

## The Czech-US Economic and Trade Relations after 1989

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### Introduction<sup>1</sup>

It did not start “out of the blue” in 1989. Relations between Czechoslovakia and the United States, including economic and trade relations, had been very good during the interwar period of the First Republic. They were based on trade between two economically advanced nations, political affinities between the two democracies, and the presence of a large number of Czechoslovak immigrants and their descendants in the US. After 1948, however, relations deteriorated rapidly, partly because of disagreements over the compensation for the property owned by US citizens but seized or nationalized by the Czechoslovak communist government. Trade relations were modest, and it was anticipated that there would be no trade agreement until claims were settled. In the late 1980s, bilateral relations remained strained because of US criticism of Prague’s continued repression of human rights activists.

The following text describes the development concerning the Czechoslovak (or, later, Czech) and US economic and trade relations after 1989. It is structured as follows. The first chapter focuses primarily on

a euphoric period after the “Velvet Revolution”. In the second chapter, a current state of affairs is outlined. The third chapter looks more into the future and discusses, for example, implications for the Czech Republic of the Transatlantic Trade and Investment Partnership, a currently negotiated treaty of global importance.

### 1 “Velvet” euphoria of the 1990s

The euphoric “Velvet Revolution” in 1989 offered Czechoslovakia a chance for profound change of its economic system. However, with the disintegration of the Soviet Bloc, it lost – like all the countries that used to orientate their economies towards the eastern market, and especially the USSR – the market for many of its products. The disintegration led, for example, to a major decrease in demand for products of armament and heavy industry, as well as brown and black coal. Thus, the whole transformation of the Czechoslovakian economy from the centrally planned – or command – system into a market economy was rather complicated since the very beginning.

On the other hand, the collapse of communism produced an extraordinary wave of euphoria among the people of Czechoslovakia. It created an unusually great unity in the whole country. The US President Ronald Reagan – together with the British Prime Minister Margaret Thatcher – were seen quite unanimously throughout Czechoslovakia as two heroes who had defeated communism on an international level and were to show the path from a musty

<sup>1</sup> The author thanks Mr. Vladimír Dlouhý, a former Czech Minister of Industry and Trade, currently a Member of the Board of International Advisers to Goldman Sachs, and Mr. Tomáš Hart, the Head of Economic Section at the Embassy of the Czech Republic in Washington D. C., for valuable comments.





society to a dynamic community of free market and human freedoms.

### 1.1 American helping hand

Without any doubt, the euphoria significantly contributed to a swift progress in Czechoslovakia-US economic relations as well. First of all, the US had supported and helped Czechoslovakia in the process of its entry (or, more precisely, re-entry, since Czechoslovakia had been a member already from 1945 until 1954) into the International Monetary Fund and the World Bank; the entry into both institutions took place in September, 1990. Secondly, the Bilateral Investment Treaty between the Czechoslovakia and the US was originally signed on October 22, 1991. It was amended in May 1, 1994, after the historical division of Czechoslovakia at the end of 1992, to serve specifically the Czech Republic. It focused on the following areas:

- Investment. According to the treaty, all equal accord should be given to both parties when doing any foreign business with that of the other.
- Tangible and Intangible Property. This gears to the protection of all properties whether movable or immovable, as well as the rights, pledges and mortgages contracted into by a national or a company.
- Intellectual Property. This specifically refers to the protection of the intellectual rights of a person in terms of a literary work, recordings, inventions, industrial designs, semi-conductor works, trade secrets and all confidential business transactions.

Just one day after the treaty was signed in Washington, Vaclav Havel, the president of Czechoslovakia, gave a speech in the US Congress, stating that the present course of the economic reform in his country filled him with optimism. He emphasized successful macroeconomic stabilization of Czechoslovakia, thanking explicitly for an “American helping hand in the IMF”.

He went on to remark on other developments in the sphere of mutual economic relations, assessing as “promisingly progressing” the Czechoslovakian-US

entrepreneurial fund, expressing his hopes the US Congress would “soon” pass a most-favored-nation-clause for Czechoslovakia and the US government would support a Czechoslovakian position on new tariffs in the GATT, or General Agreement on Tariffs and Trade. The most-favored-nation-clause was renewed in the same year and the Czechoslovakian Foreign Minister Jiri Dienstbier, President Havel’s friend from the dissent-period, could sum up already in 1991 in his speech in the Czechoslovak Federal Assembly that relations with the US, especially in the economic domain, had developed successfully in an exceptionally short period of time.

