Starting from the 1970s, it has been in the fundamental interests of countries of the developed world to protect the products developed and patented by them, to facilitate smooth sales for them through free trade and to ensure the possibility of cutting their costs by moving their production to countries with the cheapest manufacturing conditions. They develop and tailor international trade, investment protection and patent rights accordingly.


2. Further Opportunities for Cooperation

4.1. Knowledge transfer and educating an elite in a regional context

One of the first steps of reinforcing the region’s EU and world economic position could be the creation of a young, intellectual layer of society, who has a profound knowledge of the Visegrad countries’ historical traditions and shared cultural roots, a large informal network, and who are also well embedded internationally.

The fundamental foreign policy goal of the Hungarian V4 Presidency is to improve the Group’s ability to promote its interests internationally. One of the prerequisites for this is to strengthen citizens’ awareness of Group’s cohesion, which is built on our shared historical traditions. This can be ensured by deepening interpersonal relations in the (political, economic, academic) subsystems of society. In this respect, we believe a closer tie between universities to be the most effective. It is important that respecting the individual internationalisation strategies of the Visegrad countries’ higher education systems, with the help of targeted government support, an economic-social-political elite is being educated in a more targeted and deeper form than currently provided by possibilities offered by the EU (e.g. Erasmus). This group should include people who were socialised in the region, know the region’s culture and perhaps even speak its languages, and furthermore, have strong regional ties.

4.1.1. Situational picture

The internationalisation of higher education in the Visegrad countries

The European Commission published its communication entitled “European higher education in the world” [document number: COM (2013) 499].31 which builds upon efforts that started by launching the higher education modernisation programme in 2011 and aim at improving the quality of higher education in order to ensure the transfer of those skills to students that are needed in the labour market. 32

The main objectives of the Commission’s strategy aimed at internationalisation are as follows:

• Promote the mobility of students and staff;
• Support the experience of an international environment at home, promote digital education;
• Strategic cooperation, strengthening partnerships and capacities.

In this framework, Visegrad Member States strive to support the internationalisation of higher education as part of their national higher education strategies, which is in Member State competency. Currently, the share of incoming students in higher education is extremely low in Poland, and relatively high in the Czech Republic. The indicators of Slovakia and Hungary are only slightly above the OECD average and lag behind countries with successful education systems (Figure 22.).

31. IP/13/678
32. IP/11/1043

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A strategic framework for the Visegrad Group’s economic cooperation

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In the case of Hungary, 27 per cent of the international students come from neighbouring countries, in the case of Czech Republic and Slovakia 57 per cent and in the case of Poland 74 per cent. The relatively low Hungarian ratio can be explained by the high number of students from Germany, Iran, China, Norway and Turkey.

In terms of outgoing students, the Visegrad countries - with the exception of Slovakia - perform below the OECD average. While the OECD average of the share of domestic students studying abroad amounts to 5.9 per cent, in Poland this figure accounts for 1.5 per cent, in the Czech Republic for 3.5 per cent, in Hungary for 3.6 per cent and in Slovakia 14.9 per cent.

A possible area for policy action for the Visegrad countries in addition to promoting the increase in the number of incoming students could also be promoting studying abroad among the students of the region. Studies abroad constitute an advantage in terms of national economy in the long-run, as outgoing students can thus receive competitive education at renowned international universities, and if they later apply the knowledge gained in their countries of origin, the home economies will not only benefit from the knowledge itself, but also from their international relations and language skills. In this concrete case, if the students of the V4 countries were to study in each other’s countries that could also contribute to strengthening regional cooperation.

In summary, it can be noted that the internationalisation of the respective higher education systems is in the individual interests of the V4 countries and one possible means of promoting these interests could be a stronger cooperation between higher education institutions and the promotion of student mobility within the region. Promoting student mobility in the region would furthermore also contribute to strengthening political, economic and academic ties between the V4.
Available scholarships in the Visegrad countries - Scholarships of the Visegrad Fund

The Visegrad Fund was established by the V4 countries in 2000 (2014) with an annual budget of EUR 8 million, which is equally financed by the Member States.