### 1.2 “Big bang”

The already mentioned euphoria also made it easier for Czechoslovakians to accept the shock therapy that the IMF labeled the “big bang” of January 1991. It has led to the elimination of price controls, huge inflows of foreign investment, growing domestic consumption and industrial production, and a stable exchange rate. Exports to former Soviet Bloc markets shifted to Western Europe. Moreover, during the 1990s a number of Czechoslovak and later Czech state-owned industries were privatized through a voucher privatization system. State ownership of businesses was estimated to be about 97 percent under communism. The non-private sector is less than 20 percent today.

However, the “Velvet Revolution” euphoria had gradually weakened and finally faded away around the middle of the decade. President Havel had apparently anticipated this moment, since he concluded his above-mentioned Congress speech as follows: *“I often contemplate how my country would look like in ten or fifteen years from now on and regret I cannot skip over those difficult years, at least for a while, to see the future.”* Nevertheless, his very final words were filled with optimism again, still evidently reflecting the “velvet” euphoria. *“I am sure in one thing, though. In those ten or fifteen years our state will no doubt be functioning, hopefully also with help of yours, Americans.”*<sup>2</sup>

<sup>2</sup> Havel, Vaclav. A speech in the US Congress, October 23, 1991. See its Czech transcript [online] at [http://www.vaclavhavel.cz/showtrans.php?cat=projevy&val=275\\_projevy.html&typ=HTML](http://www.vaclavhavel.cz/showtrans.php?cat=projevy&val=275_projevy.html&typ=HTML).



## 2 Reality of 2014

As of 2014, nineteen bilateral treaties and documents related to economic and trade issues between the Czech Republic and the US have been valid. Some others terminated in 2004, when the Czech Republic joined the European Union and certain competencies were exclusively passed on the European Commission. The Bilateral Investment Treaty has still been of the utmost importance in the Czech-US economic relations. However, since 2011 there have been talks between both parties concerning possible renegotiation of the treaty. Its main aim is to eliminate unilateral asymmetry of mutual Czech-US foreign investments protection.

### 2.1 Traditional partners

The US belongs amongst traditional and important trade partners of the Czech Republic. Currently, it represents the 13<sup>th</sup> biggest Czech trading partner (and 3<sup>rd</sup> biggest Czech trading partner amongst non-European Union countries, after China and Russia) and, at the same time, 13<sup>th</sup> biggest export market from the perspective of the Czech Republic. The US share on the Czech foreign trade amounts to about two percent. Recent figures related to the Czech-US mutual trade (see *Table 1*) show a steady increase of its total turnover since 2009, when the global financial crisis culminated. However, the mutual trade structure has changed since then because Czech exports to the US has grown more rapidly than Czech imports from the US. Since 2011, the Czech Republic has maintained a favorable (positive) US trade balance (whereas it had a negative balance of trade with the US in the years before 2011, as shown in the *Table 1*).

**Table 1**

Czech-US mutual trade (combined figures, mil. USD)							
	2007	2008	2009	2010	2011	2012	2013
<b>Czech export</b>	2430.6	2568.7	1933	2462	3344	3926	3920.6
<b>Czech import</b>	2669.5	2926.6	2200.1	2797.9	2958.1	2961.1	3034.7
<b>Turnover</b>	5100.1	3947.1	2902.6	5259.9	6302.1	6887.1	6955.3
<b>Balance</b>	-238.9	-357.9	-267.1	-335.9	385.9	964.9	885.9

Source of data: Czech Foreign Ministry

In 2012, as *Table 2* depicts, electrical appliances and devices represented the leading type of product exported from the Czech Republic to the US, worth more than 479 million USD. On the other hand, vehicles and transport devices other than road carriages represented the leading product type imported to the Czech Republic from the US in the same year, worth more than 365 million USD.

**Table 2**

Commodity structure of Czech-US trade in 2012 (five leading product types)	
Czech export to the US (thsd. USD)	
Type of product	Statistical figure
Electrical appliances and devices	479 163
Iron and steel	418 912
Energy generating machines and equipment	373 441
Machines and equipment for general industrial usage	309 960
Various products (consumer products)	225 469

Czech import from the US (thsd. USD)	
Type of product	Statistical figure
Other vehicles and transport devices	365 554
Expert and technical machines and devices	267 842
Electrical appliances and devices	232 366
Pharmaceuticals and related products	196 912
Various products (consumer products)	195 836

Source of data: Czech Foreign Ministry

Czech companies Moravia Steel Třinec, Ispat Nova Hut Ostrava, Mitas, Aero Vodochody, GE Aviation Czech, AVX Lanskrout, Aliachem, Sellier & Bellot Vlasim, Meopta Prerov, CZ Uhersky Brod, Mitas, Plzensky Prazdroj, Budvar, Petrof Hradec Kralove, Sklo Bohemia, Preciosa, Moser, Linet Zelevcice, Arrow International CR and Inekon belong among well-known exporters to the



US. However, the dominant part of the Czech export to the US consists of intra-firm trade of multinational corporations and piecework for big American companies (eg. GE Aviation, Sikorski Helicopters, IKEA, John Deere/Bosch, AVX, Continental, Honeywell, Ingersoll Rand, Ford/Visteon, Black & Decker, Eastman Chemical, SAB/Miller, Lego, Bobcat and others).

US divisions of Czech companies have played an important role as well (eg. Mitas Tires North America, Inc., Linet Americas, Inc., Miller Brewing Co., CZ - USA, Inc., Bead & Trim, Inc., Mavel Americas, Inc., CZ-USA, Inc., Amati USA, Inc., Moser USA, LLC., Preciosa International, Inc., Sellier & Bellot, Walter America, Trustfin USA to name a few). IT firms like Javlin, Inc., Socialbakers, YSoft Americas, Inc., OKsystem, Corinth, Glogster, Tapmates and others represent an important and dynamically growing domain of mutual cooperation between the Czech and US subjects on a company level.

**Table 3**

Key US direct investors in the Czech Republic	
Automotive industry	TRW, Johnson Controls, Visteon, Delphi, Dura Automotive Systems, Tenneco, ArwinMeritor, Hayes Lemmerz, Lear, Timken, Federal Mogul
Electronic industry	Eaton, Tyco Electronics, ON Semiconductor, Lear
Food processing industry	Kraft Foods, Sara Lee, PepsiCo., Mars
Aviation industry	GE Aviation, Honeywell
Engineering	Otis, Ingersoll Rand, Chart Industries, Briggs Stratton, Parker Hannifin
Consumer goods	Philip Morris, Kimberly Clark, Procter & Gamble, Larson Juhl, MeadWestvaco
Pharmaceuticals, medicine	Baxter, IVAX, Arrow International
Chemical industry	Eastman Chemical
Glass manufacturing	Owens-Illinois, Pittsburgh Corning
Energy industry	NRG Energy, Cinergy Corp., Solarwinds

Source of data: Czech Foreign Ministry

The list of US direct investors in the Czech Republic shown in the *Table 3* above may seem impressive, but a closer look tells us something a little different. Between the years 1998 and 2008 there had been a rather steady

decline of the US share on foreign direct investment in the Czech Republic, from 8.2 percent in 1998 to only 2.8 percent in 2008, as documented in *Table 4* below. In the years 2009, 2010 and 2012 the share had been so immaterial that specific territorial data for the US were not even published and the statisticians lumped them together with other country-specific data under the bracket "Others" (thus the denotation (...) in the *Table 4*). However, the US still counted as the biggest non-European direct investor in the Czech Republic in all those three years, followed by Japan in 2009 and 2010 and by South Korea in 2012.

In 1998, the US occupied the 4<sup>th</sup> position amongst foreign direct investors in the Czech Republic. However, it currently stands only as the 9<sup>th</sup> biggest foreign direct investor.

**Table 4**

Total volume of foreign direct investment in the Czech Republic			
Year	Volume (mil. USD)	US share (pct)	US share (mil. USD)
1998	14 375	8.2	1178.75
1999	17 600	6.7	1179.2
2000	21 600	6.5	1404
2001	27 100	6.4	1734.4
2002	38 700	4.9	1896.3
2003	45 300	5.2	2355.6
2004	57 300	5.2	2979.6
2005	60 700	4.6	2792.2
2006	79 800	4.3	3431.4
2007	112 400	3.8	4271.2
2008	113 200	2.8	3169.6
2009	125 900	...	...
2010	128 500	...	...
2011	120 600	3.4	4100.4
2012	136 500	...	...