The aim of the Visegrad Fund’s scholarship programmes is to promote academic cooperation between the V4 countries and Central and South-east European non-EU member states as well as the countries of the South Caucasus. With these scholarships, Master’s and PhD (or other post-graduate) programmes or research can be financed. In 2016, the Fund financed a total of 334 semesters. In the case of 100 semesters the host was the Czech Republic, in 88 Poland, in 79 Slovakia and in 50 Hungary.

- **Vigesevad Scholarship Programme**: The duration of the scholarships is 1-2 semesters, except in the case of incoming students from non-V4 partner universities, who can apply for the financing of an entire programme. The level of support is EUR 2,300 per semester per student and EUR 1,500 per semester per student for the host institution.
- **Intra Visegrad Scholarship**: Scholarships awarded to students applying to (an accredited university of) a V4 country other than the home country.
- **Out-going Scholarship**: Scholarships awarded for studies in Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Montenegro, Georgia, Macedonia, Moldova, Serbia or Ukraine (at accredited universities).
- **In-coming Scholarship**: Scholarships for students from Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Croatia, Montenegro, Georgia, Macedonia, Moldova, Serbia or Ukraine to study at accredited universities of the V4 countries.
- **Visegrad – Taiwan Scholarship**: The aim of the programme is to enhance academic and research relations between the Visegrad countries and Taiwan, which is facilitated by the joint financing of an exchange programme between PhD research students by the Fund and Taiwan’s Ministry of Science and Technology. The scholarship amounts to EUR 750/100 (doctorate or post-doctorate programme) per month for 10 months (2 semesters) and a single grant of EUR 800.

Higher education cooperation

1. The first V4 summer school organised by the National University of Public Service (NUPS) of Hungary in summer 2017

NUPS’ Faculty for International and European Relations launched a summer school in July 2017 on various topics related to the V4 and the EU.

The one-week course that dealt with current topics was jointly organised by the Matej Bel University and the Pan-European University (Slovakia), the Metropolitan University and the University of West Bohemia (Czech Republic) and The Centre for the Studies of New Security Challenges (United Kingdom). The course was held in English and students and staff discussed different topics every day. These included the issue of a two-speed Europe, Euroscepticism, the EU-Russia relationship, security challenges and various forms of European cooperation.

2. The V4 cooperation of the National Union of Students in Hungary (HÖOK)

Student organisations of the Visegrad countries keep regular contact and also organise personal meetings twice a year. The most important goal is for representatives of the V4 student organisations to meet before the meetings of the European Students’ Union (ESU) and elaborate joint positions on the topics of the general assembly meetings, thus strengthening the region’s role in the European student movement. These occasions provide an excellent opportunity for the exchange of experiences, for discussing current topics of higher education and for launching joint projects.

### 4.1.2. Potential fields of Visegrad cooperation in the field of higher education

We recommend the establishment of the Visegrad Network University, which with its Visegrad Master’s programme to host some 30 of the region’s most outstanding students annually, could serve as a flagship of regional knowledge transfer and of economic, political and academic cooperation.

The primary objective of the network consisting of the most important science and applied science universities of the Visegrad countries would be to facilitate the establishment of a students’ and teachers’ “alliance”, which simultaneously serves:

- political purposes (e.g. by the joint education of students in public administration or defence),
- economic purposes (e.g. by involving teachers and students of economics, as well as successful market actors),
- diplomatic goals (e.g. by ensuring international experiences for students in the fields of law, foreign affairs and diplomacy).

The most important activities of the Visegrad Network University would be the following:

- **Establishing the International and Visegrad Studies Master’s Programme in the V4 countries**: The aim of the joint Master’s programme would be to educate a V4 political-diplomatic elite to strengthen cooperation and to support the internationalisation of higher education.

Students of the English language Master’s programme would spend each of the four semesters of the programme at a leading university of a different Visegrad country. The programme would host an annual maximum of 20–30 people, that is 5–7 participants per country and would create a synergy between different scientific fields, the transfer of young leadership skills and networking events. The financing would be equally shared by the V4 countries or would be provided through the Visegrad Fund.