Source of data: Czech National Bank







### 3 A few cases

To exemplify a relative decline of the US capital, or foreign direct investment, present in the Czech Republic, consider following facts<sup>3</sup>. In May, 2007, Eni, Italy's biggest oil and natural gas company by volume, doubled its stake in Ceska rafinerska, the largest crude oil processing *company* and the largest producer of oil products in the *Czech Republic*, after buying a stake from a ConocoPhillips unit and later that spring acquired 102 petrol stations in the Czech Republic, Slovakia and Hungary from a unit of Exxon Mobil. As a result, two major US oil companies left the Czech market.

#### 3.1 Temelin story

Or take another example – the Temelin story. In 2009, the Czech energy utility CEZ invited a tender for construction of new nuclear blocks at Temelin. In the wake of the Fukushima disaster, the industry looked towards the Czech Republic. The hope for a revival of nuclear energy in Europe was fed by the three main companies interested in landing the Czech procurement – the US's Westinghouse, France's Areva and Russia's Rosatom. CEZ turned down the French bid immediately and the Americans and Russians had increasingly sought feasible business elsewhere. Westinghouse has bought a company that will build three nuclear blocks in Britain, and Areva has crossed the English Channel too. Rosatom intends to purchase a one-third stake in a Finnish company planning the construction of the Fennovoima power plant and has pledged to build two blocks in Paks, Hungary. In the meantime, the Czech officials kept conducting discussions about whether or not to further pursue nuclear energy. Finally, in April, 2014, the CEZ Board of Directors called off the tender and thus put a development of new blocks on hold.

Of course, the story concerning Temelin is more complex. It is related to a disastrous collapse of the European energy market in its traditional form that we have been

<sup>3</sup> For one more example, the case of Boeing's acquisition and sale again after six years of a share in the Czech aviation company Aero Vodochody, see Jiri Schneider's paper, prepared on the occasion of the same conference, called "The U.S. – Czech Strategic Relationship: A Roadmap for the Future in Security and Defense. "

witnessing currently which has led to the fact that renewable, low-carbon energy accounts for an ever-greater share of production. It is helping push wholesale electricity prices down, and could one day lead to large reductions in greenhouse-gas emissions. For established utilities, though, this is a disaster. Take Germany, where electricity from renewable sources has grown fastest, as an example. The country's biggest utility, E.ON, has seen its share price fall by three-quarters from the peak and its income from conventional power generation – fossil fuels and nuclear – fall by more than a third between 2010 and 2013.

Two influences from outside Europe added to the problems. The first was the Fukushima nuclear disaster in Japan. This led the government of Angela Merkel into ordering the immediate closure of eight of Germany's nuclear-power plants and a phase-out of the other nine by 2022. The abruptness of the change added to the utilities' woes.

The other influence was the shale-gas boom in America. This displaced European coal that had previously been burned in America, pushing European coal prices down relative to gas prices. Simultaneously, carbon prices crashed because there were too many permits to emit carbon in Europe's emissions-trading system and the recession cut demand for them. This has reduced the penalties for burning coal, kept profit margins at coal-fired power plants healthy and slashed them for gas-fired plants.

Although the Temelin tender is put on hold right now and overall conditions are not favorable for nuclear energy, a new tender is expected to be initiated in the next five years. Then, Rosatom might arguably win the contract, as its officials, it seems, have been pretty well prepared and focused to offer highly competitive terms and conditions. Even during the recently canceled tender, Rosatom acted more proactively than its US counterpart, with apparently firmer determination to win the deal.





### 3.2 On a positive note

On the other hand, there have been positive stories, too, concerning the Czech-US economic relations (see also *Box 1*). Just recently, in February, 2014, the Czech social media monitoring firm Socialbakers, established by four young men from the Czech city of Pilsen, announced it had completed a 26 million USD financing round. Launched in 2009, Socialbakers offers benchmarking and analysis, including brand performance metrics, to enable companies to measure the effectiveness of their marketing campaigns across all major social networks. In the past year, the firm has doubled its headcount from 150 to 300, with plans to expand to more than 400 in 2014, and it has opened offices in New York, Singapore, Paris and Munich. New funding has been led by Index Ventures, a Europe- and San Francisco-based global venture capital firm, with participation from existing investor Earlybird, and adds to the 2 million USD secured in 2011, and 6 million USD raised a year later. The latest funding values the business at close to 200 million USD.