- **Establishing the “Visegrad Visiting Professors” Programme in the Visegrad countries**: In order to promote the internationalisation of higher education, to improve its quality and to enhance international scientific relations, we believe that the establishment of a new, more intensive and organised exchange programme for higher education staff supported by the governments of the V4 is justified.

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34. [http://hook.hu/szervezetunk/2-uncategorised/136-v4-egyuttmukodes](http://hook.hu/szervezetunk/2-uncategorised/136-v4-egyuttmukodes); download: 2017. 10. 09.
The programme would be realised by creating an incentive/support system for professors acknowledged in their respective fields, who could spend a definite amount of time (1-2 semesters) teaching at a leading university of other Visegrad countries.

With regard to the costs, the countries of origin or the Visegrad Fund could finance the salary of the respective staff members, while other costs of the exchange (primarily travel and accommodation) could be covered by the respective host countries.

- Establishment of joint (basic and applied) research and development projects at universities active in the key industries of the Visegrad countries.35

The internationalisation of research and development, improving its quality and enhancing international scientific relations is of utmost importance in the Visegrad countries. A possible means to improve these areas could be launching parallel research and development projects in the key industries of the region, and implementing them in the particular country, where the given industry plays the most significant role. The joint financing of the projects could be ensured from the revenues generated from technology transfer, based on the number of researchers delegated.

- Strengthening joint higher education-industry cooperation projects related to research and development in the Visegrad countries:

The aim of the jointly established organisations primarily serving the purpose of developing technology and know-how at industrial companies and of international scientific cooperation is to support knowledge transfer between market and academic actors in a Visegrad context.

4.2. Cooperation of EXIM banks at tenders outside of Europe

In the V4 countries, institutions intended to promote exports with financial tools (export-import banks and export credit insurance companies) were established in the early-mid 90s and have been operating with more or less the same structures ever since. In Slovakia and in Poland Eximbanka SR (www.eximbanka.sk) and KUKE (www.kuke.com.pl) respectively are two-in-one organisations, while in the Czech Republic the Czech Export Bank (www.ceb.cz) and the insurance company EGAP (www.egap.cz) are separate entities. In Hungary, the bank and insurance provider both operate under the name EXIM (www.exim.hu). The operations of these institutions are conservative and the decision-making is slow because of the international regulatory framework (the so called OECD Consensus and related rules) on the one hand, and because of the bureaucratic decision making system of the state as the owner of these institutions on the other. Therefore, they can only contribute to achieving foreign economic goals to a lesser extent than what is expected from them.

4.2.1. Obstacles to the export expansion of V4 countries

One of the most important lessons of the past decade (starting with the financial-economic crisis up until now) that is also reflected in the foreign economic strategies and measures of the Visegrad countries is the appreciation of markets outside of Europe and therefore the targeting of regions with constant high-growth rates. However, in all four economies concerned, the duality between the competitiveness and foreign market entry possibilities of domestic SMEs and multinational companies active in the region can be detected in the lagging behind of the former sector.

The objective of the V4 Governments is to improve the competitiveness of their national SMEs, which can be achieved through increasing exports. Taking this objective into consideration, the establishment of Exim banks proved to be a favourable development. In the following, we present three of the factors hindering the effective operations of these institutions, two external and one internal:

1. Underlying reasons in the foreign economic structures the V4 countries

The decisive share of exports (between 67 in Hungary and 78 per cent in Poland) goes to the EU, more specifically to Germany.36 However, the share of intermediaries is not visible in the statistics. Presumably, a higher amount of V4 products go to Asia and Africa than what is recorded in official data. The profits of these are however mostly realised by Western European companies.

It is characteristic of all four countries that SMEs only account for a small share of exports. Including foreign-owned SMEs, the highest rate is measured in Poland (25 per cent and lowest one in Slovakia (13 per cent).37

2. Underlying reasons in the operations of small and medium-sized enterprises

One of the conclusions of the European Commission’s study on SME exports is that only 15 per cent of companies younger than 4 years are able to enter foreign markets, while this figure amounts to 30 per cent in the case of companies with 25 years of existence.38 In the V4 countries, many companies do not have the sufficient past and experience that multi-generation companies in Western Europe were able to accumulate thanks to the different historic developments. According to data from the Hungarian export promotion agency, the most important obstacles to a successful foreign market entry are:

- lack of export related management skills: the number of enterprises is lower in the V4 countries than in other OECD Member States (with the exception of Poland where the 36 enterprises/1000 people ratio matches the European average), and it is typical that CEOs and managers do not have proper training in business;
- lack of foreign market network: due to historical reasons, most companies of the region do not have active personal ties abroad;

35. Key industries defined based on output: Hungary: food industry; trade; machine industry; business services; transportation and telecommunications; Czech Republic: mining and quarrying; chemical industry; metal industry; machine industry; computers and electronic equipment; Slovakia: machine industry; mining and oil; construction industry; electricity; dams, water services; real estate services. Poland: food industry; construction industry; mining and quarrying; metal industry. There are 5 key industries that can be found at least two of the Visegrad countries, which could provide the foundation for the research cooperation: food industry (Hungary, Poland); machine industry (Hungary, Czech Republic, Slovakia); metal industry (Czech Republic, Poland); mining and quarrying (Czech Republic, Slovakia, Poland); construction industry (Slovakia, Poland).


• lack of language skills: in the V4 region this is most typical for Hungary;
• lack of employees with exporting experience (in Hungary, even in exporting enterprises, only 0.25 people were employed in a specifically export-related job).

In addition to the above, the European Commission’s study on the internationalisation of SMEs also points out the costs of product or service developments, the lack of capital, the costs of logistics and administration and the lack of adequate state support. With respect to the latter, the study underlines that the problem is especially prevalent in third country markets.

3. Underlying reasons in the operations of Exim banks

The international system regulating Exim banks is primarily tailored to companies of the OECD’s most developed countries: these only need a stable financial background and competitive, risk mitigating constructions indeed. In contrast however, companies of the V4 countries also lack management skills and networks. Although all regional Exim banks have shifted towards the elaboration of special constructions for SMEs, the results are not in line with the expectations.39

According to the Hungarian EXIM bank’s publicly available presentation of its strategy for 2017-2021, one of the most important goals is “to increase the number and share of SME clients within the portfolio”. An increasing effort to enhance SMEs’ third country market presence can be observed in the countries of the region.

A common challenge shared by the Exim banks of the Visegrad region is that at the time of their establishment in the 90s, state-companies from the Socialist times and the former COMECON ties were still in place, thus their operations are still dominated by Eastern European, primarily Soviet relations.40 In addition to the - due to long project cycles - slowly changing relational orientation, the aim to differentiate host regions can also be detected among government efforts under the umbrella of opening to the East strategies (in Poland for example the Policy for the East). 41

4.2.2. Opportunities for Exim bank cooperation to overcome obstacles to export expansion

Countries regarded as direct competitors in attracting foreign direct investments, such as the V4, face similar challenges, and therefore their answers are also mostly similar: strengthening the institutional system for export development, economic diplomacy measures, etc.

A significant step forward could be the cooperation between the region’s Exim banks, only recently suggested in relation to the Hungarian V4 Presidency.42 In addition to the cooperation of Exim banks, active economic diplomacy measures are also needed. An ideal basis for this could be the fact that as a result of historical developments, members of the V4 have their bridge heads in different markets (Hungary for example has excellent positions in the Vietnamese market). Another advantage is that due to their similar sizes, the four countries will not crowd out each other from the customer markets, but will ensure each other a greater share of remote economic possibilities by the relatively stronger partner in the respective relation bringing together companies of the other three countries as well.

5. TABLE: Possible means of cooperation

<table>
<thead>
<tr>
<th>Problem on the SME side</th>
<th>Problem in the Exim bank side</th>
<th>Cooperative solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of management skills</td>
<td>There are no clients that could take the role of the main contractor/project manager</td>
<td>Establishing joint training programmes and V4 level consortia</td>
</tr>
<tr>
<td>Lack of foreign market network</td>
<td>Lacking cooperation with foreign economic diplomacy system</td>
<td>Joint V4 foreign market presence, opening joint offices</td>
</tr>
<tr>
<td>Lack of export officers (foreign market experts)</td>
<td>Slow decision making processes, credit scoring</td>
<td>Providing joint guidelines, methodological support</td>
</tr>
<tr>
<td>Uncompetitive financing offers</td>
<td>High administration fees and insurance costs</td>
<td>Sharing risk information, shared information system</td>
</tr>
<tr>
<td>Difficulty of ensuring appropriate level of national shares</td>
<td>The framework is provided by strict international regulation, cannot be made more flexible</td>
<td>Joint consortia financing by the bank of the largest partner</td>
</tr>
</tbody>
</table>