#### Box 1

##### Czech anti-virus makers, IPOs, and the US capital market

In January, 2012, anti-virus software maker **AVG Technologies** filed to raise up to 125 million USD in an initial public offering (IPO) at the New York Stock Exchange, looking to cash in on the increased demand for technology IPOs. AVG, which is known for its free suite of anti-virus products, monetizes its large user base through targeted advertisements and by driving traffic to online search companies such as Google and Yahoo. Formed in 1991 as Grisoft by Jan Gritzbach and Tomas Hofer, it is headquartered in the Czech city of Brno, with corporate offices in Europe and the United States.

AVG's filing came less than a month after **Avast Software**, another originally Czech anti-virus software maker, filed for a 200 million USD IPO. However, a tepid tech market and a strong financial showing had made that IPO unnecessary and Avast withdrew it. Avast's success story began at the end of 1980s, in communist Czechoslovakia. Mr. Eduard Kucera, a co-founder of the company, had no future in physics because he refused to join the Communist Party. Similarly, Mr. Pavel Baudis, who co-founded Avast with him, was prohibited by the Communists from

practicing physics, so he did information technology that led to the creation of Avast. A quarter-century later, their modest cooperative has blossomed into Avast Software, a full-fledged international phenomenon. With about 200 million customers in more than 43 languages — a staggering 1 million users in 38 different countries — it is used by more people than rivals AVG Technologies, Symantec and McAfee combined.

### 3.3 TTIP

Another source of optimism for the future may represent a deeper transatlantic economic cooperation, from which the Czech Republic would also benefit. In July, 2013, negotiations on the Transatlantic Trade and Investment Partnership (TTIP) began between the EU and the US. The proposal includes liberalization of trade in goods (basically a transatlantic free trade area encompassing both the EU and the US), liberalization of trade in services, and facilitation of investment.

The economic estimates suggest relatively modest, but positive welfare gains for the Czech Republic. The Czech Republic is likely to experience gradual expansion of its exports to the US. It can benefit indirectly as well, since indirect trade is rather important for the Czech Republic (e.g. German owned subsidiary produced in the Czech Republic components which are exported to Germany where they are used to produce e.g. a car which will be later exported to the US market). Trade liberalization between the EU and the US can thus also increase Czech exports to Germany.

#### Conclusion

To sum up, it is worth emphasizing a few particular aspects related to the previous text. Firstly, US investments in the Czech Republic are not just regular foreign investments. Through them, Czech entities gain access, and related connections, to the biggest market in the world. It is a well-known fact that managerial bodies of US companies belong to the global *crème de la crème*. A valuable know-how, gained by mutual trade or cooperation, routinely implies a significant value added for Czech entities, larger than the one gained by trade or cooperation with European countries.

Secondly, after joining the EU in 2004, the Czech Republic lost its "special status" it had had amongst peers thanks





to, first of all, President Havel and the “velvet” story, so impressive from the American point of view. Since 2004, the Czech Republic has been a regular European country again – and the same is true for its trade and economic relations with the US.

Thirdly, Czech companies increasingly invest in the US, albeit still in rather small, emerging-investor-like, volumes. Once or twice a year, on average, a Czech company appears which has the “moxie” to invest in the US. That is positive, since it was not the case ten or so years ago, when finding a Czech investor in the US was almost “mission impossible”.

Fourthly, participation in supply chains has become crucial in a globalized world. It is just one more reason for Czech companies to seek trade or cooperation with large US businesses, since they operate globally, thus acting as door-openers almost anywhere in the world.

Fifthly, to attract more foreign investors, including those from the US, an even closer cooperation within the region of Central Europe, or Visegrad region, is worth of considering. The Visegrad region, formed by the Czech Republic, Hungary, Poland and Slovakia, has had potential to successively align and strengthen the respective economies to meet EU challenges and compete effectively with larger and more developed countries, both regionally and internationally. It must be understood that Visegrad countries jointly and not separately have an appeal to foreign investors because they are striving to gain the Central European market. Jointly, they are already a good competitive market, or at least they could be. Their closer cooperation, for example in building infrastructure, can make the whole region, including all countries, more attractive for foreign investors. For example, some years ago there had been a lot of talk about the rapid development of Slovakia’s car industry. However, only few know that it has opened up serious possibilities for Hungary as well, for example through the spread of a sub-supplier network.