RECOMMENDATIONS FOR COOPERATION:

1. Joint V4 presence of Exim banks in foreign markets and ensuring project management in the target markets

Each of the banks/insurance companies have extensive foreign networks, which consist of similar institutions with state backgrounds (e.g. Prague Club) and commercial banks. This network of relations can provide primary information to exporters on potential market opportunities, public and private tenders. It would be of advantage to support the collection of this information and the supervision of market services to clients by operating joint offices. Primary regions are China, South-East Asia, the Middle East, North Africa and Central Asia.

42. In September 2017, the Hungarian EXIM organised a joint workshop for the export financing banks of the V4 countries for the first time under the title V4 Export Credit and Credit Insurance.
There is no need for establishments with large budgets, but permanent offices (operated locally with sufficient staff) could be set up in connection with successful projects to ensure project management services. This could be an effective means of gaining market shares, as especially in the African and Asian business culture, personal presence is of utmost importance in doing business. A Malaysian or South African customer for example would wish to be in constant contact with the person responsible for the project, especially so in the case of government actors. When thinking about maintaining joint project offices, the issue of cost sharing arises. Since the individual V4 countries have only had a few projects launched in their respective target markets, establishing own offices would not have made sense, however, in case of joint financing, operating such offices might bring financial benefits as well.

2. Establishing V4 level consortia
While Poland excels in food industry machinery, in the Czech Republic it is the manufacture of classical machine tools, in Slovakia the automotive industry and in Hungary the manufacture of medical equipment that provides outstanding competitive advantage. However, in the case of complex projects - such as the construction and equipping of a hospital or the implementation and operation of a smart city project - cooperation with companies of other industries is required. The aim is to establish more or less permanent consortia with the cooperation of V4 companies, which could be financed by the Exim banks in a simpler and faster manner.

3. Establishing a joint export information system
Small and medium-sized companies of the V4 operate under a significant lack of information compared to their Western European competitors. In order to lessen this problem, they could exploit the access to information on the latest tenders and public procurement calls available through the networks of their banks. A V4-level data base could significantly increase access to opportunities for the joint consortia.

4. One-stop-shop administration for V4 consortia
It is necessary to ensure a one-stop-shop administration for the consortia: the financing body would be the bank of the country, where the company representing the highest value has its headquarters. Another alternative could be dividing the consortia on a sectoral basis according to the agreement of the joint consortia.

5. Harmonising training programmes
The fundamental prerequisite of establishing successful consortia is for the potential enterprises to be prepared to implement foreign market projects that require multi-annual and multilateral cooperation with different companies. Each of the four countries’ Exim banks organises trainings for companies. We recommend the harmonisation of the topics to potentially facilitate the elaboration of a joint V4 handbook on export management development.

4.3. Building mutual reserves in each other’s government bonds

The Visegrad countries could give evidence of their common economic and political values and interests with a closer cooperation of their national banks, the mutual reserve building in each other’s government bonds and by issuing joint government bonds. As part of the individual Visegrad countries’ foreign exchange reserves, national banks of the region could opt for a higher share of V4 government bonds in the structure of their reserves.43

An advantage of building reserves in each other’s government bonds is that it makes the Visegrad countries’ financing cheaper and decreases the external financial vulnerability by increasing the demand for the government bonds of the individual Member States. Increasing demand would have a decreasing effect on interest rates, which can become an important factor, when their mid- or long-term increase starts again. Of course, seigniorage is an important source of revenue, which is being generated when other countries are willing to hold their investments in the instruments produced by the particular state, that is in foreign exchange.

If a currency of a country becomes international, it also produces political power. Central European countries have committed to introducing the Euro, and therefore in the long-run, they theoretically have to waive the right of increasing the international importance of their currencies. The internationalisation of the own currency strengthens the issuing country’s autonomy and increases its room for manoeuvre.44 As in most countries of the world internationalised currencies are being used, which are being printed by particular countries, their dependence of the markets is lower. At the same time, the possibility of other countries influencing the country’s economic policy also decreases, as its economy is not that dependent on other countries’ currencies. To internationalise a currency, trust, a certain level of development of the issuing country’s capital market (and a resulting liquidity) and a significant world economic market share is necessary.

4.3.1. The practice of foreign exchange reserves

The practice of foreign exchange reserves depends on a number of factors that determine to what extent the Visegrad countries can rely on each other’s government bonds when building reserves.

According to the Hungarian National Bank “the general framework of foreign exchange reserve management and the investment behaviour of central banks is primarily defined by the goals of reserve building”.45 The aim of central banks is to support monetary and currency policy to maintain foreign exchange liquidity and investor confidence for the sake of economic actors. Central banks apply foreign exchange reserves to facilitate their foreign exchange interventions.46 Building foreign

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43. There is currently no information on similar efforts. Although there may be a number of obstacles to the implementation of this plan, below we will review current trends in reserve management.
exchange reserves practically means that one country accumulates instruments (foreign exchange or government bonds) of another.47 The aim of building foreign exchange reserves is to protect the economy from a sudden stop in the inflow of foreign capital and to mitigate shocks. Reserves reduce the probability of bankruptcy and may decrease the country’s costs of borrowing.48

There is little information on what investment strategies national banks apply to realise their goals, because they typically do not publish their investment strategies.49

A general trend is that from the 80s on, the role of gold played in reserve management has decreased, and from the 90s on, national banks have turned to government bonds to an even greater extent. By the 2000s, the role of gold in national bank reserves decreased to below 10 per cent and the importance of bank deposits and government bonds increased. In order to earn higher yields, in the 90s, other assets also appeared in the portfolios: mortgage-backed securities, asset-backed securities and corporate bonds. Low government bond yields raise the question whether it might pay off to include other, higher risk instruments in the national banks’ portfolios.

National banks do not hold foreign exchange in central bank money but invest in a secure manner to earn yields. All of the Visegrad countries do so by mostly investing in government bonds. The characteristics of the investments are defined by the hierarchy of the given national bank’s target system (the classic target constellation of liquidity, security and yields).50 The liquidity requirement ensures that assets can rapidly be liquidated. Once the requirements of liquidity and security are met, a third aspect can be maximising the yields of the portfolio.51 Portfolios established in this manner are usually managed passively, in other words, they are being held for extremely long periods of time.

As a result of the crisis, the supply of risk-free assets fell, moreover, risk-free bonds also offer zero yield. In order to avoid negative results, national banks are gradually turning towards riskier assets, such as medium category government bonds (with ratings lower than AAA, but still in the investment category) agency, supranational and state guarantee backed securities.52 German, French and Japanese government bonds are the most popular ones. These euro or yen denominated instruments constitute the reserves of most developed countries next to deposits at international organisations.53 Turning to higher yield instruments also requires more active portfolio management techniques.

Foreign reserves always benefit the issuing country, as through these, the state has “free access to purchasing power”.54 Gergely Szabó argues that ‘every year, the United States of America and countries of the eurozone spend more money than they earn, and part of this is financed by those, who build reserves. It is true that the issuing countries become over-indebted in exchange, but these debts will never be paid back’.55

The importance of mutual reserve building in the Visegrad countries is provided by the fact that “when one country generates money against another country’s money, the first one’s citizens unconsciously generate demand for the other country’s money”.56 Today, similar to other countries, Hungary also builds its reserves in euros and in government bonds of the eurozone: the reason for this is that the support ensured by the EU and international organisations is provided in euros and is accumulated at the national bank in the form of government bonds of EU Member States.57

This decision - as it has always been the case with reserve building throughout history - is partly influenced by political (soft power) factors, but primarily economic ones. An interesting question is to what extent mutual reserve building could be facilitated, if all Visegrad countries were Member States of the eurozone.

4.3.2. Country examples

SLOVAKIA

Slovakia is a member of the eurozone and therefore has no sovereign monetary policy. This fundamentally makes reserve building decisions in a national competency difficult (a detailed analysis of the legal background could constitute the topic of further research).

Before its accession to the eurozone, Slovakia’s foreign reserves were held in US dollars, euros and gold, since 2009 however, they are held in US dollars and gold, as according to the market’s evaluation, these are the most reliable and most liquid assets. By joining the eurozone, Slovakia also accepted the new framework for reserve management.58 Reserve management is not exclusive national competency, it is to be determined together with the institutions of the eurozone.59 Based on this, only the purchase of Hungarian dollar bonds is a viable option in relation to Slovakia.

49. Kiss – Teremi (2014) 
50. FED NY (2015) 
51. ibid. 
52. Kiss – Teremi (2014) 
53. FED NY (2015) 
54. Szabó (2015a) 
55. ibid. 
56. ibid. 
CZECH REPUBLIC

The Czech Republic does not use euros and this fact also defines its reserve strategy. As its foreign trade and foreign transactions mostly link the country to European and American partners, before the eurozone’s existence, the country held its reserves in three currencies: American dollars, German marks and yen. Their composition was harmonised with the ratios in the balance of payments, thus 65 per cent in held in marks, 30 per cent in dollars and 5 per cent in yen. Aside from the foreign trade relations, the Czech Republic also opted for these currencies because they have complex and liquid markets, which are the closest to efficiency. Following the Japanese crises, the currency of the island state was left out of the portfolio, and starting from the 2000s, foreign reserves are exclusively built in euros (73.4 per cent) and dollars (26.6 per cent).60 If there were no significant changes in the central bank’s portfolio compared to the IMF data from the 2000s, in the Czech relation, the purchase of Hungarian euro and dollar bonds could be a viable option.


POLAND

Poland’s reserves are also denominated in dollars and euros, and more than 80 per cent in government bonds explicitly.61 The foreign exchange composition is depicted in the graph below, which shows that dollars and euros are the primary currencies, that together with pounds account for 75 per cent of the portfolio. They are then followed by Australia’s, Norway’s and New Zealand’s currencies.62

HUNGARY

As part of Hungary’s reserve strategy, instead of the European Central Bank, it is the Monetary Council that makes the decisions on long-term objectives, which are implemented by a commission that holds monthly meetings.

As a result of the significant indebtedness of the 2000s, Hungary primarily holds its reserves in euros, and in terms of resources, it is almost the only asset currently as well. As support is provided to the Hungarian economy in euros and since Hungary is also in the waiting room of its eurozone accession, furthermore, the majority of the economy is already using euros, it is important that the country’s reserves are also held in euros (representing an intervention currency). This also allows the forint to be attached to euros and to it to be maintained like this (within a certain band).63

62. Ibid.
63. IMF (2015)
As in the case of other countries, it is also regulated in Hungary, what the rating requirement of the assets to be purchased are: the maturity of bonds must not exceed ten years, and they have to have an AA rating as a minimum requirement.\textsuperscript{64} The portfolio has two parts: a liquidity and an investment fund. The total portfolio decreased from EUR 34.6 billion in December 2014 to EUR 24.4 billion by the end of 2016. \textbf{Bonds play an almost exclusive role in the portfolio.}\textsuperscript{65}

\textbf{4.3.3. Conclusions}

The aim of the Visegrad countries could be to regroup their currently German and French government bond dominated foreign exchange reserves to also include the region’s government bonds according to the economic importance of the given country in the economy.\textsuperscript{66} In spite of the fact that the Visegrad economies so far held the euro or dollar bonds of Western countries, a mutual government bond purchase in a low amount in line with the foreign trade shares could be an option.

This \textit{- within the boundaries of rationality \textendash;} is primarily a question of political will. It is possible that the implementation of this recommendation would make the financing of the Visegrad countries less expensive, but due to the strong link to the eurozone and based on the current trade patterns, a change in the current reserve building trends is unlikely.

\textsuperscript{64} ibid